

**JOINT COMMENTS OF:  
ELECTRICITY CONSUMERS RESOURCE COUNCIL  
TRANSMISSION DEPENDENT UTILITY SYSTEMS  
AMERICAN PUBLIC POWER ASSOCIATION  
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION  
AMERICAN FOREST AND PAPER ASSOCIATION  
TRANSMISSION ACCESS POLICY STUDY GROUP**

May 9, 2002

Hon. Patrick H. Wood, III, Chairman  
Hon. Linda K. Breathitt, Commissioner  
Hon. Nora M. Brownell, Commissioner  
Hon. William L. Massey, Commissioner  
Federal Energy Regulatory Commission  
888 1st St., N.E.  
Washington, DC 20426

Re: Docket EL01-118-000

Dear Chairman Wood and Commissioners:

The Electricity Consumers Resource Council (“ELCON”), Transmission Dependent Utility Systems (“TDU Systems”), American Public Power Association (“APPA”), National Rural Electric Cooperative Association (“NRECA”), American Forest and Paper Association (AF&PA), and Transmission Access Policy Study Group (“TAPS”) (together, “Joint Commenters”)<sup>1</sup> urge the Federal Energy Regulatory Commission (“Commission”) to adopt its proposed Market Power Abuse Refund Obligation in market-based tariffs in all areas of the country, including Regional Transmission Organizations (“RTOs”) with bid-based markets an even after RTOs are established. The Commissioners could not resolve the issue of applicability of the Market Power Abuse Refund Obligation in regions served by RTOs at its recent April 24, 2002 meeting.

We believe that FERC’s statutory duty *requires* that it adopt the Market Power Abuse Refund Obligation, given the record evidence that market power and market manipulation remain a concern even within regions with ISOs and bid-based markets. FERC’s paramount statutory duties under Section 205 and 206 of the Federal Power Act (“FPA”) are not overridden by the policy objective of incentivizing formation of RTOs and encouraging bid-based markets. The Joint Commenters are advocates of deregulated markets, but markets that are not yet liquid or fully competitive require that market participants be subject to refund obligations. Only FERC is vested with the statutory authority to administer refunds. Having found that market power exists and that inclusion of a refund obligation as a condition of market-based rate tariffs is necessary to address abuse, FERC has a duty to protect all customers, regardless of whether they reside or do business in an RTO/ISO. White House spokesman Ari Fleischer stated in

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<sup>1</sup> For a description of each of the Joint Commenters, see Appendix A.

relation to the Enron memoranda that “the Administration supports very tough enforcement of laws that protect consumers.”<sup>2</sup> It is difficult to conceive of a consumer protection more basic than one providing for refunds when markets have been manipulated to the detriment of those consumers. FERC’s new Office of Market Oversight and Investigations is not yet up and running. At present, there is no evidence that RTOs or ISOs can protect consumers from market manipulation and market power abuse by sellers inclined to engage in that activity.

A. FERC has a Statutory Duty to Adopt a Tariff Condition Requiring Refunds to Address Anticompetitive Practices and Exercise of Market Power as a Condition to Market-Based Rate Authority

Section 206 requires that the Commission take corrective action when it finds that “any rate...or practice” is unjust and unreasonable. FERC has determined that it is unjust and unreasonable to allow sellers to charge market-based rates without prospectively imposing a condition on market-based rate authority that the seller is required to refund if found to have exerted market power. FERC recognized in its November 21, 2001 Order in Docket EL01-118 that (i) there is current evidence of physical and economic withholding and other evidence of exercise of market power and (ii) its statutory obligation to ensure that rates are just and reasonable necessitated a refund obligation:

Based on our recent experience involving wholesale electric markets in California and the rest of the WSCC, and consistent with our intention to review the Commission's approach to evaluating market-based rate applications and also to explore generic transmission and market design protocols, we believe it is necessary and appropriate to impose a tariff condition on all public utility sellers with market-based rate authority. This tariff condition...will ensure that rates collected pursuant to market-based rate tariffs and authorizations are just and reasonable and that customers have full refund protection against anticompetitive behavior or abuse of market power.

