ORAL ARGUMENT HAS NOT BEEN SCHEDULED

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IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 06-1025 and 06-1027

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., *et al.*
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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FINAL BRIEF: APRIL 27, 2007

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CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties:

All parties and intervenors appearing below and in this Court are listed in Petitioner's brief. There are no amici.

B. Rulings Under Review:

1. *New York Independent System Operator*, 110 FERC ¶ 61,244 (2005) ("Remand Order"), R. 266, JA ___.

2. *New York Independent System Operator*, 113 FERC ¶ 61,155 (2005) ("Rehearing Order"), R. 275, JA ___.

C. Related Cases:

This case is on remand as directed by the Court in *Consolidated Edison Co. v. FERC*, 347 F.3d 964 (D.C. Cir. 2003), in which the Court affirmed in part and remanded in part for further proceedings the following FERC orders: *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218 (2000), *order on reh'g*, 97 FERC ¶ 61,155 (2001), *order on reh'g*, 99 FERC ¶ 61,125 (2002). Counsel is not aware of any other related cases pending before this or any other court.

_____
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Attorney

February 23, 2007

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GLOSSARY

Commission or FERC	Federal Energy Regulatory Commission
Consolidated Edison	*Consolidated Edison Co. v. FERC*, 347 F.3d 964 (D.C. Cir. 2003)
FPA	Federal Power Act
NYISO	New York Independent System Operator, Inc.
Operating Reserves	Electricity generation supplies that must be maintained for electric system reliability, to allow electric utilities to produce electricity on short notice to serve load
Remand Order	*New York Independent System Operator, Inc.*, 110 FERC ¶ 61,244 (2005), R.266, JA 344
Rehearing Order	*New York Independent System Operator, Inc.*, 113 FERC ¶ 61,155 (2005), R.275, JA 403
TEP	Temporary Extraordinary Procedures, the NYISO tariff provision allowing for corrective actions to address market design flaws
Towns of Concord	*Towns of Concord et al. v. FERC*, 955 F.2d 67 (D.C. Cir. 1992)

IN THE UNITED STATES COURT OF APPEALS
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Nos. 06-1025 and 06-1027
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CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., *et al.*,
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v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission ("Commission" or "FERC") complied with this Court's remand in *Consolidated Edison Co. v. FERC*, 347 F.3d 964 (D.C. Cir. 2003), and, in so doing, whether the Commission: (1) reasonably concluded that the New York Independent System Operator, Inc.'s ("NYISO") Temporary Extraordinary Procedures ("TEP") do not apply under the circumstances of this case; and (2) reasonably exercised its remedial discretion in

declining to order refunds for NYISO's tariff violation in its pricing of operating reserves.

STATUTES AND REGULATIONS

The relevant statutes and regulations are contained in the Addendum to this brief.

STATEMENT OF THE CASE

These proceedings address the response of NYISO and the Commission to a significant rise in prices experienced in NYISO's non-spinning operating reserves market in 2000, shortly after NYISO began operating wholesale electricity markets. In *Consolidated Edison Co. v. FERC*, 347 F.3d 964 (D.C. Cir. 2003) ("*Consolidated Edison*"), this Court reviewed three Commission orders addressing these events. In those orders, the Commission granted prospective relief to address the price increases, but declined to order retroactive relief for the period from January 29, 2000 to March 27, 2000. The Court affirmed the Commission's orders in part, and remanded them in part to consider three discrete issues: (1) whether NYISO's TEP tariff mechanism, allowing retroactive recalculation of prices, applies; (2) whether refunds should be provided for NYISO's tariff violation related to its pricing of operating reserves; and (3) whether NYISO's exclusion of the Blenheim-Gilboa pumped storage hydroelectric facility from the operating reserves market violated the NYISO tariff.

The orders on review in this appeal were issued by the Commission in response to the Court's remand. Specifically, Petitioners seek review of the Commission's response to the first two issues remanded by the Court. As discussed in more detail below, the Commission concluded in the challenged orders that TEP should not be applied retroactively under the circumstances of this case, and that refunds should not be provided for NYISO's tariff violation in its pricing of operating reserves. *See New York Independent System Operator, Inc.*, 110 FERC ¶ 61,244 (2005) ("Remand Order"), R.266, JA 344; *New York Independent System Operator, Inc.*, 113 FERC ¶ 61,155 (2005) ("Rehearing Order"), R.275, JA 403.

STATEMENT OF FACTS

I. Statutory Framework

Under Section 201(b) of the Federal Power Act ("FPA"), 16 U.S.C. § 824(b), the Commission has exclusive jurisdiction to regulate the transmission and sale at wholesale of electric energy in interstate commerce. *See, e.g., New York v. FERC*, 535 U.S. 1 (2002) (discussing statutory framework and Commission jurisdiction under the FPA).

Section 205(c) of the FPA, 16 U.S.C. § 824d(c), requires public utilities to file tariff schedules with the Commission showing their rates and terms of service, along with related contracts, for service subject to FERC jurisdiction. When those

tariff schedules are filed, Sections 205(a)-(b) of the FPA, 16 U.S.C. §§ 824d(a)-(b), direct the Commission to assure that the rates and services described in the tariff are just and reasonable and not unduly discriminatory.

Section 206 of the FPA, 16 U.S.C. § 824e, authorizes the Commission, on its own motion or on complaint, to investigate whether existing rates are lawful. If the Commission finds that an existing rate or charge is "unjust, unreasonable, unduly discriminatory, or preferential," it must determine the just and reasonable rate or charge "to be thereafter observed and in force." Section 206(b) states that the Commission may also order refunds of any amounts paid in excess of the just and reasonable rate during the 15-month period beginning with the refund effective date established by the Commission. *See* 16 U.S.C. § 824e(b).

II. NYISO and Electricity Markets in New York

The Court's opinion in *Consolidated Edison* describes NYISO's operation of the bulk power transmission system in New York and its administration of bid-based electricity markets. 347 F.3d at 966. This Court is familiar with many of the issues arising from New York's creation of and transition to competitive wholesale electricity markets. *See, e.g., Niagara Mohawk Power Corp. v. FERC*, 452 F.3d 822 (D.C. Cir. 2006) (pricing and treatment of station power); *Electricity Consumers Resource Council v. FERC*, 407 F.3d 1232 (D.C. Cir. 2005) (approval of rate design for installed capacity market); *Edison Mission Energy, Inc. v. FERC*,

394 F.3d 964 (D.C. Cir. 2005) (mitigation of prices charged by New York generators and marketers); *PSEG Energy Resources & Trade, LLC v. FERC*, 360 F.3d 200 (D.C. Cir. 2004) (use of Temporary Extraordinary Procedures to reduce market prices); *KeySpan-Ravenswood, LLC v. FERC*, 348 F.3d 1053 (D.C. Cir. 2003) (price cap for New York City capacity market).

As noted in *Consolidated Edison*, NYISO maintains a market for the sale of operating reserves at market-based rates. 347 F.3d at 966-67. Operating reserves are generation supplies that must be maintained for system reliability, to "allow utilities to produce electricity on short notice to meet load (the total demand for service on a utility system)." *Id.* at 966. As relevant here, the NYISO tariff characterizes operating reserves that can be available within 10 minutes as either spinning reserves or non-spinning reserves, and requires that at least 50 percent of the 10-minute reserve requirement be met with spinning reserves, which are of a "higher quality" than non-spinning reserves. *See Central Hudson Gas & Elec. Co.*, 86 FERC ¶ 61,062, 61,227-28 (1999); *Consolidated Edison*, 347 F.3d at 966-67 (describing 10-minute spinning and non-spinning reserves).

