No. 09-1309

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

NEW YORK REGIONAL INTERCONNECT, INC.,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

On Petition for Review of Orders of the
Federal Energy Regulatory Commission

BRIEF FOR THE AMERICAN ANTITRUST INSTITUTE AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to Circuit Rule 28(a)(1), the American Antitrust Institute certifies that:

A. Parties and Amici:

All parties, intervenors, and amici appearing below are listed in the Brief for the Petitioner, New York Regional Interconnect, Inc., except that the list does not include the American Antitrust Institute as an amicus in this court.

B. Rulings Under Review:

New York Independent System Operator, Inc., Order on Rehearing and Motion, 129 FERC ¶ 61,045 (October 15, 2009)

New York Independent System Operator, Inc., Order on Rehearing, 126 FERC ¶ 61,320 (March 31, 2009)

New York Independent System Operator, Inc., Order on Compliance Filing, 125 FERC ¶ 61,068 (October 16, 2008)

C. Related Cases:

This case was not previously before this Court, except as noted in Petitioner's Brief. AAI is not aware of any related cases.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Circuit Rule 26.1, the American Antitrust Institute states that it is a non-profit corporation and, as such, no entity has any ownership interest in it.

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INTEREST OF AMICUS CURIAE

The American Antitrust Institute (AAI) is an independent and nonprofit education, research, and advocacy organization whose mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. AAI is managed by its Board of Directors with the guidance of an Advisory Board consisting of over 100 prominent antitrust lawyers, law professors, economists and business leaders.[1] AAI frequently appears as amicus curiae in cases raising important competition issues. And it has long been involved in competition policy and regulatory issues in the electric power industry, including sponsoring an annual Energy Roundtable for experts in government, academia, and the private sector. See www.antitrustinstitute.org for a description of AAI's activities in energy and other matters. AAI submits this brief because expanding transmission capacity to relieve congestion is critical to promote competitive wholesale generation markets and accommodate renewable energy production. Yet, the Federal Energy Regulatory Commission's ruling at issue in this case discourages needed transmission investment and diminishes the role of competition in the regulation of the electric power industry.

[1] AAI's Board of Directors alone has approved this filing for AAI. The individual views of members of the Advisory Board may differ from AAI's positions. No counsel for a party has authored this brief in whole or in part, and no person or entity other than AAI has made a monetary contribution intended to fund the preparation or submission of this brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

This appeal from a series of Federal Energy Regulatory Commission (FERC or Commission) orders approving the New York Independent System Operator's (NYISO) transmission planning process raises important issues regarding the Commission's obligation to take into account anticompetitive harms and procompetitive benefits in approving tariffs under the Federal Power Act (FPA) in general and in promoting needed transmission infrastructure development under FERC Order 890 in particular. *See Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 Fed. Reg. 12,266 (Mar. 15, 2007), 118 FERC ¶ 61,119 (Order 890).

Order 890 is a follow-up to FERC's landmark "open access" Order 888 issued in 1996, which "sought to establish competitive wholesale power markets to increase consumer welfare," *Exxon Mobil Corp. v. FERC*, 571 F.3d 1208, 1212 (D.C. Cir. 2009), and a response to the Energy Policy Act of 2005, which "recognized the importance of adequate transmission infrastructure development and its role in facilitating the development of competitive wholesale markets." Order No. 890 ¶ 22. Order 888 sought to prevent vertically integrated utilities from discriminating in providing transmission service by requiring them to functionally unbundle their generation and transmission offerings and to offer the latter under a Commission-approved open-access transmission tariff (OATT). *See*

Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 682 (D.C. Cir. 2000), *aff'd sub nom.*, *New York v. FERC*, 535 U.S. 1 (2002). More than a decade later, and in response to ongoing concerns regarding transmission availability, Order 890 was promulgated to remedy the potential for undue discrimination in *transmission planning activities*, an essential complement to the actual provision of transmission service. Recognizing "the substantial need for new transmission infrastructure in this Nation," the Commission designed the rule to "increase the ability of customers to access new generating sources and promote efficient utilization of transmission by requiring an open, transparent, and coordinated transmission planning process." Order 890 ¶ 3.