Market-based rates are only just and reasonable if the market is sufficiently competitive that market participants cannot exercise market power. “[W]hen there is a competitive market the FERC may rely upon market-based prices . . . to assure a ‘just and reasonable’ result.” Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 870-71 (D.C. Cir. 1993); Louisiana Energy and Power Authority (“LEPA”) v. FERC, 141 F.3d 364 (D.C. Cir. 1998). “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.” Tejas Power Corp. v. FERC, 908 F.2d 998, 1004 (D.C. Cir. 1990). 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.

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<sup>2</sup> Energy Daily, May 8, 2002.

Process Gas Consumers v. FERC, 177 F.3d 995, 1002 (D.C. Cir. 1999) (“FERC must remain attuned to the status of the affected market vis-a-vis monopoly and competition.”).<sup>3</sup>

Including a Market Power Abuse Refund Obligation as a prospective condition in market-based rate tariffs not only carries out FERC’s Section 205 and 206 duties but avoids the dilemma that FERC confronted in San Diego Gas & Elec., 96 FERC ¶ 61,120 (2001), where the Commission was unable to order refunds to remedy market power abuse occurring prior to the refund effective date in that proceeding because there was no express condition in the market based rate authorizations that exercise of market power would entail a refund obligation.

Having found that the Market Power Abuse Refund Obligation is necessary to protect consumers from anticompetitive practices, FERC must adopt the condition for all customers because it cannot defend the proposition that RTO/ISO bid-based markets, as they currently exist, are competitive within the Elizabethtown standard.

**B. Current RTOs and ISOs are Not Competitive Markets: Just Ask the ISOs and the State Commissions**

It is instructive that in Docket EL01-118, state entities, ISOs, and customers all urged adoption of the Market Power Abuse Refund Obligation within RTOs and ISOs. For example, the New York, Connecticut, Michigan, and New England public utility commissions, the Attorney Generals of Rhode Island, Massachusetts, New York and New Mexico and the California Electricity Oversight Board all advocated FERC’s proposal, or a stronger variant.

Market power problems persist in all the nascent power markets. The fact that an RTO has been initiated does not mean that there is a liquid market. The West Coast/California PX crisis was a trigger for adoption of the Market Power Abuse Refund Obligation. The California Electric Oversight Board in its recent comments in Docket EL01-118 referred to “past and continuing market power abuses.” In Enron memoranda recently disclosed to the Commission, attorneys for Enron graphically described the strategies Enron was using to drive up energy prices in order to benefit from the West Coast energy crisis. The December 6, 2000 and December 8, 2000 memoranda indicate that other traders were following Enron’s practices; indeed that Enron and other traders discussed these strategies among themselves. These memoranda are a wake up call to the Commission that bid-based markets are vulnerable to abuse – not only by a single company and not only in a single state.<sup>4</sup> By notice dated May 7, 2002, in

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<sup>3</sup> Departures from cost-based rates have been invalidated where competitive markets do not exist and where market power has not been mitigated. In Tejas Power, the court rejected a gas inventory charge that deviated from the cost-based model then in place for natural gas pipeline regulation. 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] lacked significant market power vis-a-vis the [customers].” 908 F.2d at 1004. See also Farmers Union Central Exchange v. FERC, 734 F.2d 1486, 1502 (D.C. Cir. 1984) (invalidating departure from cost-based regulation for oil pipelines).

<sup>4</sup> For example, Enron created phantom congestion on electricity transmission lines and engaged in sham sales among its affiliates to increase electricity prices, the net effect being that Enron was paid for moving energy to

Docket No. PA02-2-000, the Commission put the industry on notice that it is now conducting a broad investigation into market manipulation. Given that the Commission has just become informed of the abuse referred to in the Enron memoranda, and is conducting an investigation to learn more, it follows that FERC does not know enough about the practice in abuse to exclude sales within RTOs/ISOs from refund obligations.