A. Temporary Extraordinary Procedures ("TEP")

When it approved NYISO's proposal to operate energy markets, the Commission directed NYISO to submit plans to take measures that would mitigate the exercise of market power or remedy market design flaws, recognizing the

complexity of the new markets and the fact that market design flaws may not be revealed until after the markets are in operation. *Central Hudson Gas & Elec. Co.*, 86 FERC at 61,237-39. In response, NYISO submitted, and the Commission approved, Temporary Extraordinary Procedures ("TEP") to allow NYISO to address market design flaws and transitional abnormalities that might surface after the markets became operational. *See New York Independent System Operator, Inc.*, 88 FERC ¶ 61,228, *order on reh'g*, 89 FERC ¶ 61,168 (1999) (accepting TEP); *New York Independent System Operator, Inc.*, 90 FERC ¶ 61,320 (2000) (accepting 90-day extension of TEP); *see also PSEG*, 360 F.3d at 201-202 (describing NYISO's TEP authority).

Specifically, TEP empowered the NYISO to take specific extraordinary corrective actions, including recalculating market clearing prices, in the event of a market design flaw. *New York Independent System Operator, Inc.*, 88 FERC at 61,753; *PSEG*, 360 F.3d at 201-202. The NYISO tariff defined a market design flaw as "a market structure, market design, or implementation flaw that would not be produced in a workably competitive market." 88 FERC at 61,752-53. The tariff identified examples of possible market design flaws to include:

> the dispatch of higher priced resources in the market when resources with lower-priced bids are available and not selected to operate, and there is no valid reason for not operating the lower-priced resource; situations in which approved procedures would inadvertently create a shortage of supply in actual operations when sufficient supply would have otherwise been available; or the derivation of prices in the price

> model that are significantly inconsistent with the actual operation of the system.

Remand Order at P 5, JA 345 (citing NYISO Services Tariff, Attachment E, Section A). Under TEP, NYISO had a range of options for taking corrective actions, including recalculating a clearing price as it should have been absent the market design flaw "[i]f possible with reasonable certainty." *Id*. at P 6, JA 345 (citing NYISO Services Tariff, Attachment E, Section C.2.c(2)). TEP also contained notice and posting requirements, and required NYISO to take the least restrictive action available, with recalculation of prices the most restrictive. Rehearing Order at P 25, JA 406.

III. Events Leading to the Proceedings Below and Commission Response

The events giving rise to these proceedings are thoroughly detailed in *Consolidated Edison*, 347 F.3d at 967-68. Beginning on January 29, 2000, shortly after NYISO's wholesale electricity markets began operation, the non-spinning reserves market experienced a significant decrease in the amount of supply offered, along with a significant rise in prices. *See id.* at 967; Remand Order at P 8, JA 345-46.

In response to this development, on March 27, 2000, NYISO made a filing with the Commission under FPA § 205. *See* R.3, JA 1. NYISO sought to: (1) suspend market-based pricing and impose a bid-cap of $2.52 per megawatt hour for 10-minute non-spinning reserves, as well as a cap equal to verifiable fuel costs

(plus any applicable opportunity costs) for 10-minute spinning reserves; and (2) re-bill for operating reserves from March 1 to March 28, 2000 (based on a weighted average of operating reserves prices from previous periods). *Consolidated Edison*, 347 F.3d at 967-68; *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218, 61,794-95 (2000), JA 161-62. At the same time, several complaints were filed with the Commission under FPA § 206 seeking retroactive price relief for the two-month period in question. Remand Order at P 10, JA 346. The complaints generally asserted that market design flaws (including exclusion of certain potential suppliers of reserves from bidding into the reserves market) compounded the problems in the 10-minute reserves market, and that NYISO should be directed to use its TEP authority to correct prices for the relevant period. *Consolidated Edison*, 347 F.3d at 968; Remand Order at P 10, JA 346.

The Commission addressed NYISO's filing and the complaints in three orders. *New York Independent System Operator, Inc.*, 91 FERC ¶ 61,218, JA 160, *order on reh'g*, 97 FERC ¶ 61,155 (2001), JA 195, *order on reh'g*, 99 FERC ¶ 61,125 (2002), JA 202A. The Commission prospectively accepted NYISO's proposed bid cap for non-spinning reserves, and granted waiver of the 60-day notice requirement in FPA § 205 to make the bid cap effective March 28, 2000, one day after NYISO's filing. 91 FERC at 61,798-800, JA 165-67. While it made no finding that any supplier withheld capacity, the Commission agreed with

NYISO that market-based rates for non-spinning reserves were no longer appropriate, given the evidence of increased market concentration and decreased quantity of supplies as compared to the conditions under which market-based rate authority for operating reserves was granted. *Id.* at 61,798-99, JA 165-66. Granting further prospective relief, the Commission also required NYISO to make certain changes to the operating reserves market, including changes to the software model to allow the Blenheim-Gilboa pumped storage hydroelectric plant to offer supplies into the market and changes to clarify NYISO practices for setting the prices of spinning and non-spinning reserves. *Id.* at 61,799-800, 61,806-07, JA 166-67, 173-74.

The Commission rejected, however, requests for retroactive relief. In particular, it denied NYISO's request to re-bill for operating reserves, concluding that such rate changes could only be made prospectively. *Id.* at 61,804, JA 171, *order on reh'g*, 97 FERC at 61,681, JA 200. Additionally, the Commission rejected requests for retroactive refunds under the FPA on the basis of tariff violations, since it found that NYISO had not violated the tariff. 97 FERC at 61,682, JA 201. The Commission also rejected arguments that NYISO should be directed to exercise its TEP authority to retroactively correct operating reserves prices for the past period. It noted initially that NYISO had not invoked TEP, 91 FERC at 61,804, JA 171, and concluded on rehearing that TEP was designed to be

used only in circumstances involving a limited, simple and precise correction of prices. 97 FERC at 61,682, JA 201.

IV. This Court's Opinion in *Consolidated Edison*

NYISO and the load-serving entities who filed complaints sought judicial review of the Commission's three orders responding to the events in New York's operating reserves markets. In *Consolidated Edison*, this Court addressed three issues: (1) whether the Commission properly concluded that it had no authority to provide retroactive relief under FPA § 205; (2) whether the Commission's conclusion that the TEP mechanism was inapplicable was reasonable; and (3) whether the Commission erred in holding that NYISO had not violated its tariff. 347 F.3d at 968.

On the first issue, this Court agreed with the Commission's conclusion that it could not order retroactive relief under FPA § 205. *Id*. at 968-70. As to the remaining issues, the Court remanded to the Commission for further proceedings. With regard to the second issue, the Court held that the Commission's "summary conclusion that TEP is inapplicable to the circumstances of this case fails its obligation of reasoned decisionmaking," and remanded "for FERC to explain why TEP does not apply here." *Id*. at 972. On the third issue, the Court concluded that NYISO's method of pricing spinning and non-spinning reserves during the period in question violated the plain language of its tariff, and remanded to the

Commission with instructions "either to follow its 'general policy' of providing refunds, or to explain . . . its divergence from this policy." *Id.* at 973. Also, the Court remanded for the Commission to explain why excluding the Blenheim-Gilboa facility from the reserves market was not a violation of the NYISO tariff, finding its earlier response inadequate. *Id.* at 974. (This Court's mandate to the Commission in *Consolidated Edison* is discussed more fully in the following sections of this brief).