Order 890 directs all transmission providers, including regional transmission organizations (RTOs) and independent system operators (ISOs), to develop a transmission planning process that satisfies nine principles. One of those principles is planning for cost allocation for new transmission projects. The Commission found that "[t]he manner in which the costs of new transmission are allocated is critical to the development of new infrastructure," *id.* ¶ 557, and "is particularly important as applied to economic upgrades," *Preventing Undue Discrimination and Preference in Transmission Service*, Order on Rh'g and

Clarification, Order No. 890-A, ¶ 251, 73 Fed. Reg. 2984 (Jan. 16, 2008), 121 FERC ¶ 61,297 (Order 890-A).[2]

At issue in the appeal are the conditions that must be satisfied for an "economic" congestion-reducing transmission project proposed in the service territories encompassed by NYISO to be eligible for cost allocation and thus recovery from ratepayers under NYISO's open access transmission tariff. NYISO has established a two-part test for eligibility. First, the project must satisfy the "project benefit test," which is a system-wide cost-benefit analysis whereby benefits are measured solely in terms of savings in production costs.[3] Second, a project must be approved by at least 80 percent of the weighted vote of the project beneficiaries, i.e. distribution utilities or competitive power suppliers that sell power to end users, referred to as load serving entities (LSEs). Benefit under the

[2] An "economic" transmission project is distinguishable from a "reliability" project. The latter is one that ameliorates transmission constraints that violate reliability criteria; the former removes other constraints that impede efficient transmission on the system. The distinction between reliability and economic upgrades is open to question because reliability upgrades also have economic benefits, while economic upgrades also have reliability benefits. *See* New York Independent System Operator, *Transmission Expansion in New York State: A New York ISO White Paper* 5-4 (2008) (*NYISO White Paper*).

[3] "The project benefit is measured as the present value of annual New York system-wide production cost savings that would result from the implementation of the proposed project, measured for the first ten years from the project's proposed commercial operation date." *N.Y. Indep. Sys. Operator, Inc.*, Order on Rh'g, 126 FERC ¶ 61,320, at ¶ 5 (2009) (Second Order). A transmission project will reduce production costs insofar as it permits lower-cost generation to serve load. Production cost is largely a function of the cost of the fuel used by the generator.

second step is measured in terms of the reduction in load payments resulting from the project.[4] The second step will not be undertaken unless the total load benefit to all zones with load savings exceeds the revenue requirements for the project. *See N.Y. Indep. Sys. Operator, Inc.,* Order on Compliance, 129 FERC ¶ 61,044, at ¶ 49 (2009) (Oct. 15, 2009 Compliance Order). NYISO will calculate other cost-benefit metrics "for information only" that measure reductions in ancillary service costs, capacity costs, emissions costs, and losses, which LSEs can consider in determining how to vote. *N.Y. Indep. Sys. Operator, Inc.,* Order on Compliance Filing, 125 FERC ¶ 61,068, at ¶ 113 & n.101 (2008) (First Order).

FERC approved NYISO's project-benefit test and supermajority-voting procedure although no other RTOs or ISOs require a project's production-cost savings alone to exceed its revenue requirement or have a voting procedure for approving specific projects. Indeed, FERC had expressly refused to require the Pennsylvania-New Jersey-Maryland (PJM) Interconnection to adopt a voting mechanism. *See PJM Interconnection, L.L.C.*, Order on Compliance Filing, 123 FERC ¶ 61,163, at ¶ 114 (2008). FERC upheld the project-benefit test as a reasonable screen because it supposedly "measures a project's total benefits on the

[4] "To identify beneficiaries, NYISO will measure the present value of annual Locational Based Marginal Price (LBMP) load savings for all load zones which would have a load savings, net of reductions in transmission congestion credit payments, and bilateral [power purchase] contracts as a result of the implementation of the proposed project." Second Order ¶ 5. Each LSE's vote is weighted in accordance with its percentage of the total benefit so measured.

entire system." First Order ¶ 110. FERC upheld the supermajority-voting requirement as a "useful check to ensure that a project has net benefits, by requiring that most of those whom NYISO expects to benefit from a project agree that they will actually benefit." *Id.* ¶ 130. FERC said it was permissible for RTOs to have different transmission planning processes and different cost-benefit tests if that is what the stakeholders agree to, *see* Second Order ¶¶ 36, 40 ("there can be more than one just and reasonable planning process"), without considering whether the differences were justified by legitimate concerns or underlying economic characteristics of the different regional RTOs, rather than the result of the influence of particular market participants under inadequate governance structures.[5]

