

DC Circuit Reconfirms FERC's Remedial Discretion

The U.S. Court of Appeals for the District of Columbia Circuit (D.C. Circuit) has strongly reconfirmed the enforcement and remedial discretion of the Federal Energy Regulatory Commission ("FERC" or "Commission") in its decision, *Consolidated Edison Co. of New York v. FERC*, No. 06-1025, (D.C. Cir. Dec. 18, 2007) ("*ConEd I*"). The court reemphasized that on judicial review it must defer to FERC's reasonably explained decisions because "agency discretion is at its zenith" when the agency is fashioning remedies. *ConEd II*, slip op. at 9. This decision is likely to be significant to pending proceedings before FERC and the Ninth Circuit concerning similar issues arising in the California and Pacific Northwest markets, and to future proceedings involving FERC's exercise of its enforcement and remedial discretion.

ConEd II reviewed Commission orders issued in response to a remand of the case by the same court four years ago. *Consolidated Edison Co. of New York v. FERC*, 347 F.3d 964 (D.C. Cir. 2003) ("*ConEd I*"). This time the court upheld FERC's refusal, on remand, to order the New York Independent System Operator, Inc. ("NYISO") to use temporary emergency procedures ("TEP") contained in its tariff. The TEP would have allowed NYISO to reset prices for completed transactions in the NYISO reserves markets. *ConEd II* also upheld FERC's refusal to order refunds after finding a violation by the NYISO of the tariff under which the NYISO administered those markets.

CON ED I

The case arose from proceedings at FERC under the Federal Power Act ("FPA") initiated by the NYISO and certain load serving entities ("LSEs"). The NYISO and complainant LSEs were concerned about the abrupt increases in the bids and resulting market clearing prices in the NYISO operating reserve markets between January and March 2000, shortly after the NYISO had begun operations. Two distinctive kinds of reserves were involved: non-spinning reserves ("NSR") and spinning reserves ("SR"). Utilities must have access to both kinds in order to produce electricity on short notice to meet load and assure reliability in their systems. SR is considered superior to NSR because it can be synchronized almost immediately while NSR requires ten minutes before it can send power through the grid. In 2000, the NYISO's tariff expressly required that SR and NSR be priced separately, but the NYISO had treated the NSR price as a floor for the SR bids it would accept. The LSEs asserted that the violation had led to windfall profits for SR sellers and demanded that FERC order such profits disgorged.

The tariff also empowered the NYISO to implement TEP. TEP permitted the NYISO to recalculate prices to competitive levels that would have prevailed but for market design flaws or transitional abnormalities that might arise during the period when the NYISO's auction markets were first starting up.

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However, the NYISO did not invoke TEP. Instead, it asked FERC for the authority under §205 of the FPA to include an NSR bid cap in its tariff. At the time, the NYISO told FERC that market power concentration, not market design flaws were the source of the increases. The NYISO also sought authority to reprice the bids it had accepted when reserve prices spiked. FERC agreed that the NYISO's reserve market was not operating properly and authorized a prospective bid cap. However, the Commission found no withholding of capacity by any supplier and concluded that it lacked authority to grant retroactive relief under §205. It also ruled that TEP did not apply in the circumstances. Finally, it held that the NYISO had not violated its tariff by linking SR and NSR pricing. Thus, FERC denied the LSEs any refunds.

In *ConEd I*, the D.C. Circuit sustained FERC's ruling that it lacked authority to revise rates retroactively under the FPA. It found, however, that FERC had not adequately explained its rationales for not compelling the NYISO to invoke TEP and for not ordering refunds. It also held that the NYISO had violated the plain language of its tariff requiring separate pricing of SR and NSR. Accordingly, the court remanded the case to FERC for reconsideration to address these errors.

