

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

<b>Market-Based Rates for Public Utilities</b>	) ) ) ) )	<b>Docket No. RM04-7-000</b>
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**COMMENTS OF**

**THE ELECTRICITY CONSUMERS RESOURCE COUNCIL (ELCON),**

**THE AMERICAN IRON AND STEEL INSTITUTE (AISI),**

**THE AMERICAN CHEMISTRY COUNCIL (ACC), AND**

**THE AMERICAN FOREST & PAPER ASSOCIATION (AF&PA)**

The Electricity Consumers Resource Council (ELCON), the American Iron and Steel Institute (AISI), the American Chemistry Council (ACC), and the American Forest & Paper Association (AF&PA) (“Industrial Consumers”) strongly support FERC’s revised market power tests. For example, ELCON has previously submitted comments (mostly recently June 9, 2004 comments in Docket No. RM04-7-000) pointing out that mitigation of market power is a legal precondition for charging market based rates and commending FERC on revising its market power analysis tests.<sup>1</sup> Under FERC’s test, the first step is to determine whether the applicant is a pivotal supplier or has seasonal market power. If so, the applicant can provide FERC with a

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<sup>1</sup> ELCON again stated its support for the implementation of the market power screens in its August 30, 2004 comments in Southern Company Services, Docket No. ER97-4166-015. ELCON recently filed an intervention in support of FERC in Southern Companies v. FERC, D.C. Cir. No. 04-1301, in which Southern and several other transmission-owning utilities have challenged FERC’s revised market power analysis.

more sophisticated delivered price analysis to rebut the inference of market power. Even if there is market power, mitigation methods are encouraged.<sup>2</sup>

In the December 22, 2004 Notice of Technical Conference, FERC proposes to consider “whether, and if so to what extent, the Commission should modify the interim market screens adopted by the Commission and the appropriate mitigation for those found to have generation market power.”

### **Summary of Comments**

Industrial Consumers are concerned that FERC’s most recent request for comments in connection with revising the market power screen yet again and calling for yet another technical conference may indicate that FERC is retreating in its resolve to carefully scrutinize the market-based rate application of transmission-owning utilities. FERC should not allow debate over the optimal means of screening market power to degenerate into an academic exercise. FERC should continue to enforce its screens.

Both the courts and FERC have recognized that application of a well-conceived market power screen is not an optional frill, it is a necessity to meet the statutory predicate for authorizing market-based rates.

Any FERC decision to revise the market power screens must be supported with record findings and a rationale comparable to the evidence and findings necessary to support initial rulemaking. There has been no change in circumstances in the few months since these tests were adopted and affirmed lessening market power concerns that would justify relaxation of the standards. To the contrary, over-reliance on spot markets in “organized” markets threatens to

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<sup>2</sup> ELCON’s June 2004 Comments urged the Commission to apply the new tests flexibly and to implement the new interim screens without delay. The Commission should be mindful of the risk of targeting participants who in fact may not be able to exercise market power, but who for one reason or another are caught by the screens. This is where there is a need for flexibility.

exacerbate market power impacts. In the current environment, ELCON members are finding that viable long-term contracts are not being offered, thus forcing customers into the spot markets.

## COMMENTS

### **I. Over-Reliance On Spot Markets Exacerbates Market Power Concerns**

There is no reason to believe that market power concerns have lessened since FERC issued its revised market power screen a few months ago. The American Public Power Association (“APPA”) has recently explained that many of its members are “facing very serious threats to their viability” in part because of “dramatic increases from local suppliers with significant market power.”<sup>3</sup>

Market power concerns have been heightened by a design defect in wholesale “organized” markets that has, as of yet, received insufficient attention: the growing preference given to spot markets over long-term contracts. The over-reliance on the spot market was reflected in recent comments of the head of New York Public Service Commission that “that the day-ahead and real-time wholesale prices in New York are ‘just and reasonable’ for all customer classes” and warning that “[u]tilities that enter into long-term contracts to retain market share will do so at their own risk.” William M. Flynn, Address to Thirty-sixth Plenary Session Harvard Electricity Policy Group (Oct. 7, 2004), *available at* <http://www.ksg.harvard.edu/hepg/Papers/Flynn.core.non-core.bifur.mkts.1004.pdf>.

Industrial Consumers find they often cannot enter into long-term contracts except pegged to spot price, which does not offer the protection and other advantages of true long-term

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<sup>3</sup> American Public Power Association, Restructuring at the Crossroads: FERC Electric Policy Reconsidered, 25 (December 2004).

contacts. *See also* PJM Interconnection, 107 FERC ¶ 61,112 at ¶ 20 (2004) (acknowledging the advice of the financial community that long-term contracting is a preferred solution). The problem of over-reliance on spot market transactions and lack of sufficient forward contracts was of course a key event in the California debacle as recognized by FERC's order addressing the debacle in western markets. 93 FERC ¶ 61,294 (issued Dec. 15, 2000, in Docket Nos. EL00-95-000 *et al.*).

