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March 20, 2006

Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

Re: Docket No. EL06-16-000

Dear Ms. Salas:

Earlier today, I filed the "Request for Clarification or, in the Alternative, Rehearing of the American Public Power Association, the Transmission Access Policy Study Group and the Sacramento *Public* Utility District" in the above-referenced proceeding. However, the title of the pleading should have read "Request for Clarification or, in the Alternative, Rehearing of the American Public Power Association, the Transmission Access Policy Study Group and the Sacramento *Municipal* Utility District." The Sacramento Municipal Utility District was also misidentified in the opening paragraph of the pleading. Please accept for filing this corrected version.

Thank you for your cooperation. If you have any questions, please do not hesitate to contact me.

Sincerely,

/s/ *Mark S. Hegedus*

Mark S. Hegedus

cc: Service List

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations	Docket No. EL06-16-000

**REQUEST FOR CLARIFICATION
OR, IN THE ALTERNATIVE, REHEARING OF
THE AMERICAN PUBLIC POWER ASSOCIATION,
THE TRANSMISSION ACCESS POLICY STUDY GROUP AND
THE SACRAMENTO MUNICIPAL UTILITY DISTRICT**

On February 16, 2006, the Commission issued its "Order Revising Market-Based Rate Tariffs and Authorizations" in *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 114 F.E.R.C. ¶ 61,165 (2006) (hereafter "Order"). The American Public Power Association ("APPA"), the Transmission Access Policy Study Group ("TAPS") and the Sacramento Municipal Utility District ("SMUD")[*] support the Commission's correct conclusion that it "clearly has the authority to order disgorgement of profits associated with an illegally charged rate, *i.e.*, a rate other than the rate on file or in violation of a Commission rule, order, regulation, or tariff on file." Order P 32. However, they are concerned that some may construe certain statements in the Commission's Order regarding the mitigation of market power as a license for public utilities with market-based rate ("MBR") tariffs accepted under Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d, to exercise market power so long as the conduct does not rise to a violation of the FPA's new prohibition of market

[*] A previously filed version of this pleading misidentified SMUD as the "Sacramento Public Utility District."

CORRECTED VERSION

manipulation.[1] Therefore, APPA, TAPS and SMUD request that the Commission clarify that (1) a public utility with an MBR tariff shall not use its MBR authority to intentionally or knowingly exercise market power, and (2) where a public utility with an MBR tariff intentionally or knowingly exercises market power in violation of its tariff (not to mention the FPA), it will be subject to the remedies for charging rates that violate statutes, rules, orders, regulations or tariffs on file.[2] If the Commission does not so clarify, then APPA, TAPS and SMUD in the alternative seek rehearing of these issues.

I. STATEMENT OF ISSUES

1. Whether the Commission should clarify that a public utility with an MBR tariff shall not use its MBR authority to intentionally or knowingly exercise market power? 16 U.S.C. § 824b; *State of California, ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), *reh'g pending.*

2. Whether the Commission should clarify that where a public utility under its MBR tariff intentionally or knowingly exercises market power in violation of the tariff (not to mention the FPA), it will be subject to the remedies for charging rates that violate statutes, rules, orders, regulations or tariffs on file. *Id.*

II. ALTERNATIVE SPECIFICATION OF ERRORS[3]

1. The Commission should hold on rehearing that a public utility with an MBR tariff shall not use its MBR authority to intentionally or knowingly exercise market power.

2. The Commission should hold on rehearing that where a public utility under its MBR tariff intentionally or knowingly exercises market power in violation of the tariff (not to mention the FPA), it will be subject to the remedies for charging rates that violate statutes, rules, orders, regulations or tariffs on file.

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[1] FPA Section 222, Energy Policy Act 2005 Section 1283, Pub. L. No. 109-58, 119 Stat. 594 (2005); *see also* 18 C.F.R. § 1c.2(a).

[2] APPA, TAPS and SMUD do not oppose the Commission's requiring that these clarifications be explicitly included in writing in MBR tariffs, if the Commission deems that necessary or appropriate.

[3] While APPA, TAPS and SMUD are seeking clarification of the Order, they include this specification of errors pursuant to 18 C.F.R. § 713(c)(1) given their alternative request for rehearing.