V. The Commission's Orders on Remand

Following the opinion in *Consolidated Edison*, NYISO submitted a filing with the Commission that sought to reopen the record and submit additional evidence. *See* Motion of NYISO to Reopen Record and For Disposition on Remand (June 25, 2004), R.241, JA 208. NYISO stated in this filing that it agreed with the Court that its TEP authority is broader than the Commission found earlier, and that the exclusion of the Blenheim-Gilboa facility could be characterized as a market design flaw for which prices could be recalculated under the TEP. NYISO's filing included proposed methods for calculating refunds for the tariff violation found by the Court with regard to pricing spinning and non-spinning reserves, and for the exclusion of the Blenheim-Gilboa facility. The Commission issued notice of the filing and sought comments.

In its March 4, 2005 Order on Remand, the Commission addressed the issues remanded in *Consolidated Edison*, NYISO's post-remand filing, and the responses thereto. *New York Independent System Operator, Inc.*, 110 FERC ¶ 61,244 (2005) ("Remand Order"), R.266, JA 344. The Commission reached the following conclusions on remand: (1) NYISO had acted reasonably when it initially declined to invoke TEP to recalculate operating reserves prices, and TEP should not be invoked retroactively; (2) refunds should not be granted for NYISO's tariff violation in pricing spinning and non-spinning reserves; and (3) NYISO did not violate its tariff in modeling the operating reserves market to exclude the Blenheim-Gilboa facility. The Commission denied rehearing of these conclusions on November 17, 2005. *New York Independent System Operator, Inc.*, 113 FERC ¶ 61,155 (2005) ("Rehearing Order"), R.275, JA 403. (The Remand Order and Rehearing Order are discussed more fully in the following sections of this brief.)

SUMMARY OF ARGUMENT

The challenged orders fully responded to this Court's mandate in *Consolidated Edison*, are reasonable in all respects, and should be upheld.

With regard to the first issue remanded by the Court, the Commission reasonably concluded, for two reasons, that the TEP mechanism does not apply here and that NYISO acted reasonably at the time of the events in the reserves

market (seven years ago) when it declined to invoke TEP. First, the Commission reasonably held, on the basis of the language in NYISO's tariff and record evidence regarding the scheduling of the Blenheim-Gilboa plant, that excluding this generating facility was not a market design flaw as defined in TEP. Alternatively, even if the exclusion of Blenheim-Gilboa was a market design flaw, TEP could not be applied because prices could not be recalculated with "reasonable certainty," as the NYISO tariff requires. Petitioners' arguments to the contrary were fully addressed by the Commission, lack merit, and should be rejected.

With regard to the second issue remanded by the Court, the Commission, exercising its remedial discretion, concluded that refunds should not be ordered for NYISO's violation of its tariff by interdependently pricing spinning and non-spinning reserves. Consistent with this Court's mandate, and in accordance with *Towns of Concord et al. v. FERC,* 955 F.2d 67 (D.C. Cir. 1992), the Commission considered the relevant factors and concluded that NYISO's pricing of operating reserves, while technically violative of its tariff, was an appropriate method of pricing consistent with its least cost dispatch market design. Further, the Commission's decision did not provide a windfall to suppliers of operating reserves, nor did it conflict with the core purposes of the FPA. In light of the

deference afforded to the Commission in exercising its remedial discretion, the Commission's well-reasoned conclusion with regard to refunds should be upheld.

ARGUMENT

I. Standard of Review

The standards of review applicable to each of the two issues raised in this appeal are set forth in the sections that follow. In proceedings on remand, however, the Commission's determinations are generally reviewed to ensure that they are responsive to the Court's mandate. *See, e.g., Process Gas Consumers Group v. FERC*, 292 F.3d 831 (D.C. Cir. 2002).

II. The Commission Fully Complied with This Court's Remand in *Consolidated Edison*

As noted above, and discussed in detail below, this Court's opinion in *Consolidated Edison* directed the Commission to do three things: (1) explain why TEP does not apply in these circumstances (347 F.3d at 972); (2) in light of the Court's conclusion that interdependent pricing of spinning and non-spinning violated the NYISO tariff, either provide refunds in accordance with the Commission's "general policy" or explain why it would not provide refunds (*id.* at 973); and (3) explain why the exclusion of the Blenheim-Gilboa facility from the reserves market did not violate the NYISO tariff (and if it did, explain any decision to deny refunds) (*id.* at 974).

Petitioners here challenge the Commission's response to the first two directives of this Court.[1] The challenged orders fully responded to these directives, are reasonable in all other respects, and should be upheld.

A. Whether TEP Applies to These Circumstances

1. Mandate of the Court

In its earlier orders in this proceeding, the Commission concluded that TEP should be applied only in circumstances where a straightforward calculation error occurred, and that it was not designed for circumstances like those present in the operating reserves market. *New York Independent System Operator, Inc.*, 97 FERC at 61,682, JA 201. The Commission distinguished its approval of the use of TEP in *NRG Power Marketing v. New York Independent Transmission System Operator, Inc.*, 91 FERC ¶ 61,346 (2000), which it said involved limited and simple price corrections to ensure that prices conformed to the filed rate. 97 FERC at 61,682, JA 201.

The Court held in *Consolidated Edison* that this explanation "suffer[ed] from two related defects." 347 F.3d at 971. First, the Court noted that the Commission had not imposed such a limitation on TEP when it first approved the

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[1] As a result, this brief focuses on the Commission's response to the first two directives of the Court. The challenged orders also provided a well-reasoned response to the third directive, concluding that NYISO's exclusion of the Blenheim-Gilboa plant did not violate its tariff. *See* Remand Order at PP 71-75, JA 356-57; Rehearing Order at PP 57-60, JA 412.

mechanism, and, while it used slightly narrower language when it approved an extension of TEP, it had not explained that narrower language. *Id.* Accordingly, the Commission could not rely on its orders approving TEP to support its narrow view of the mechanism's application. *Id.* Second, the Court did not agree with the Commission's rationale distinguishing *NRG Power*, stating that it saw nothing in that case to suggest that the decision "turned on whether the price recalculation was simple, straightforward, or precise." *Id.* It also found similarities between the situation in *NRG Power* and the situation here, including the finding by FERC in both cases that software problems prevented the ISO from accepting certain low-cost bids. *Id.* at 971-72.

The Court held:

> In sum, given that FERC points to only one case as precedent for limiting the scope of TEP to technical miscalculations -- a case that itself expressed no such limitation -- and given the broad language of TEP and the orders approving it, we find FERC's summary conclusion that TEP is inapplicable to the circumstances of this case fails its obligation of reasoned decisionmaking.

Id. at 972. Accordingly, the Court remanded to FERC "to explain why TEP does not apply here." *Id.*

2. Commission Response

Pursuant to this Court's remand, the Commission reconsidered the applicability of TEP in the challenged orders on remand. The Commission agreed with the Court that TEP does not apply only to certain technical miscalculations,

but ultimately concluded that, under the circumstances of this case, NYISO acted reasonably when it declined to exercise its TEP authority at the time of the subject events in the reserves market, and thus TEP should not be invoked retroactively. Remand Order at P 49, JA 351.