FERC's approval of NYISO's uniquely stringent conditions for projects to be eligible for cost allocation was arbitrary and capricious and inconsistent with

[5] A decade ago FERC rejected NYISO's application to become an RTO in part because of its "concerns with the degree of independence that will be held by NYISO's proposed RTO," including the fact that NYISO's plan would "allow market participants to block expansions, as it appears to provide that ultimate decision-making authority to construct new transmission expansions or upgrades will rest in the hands of existing transmission owners." *N.Y. Indep. Sys. Operator, Inc.,* Order on Compliance Filing, 96 FERC ¶ 61,059 at 61,203 (2001). Even now, NYISO itself acknowledges that "[t]he existing contractual relationship between the NYISO and the NYTOs [New York transmission owners] limits the ability of the NYISO to promote a transmission buildout as compared to" other RTOs or ISOs. *NYISO White Paper* 6-1. Moreover, although FERC below emphasized the importance of stakeholder support for different planning processes and tests, it did not consider that there was significant dispute among NYISO stakeholders with respect to the rules at issue. *See* Initial Br. of New York Regional Interconnect, Inc. (NYRI) 4-15, 37.

FERC's statutory obligations to promote competition in wholesale energy markets, ensure just and reasonable rates, and encourage the development of transmission infrastructure.

FERC's approval of NYSO's production-cost test was unreasonable because FERC ignored the benefits to consumers from increased competition in wholesale generation markets enabled by new transmission capacity. FERC relied on an unjustified and narrow definition of economic efficiency that: (1) fails to account for the efficiency and consumer-welfare benefits of preventing the exercise of market power, and (2) treats consumer and producer welfare equally.

FERC's approval of NYISO's voting provision was unreasonable because FERC failed to weigh the anticompetitive risks of allowing incumbent transmission owners to veto independent transmission projects. FERC's reliance on *post hoc* policing to prevent anticompetitive behavior is inconsistent with the entire thrust of Orders 888 and 890, which is to adopt prophylactic rules to avoid the potential for anticompetitive conduct given transmission owners' anticompetitive incentives to discriminate in transmission service and expansion. The likely result of FERC's abdication of its competition-enforcement role is that independent project developers will be deterred from even proposing transmission projects in New York to the detriment of energy consumers in the state.

ARGUMENT

I. FERC IGNORED THE BENEFITS TO CONSUMERS FROM INCREASED COMPETITION ENABLED BY TRANSMISSION

NYISO's production-cost test should have been rejected by FERC because it fails to take into account benefits to consumers from increased competition in generation markets enabled by new transmission capacity.[6] New transmission not only provides access to new, potentially cheaper sources of generation, but by expanding the geographic market in which competition occurs, it can lower the cost of delivered power to consumers independent of whether it reduces production costs.

The role of transmission as a facilitator of generation market competition is well recognized. As the California Independent System Operator explains:

> A new transmission project can enhance market competitiveness by both increasing the total supply that can be delivered to consumers and the number of suppliers that are available to serve load. . . . [A] transmission expansion has the . . . benefit of improving the competitiveness, of not just the spot market, but also the longer-term forward energy market [by] creat[ing] greater access to a broader regional market and thereby increas[ing] the number of sellers that can offer long-term energy contracts.

California Independent System Operator *Transmission Economic Assessment Methodology (TEAM)* 4-1 (2004) (California ISO), http://www.caiso.com/docs /2004/06/03/2004060313241622985.pdf; *see also* Paul Joskow, *Patterns of*

[6] We agree with petitioner and other amici that the production-cost test improperly excludes other important benefits, but do not address those benefits here.

Transmission Investment, *in Competitive Electricity Markets and Sustainability* 131, 131 (Francois Leveque, ed. 2006) ("By expanding the geographic expanse of competition the transmission network can increase the effective number of competitors and reduce market power and thus prices.").