III. REQUEST FOR CLARIFICATION

While the Order largely focused on the Commission's decision to repeal Market Behavior Rule 2 in light of the passage of Section 222 of the FPA, the Commission also discussed its remedial authority under Sections 205 and 206, stating:

> Accordingly, if companies subject to our jurisdiction violate the statutes, orders, rules, or regulations administered by the Commission, the Commission can order, among other things, disgorgement of unjust profits. The Commission also has the option of conditioning, suspending, or revoking market-based rate authority, certificate authority, or blanket certificate authority. Moreover, while section 206 of the FPA does not permit the Commission to establish just and reasonable rates prior to the refund effective date established under section 206, *the Commission clearly has authority to order disgorgement of profits associated with an illegally charged rate, i.e., a rate other than the rate on file or in violation of a Commission rule, order, regulation, or tariff on file.* Therefore, the Commission may use disgorgement of unjust profits where appropriate, including to remedy a violation of the new anti-manipulation regulations.

Id. P 32 (emphasis added, footnotes omitted). This statement correctly establishes that the Commission can remedy a public utility's failure to charge the previously filed, lawful rate, for example, by ordering the disgorgement of unjust profits. However, APPA, TAPS and SMUD are concerned that some might read earlier statements in the Order as foreclosing remedies such as disgorgement, if a public utility with an MBR tariff uses its MBR authority to exercise market power, especially knowingly or intentionally, and the conduct does not otherwise violate Section 222.

Specifically, in its discussion of market power, the Commission observed:

> Market power, of course, can be used by a seller to manipulate markets; in such cases it is the act of manipulation – perpetrating a fraud or deceit of some kind

> – that is the violation of Rule 2 or of the new anti-manipulation rule.
>
> Generally speaking, however, market power is a structural issue to be remedied, not by behavioral prohibitions, but by processes to identify and, where necessary, mitigate market power that a tariff applicant may possess or acquire. This occurs in the screening process before the Commission grants an application for market-based rate authority, on consideration of changes in the seller's status or operations, and in the triennial review of market-based rate authorization, all of which are designed to assure just and reasonable rates. In addition, the Commission requires RTOs and ISOs to have independent market monitors, and the Office of Market Oversight and Investigations monitors market operations. When such monitoring detects market abuse or structural problems, they will be addressed under FPA sections 205 or 206 to assure that reliance on market mechanisms produces just and reasonable rates.

Order PP 22-23 (footnote omitted). It later added:

> If conduct occurs that is not the result of fraud or deceit but nonetheless results in unjust and unreasonable rates, a person may file a complaint at the Commission under FPA section 206, or the Commission on its own motion may institute a proceeding under section 206, to modify the rates that have become unjust and unreasonable.

Id. P 25. These statements could be read to suggest that the Commission's only response in the face of intentional market power exercise that does not involve fraud or deceit will be to modify the MBR tariff on a going-forward basis, *e.g.*, to revoke or condition the public utility's MBR authority,[4] and that the Commission would not "order disgorgement

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[4] APPA, TAPS and SMUD agree that market power is also a structural issue, and have consistently urged the Commission to take additional actions, such as measures to reduce generation market power, to encourage structurally competitive markets so that incentives for procompetitive behavior are built into the market design and structure itself. However, even if U.S. wholesale electric power markets were structurally competitive, behavioral prohibitions would remain necessary, because market structures change. The Commission's examinations of market structure are of necessity snapshots and do not account for the dynamic nature of electricity markets. Behavioral prohibitions provide sellers with "rules of the road" to guide their conduct in wholesale markets.

of profits associated with an illegally charged rate, *i.e.*, a rate other than the rate on file or in violation of a Commission rule, order, regulation, or tariff on file" (Order P 32). Because such a reading would be inconsistent with a proper reading of the Commission's authority under Sections 205, 206 and 309 of the FPA, 16 U.S.C. §§ 824d, 824e, and 825h, APPA, TAPS and SMUD request clarification as follows.

The Commission should clarify that a public utility with an MBR tariff shall not use the tariff to knowingly or intentionally exercise market power. MBR authority carries with it an obligation not to exercise market power, which arises directly from the Commission's authority to authorize market-based rates in the first instance:

> The use of market-based tariffs was first approved in the natural gas context, *see Elizabethtown Gas Co. v. FERC*, 304 U.S. App. D.C. 91, 10 F.3d 866, 870 (D.C. Cir. 1993), then as to wholesale sellers of electricity, *see Louisiana Energy and Power Authority v. FERC*, 329 U.S. App. D.C. 401, 141 F.3d 364, 365 (D.C. Cir. 1998). However, approval of such tariffs was conditioned on the existence of a competitive market. *Id.* Thus, market-based applications were approved only if FERC made a finding that "the seller and its affiliates [did] not have, or adequately [had] mitigated, market power." *Id.* n.4. The principle justifying this approach as "just and reasonable" was that "[i]n 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*, 285 U.S. App. D.C. 239, 908 F.2d 998, 1004 (D.C. Cir. 1990).