The Commission's conclusion is supported by its interpretation of the language of NYISO's tariff and evidence in the record. First, the Commission explained that the language of TEP gave NYISO discretion to "exercise its judgment as to whether and when TEP should be applied." *Id.* at PP 50-53, JA 351-52; *see also* Rehearing Order at P 24, JA 406. This discretion includes the ability to determine whether a market design flaw or transitional abnormality has occurred, and whether the situation is substantial enough to invoke TEP. Remand Order at P 51, JA 351-52 (noting that tariff language says NYISO "may" take extraordinary corrective actions, not that it must).

The Commission also noted that TEP contains notice requirements, Rehearing Order at P 25, JA 406, and also requires that NYISO take the least restrictive action available (with recalculation of prices the most restrictive). *Id.* Given these requirements and the discretion afforded to NYISO in the language of TEP, the Commission determined that it would give considerable weight to NYISO's initial determination at the time of the events in the reserves market that the failure to include western suppliers or the Blenheim-Gilboa facility in the

reserves market did not require that TEP be invoked. Remand Order at PP 54-55, JA 352; Rehearing Order at P 25, JA 406. Accordingly, the Commission stated that, on remand, it would require retroactive application of TEP only if it found NYISO's initial decision not to use TEP unreasonable. Remand Order at PP 54-56, JA 352; Rehearing Order at PP 25-27, JA 406-07.

Following this approach, the Commission found that NYISO acted reasonably when it initially declined to invoke TEP. *See* Remand Order at PP 55-61, JA 352-53; Rehearing Order at PP 28-43, JA 407-09. Noting NYISO's determinations in 2000 that the problems in the reserves market were due to market concentration levels and related bidding behavior rather than any market design flaws (and that correcting any market design flaws would not return markets to a reasonably competitive state), the Commission held that NYISO "made a reasonable determination that the problems in its market were primarily due to market power, not market design flaws, and that invocation of TEP was not the best and most efficient procedure to remedy such flaws." *Id.* at PP 55-56, JA 352; Rehearing Order at P 28, JA 407 (noting that NYISO instead sought to directly address the problem with a prospective FPA § 205 filing).

More specifically, based on the circumstances at the time of the price increase in the reserves market and the language of TEP, the Commission could not find that the exclusion of western suppliers and the Blenheim-Gilboa facility

from bidding into the reserves market were market design flaws as defined by TEP. Remand Order at P 57, JA 352. As the Commission noted, the TEP language in NYISO's tariff explains that "'possible indications of Market Design Flaws include the dispatch of higher priced resources in the market when resources with lower-priced bids are available and not selected to operate, *and there is no valid reason for not operating the lower-priced resource*.'" *Id.* (quoting NYISO Services Tariff, Attachment E, Section A) (emphasis in original).

Applying this tariff language, the Commission concluded in the challenged orders that NYISO had valid reasons for not operating the lower-priced resources in question. *Id*. at PP 58-59, JA 352-53. With regard to the Blenheim-Gilboa plant specifically, the Commission found based on record evidence that NYISO had a "valid reason for not operating the lower-priced resource," since its failure to include the plant in its software model for non-spinning reserves reflected the fact that the owners of the plant were using it to produce energy for sale in the energy markets, rather than to produce reserves for sale in the reserves markets. *Id.* at P 59, JA 353 (citing NYISO's April 20, 2000 answer to complaint at 4, R.83, JA 87); Rehearing Order at P 37, JA 408 (citing same).

Alternatively, even if the failure to include these resources in the reserves markets was a market design flaw, TEP can be used to recalculate prices "only when the prices can be recalculated with 'reasonable certainty.'" Remand Order at

P 58, JA 352-53 (quoting NYISO Services Tariff, Attachment E, Section C.2.c); Rehearing Order at P 40, JA 408-09. With regard to Blenheim-Gilboa, the Commission held that there was no evidence that the effect of including the plant in the market could be predicted with the required reasonable certainty. Remand Order at P 60, JA 353; Rehearing Order at P 40, JA 408-09. In particular, there was no evidence of what Blenheim-Gilboa's bid would have been, what factors would have influenced that bid, and what the effect of one additional bidder would have been on prices. *Id.* As a result of this lack of evidence and the early stage of NYISO's operation of markets, NYISO had no clear basis to recalculate prices under the TEP with "reasonable certainty," as required by the tariff. *Id.* While NYISO attempted in its post-remand filing to recalculate prices with Blenheim-Gilboa included, the Commission concluded that this evidence did not establish the required certainty, since it used future prices as a proxy rather than contemporaneous prices, and other parties had raised significant objections to NYISO's after-the-fact calculation methodology. Remand Order at P 61, JA 353; Rehearing Order at PP 41-43, JA 409.

3. The Commission Reasonably Concluded That TEP Should Not Be Applied Retroactively

(i) Standard of Review

In addition to assessing whether the Commission complied with the Court's mandate in *Consolidated Edison*, the Commission's determination that TEP does

not apply should be reviewed, as with other Commission orders, under the deferential arbitrary and capricious standard of the Administrative Procedure Act. *See, e.g.*, *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under this standard, the court "will affirm the Commission's orders so long as FERC 'examined the relevant data and articulated a . . . rational connection between the facts found and the choice made.'" *Midwest ISO Transmission Owners*, 373 F.3d 1361, 1368 (D.C. Cir. 2004) (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 26, 43 (1983)). Further, "this circuit gives substantial deference to [the Commission's] interpretation of filed tariffs." *Koch Gateway Pipeline Co. v. FERC*, 136 F.3d 810, 814 (D.C. Cir. 1998); *see also Consolidated Edison*, 347 F.3d at 972 ("FERC's interpretation of tariffs receive[s] *Chevron*-like deference").

(ii) The Commission Complied with the Court's Directives and Rationally Concluded That TEP Does Not Apply Here

The above discussion illustrates that, on remand, the Commission provided a reasoned and thorough response, based on record evidence and the language of NYISO's tariff, to the Court's directive in *Consolidated Edison* that it "explain why TEP does not apply here." 347 F.3d at 972.

Significantly, Petitioners overstate this Court's remand in *Consolidated Edison* as somehow definitively holding that TEP was applicable to the circumstances in the reserves markets at issue here. *See, e.g.*, Pet. Br. at 4-5, 21, 24,

26. In fact, the Court simply found the Commission's original explanation that TEP did not apply lacking, given its mistaken reliance on *NRG Power* and the broad language of TEP itself, and the Commission's orders approving that mechanism. *Consolidated Edison*, 347 F.3d at 972.

Applying the language of TEP in the NYISO tariff, the Commission explained two reasons why TEP should not be applied retroactively in this case: (1) the exclusion of the Blenheim-Gilboa resource was not a market design flaw, but was instead based on the owners' decision to use the plant to supply energy rather than reserves; and (2) even if excluding Blenheim-Gilboa was a market design flaw, TEP could not be applied because prices could not be recalculated with reasonable certainty, as the tariff requires. The Commission's orders on remand addressed all of Petitioners' various objections to the Commission's reasoning, which are unavailing and should be rejected.