NYISO has acknowledged the perspective that "[t]ransmission is an essential facilitator and enabler of competitive generation markets" and that "transmission should be allowed to provide benefits in the form of enhanced competition for energy and capacity generation services." *NYISO White Paper* 5-1, 5-2. And FERC has long recognized that "[l]imitations on available transmission capability that prevent competitors from participating in a market can give substantial market power to incumbents in the market." *Policy Statement Establishing Factors the Commission will Consider in Evaluating Whether a Proposed Merger is Consistent with the Public Interest*, Order No. 592, 61 Fed. Reg. 68,595, 68,610 (Dec. 30, 1996), 77 FERC ¶ 61,263; *see also N.Y. Regional Interconnect, Inc.,* Order Granting, in Part, and Denying, in Part, Petition for Declaratory Order, 124 FERC ¶ 61,259, at ¶ 41 (2008) (noting that independent transmission companies are entitled to incentive rates under § 219 of the Federal Power Act because "this business model promotes increased investment in new transmission, which in turn reduces costs and *increases competition*") (emphasis added).

NYISO's production-cost test does not take into account benefits to consumers from increased competitiveness, as it assumes that markets are perfectly competitive and suppliers always bid their marginal costs. *See* Ross Baldick, Ashley Brown, James Bushnell, Susan Tierney & Terry Winter, *A National Perspective on Allocating the Costs of New Transmission Investment: Practice and Principles* 20 (2007), http://www.wiresgroup.com/images/ Blue_Ribbon_Panel_-_Final_Report.pdf ("Traditional production cost models in effect assume . . . perfectly competitive behavior and can therefore understate both the efficiency and consumer price benefits of certain projects.") (report prepared for WIRES, a transmission trade group). While the production cost "approach may make sense in a cost-of-service vertically integrated utility paradigm, assuming marginal cost pricing in a restructured market environment where suppliers are seeking to maximize market revenues may result in inaccurate benefit estimates." California ISO 4-1; *see also* Paola Bresesti et al., *The Benefits of Transmission Expansions in Competitive Electricity Markets*, 34 Energy 274, 279 (2009) ("[T]he impact of transmission expansions in mitigating market power may be significant and . . . a simple and traditional cost-based approach may lead to a wrong evaluation of benefits given by transmission expansions.").

FERC found the production-cost metric an appropriate screen for cost recovery because FERC believed that the test properly measures whether a

transmission upgrade increases economic efficiency. *See* Second Order ¶ 21 ("As the objective is to promote economic efficiency, a production cost reduction test is the relevant test."). Moreover, in FERC's view, a transmission upgrade that decreases consumer prices, but does so at the expense of generator revenues does not provide system-wide benefit. *See* First Order ¶ 111 ("[C]onsidering separately the effects on load payments will not accurately measure the net economic effect of the project on the market as a whole, because it does not consider the effects of the project on generator revenues.").

What FERC's analysis misses is that a transmission project that increases competitiveness and prevents the exercise of market power *does* increase economic efficiency, even as narrowly defined by FERC as maximizing "total welfare," unless demand is perfectly inelastic. *See, e.g.,* Severin Borenstein et al., *The Competitive Effects of Transmission Capacity in a Deregulated Electricity Industry*, 31 Rand J. Econ. 294, 320 (2000). Moreover, both national competition policy and energy policy seek to prevent the exercise of market power not only to avoid the "deadweight loss" associated with monopoly, but to prevent the transfer of wealth from consumers to producers. *See, e.g., N. Natural Gas Co. v. Fed. Power Comm'n*, 399 F.2d 953, 959 (D.C. Cir. 1968) (both regulation and antitrust policy share the purpose of "avoiding monopoly profits"). Accordingly, "to the extent that transmission investments serve to increase competition, the ensuing

benefits to consumers in diminishing the severity of market power could be taken into account in decisions about whether to approve a project, even if it only acts to improve consumer, but not societal, welfare." Baldick et al. 19-20. And there is no doubt that generation "market power is an ever-present concern" in New York City. *N.Y. Indep. Sys. Operator*, Order on Proposed Application of Mitigation Measures and Compliance Filings, 131 FERC ¶ 61,169, at ¶ 69 (2010).