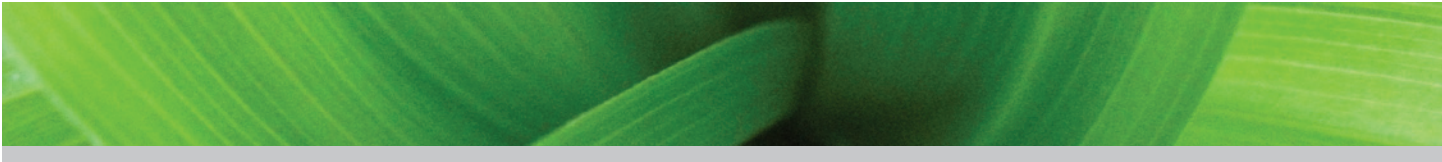
CON ED II

On remand, FERC held that the NYISO had reasonably exercised its discretion not to invoke TEP, and that the NYISO's violation of its tariff did not warrant disgorgement. It also ruled that sellers had not received windfalls; rather reliability had been increased from the linkage of SR and NSR pricing, thus benefiting consumers.

On petition for review of FERC's orders on remand, the LSEs, supported by the NYISO, contended that (1) FERC had arbitrarily refused to order the NYISO to implement TEP; and (2) FERC had arbitrarily denied refunds despite *ConEd I*'s finding that the NYISO had violated the tariff provision requiring separate pricing of SR and NSR.

The D.C. Circuit concluded that on remand FERC had examined relevant data and provided reasonable explanations for the exercise of its enforcement and remedial discretion. The court held that having explained its choices reasonably, the Commission's orders were entitled to the highest degree of deference. In doing so, the court distinguished *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004). In that decision, the Ninth Circuit ordered FERC to reconsider its denial of retroactive monetary remedies despite the Commission's finding that numerous public utilities had violated reporting requirements integral to their right to sell at market-based rates. Notably, the D.C. Circuit emphasized *Lockyer's* holding that even in the face of such a finding the agency was not *required* to order refunds and had discretion to deny them if it could provide a reasonable explanation.

With respect to TEP, the court agreed with FERC that the high prices in early 2000 had not been caused by a market design flaw within the meaning of the NYISO tariff's TEP provisions. It also held that FERC would not have been required to order the NYISO to invoke TEP even if it had found such a flaw. The court explained that **“acknowledging the existence and utility of a remedial tool is not equivalent to requiring its use in a specific circumstance.”** *ConEd II*, slip op. at 11. Under its tariff, the court ruled, the NYISO possessed



discretion to decide whether or not to invoke TEP. Absent an abuse of that discretion, FERC could not compel it to act. Here, as FERC found, the NYISO had acted reasonably in not invoking TEP. Moreover, refunds were not warranted even though the Commission itself had decided to impose a prospective rate cap in light of conditions in the NYISO reserves market. In a noteworthy observation, the court confirmed FERC's power to grant prospective remedies while contemporaneously denying retroactive relief: **“Concluding otherwise would, as the NYISO has previously noted, open the gates to retroactive changes in tariffs any time the power markets’ rules were adjusted.”** *Id.*

With respect to the NYISO's tariff violation, the court held: **“FERC's decision not to order refunds for the NYISO's tariff violation was not inconsistent with the FPA's ‘core purpose’ for...the FPA has multiple purposes in addition to preventing ‘excessive rates,’ including protecting against ‘inadequate service,’ ... and promoting the ‘orderly development of plentiful supplies of electricity.’ FERC reasonably explained that the NYISO's linking of the SR and NSR pricing was most advantageous to consumers precisely because that linking protected the availability of higher quality SR reserves and thus system reliability.”** *ConEd II*, slip op. 14 (citations omitted).

IMPLICATIONS

ConEd II will impact pending and future cases involving claims that FERC has an affirmative obligation to fashion retroactive monetary relief in the face of market disruptions. The Commission and the courts will have to address the decision's holding that FERC may deny such relief even when it finds market disruptions or violations of its tariffs and orders, and even when it contemporaneously grants prospective relief to correct such disruptions. FERC's exercise of its broad discretion, however, is tightly bound to the fundamental principle that the agency must provide reasonable explanations for its actions.

FOR ADDITIONAL INFORMATION

Van Ness Feldman, P.C. participated as one of counsel supporting FERC's decision in this case. For more information, please contact David P. Yaffe, Howard E. Shapiro, Joseph B. Nelson, or any member of the firm's Electricity Practice Group on 202.298.1800.

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