(iii) The Commission Reasonably Applied TEP, and its Conclusions Do Not Conflict with Its Prior Orders

Petitioners contend that the Commission's application of the language of the TEP mechanism in the challenged orders conflicts with its earlier conclusions, including its orders approving the TEP and its earlier findings in this case.

With regard to the alleged conflict with the Commission's approval of TEP, Petitioners cite to the Commission's generic statement in its 1999 order accepting TEP that NYISO's new markets "could contain unintended design flaws which

may require immediate corrective actions." Pet. Br. at 22 (citing *New York Independent System Operator, Inc.*, 88 FERC at 61,754). The Commission explained in the challenged orders, however, that the actual language of TEP, as approved by the Commission, gives the NYISO discretion as to whether it will invoke TEP. *See* Remand Order at PP 50-51, JA 351-52; Rehearing Order at P 24, JA 406 (noting that TEP language provides that NYISO "may" invoke TEP to take an "Extraordinary Corrective Action"). Further, TEP gives NYISO a range of options as to what measures it might take under TEP, Remand Order at P 51, JA 351-52, states a preference that TEP be used only to correct imminent harm (with longer-term problems corrected using NYISO's regular procedures, such as through the FPA § 205 rate filing it made in these proceedings), *id.* at P 52, JA 352, requires that notice be given of possible corrective actions, Rehearing Order at P 25, JA 406, and requires NYISO to take the least restrictive action available to it, with price recalculation being the most restrictive. *Id.*

The Commission's explanation of the discretion inherent in TEP is consistent with the Commission's observation, when it approved TEP, of the "limited . . . circumstances under which the procedures [would] be invoked." *New York Independent System Operator, Inc.*, 88 FERC at 61,754; *see also order denying reh'g*, 89 FERC at 61,506 (noting Commission's expectation that NYISO would institute corrective actions under TEP in limited circumstances, and that the

notice requirement in TEP would deter NYISO from using its TEP authority too broadly). Accordingly, the Commission's review here of whether NYISO's initial determination not to invoke TEP was reasonable under the circumstances at the time was entirely appropriate and consistent with its approval of TEP, and, most important, consistent with the language of the tariff.

As to their argument that the Commission's conclusion conflicts with its earlier orders in this case, Petitioners cite to Commission findings made when it approved NYISO's filing to discontinue prospectively the use of market-based rates for operating reserves and institute a bid cap. Pet. Br. at 24-25. This contention confuses the Commission's approval of NYISO's prospective filing, made under FPA § 205, with its consideration on remand of the far different question of whether TEP should have been invoked to recalculate retroactively past operating reserves prices. As the Commission noted in the challenged orders, finding that a market rule change is just and reasonable under FPA § 205 does not require that TEP be invoked to recalculate "all prior implementations of the market." *See* Remand Order at P 53, JA 352; Rehearing Order at P 24, JA 406 (quoting NYISO Motion to Reopen Record, R.241, JA 208).

The Commission findings in its earlier orders that NYISO had "presented sufficient evidence to call into question continued reliance on market-based pricing for non-spinning reserves" represented simply the Commission's conclusion that

NYISO had supported its prospective filing as just and reasonable, not that a retroactive remedy for past periods was warranted. *See New York Independent System Operator, Inc.*, 91 FERC at 61,798-99, JA 165-66. Likewise, the Commission's direction in that order that NYISO include the Blenheim-Gilboa plant in the reserves market "as quickly as possible" to reduce market concentration was a prospective remedy to ensure that NYISO's markets produced just and reasonable prices, not a finding that retroactive remedies were required. *Id.* at 61,800, JA 167.

(iv) The Exclusion of the Blenheim-Gilboa Resource Was Not a Market Design Flaw as Defined by TEP

Petitioners also challenge the Commission's finding that the exclusion of the Blenheim-Gilboa plant was not a market design flaw (as described in the NYISO tariff), but rather reflected the intent of the plant's owners that it be used to produce energy instead of operating reserves. Pet. Br. at 25-27. In particular, they argue that this rationale fails because both the Commission and this Court already found that the failure of NYISO to model Blenheim-Gilboa in its software was a "market design flaw" for which the TEP should be invoked. *Id.*

Once again, Petitioners misstate the prior findings of the Commission and the holding of this Court in *Consolidated Edison*. The Commission found in its prior orders that, as a prospective remedy, Blenheim-Gilboa should be included in the software model to provide reserves because it could lower market

concentrations and add another large competitor to the market. *New York Independent System Operator, Inc.*, 91 FERC at 61,800, JA 167. While it is true that the Commission later used the words "software flaws," *see order on reh'g*, 97 FERC at 61,681, JA 200, and "other market flaws," *order on reh'g*, 99 FERC at 61,533, JA 202B, it did not make a finding that excluding Blenheim-Gilboa was a "market design flaw" as defined by TEP, as Petitioners suggest.

Further, the Court in *Consolidated Edison* made no finding that the exclusion of Blenheim-Gilboa was a market design flaw within the meaning of the TEP. Rather, as discussed above, the Court simply found the Commission's earlier rationale for limiting the scope of TEP insufficient, and remanded for the Commission to reconsider whether TEP should apply in these particular circumstances. *Consolidated Edison*, 347 F.3d at 972.

Moreover, Petitioners' arguments gloss over the Commission's detailed discussion in the challenged orders of the fact that Blenheim-Gilboa's owners intended to use the plant to produce energy instead of operating reserves, and that, as a result, NYISO's market software did not include the plant as available to provide operating reserves. *See* Remand Order at P 59, JA 353; Rehearing Order at P 37, JA 408; *see also* Remand Order at PP 72-74, JA 356 (concluding that exclusion of Blenheim-Gilboa from the reserves market was not a tariff violation). While Petitioners summarily assert that NYISO's reason for designing the software

to exclude Blenheim-Gilboa is "irrelevant," Pet. Br. at 26, the actual language of TEP in the NYISO tariff makes the reason for this software design decision particularly relevant. TEP states that market design flaws, subject to possible retroactive correction, can exist where a higher-priced resource is dispatched when lower-priced resources are available "*and there is no valid reason for not operating the lower-priced resource*." Remand Order at PP 57, 59, JA 352, 353. The Commission relied on NYISO's on-the-record statement that it originally modeled the operating reserves market without Blenheim-Gilboa to reflect the owners' choice to schedule the facility for energy only, which was embodied in a scheduling agreement entered into by Blenheim-Gilboa's owners. *Id.* at P 59, JA 353; Rehearing Order at P 37, JA 408 (citing NYISO's April 20, 2000 answer in this proceeding, at 5, R.83, JA 88).

Given this record evidence and the actual language of TEP, the Commission reasonably concluded that excluding Blenheim-Gilboa was not a market design flaw as defined in the TEP. Petitioners' assertion that this conclusion "is wholly unsupported and simply wrong," Pet. Br. at 25, lacks any foundation and fails to address the record evidence relied on by the Commission.

(v) Prices Could Not Be Recalculated with Reasonable Certainty

Petitioners assail the Commission's alternative finding that even if the exclusion of Blenheim-Gilboa was a market design flaw within the meaning of TEP,

prices for the period (January to March 2000) could not be recalculated with the "reasonable certainty" required under TEP. Pet. Br. at 27-31. Primarily, they claim that the Commission's "difficulty" rationale is inconsistent with its "general policy of granting refunds," and that this rationale fails because "a just and reasonable rate is not a single amount, but rather . . . encompasses a range of just and reasonable rates." *Id.* at 28-29.