Nowhere does the Commission explain why its narrow definition of efficiency, which equates consumer and producer welfare, is the appropriate goal of "economic" transmission upgrades. On the contrary, FERC's definition is inconsistent with the Energy Policy Act of 2005, which establishes that Congress intended to promote transmission investment to "*benefit[] consumers* by ensuring reliability and reducing the cost of *delivered power* by reducing transmission congestion." 16 U.S.C. § 824s(a) (2006) (emphasis added); *see also id*., § 824q(b)(4) (Commission must exercise its authority under Federal Power Act "in a manner that facilitates the planning and expansion of transmission facilities to meet the reasonable needs of load-serving entities"). And it is inconsistent with the goal of Order 888, which is "to increase competition from alternative power suppliers, giving consumers the benefit of a competitive market" and "to ensure that electricity customers pay the lowest prices possible." *Transmission Access Policy Study Group,* 225 F.3d at 681; *see also Otter Tail Power Co. v. United States*, 410

U.S. 366, 374 (1973) ("[T]he history of Part II of the Federal Power Act indicates an overriding policy of maintaining competition to the maximum extent possible consistent with the public interest."); *Maryland People's Counsel v. FERC*, 761 F.2d 780, 781 (D.C.Cir.1985) (utility consumers are the agency's "prime constituency").

FERC acknowledged that reducing customer energy prices and benefitting consumers *are* relevant goals in economic transmission planning.[7] It noted that "both MISO [the Midwest Independent Service Operator] and PJM consider whether load payments will be reduced as a metric in determining whether a project should be included in the transmission plan," and that "[t]hese processes are also reasonable." Second Order ¶ 23.[8] FERC said that "NYISO, however, does not need to consider the load payment metric in the first step, because the

[7] Indeed, FERC justified the voting procedure in part on the ground that the "costs of economic transmission projects are recovered directly from the ratepayers who bear both the cost and risk of these projects," Second Order ¶ 35, and so they should benefit from any project. At the same time, FERC suggested somewhat inconsistently that the fact "costs are allocated, and not voluntary" means that "a project should provide a system-wide benefit" as measured by the production-cost test. *Id.* ¶ 21.

[8] In evaluating the benefits of a project, PJM and MISO weigh production cost savings at 70% and load savings at 30%, which the Commission found was a "just and reasonable balance of resource savings and savings to load." *PJM Interconnection, L.L.C.*, Order on Rh'g and Compliance, 123 FERC ¶ 61,051, at ¶ 63 (2008). However, the NYISO test does not balance resource savings and load savings at all; rather, it requires a project's production cost savings to be at least 100% of its revenue requirement, *and* that its savings to load be at least 100% of its revenue requirement, *and* that it be approved by a supermajority vote.

NYISO process factors in the beneficiaries' estimate of benefits in the second step, the voting process." *Id.*

FERC's reasoning is faulty on at least two counts. First, NYISO's calculation of consumer benefits in the second step does not take into account reductions in load payments due to increased competitiveness, as it is based on the same flawed production-cost model used in the first step. *See* N.Y. Indep. Sys. Operator, Inc., Compliance Filing, May 19, 2009, Attachment I (calculation of load savings benefit "will be the result of the forward looking production cost simulation") (OATT, Attachment Y, § 11.3(e)).[9] Second, even if the calculation included competitiveness benefits, it is no consolation that consumer benefits are considered in the second step of the process. A project with substantial consumer benefits (say, because it results in increased competitiveness), but without production cost savings sufficient to exceed the project's cost, is simply not eligible for cost recovery under the NYISO rule.[10] For example, a project with a revenue requirement of $100 million might reduce production costs by $99 million and benefit consumers by $300 million, but yet would not pass muster under

[9] As noted, *supra*, the voting process will not be undertaken unless the total load benefit to all zones with load savings exceeds the revenue requirements for the project.

[10] Similarly, other metrics deemed relevant for voting purposes, such as reductions in installed capacity costs, may show significant benefits to LSEs, but if production cost savings alone do not exceed the revenue requirement for the project, then these benefits will never be considered.