In the Northeast as well, there is evidence of market power in bid-based markets. The PJM Interconnection has found that its ICAP markets were the subjects of market power abuse. During January through April, 2001, the exercise of market power resulted in supra-competitive prices in PJM. The New York PSC supported the Market Power Abuse Refund Obligation because NY ISO can only apply market mitigation authority prospectively. NY PSC cited six events in summer 2001 when allegedly anticompetitive conduct pushed real time prices to or above \$700/MWH.

In bid-based day-ahead and real-time energy markets, where bids are "cleared" using a uniform price auction (all suppliers get the highest bid that serves the last unit of load), the financial consequences of any exercise of market power is greatly magnified by this auction format. The same holds true for other bid-based markets that the RTOs will be facilitating (e.g., ICAP and ancillary services).

At the April 24, 2002 meeting, there was discussion among the Commissioners of the effect on customers of application or non-application of the Supply Margin Assessment and refund obligations. There is no doubt where customers stand based on ongoing problems in the ISO power markets. Retail customers – ELCON, the PJM Industrial Coalition, NEPOOL Industrial Coalition, AF&PA, and the Steel Manufacturers Association – strongly support the Market Power Abuse Refund Obligation as a tariff condition. Wholesale customers – APPA, TAPS, NRECA, and TDU Systems – also support this tariff condition. Additionally, State Commissions and consumer advocates have supported this condition.

FERC must address anticompetitive behavior or the exercise of market power in bid-based markets. The indicia of a "well-developed" generation market are not whether an RTO is or is not present, or whether that RTO runs a bid-based market. Rather, the indicia of a competitive wholesale electric generation market are the same as that of any other market: many buyers, many sellers, adequate infrastructure, and ample market information on price, terms and quantity. If these basic building blocks are not present, then the presence or absence of an RTO and its market-monitoring unit, or the existence of a centralized, bid-based market, will make little difference. California had a Commission-approved ISO, both internal and external market monitors, and a centralized, bid-based market. None of these structures prevented a fearsome market meltdown.

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relieve congestion without actually moving any energy or relieving any congestion. Another practice allowed Enron to send power out of California and then resell it back into the state to avoid price caps that applied to transactions solely within California. Available at <http://www.ferc.gov/electric/bulkpower/pa02-2/pa02-2.htm#memo>. This is evidence that bid-based markets can be easily manipulated.

Hence, the Commission cannot forego the Market Power Abuse Refund Obligation on the assumption that the mere presence of an RTO, a market monitor, and/or an RTO-run centralized, bid-based market will cause a competitive generation market to spring up. This would amount to no more than “faith-based regulation.”

C. Conclusion

Joint Commenters urge the Commission to apply the Market Power Abuse Refund Obligation as a condition to market-based rate suppliers both within and outside RTOs and ISOs.

Respectfully Submitted,

**Electricity Consumers Resource Council**

By: /s/ Dr. John A. Anderson

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Dr. John A. Anderson, Executive Director  
Electricity Consumers Resource Council  
1333 H Street, N.W., West Tower, Suite 800  
Washington, DC 20005  
Phone: 202-682-1390  
Fax: 202-289-6370  
E-mail: [janderson@elcon.org](mailto:janderson@elcon.org)  
[jhughes@elcon.org](mailto:jhughes@elcon.org)

**American Public Power Association**

By: /s/ Allen Mosher

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Allen Mosher  
American Public Power Association  
2301 M Street NW  
Washington, DC 20037  
Voice: 202-467-2944  
Fax: 202-467-2992  
E-mail: [amosher@APPAnet.org](mailto:amosher@APPAnet.org)

**Transmission Dependent Utility Systems**

By: /s/ Susan N. Kelly

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Susan N. Kelly  
Miller, Balis & O’Neil, P.C.  
1149 19<sup>th</sup> Street, N.W., Suite 700  
Washington, D.C. 20036  
Phone: 202-296-2960  
Fax: 202-296-0166  
E-mail: [skelly@mbolaw.com](mailto:skelly@mbolaw.com)

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**National Rural Electric Cooperative Association**

By: /s/ Richard Meyer

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Wallace F. Tillman, General Counsel  
Richard Meyer, Senior Regulatory Counsel  
National Rural Electric Cooperative Association  
4301 Wilson Boulevard  
Arlington, VA 22203  
Phone: 703-907-5811  
Fax: 703-907-5517  
E-mail: [rich.meyer@nreca.org](mailto:rich.meyer@nreca.org)