An additional factor raising concern over the threat of market power are legal questions raised as to the status of market monitors by the D.C. Circuit's decision last month in Electric Power Supply Association v. FERC, 2004 U.S. App. LEXIS 25470 (D.C. Cir. 2004). In *EP SA*, the court condemned as clearly unlawful under the Sunshine Act, 5 U.S.C. § 557, FERC's regulation permitting *ex parte* communications with market monitors, 102 FERC ¶ 61,041, *reh'g denied*, 103 FERC ¶ 61,151 (2003). Under this precedent, FERC may be required to bring market monitoring in-house—FERC's resources to do so are at this time uncertain.<sup>4</sup>

## **II. Under The State Farm Doctrine, The Commission May Not Abandon Its Revised Market Power Screens Without Adequate Justification**

It is an axiom of administrative law that an agency must explain its reasons when it changes its mind. Most recently, in NY Cross Harbor Rd. v. Surface Transp. Bd., 374 F.3d 1177, 1181 (D.C. Cir. 2004), the D.C. Circuit stated:

In short, we review the Board's decision under the *Administrative Procedure Act's* "arbitrary and capricious" test. ... An agency acts arbitrarily and capriciously if it "reverses its position in the face of a precedent it has not persuasively distinguished," *Louisiana Pub. Serv. Comm'n v. FERC*, 337 U.S. App. D.C. 312, 184 F.3d 892, 897 (D.C. Cir. 1999); *see Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57, 77 L. Ed. 2d 443, 103 S. Ct. 2856 (1983) ("An agency's view of what is in the public interest

<sup>4</sup> *See also* Edison Mission Energy v. FERC, No. 03-1228 (D.C. Cir. Jan. 14, 2005) (vacating and remanding FERC orders approving NYISO's mitigation scheme under its Market Monitoring Plan).

may change, either with or without a change in circumstances. But an agency changing its course must supply a reasoned analysis....” (internal quotation omitted)), and if it fails to “consider[] all the relevant factors” in reaching its decision. *N. Mun. Distribs. Group v. FERC*, 334 U.S. App. D.C. 148, 165 F.3d 935, 941 (D.C. Cir. 1999); see *Motor Vehicles Mfrs. Ass’n*, 463 U.S. at 43 (agency action “arbitrary and capricious if the agency...entirely failed to consider an important aspect of the problem”).

See also *Fox Television v. FCC*, 280 F.3d 127, 145 (D.C. 2002) (“The Commission may, of course, change its mind, but it must explain why it is reasonable to do so.... [T]he Commission has not fulfilled its obligation, upon changing its mind, to give a reasoned account of its decision”).

In *Panhandle E. Pipeline Co. v. FERC*, 196 F.3d at 1273 (D.C. Cir. 1999), the D.C. Circuit remanded FERC pipeline interconnection construction orders for failure to explain rationale for change in policy. “FERC may well be able to defend its new policy. The orders below, however, neither acknowledge the change nor explain its rationale. ‘An agency’s view of what is in the public interest may change, either with or without a change in circumstances. But an agency changing its course must supply a reasoned analysis....’” 196 F.3d 1275, citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57 (1983) (quoting *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970)).

In *Louisiana Pub. Serv. Comm’n. v. FERC*, 184 F.3d 892, 897 (D.C. Cir. 1999), the D.C. Circuit vacated a FERC order allocating capacity costs to interruptible customers. The court observed:

We therefore hold that the Commission’s 180 degree turn away from *Kentucky Utilities* was arbitrary and capricious. For the agency to reverse its position in the face of precedent it has not persuasively distinguished is quintessentially arbitrary and capricious.... If there is any reason interruptible load should be considered in the assessment of capacity costs, it has not been articulated either by the Commission or by its claue in this proceeding.

See also Oxy USA v. FERC, 64 F.3d 679, 690 (D.C. Cir. 1995): “[W]hen changing course, [FERC] ‘must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed,’” citing Michigan Consol. Gas v. FERC, 883 F.2d 117, 122 (D.C. Cir. 1989).

### **III. FERC’s Authority To Allow Market-Based Rates Depends On A Finding Of No Market Power**

Industrial Consumers would like to recapitulate from prior comments that FERC’s authority to approve market-based rates is conditioned on the mitigation of market power. In interpreting Section 205 of the Federal Power Act, the courts have stated that the overriding purpose of prohibiting unjust and unreasonable rates and charges is “to protect consumers from exorbitant prices and unfair business practices.”<sup>5</sup> “[T]he prevailing price in the marketplace cannot be the final measure of ‘just and reasonable’ rates mandated by the Act.”<sup>6</sup>

FERC has recognized that market-based rates may not be sustained in the absence of market power. In FERC’s July 8, 2004 Order on Rehearing in AEP Power Marketing, et al, 108 FERC ¶ 61,026 at ¶ 25 (2004), the Commission affirmed that “[m]arket-based rate authority is not a right. The Commission may grant such authority under the FPA only to applicants who demonstrably lack market power.” Consequently, “where a market-based rate applicant is found to have market power it is incumbent upon the Commission either to reject such rates or to ensure that adequate mitigation measures are in place to ensure that the rates are just and reasonable.” Id. at ¶ 144. The Commission’s subsequent decision on December 15, 2004 to initiate Section 206 proceedings against Southern, AEP and Entergy reiterated the mandate that

<sup>5</sup> Public Systems v. FERC, 606 F.2d 973, 979, n.27 (D.C. Cir. 1979).