NYISO's test.[11] FERC asserted that "the production cost savings metric . . . captures the energy price effect on customers system-wide." Second Order ¶ 26. However, that is simply incorrect. On the one hand, a transmission project could reduce energy prices without any production-cost savings because of its effect on the competitiveness of markets; on the other hand, lower production costs may not necessarily translate into lower energy prices.[12] It is one thing to say that a transmission project that reduces production costs should not proceed unless those gains are shared by consumers; it is another to say, as FERC erroneously did here,

[11] Such a high ratio of consumer benefits to production-cost savings is not far fetched. For example, in explaining that "[t]ransmission congestion can have significant impacts on consumers," FERC cited a Department of Energy congestion study showing that relieving bottlenecks in four regions alone could save consumers about $500 million annually when price spikes are considered, which is *triple* the savings under a production cost savings model that assumes generators bid their marginal costs. Order 890 ¶ 60 & n.60; *see* U.S. Dept. of Energy, *National Transmission Grid Study* 17 (2002); *see also* Mohamed Awad et al., *Using Market Simulations for Economic Assessment of Transmission Upgrades: Application of the California ISO Approach, in Restructured Electric Power Systems* 241, 261-62 (Xiao-Ping Zhang ed., 2010) (showing that PVD2 transmission project had consumer benefits that exceeded production-cost benefits by about 50%).

[12] "[E]conomic efficiency as measured by a production cost savings analysis does not automatically create what could be called 'benefits' for the customers of the load beneficiary members of the NYISO. If the lower cost power does not affect the pool price or the region's location-based marginal price (LBMP), then the 'benefit' associated with the more efficient generation of power will go to the power plant's owners, not to those who consume the electricity. Such will occur any time that an economic transmission enhancement displaces only a portion of the high-cost generation that sets the LBMP." Affidavit of Jeff D. Makholm, Ph.D on behalf of Consolidated Edison Company of New York ¶ 21 (Jan. 7, 2008) (submitted below).

that a project with large gains for consumers should not proceed unless otherwise justified by its production cost savings.

II. FERC FAILED TO WEIGH THE ANTICOMPETITIVE RISKS OF ALLOWING TRANSMISSION OWNERS TO VETO INDEPENDENT TRANSMISSION PROJECTS

Having erred by approving a rule that fails to consider the gains from competition and other consumer benefits of economic transmission projects in the first step of determining a project's eligibility for cost recovery, FERC compounded its error by assuming that benefits to consumers would necessarily be reflected in the second step, the voting process that allows incumbent transmission-owning LSEs to veto a project. FERC failed to give sufficient weight to the anticompetitive incentives of transmission-owning LSEs to deviate from ratepayers' interests. In particular, FERC failed to evaluate whether transmission owners' interests in generation assets, long-term power contracts, and transmission congestion contracts give them incentives to maintain congestion and the higher wholesale generation prices that accompany it, and thus to vote against economic transmission projects that would benefit ratepayers. Moreover, while FERC recognized that incumbent transmission owners are in a competitive relationship with independent transmission developers, the Commission failed to evaluate whether giving incumbent transmission owners a veto over economic projects means that independent transmission companies will be deterred from proposing

and developing such projects in New York, as Commissioner Moeller maintained in his dissent.

FERC's failure to meaningfully address the anticompetitive incentives of incumbent transmission owners in NYISO is inconsistent with the very reason that FERC mandated the transmission planning process in Order 890, namely that transmission owners did not have the proper incentives to expand the grid on their own. The Commission said:

> We cannot rely on the self-interest of transmission providers to expand the grid in a nondiscriminatory manner. Although many transmission providers have an incentive to expand the grid to meet their state-imposed obligations to serve, *they can have a disincentive to remedy transmission congestion when doing so reduces the value of their generation or otherwise stimulates new entry or greater competition in their area.* For example, a transmission provider does not have an incentive to relieve local congestion that restricts the output of a competing merchant generator if doing so will make the transmission provider's own generation less competitive. A transmission provider also does not have an incentive to increase the import or export capacity of its transmission system if doing so would allow cheaper power to displace its higher cost generation or otherwise make new entry more profitable by facilitating exports.

Order 890 ¶ 422 (emphasis added). Indeed, more than a decade ago, FERC ruled that an RTO may not permit "a governance system that allows market participants to block expansions that will harm their commercial interests." *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809, 910 (Jan. 6, 2000).