**American Forest and Paper Association**

By: /s/ David Friedman

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David Friedman  
American Forest & Paper Association  
1111 19th Street, N.W., Suite 800  
Washington, DC 20036  
Tel: 202-463-5159  
E-mail: [david\\_friedman@afandpa.org](mailto:david_friedman@afandpa.org)

**Transmission Access Policy Study Group**

By: /s/ Cynthia S. Bogorad

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Robert C. McDiarmid  
Cynthia S. Bogorad  
Jeffrey A. Schwartz  
Spiegel & McDiarmid  
1350 New York Ave., N.W., Suite 1100  
Washington, D.C. 20005  
Phone: 202-879-4000  
E-mail: [robert.mcdiarmid@spiegelmc.com](mailto:robert.mcdiarmid@spiegelmc.com)  
[cynthia.bogorad@spiegelmc.com](mailto:cynthia.bogorad@spiegelmc.com)  
[jeffrey.schwarz@spiegelmc.com](mailto:jeffrey.schwarz@spiegelmc.com)

### Description of Joint Commenters

The Electricity Consumers Resource Council (“ELCON”) is the national 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 prices. ELCON’s member companies produce a wide range of products, including: steel, aluminum, chemicals, petroleum, motor vehicles, industrial gasses, machinery, glass, agricultural and food products, rubber, computer chips, paper and electronics. The member companies of ELCON consume approximately five percent of all electricity in the United States.

The following rural electric generation and transmission (“G&T”) cooperatives are members of the TDU Systems participating in these comments: Alabama Electric Cooperative, Inc.; Old Dominion Electric Cooperative, Inc.; Kansas Electric Power Cooperative; and North Carolina Electric Membership Corporation. While a number of the TDU Systems own substantial transmission facilities, all of them are dependent upon the transmission systems of neighboring investor-owned transmission owners regulated by this Commission to move their power supplies to their member distribution cooperatives’ loads. The TDU System own substantial generation facilities, but they also purchase power from both traditional, vertically integrated utilities and new market entrants to serve their loads, and thus have a keen interest in both generation and transmission power issues.

APPA is the national service organization representing the interests of not-for-profit, publicly owned electric utilities throughout the United States. More than 2,000 public power systems provide over 15 percent of all kilowatt-hour (kWh) sales to ultimate customers in the United States. Approximately 1,870 of these systems are cities and municipal governments that currently own and control the day-to-day operation of their electric utility systems. They purchase nearly 70 percent of the power used to serve their ultimate customers. Public power systems own about 8 percent of the nation’s high voltage transmission lines, although many of these lines are configured to deliver energy to our load centers, not to provide transmission service in interstate commerce. On balance, public power systems buy much more energy and transmission than they sell to third parties.

NRECA is a not-for-profit national service organization representing 930 not-for-profit, consumer-owned rural electric cooperatives located in 46 states. NRECA’s members serve more than 35 million end use electric customers. NRECA’s membership includes both transmission-owning and transmission dependent utilities. While NRECA members do generate their own power and make sales of power to third parties in wholesale markets, electric cooperatives on the whole are net buyers of power.

AF&PA is the national trade association of the forest, paper and wood products industry. AF&PA represents member companies engaged in growing, harvesting and processing wood and wood fiber, manufacturing pulp, paper and paperboard products from both virgin and recycled fiber, and producing engineered and traditional wood products. Members include

manufacturers of over 80 percent of the paper, wood and forest products produced in the United States.

TAPS is an informal association of transmission-dependent utilities in more than 30 states, promoting open and non-discriminatory transmission access. As entities entirely or predominately dependent on transmission facilities owned by and controlled by others, TAPS members are vitally interested in issues of industry structure, and concerned about the ability of larger market participants to exercise market power as a result of Commission grants of market-based rates authority. TAPS and its members have commented upon and been involved in nearly all aspects of electric industry restructuring activities both before this Commission and in the legislative arena.