<sup>6</sup> FPC v. Texaco, Inc., 417 U.S. 380, 397 (1974).

sales at market-based rates are allowed only if the sellers lack generation and transmission market power and cannot erect other barriers to entry.<sup>7</sup>

Courts have stated that to be “just and reasonable,” rates must fall within a “zone of reasonableness” where they are neither “less than compensatory” to producers nor “excessive” to consumers. Farmers Union Central Exchange v. FERC, 734 F.2d 1486 (D.C. Cir. 1984), cert denied, 469 U.S. 1034 (1984). When the inquiry is on whether the rate is reasonable to a producer, the underlying focus of concern is on the question of whether it is high enough to both maintain the producer’s credit and attract capital. “[W]hen the inquiry is on whether a given rate is just and reasonable to the consumer, the underlying concern is whether it is *low* enough so that exploitation by the [regulated business] is prevented.” Id. at 1502 (quoting City of Chicago v. FPC, 458 F.2d 731, 750 (D.C. Cir. 1971)).

When the Commission authorizes market-based rates, it is under a continuing duty to ensure that the relevant market remains sufficiently competitive to prevent unjust and unreasonable prices.<sup>8</sup> Where markets are not sufficiently competitive to keep prices at reasonable levels, the Commission must exercise its ratemaking and refund powers to protect consumers.

FERC has the flexibility to allow market-based rates if it is assured that the result is just and reasonable rates, e.g., because market power does not exist or has been mitigated. In Farmers Union, the court rejected the Commission’s reliance on a cost-based cap for oil transportation rates, because the cap was set at a level designed merely to prevent “egregious exploitation and gross abuse” rather than to ensure a just and reasonable rate. Although

<sup>7</sup> Southern Co. Energy Marketing, 109 FERC ¶61,275 at ¶ 29 (2004).

<sup>8</sup> Process Gas Consumers v. FERC, 177 F.3d 995 (D.C. Cir. 1999) (“FERC must remain attuned to the status of the affected market vis-à-vis monopoly and competition.”).

premised on an assumption that competition would keep prices in the “zone of reasonableness,” the Commission made no findings that competition for oil transportation services was in fact sufficient to do so. The Commission did not look at market share or otherwise assess the number of competitors available to provide transportation service.

Similarly, in Tejas Power v. FERC, the court rejected a gas inventory charge that deviated from the cost-based model then in place for natural gas pipeline regulation.<sup>9</sup> The court held that the Commission had erred in accepting the rate as part of a larger settlement package, having “made no prior finding that [the pipeline] lack[ed] significant market power vis-à-vis the [customers]. In a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment.”<sup>10</sup>

In Elizabethtown Gas Co. v. FERC, the D.C. Circuit upheld a market-based rate for the sale of natural gas, indicating that “when there is a competitive market the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a ‘just and reasonable’ result.”<sup>11</sup>

And in Louisiana Energy and Power Authority v. FERC, the D.C. Circuit rejected plaintiff’s challenge to FERC’s approval of an application by CLECO to charge market based rates because FERC had determined that CLECO lacked market power. The decision cites

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<sup>9</sup> 908 F.2d 998 (D.C. Cir. 1990).

<sup>10</sup> Id. at 1004.

<sup>11</sup> 10 F.3d 866 (D.C. Cir. 1993).

Elizabethtown for the proposition that *where markets are competitive*, FERC can authorize market-based rates.<sup>12</sup>

### **Description of Commenters**

ELCON is an association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate, reliable, and efficient electricity supply for all users at competitive rates. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing community. The member companies of ELCON consume approximately five percent of all electricity in the United States.

AISI is the principal trade association of the North American steel industry. Its member companies account for about seventy percent of the raw steel production in the United States. The steel industry is one of the most energy-intensive sectors in the United States; the cost of electricity for AISI members may constitute as much as twenty percent of the manufacturing cost of a steel mill product.

ACC is a nonprofit trade association whose member companies represent more than ninety percent of the productive capacity of basic industrial chemicals in the United States. The manufacturing processes of many ACC member companies are highly energy-intensive. In addition, the chemical industry uses a substantial amount of self-generated electricity. Total electricity used by the industry (purchases plus self-generated) represents approximately eighteen percent of industrial electricity consumption in the United States and approximately six percent of national electricity consumption.

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<sup>12</sup> 141 F.3d 364 (D.C. Cir. 1998).

AF&PA is the trade association of the forest, pulp, paper, paperboard, and wood products industry in the United States. AF&PA's members are among the nation's largest consumers of electric power, purchasing over 82 billion kilowatt-hours of electricity annually nationwide.

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**CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing Comments were today mailed to parties on the service lists of these proceedings by U.S. mail, postage prepaid.

Dated at Washington, D.C., this 21st day of January 2005.

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