Given these well-recognized disincentives of transmission owners to remedy transmission congestion, it is inexplicable that FERC would tolerate a rule that permitted a generation-owning transmission owner to veto an economic transmission project, and that it failed even to consider whether a "NYTO's negative vote motivated by a desire to preserve its owned generation value" would be an abuse of the voting process. *N.Y. Indep. Sys. Operator, Inc.*, Order on Rehearing and Motion, 129 FERC ¶ 61,045, at ¶ 25 (2009) (Final Order). To be sure, New York transmission owners have divested most of their power plants as part of the restructuring of the electric power industry in New York. However, disincentives to expand transmission are still very much alive. For example, some NYISO transmission owners or their affiliates still own generation facilities, *see, e.g.,* ConEdison, Inc., 2009 Annual Report 15, http://www.coned.com/documents/Con_Edison_2009_Annual_Report.pdf, continue to be involved in the operation of divested plants, *see id.* at 134, and are planning to invest in renewable generation that may compete with renewables located upstate, *see* Press Release, LIPA and Con Edison Form Collaborative for Major Offshore Wind Initiative, April 20, 2009, http://www.coned.com/newsroom/news/pr20090420.asp. And they remain vertically integrated into the competitive *retail* power supply market as load serving entities. This gives them an incentive to block transmission projects that would give competing retail suppliers access to lower cost generation that the

transmission owners may already enjoy through long-term fixed-price power contracts or merchant transmission projects connecting neighboring RTOs.

Even apart from retail competition, transmission owners' incentive to support lower generation market prices may be blunted by the fact that the value of their long-term fixed-price power contracts, transmission congestion contracts, and other hedging contracts would decline.[13] Yet the Commission made no findings with regard to these incentives of incumbent utilities to *maintain* congestion, concluding, "What constitutes abuse of the voting process is a fact specific determination to be made by the Commission on a case by case basis after the information NYISO submits in its reports." Final Order ¶ 25.

[13] As Commissioner Moeller noted in dissent, "a Transmission Owner (TO) holding valuable Transmission Congestion Contracts may choose not to support a congestion-reducing project because it financially benefits from existing levels of congestion." Final Order, 129 FERC at 61,254 (Commissioner Moeller dissenting). In fact, the NYISO voting process expressly allows LSEs to take into account the offsetting losses in TCCs that may result from a transmission project, which FERC approved on the theory that otherwise "the benefits to load from a transmission project would be significantly overstated because benefits would be counted even though load is already hedged against congestion on the line." Oct. 15, 2009 Compliance Order ¶ 50. Yet the Commission had previously rejected the argument that a voting mechanism was necessary to ensure "that parties who have acquired FTRs [financial transmission rights, which are equivalent to TCCs] as a hedge against congestion [do not] end up paying twice if economic transmission is built along the particular path for which they have FTRs" because "[a]n FTR is not a guarantee of a particular dollar figure of revenue, nor does it provide protection against the future construction of transmission projects or any other reduction in congestion; it does not provide a right to veto future projects." *PJM Interconnection, L.L.C.*, Order Denying Reh'g, 124 FERC ¶ 61,187, at ¶ 22 (2008).

Similarly, the Commission downplayed the incentive of incumbent transmission owners to exclude competing independent transmission owners from building transmission lines in their service territories. NYISO itself acknowledged in its white paper that "[u]tilities will protect their franchise areas, a valuable and exclusive asset, and are loathe to allow competitors' projects through their areas without some control and participation," *NYISO White Paper* 4-7 - 4-8, and concluded, "Simply put, a load-serving entity, even one that is clearly the beneficiary, will not want to pay for a transmission project when the ownership benefits go to its competitor." *Id.* at 5-6.