As the Commission explained in the challenged orders, its task on remand was to "explain why TEP does not apply here." *Consolidated Edison*, 347 F.3d at 972. As a result, the issue facing the Commission was whether TEP should be applied to the circumstances at issue in this case, and not "the extent of the Commission's authority to determine just and reasonable rates or order refunds." Rehearing Order at P 39, JA 408. Petitioners' arguments that the Commission can recalculate prices here within a "broad range" of just and reasonable rates confuses the standard under FPA § 205 for prospective rate filings with the question presented on remand. The relevant question now is whether TEP, which requires that price recalculations be performed with "reasonable certainty" (and only as the last potential remedy to be invoked), should have been applied to recalculate prices for the historical period in question. *Id.*

To be sure, the Commission did far more on remand than simply assert "difficulty." As discussed above, the Commission fully explained in the

challenged orders why prices could not be recalculated with reasonable certainty. In particular, the Commission explained that the effect of including Blenheim-Gilboa in the reserves market could not be predicted with reasonable certainty, since there was no evidence of what the plant would have bid at the time or what the impact of including the plant would have been on prices. *See* Remand Order at P 60, JA 353; Rehearing Order at P 40, JA 408-09. This is especially so given that, at the time, NYISO was in the early stages of operation. *Id.*

Additionally, the Commission considered and ultimately found unpersuasive the post-remand submission by NYISO (relied on by Petitioners here) to attempt to reconstruct the market for purposes of refunds. *See* Pet. Br. at 31 (asserting that the record supported NYISO's calculations). NYISO attempted in its filing, many years after the historical period in question, to recreate "proxy" prices with Blenheim-Gilboa included for the purposes of determining refunds. The Commission reasonably found that "such ex post calculations do not satisfy" the TEP's requirement that prices be recalculated with reasonable certainty, since they used future rather than contemporary prices. Remand Order at P 61, JA 353; Rehearing Order at P 41, JA 409.

Moreover, intervening parties raised significant objections to NYISO's calculations, demonstrating that those prices could not be relied upon as "reasonably certain." *See* Rehearing Order at P 42, JA 409; *see also, e.g.*, Answer

of Long Island Power Authority at 14-16 (July 16, 2004), R.249, JA 338-40; Answer of KeySpan Ravenswood, LLC at 29-33 (July 16, 2004), R.247, JA 262-66. For example, intervening parties contended that the "average price methodology" used by NYISO "ignores the features of a dynamic market by not reflecting hourly variations in [non-spinning reserves] supply, demand and prices." Rehearing Order at P 42, JA 409. They also argued that changes in market design, the entry of new competitors, and changes in weather and load conditions made the use of future prices to recalculate prices for a long-past period unreliable. *Id.* Weighing all the submissions, the Commission found these objections persuasive, and Petitioners offered no evidence that convinced the Commission that prices could be recalculated with the reasonable certainty mandated by the tariff. *See, e.g., Florida Mun. Power Agency v. FERC*, 315 F.3d 362, 368 (D.C. Cir. 2003) (under the substantial evidence standard, Commission's choice between competing submissions is entitled to respect).

For similar reasons, Petitioners' argument that the Commission could have simply applied the bid cap proposed by NYISO in its March 2000 FPA § 205 filing to the period at issue lacks merit. Pet. Br. at 30. The Commission's orders addressed this contention by explaining, as discussed above, that whether a rate is supported as just and reasonable in a prospective FPA § 205 filing is a different issue than that presented here, which is whether prices can be recalculated

retroactively with reasonable certainty as required by TEP. *See* Rehearing Order at P 39, JA 408. Moreover, as NYISO explained in its filing to institute the prospective bid cap, the $2.52 per megawatt hour cap represented the highest market clearing price for non-spinning reserves in the period *prior to* January 29, 2000, the beginning of the period at issue here. *See New York Independent System Operator, Inc.*, 91 FERC at 61,795, JA 162. As a result, this rate does not represent a contemporaneous price, which the Commission found was necessary to recalculate rates with the reasonable certainty TEP requires. *See* Remand Order at P 61, JA 353.

B. Whether Refunds Should Be Ordered for NYISO's Tariff Violation

1. Mandate of the Court

During the historical time period at issue in these proceedings (January to March 2000), NYISO's practice was to set the price of spinning reserves no lower than the price of non-spinning reserves (termed "interdependent pricing"). In *Consolidated Edison*, the Court agreed with load-serving entities that this practice violated the NYISO tariff. 347 F.3d at 972-73. The Commission had explained in its orders that NYISO priced reserves in this manner to ensure that suppliers would not offer all of their reserves in the non-spinning reserves market, which could pose the risk that insufficient spinning reserves would be available. *Id.* While this explanation "might well be reasonable," the Court held that such a practice

violated the plain language of Rate Schedule 4 in the NYISO tariff, which "requires [NYISO] to price [spinning reserves] and [non-spinning reserves] separately." *Id.* at 973.

In light of this tariff violation, the Court remanded for the Commission to "either . . . follow its 'general policy' of providing refunds, or to explain, in accordance with *Towns of Concord*, . . . its divergence from this policy." *Id.*

2. Commission Response

Exercising its remedial discretion, the Commission declined to order refunds for NYISO's tariff violation in pricing reserves. Remand Order at PP 63-70, JA 354-56; Rehearing Order at PP 47-54, JA 410-11. The Commission noted the judicially-recognized "breadth" of agency discretion when fashioning remedies. Remand Order at P 63, JA 354; Rehearing Order at P 47, JA 410 (citing *Connecticut Valley Elec. Co. v. FERC*, 208 F.3d 1037 (D.C. Cir 2000)). The Commission also explained that while its general policy is to provide refunds for violations of the filed rate or tariff, it has found that refunds are not appropriate in certain circumstances, including situations where "the end result . . . is not 'unjust, unreasonable or unduly discriminatory,'" or where no "windfall" was gained as a result of the tariff violation. Remand Order at P 64, JA 354; Rehearing Order at P 47, JA 410 (citing *Towns of Concord*, 955 F.2d 67; *Louisiana Pub. Serv. Comm'n*

v. FERC, 174 F.3d 218, 223 (D.C. Cir. 1999); *Koch Gateway Pipeline*, 136 F.3d 810)).

The Commission concluded that refunds should not be paid because NYISO's pricing policy, while technically in violation of Section 4.21 of its tariff, "was the correct method of implementing its least cost dispatch market design." Rehearing Order at P 49, JA 410-11; *see also* Remand Order at PP 69-70, JA 355-56. In doing so, the Commission considered several factors. *See* Remand Order at PP 65-70, JA 354-56; Rehearing Order at PP 49-54, JA 410-11. For example, the Commission explained that the pricing method used by NYISO allowed for cost-saving substitution between the spinning and non-spinning reserves markets, producing the lowest cost to consumers over the long-term. *See* Remand Order at PP 65-69, JA 354-56 (in particular P 67, JA 355, providing example calculation showing the benefits of substituting higher-quality spinning reserves for non-spinning reserves when prices for the former are lower); *see also* Rehearing Order at P 49, JA 410-11 (quoting NYISO's explanation of its ability to substitute the two types of reserves once a minimum portion of spinning reserves is obtained). Additionally, the Commission noted that this pricing method protected reliability by ensuring that suppliers would not have the incentive to offer more non-spinning reserves when prices for that product were higher, which could leave NYISO short of needed higher-quality spinning reserves. Remand Order at PP 66-68, JA 355;

see also Rehearing Order at P 49, JA 410-11 (quoting NYISO's explanation that it must procure a minimum portion of reserves as spinning reserves).