Lockyer, 383 F.3d at 1012-13. If a market-based rate is just and reasonable only if the seller does not have, or has adequately mitigated, market power, it follows that a rate that reflects market power exercise, especially where that exercise is intentional or knowing, is by definition not just and reasonable. As the Commission has stated: "In a market-

based rate regime, this means that public utility sellers will not be permitted to exercise market power or take anti-competitive actions that may increase market prices and that the Commission will take appropriate remedial steps."[5] In other words, MBR authorization does not include permission to charge rates that reflect market power exercise or are not otherwise constrained by competition. *Lockyer*, 383 F.3d at 1012-13.

In addition, the Commission must ensure that MBR sellers are complying with their tariffs by charging the authorized, just and reasonable rate. The Commission's ability to authorize market-based rates is tied to its continued oversight of the rates actually charged to determine whether they are, in fact, just and reasonable. *Id.* at 1013. According to *Lockyer*: "The structure of the [MBR] tariff complie[s] with the FPA, so long as it [is] coupled with enforceable post-approval reporting that would enable FERC to determine whether the rates were 'just and reasonable' and whether market forces were truly determining the price." *Id.* at 1014.[6] The reporting requirement is not an academic exercise, but an integral part of the Commission's obligation to determine the appropriate remedy where the rate actually charged is unjust and unreasonable.

The Order (PP 32-33) appropriately and correctly describes the Commission's power to remedy unlawfully charged rates. Indeed, the *Lockyer* decision strongly supports the Order's discussion of the Commission's remedial power and affirms that

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[5] *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, "Order Seeking Comments on Proposed Revisions to Market-Based Rate Tariffs and Authorizations," 103 F.E.R.C. ¶ 61,349, P 21 (2003).

[6] While *Lockyer* involved the Commission's failure to enforce reporting requirements, those reporting requirements exist not for their own sake but to permit the Commission to determine whether the market-based rates actually charged are just and reasonable.

where the MBR tariff is violated, the Commission has the authority to remedy the violation, including through refunds:

> FERC possesses broad remedial authority to address anti-competitive behavior. *See Transmission Access Policy Study Group v. FERC*, 343 U.S. App. D.C. 151, 225 F.3d 667, 686 (D.C. Cir. 2000). Indeed, in the past, FERC has ordered refunds in instances where utilities violated FPA § 205, either by violating the terms of an accepted rate, or by charging rates without first seeking approval under FPA § 205. In *The Washington Water Power Co*., 83 FERC ¶ 61,282 (1998), FERC ordered profits disgorged because a regulated utility had violated posting requirements and conferred undue preferences on its marketing affiliate. ["]To do otherwise would allow companies to flout our regulations, and overcharge consumers with impunity." 24 FERC ¶ 61,199 at 61,461, *reh'g order*, 24 FERC ¶ 61,380, *reh'g denied*, 25 FERC ¶ 61,308 (1983).
>
> Here, because the reporting requirements were an integral part of a market-based tariff that could pass legal muster, FERC cannot dismiss the requirements as mere punctilio. If the ability to monitor the market, or *gauge the "just and reasonable" nature of the rates is eliminated, then effective federal regulation is removed altogether*. Without the required filings, neither FERC nor any affected party may challenge the rate. Pragmatically, under such circumstances, there is no filed tariff in place at all. The power to order retroactive refunds when a company's non-compliance has been so egregious that it eviscerates the tariff is inherent in FERC's authority to approve a market-based tariff in the first instance. FERC may elect not to exercise its remedial discretion by requiring refunds, but it unquestionably has the power to do so. *In fact, if no retroactive refunds were legally available, then the refund mechanism under a market-based tariff would be illusory. Parties aggrieved by the illegal rate would have no FERC remedy, and the filed rate doctrine would preclude a direct action against the offending seller. That result does not comport with the underlying theory or the regulatory structure established by the FPA.*

Lockyer, 383 F.3d at 1015-16 (emphasis added). Moreover, if the Commission did not possess such remedial authority, it would not be able to approve market-based rates: "If,

on the other hand, we view the reporting requirements as integral to the tariff, *with implied enforcement mechanisms sufficient to provide substitute remedies for the obtaining of refunds for the imposition of unjust, unreasonable and discriminatory rates*, then a market-based tariff is permitted." *Id.* at 1016 (emphasis added).