Further, the Commission noted that NYISO's pricing method was consistent with another specific provision in the tariff requiring it to select the least cost mix of operating reserves. Section 4.9 of the NYISO tariff requires it to:

> select the least cost mix of Ancillary Services [i.e. operating reserves] and Energy Suppliers. The ISO may substitute higher quality Ancillary Services (i.e., shorter response time) for lower quality Ancillary Services when doing so would result in an overall least cost solution.

Remand Order at P 69, JA 355-56 (citing NYISO Services Tariff, Section 4.9, JA 420-21).[2] The Commission found this provision to be "at odds" with the requirement in Section 4.21 of the tariff that spinning and non-spinning reserves be priced separately, since separate pricing would not allow NYISO to substitute spinning reserves for non-spinning reserves when prices for the former product are lower. Remand Order at PP 67-68, 70, JA 355, 356; *see also* Rehearing Order at P 49, JA 410-11 (quoting NYISO's explanation of its ability to substitute the two types of reserves).

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[2] NYISO added this provision to its tariff in response to a Commission directive that it take measures to make sure that lower priced, higher quality reserves would be used in place of higher priced, lower quality reserves, to ensure an efficient allocation of prices. *Id.* (citing *Central Hudson Gas & Elec. Corp.*, 86 FERC ¶ 61,062 at 61,227 (1999)).

Also, on rehearing, the Commission noted that NYISO itself agreed that interdependent pricing of spinning and non-spinning reserves was appropriate and most consistent with its least cost dispatch market design, and ensured "that the total bid cost for all reserves will be minimized." *See* Rehearing Order at PP 49-50, JA 410-11 (quoting NYISO Answer to Complaint at 7-8 (April 13, 2000), R.76, JA 56-57; NYISO Request for Rehearing at 6 (April 4, 2005), R.269, JA 399).

For all of these reasons, the Commission found, "in balancing the equities, that refunds should not be paid in this case." Remand Order at P 70, JA 356. It concluded that the payments received by generators for reserves did not constitute a windfall or unjust enrichment because they represented the proper market price under NYISO's least cost dispatch market design. *Id.* Further, the Commission held that a refund would "run counter to the Commission's goals of establishing an efficient market mechanism for generator dispatch." *Id.*

3. The Commission Did Not Abuse Its Discretion by Declining to Grant Refunds for NYISO's Tariff Violation

(i) Standard of Review

As noted above, the Court in *Consolidated Edison* directed the Commission either to provide refunds for NYISO's tariff violation with regard to the pricing of spinning and non-spinning reserves, or to explain, in accordance with *Towns of Concord*, why refunds are not appropriate. 347 F.3d at 972-73.

Towns of Concord confirms the Commission's discretion under the FPA to fashion remedies for statutory violations, including the discretion to consider whether or not refunds are appropriate. 955 F.2d at 72-73 (noting that the FPA does not mandate a particular remedy and "quite clearly" confers remedial discretion on the Commission with respect to refunds).

The Commission's discretion is "at its 'zenith' when the challenged action relates to the fashioning of remedies." *Id.* at 76 (citing *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967)). Accordingly, this Court reviews the Commission's exercise of its remedial discretion "only for abuse." *Connecticut Valley Elec. Co.*, 208 F.3d at 1044; *see also Louisiana Pub. Serv. Comm'n v. FERC*, 174 F.3d at 224 (when reviewing an agency's choice of remedy, "the scope of judicial review is particularly narrow"). "An agency abuses its remedial discretion if its decision conflicts with the core purpose of the statute it administers, or if it is not otherwise reasonable, that is, based upon a reasonable accommodation of all the relevant considerations and not inequitable under the circumstances." *Connecticut Valley Elec. Co.*, 208 F.3d at 1044-45 (citing *Towns of Concord*, 955 F.2d at 74-76) (internal quotation marks omitted). This Court generally defers to the Commission's remedial determinations, "respecting that the difficult problem of balancing competing equities and interests has been given by Congress to the Commission with full knowledge that this judgment requires a

great deal of discretion." *Koch Gateway Pipeline*, 136 F.3d at 816 (citations and internal quotation marks omitted); *see also Towns of Concord*, 955 F.2d at 76 (noting that the FPA leaves the determination of whether refunds are necessary "to the Commission's expert judgment").

The Commission fully complied here with the Court's directive in *Consolidated Edison* to explain why refunds were inappropriate, in accordance with *Towns of Concord*, and did not abuse its discretion by declining to order refunds. The discussion above demonstrates that the Commission "considered relevant factors and . . . struck a reasonable accommodation among them," and its conclusion that refunds would not be appropriate "was equitable in the circumstances of this litigation." *Towns of Concord*, 955 F.2d at 76 (citations omitted). Accordingly, "absent some conflict with the explicit requirements or core purposes of a statute," this Court should reject Petitioners' arguments, consistent with its long-standing "refus[al] to constrain agency discretion by imposing a presumption in favor of refunds." *Id.*

(ii) The Commission Considered Relevant Factors

Petitioners argue generally that the Commission's decision "is not based on a reasonable accommodation of all relevant considerations." Pet. Br. at 14. Quite to the contrary, the Commission considered and balanced the relevant considerations in the challenged orders. As discussed above, the Commission

found, for several reasons, that NYISO's interdependent pricing of non-spinning and spinning operating reserves was an appropriate (*i.e.*, just and reasonable) pricing method under its least cost dispatch market design, despite the fact that it technically violated a provision of the NYISO tariff. *See supra* pp. 32-35. The Commission reasoned that this pricing method was efficient and beneficial to consumers because, *inter alia,* it allowed for cost-saving substitution between the two reserves products, produced the lowest cost to consumers over the long term, and protected reliability by limiting the incentive for generators to "guess" which reserves product would garner a higher price, potentially leaving the system short of needed reserves. *See* Remand Order at PP 65-69, JA 354-56; *see also* Rehearing Order at PP 49-50, JA 410-11; *compare Electricity Consumers Resource Council*, 407 F.3d at 1240 (balancing of short-term costs against long-term benefits is within the Commission's discretion).

Indeed, NYISO itself agreed with the Commission's view that pricing the reserves products together produced the lowest cost to consumers. As the Commission noted on rehearing, NYISO argued when this proceeding began that interdependent pricing "produce[s] the least cost mix" of operating reserves, and that this pricing system, by allowing for substitution, "guarantees that the total bid cost for all reserves will be minimized." *See* Rehearing Order at P 49, JA 410-11 (quoting NYISO Answer to Complaint at 7-8 (April 13, 2000), R.76, JA 56-57).

While it later changed course and advocated for refunds, NYISO still agreed that the Commission, in the Initial Order, "correctly describes the virtues of interdependent reserves pricing." *Id.* at P 50, JA 411 (quoting NYISO Request for Rehearing at 6 (April 4, 2005), R.269, JA 399).

Moreover, the Commission took into account the fact that the NYISO tariff, at Section 4.9, specifically required it to choose the least cost mix of reserves. Remand Order at P 69, JA 355-56; Rehearing Order at P 49, JA 410-11. As discussed above, this provision was at odds with the separate pricing provision that the Court found NYISO had violated, since that provision would require NYISO to take higher priced non-spinning reserves even where lower-cost spinning reserves could be dispatched instead. *See* Remand Order at P 70, JA 356; Rehearing Order at P 49, JA 410-11; *see also* Remand Order at P 67, JA 355 (providing example calculations). As a result, it found that "the pricing implemented by NYISO, while technically at odds with [S]ection 4.21[,] comported with NYISO's pricing model and produces the least cost pricing of reserves," consistent with Section 4.9 in its tariff. *See* Rehearing Order at P 49, JA 410-11.

Still further, the Commission considered the market context in which NYISO's tariff violation occurred, contrary to Petitioners' assertions. *See, e.g.*, Pet. Br. at 15-16 (asserting that the Commission ignored that the non-spinning reserves market was "dysfunctional and non-competitive" and, by so doing,

avoided balancing the interests of consumers and generators of operating reserves). In particular, the Commission noted, in response to claims that the markets were not operating competitively, that Petitioners had not shown that NYISO's tariff violation in pricing reserves had caused market manipulation or the exercise of market power, and concluded that ordering refunds would be inequitable because it "would be unrelated to the alleged exercise of market power and market manipulation for which [Petitioners] argue refunds are appropriate." Rehearing Order at PP 51-52, JA 411 (noting also that refunds would penalize generators who bid competitively, not those who allegedly manipulated the market); *see also New York Independent System Operator, Inc.*, 91 FERC at 61,799, JA 166 (emphasizing that the Commission was making no finding of withholding of supply).

(iii) The Commission Found That No Windfall Would Result

Significantly, in considering the relevant factors, the Commission took into account whether providers of operating reserves received a "windfall" from NYISO's tariff violation. *See* Remand Order at PP 64-65, JA 354-55 (citing *Koch Gateway Pipeline Co.*, 136 F.3d at 817). Customer refunds, as a form of restitution, are generally ordered by an agency "only when money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it." *Towns of Concord*, 955 F.2d at 75. Here, the Commission reasonably concluded, given that there were different tariff provisions

regarding operating reserves pricing and that the generators received proper market clearing prices based on NYISO's least cost dispatch model, that "no generator obtained a windfall from the violation" and that no restitution was required. Remand Order at P 70, JA 356; Rehearing Order at P 51, JA 411 (concluding that "generators received no windfall from *this specific tariff violation*") (emphasis added).

In fact, far from providing a windfall, NYISO's pricing of reserves during this time actually protected the reliability of the system by ensuring that NYISO was not left short of "more crucial spinning reserves." *See* Rehearing Order at P 51, JA 411. Accordingly, the Commission found it inequitable for NYISO to adopt a pricing system that preserves reliability and then "require the generators that provided that reliability to pay refunds." *Id.*

The fact that market prices may have risen above marginal cost during the period at issue does not establish that generators received a windfall or obtained revenues in inequitable or unconscionable circumstances. *See* Pet. Br. at 15-16. Brief price spikes "are completely consistent with competition, reflecting scarcity." *Interstate Natural Gas Ass'n of Am. v. FERC*, 285 F.3d 18, 32 (D.C. Cir. 2002); *see also Edison Mission Energy*, 394 F.3d at 968-69 (criticizing mitigation program that could "curtai[l] price increments attributable to genuine scarcity"). Thus, the fact that prices rose dramatically during this time was not reason,

standing alone, to require suppliers who "had bid competitively, at low prices," in the reserves market to refund the prices they received. Rehearing Order at P 52, JA 411; *see also New York Independent System Operator, Inc.*, 91 FERC at 61,799, JA 166 (emphasizing that the Commission was making no finding of withholding of supply).

(iv) The Commission's Decision Does Not Conflict with the FPA's Core Purposes

Petitioners also generally contend that the Commission's decision not to order refunds conflicts with the core purposes of the FPA. Pet. Br. at 14. As explained above, the Commission concluded that the pricing mechanism utilized by NYISO was an appropriate least cost method for pricing reserves and would benefit market participants, serving the FPA's core purpose of ensuring "the orderly development of plentiful supplies of electricity . . . at reasonable prices." *California Pub. Util. Comm'n v. FERC*, 367 F.3d 925, 929 (D.C. Cir. 2004) (citing *NAACP v. FPC*, 425 U.S. 662, 670 (1976)). Moreover, the Commission concluded that ordering refunds would "run counter to the Commission's goals of establishing an efficient market mechanism for generator dispatch," Remand Order at P 70, JA 356, and would "penalize those generators that bid competitively," Rehearing Order at P 52, JA 411, both outcomes that would inhibit the "orderly development" of competitive, just and reasonable wholesale markets. In short, the Commission's

conclusion as to remedy here did not "conflict with the explicit requirements or core purposes" of the FPA. *Towns of Concord*, 955 F.2d at 76.

(v) Petitioners' Remaining Arguments Lack Merit

As they did with regard to the TEP issue, Petitioners again assert that the Commission's reasoning in denying refunds conflicts with its earlier conclusion in this proceeding regarding NYISO's prospective filing to suspend market-based pricing and impose a bid cap. Pet. Br. at 17-18. Here again, Petitioners confuse the Commission's acceptance of NYISO's prospective rate filing under FPA § 205 with its consideration, on remand, of whether refunds should be ordered retroactively for NYISO's tariff violation. The findings that Petitioners claim conflict with the Commission's refund decision were made by the Commission in the context of its consideration and approval of NYISO's prospective FPA § 205 filing. *See New York Independent System Operator, Inc.*, 91 FERC at 61,798-99, JA 165-66. Those findings do not in any way mandate a finding that refunds are required for NYISO's violation of a tariff provision previously in effect.

Finally, in considering whether refunds should be provided for NYISO's tariff violation, the Commission distinguished the Ninth Circuit's decision in *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), a case which Petitioners again rely on here. Pet. Br. at 10-12. As the Commission explained, *Lockyer* is inapposite. *See* Rehearing Order at PP 53-54, JA 411. In that case, the

court held that market-based rates could be authorized by the Commission, consistent with the prior notice and filing requirement of FPA § 205, but remanded for the Commission to consider whether violations of after-the-fact reporting requirements necessitated refunds. That case did not limit the Commission's well-settled remedial discretion as outlined in *Towns of Concord* and its progeny and, in fact, recognized that "FERC may elect not to exercise its remedial discretion by requiring refunds," as it did here. *Lockyer*, 383 F.3d at 1016; Rehearing Order at P 53, JA 411.

CONCLUSION

For the reasons stated, the Commission's orders should be upheld in all respects.

Respectfully submitted,

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April 27, 2007

Consolidated Edison Co. of NY, et al v. FERC **Docket No. ER00-1069**
D.C. Cir. Nos. 06-1025 et al.

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C)(i), I certify that the Brief of Respondent Federal Energy Regulatory Commission contains 10,048 words, not including the tables of contents and authorities, the certificates of counsel and the addendum.

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April 27, 2007