The Commission's statement (Order P 32) that it "clearly has authority to order disgorgement of profits associated with an illegally charged rate, *i.e.*, a rate other than the rate on file or in violation of a Commission rule, order, regulation or tariff on file," is consistent with and supported by *Lockyer*. However, its earlier statements – (a) "market power is a structural issue to be remedied, not by behavior prohibitions, but by processes to identify and, where necessary, mitigate market power that a tariff applicant may possess or acquire," Order P 23, and (b) "If conduct occurs that is not the result of fraud or deceit but nonetheless results in unjust and unreasonable rates, a person may file a complaint at the Commission under FPA section 206, or the Commission on its own motion may institute a proceeding under section 206, to modify the rates that have become unjust and unreasonable" (*id.* P 25) – could be read by some to foreclose the very remedies that *Lockyer* holds are required for the Commission's reliance upon market-based pricing.[7] Accordingly, the Commission should clarify that where a public utility selling under its MBR tariff knowingly or intentionally exercises market power in violation of the tariff (not to mention the FPA), it will be subject to the Commission's

[7] As the Chairman has observed: "The legal duty of the Commission to prevent unjust and unreasonable rates and undue discrimination or preference in the sale of wholesale power or interstate transmission by jurisdictional sellers is absolute; the Commission does not have the discretion to ignore them." JOSEPH T. KELLIHER, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 ENERGY L.J. 1, 3-4 (2005).

remedial authority, such as disgorgement of unjust profits, for charging rates in violation of a rule, order, regulation or tariff on file.

APPA, TAPS and SMUD emphasize that the requested clarifications involve the Commission's obligations under FPA Sections 205 and 206. Congress enacted these sections, along with the rest of the FPA, because of concerns about the absence of "free and independent competition" in the power industry. *NAACP v. FPC*, 520 F.2d 432, 438 (D.C. Cir. 1975). Those concerns are even more acute in an era where the Commission's policy is to rely upon competitive markets to ensure that rates are just, reasonable and not unduly discriminatory or preferential. As the D.C. Circuit observed: "Of the Commission's primary tasks there is no doubt, however, and that is to guard the consumer from exploitation by non-competitive electric power companies." *Id.* In enacting the Energy Policy Act of 2005, Congress did not repeal Sections 205 and 206, nor did its adoption of Section 222's prohibition of market manipulation signal or direct that the Commission should retreat from its obligation and authority to enforce Sections 205 and 206. Rather, Section 222 is a new tool (not a substitute) for the Commission to address "exploitation by non-competitive power companies."[8] However, APPA, TAPS and SMUD are concerned the Commission's statements in the Order (PP 22, 23 and 25) could be understood by public utilities to hold that, when they knowingly or intentionally exercise market power under their MBR tariffs and their conduct does not rise to a violation of Section 222 and 18 C.F.R. § 1c.2(a), they will no longer need to worry about being found in violation of the statutes, orders, rules, regulations or tariffs administered

[8] *See also* 151 CONG. REC. S7053 (daily ed. June 22, 2005) (statement of Sen. Bingaman) (directing the Commission to use its existing authority in addition to the new anti-market manipulation language).

by the Commission and thus subject to remedies, such as disgorgement of profits, for the violations. Because they do not believe the Commission intended to send this message of retreat, APPA, TAPS and SMUD urge the Commission to grant the clarifications requested herein.[9]

IV. ALTERNATIVE REQUEST FOR REHEARING

In the event that the Commission does not grant the clarifications requested above, APPA, TAPS and SMUD seek rehearing of the Order for the reasons set out in Section III. APPA, TAPS and SMUD believe that the Commission's duties and powers under FPA Sections 205 and 206 to ensure that public utilities charge only just and reasonable rates, and to provide relief when they do not, have not been diminished in any way due to passage of the Energy Policy Act of 2005, and request the Commission to so rule on rehearing.

[9] As noted at the outset, APPA, TAPS and SMUD do not oppose the Commission's requiring that the clarifications be explicitly included in writing in MBR tariffs, if the Commission deems that necessary or appropriate.

CONCLUSION

The Commission should grant clarification or, in the alternative, rehearing as set forth above.

Respectfully submitted,

/s/ *Mark S. Hegedus*

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March 20, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have on this 20th day of March, 2006, caused the foregoing document to be sent by electronic mail to all parties on the list compiled by the Secretary of the Commission in this proceeding.

/s/ *Mark S. Hegedus*
Mark S. Hegedus

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CORRECTED VERSION