New York transmission owners compete with each other and with independent transmission companies in the market for developing transmission projects, as one project may foreclose the development of another project. They may also compete in more subtle ways: an independent transmission owner may provide "yardstick competition" with respect to rate recovery for investments in transmission capacity. *See generally* Ian Ayres & John Braithwaite, *Partial-Industry Regulation: A Monopsony Standard for Consumer Protection*, 80 Cal. L. Rev. 13, 29 (1992) ("Yardstick competition, which bases price on an average of the cost of similar utilities, [requires] utilities in otherwise distinct geographic markets [to] compete in a sense to lower their own costs and increase their profit."); *cf. N. Natural Gas Co.*, 399 F.2d at 971 ("comparative proceedings

before regulatory agencies are sensitive mechanism(s) for weighing the relative merits of rival projects[] and one of the main competitive arenas of the natural gas industry since it is there that the sellers challenge one another for favor of the Commission") (internal quotes and ellipses omitted). And any "foreign" transmission project that obtains rate recovery in a utility's franchise area may put pressure on a utility's ability to recover its own costs, as state regulators seek to keep rates low.

The Commission acknowledged the competitive relationship between incumbent transmission owners and independent transmission developers, and conceded that it would be an abuse of the voting process if "a project built by a competitor that reduces the cost of energy to the voting entity's customers [were] rejected in order to drive that competitor out of business and increase the voting entity's market share," or if "a Southeastern NYTO . . . den[ied] NYRI cost recovery for its project and then grant[ed] cost recovery to an identical project proposed by itself or its affiliate . . . ." Final Order ¶ 24.[14] However, FERC

[14] In its recent proposal to eliminate incumbent transmission owners' right of first refusal with respect to transmission projects in their service territories, FERC explained that excluding independent transmission companies "may not result in a cost-effective solution to regional transmission needs[,] and projects . . . therefore may be developed at a higher cost than necessary," which may result in rates, terms and conditions that are not just and reasonable. *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, Notice of Proposed Rulemaking, 75 Fed. Reg. 37,884 (June 30, 2010), 131 FERC ¶ 61,253, at ¶ 88 (Transmission Planning NOPR).

claimed that such abuse "may be deterred by the requirement to report reasons for the negative vote," and policed after the fact. *Id.* FERC said, "Evidence of such an improper vote could warrant an investigation by the Commission and possible further action," but it dismissed claims of potential abuse at this point as "speculation." *Id.*[15]

FERC's proposed *ad hoc* treatment of the concerns surrounding potential abuse of the NYISO voting procedure is squarely at odds with an effective enforcement regime. The central importance of promoting competitive wholesale power markets and protecting consumers requires an approach that *prevents* anticompetitive abuse, not one that allows it and then provides for an *ex post* case-by-case evaluation of the intent of the alleged malefactor. Indeed, FERC is obligated to consider the anticompetitive effects of rules or tariffs *before* they are implemented, or at least offer a well-reasoned explanation as to why a case-by-case determination is appropriate. *See Maryland People's Counsel,* 761 F.2d at 787

[15] FERC also reasoned that the voting procedure does not foreclose potential competition because "market participants remain free to individually or jointly develop projects that have not received supermajority support at their own costs." Second Order ¶¶ 37, 39. Of course, if merchant (i.e., participant-funded) transmission projects were a good alternative, then there would be little need to require transmission organizations to have a cost allocation provision in the first place. But the Commission in Order 890 found that cost allocation "is critical to the development of new infrastructure," Order 890 ¶ 557, and has proposed to strengthen the OATT cost-allocation requirements because "a threshold consideration for any company considering investing in transmission is whether it will have a reasonable opportunity to recover its costs." Transmission Planning NOPR ¶ 152.

(rejecting argument that consideration of anticompetitive effects could be deferred; "'[l]ater' rather than 'sooner' seems dubious counsel given the incentive" of incumbent pipelines to discriminate); *Public Systems v. FERC*, 606 F.2d 973, 982-83 (D.C. Cir. 1979) (FERC may not defer consideration of anticompetitive effects until the adjudication of specific cases without good cause to believe that case-by-case treatment "would be a superior administrative method for handling the problem"); *Gulf States Utilities Co. v. Federal Power Comm'n*, 411 U.S. 747, 760 (1973) ("Consideration of antitrust and anticompetitive issues by the Commission . . . serves the important function of establishing a first line of defense against those competitive practices that might later be the subject of antitrust proceedings.").

Orders 890 and 888 were premised on the idea that transmission owners have anticompetitive incentives to discriminate in the expansion or operation of the grid and that prophylactic or structural measures are necessary to obviate *potential* anticompetitive behavior. *Post hoc* "policing" was inadequate to the task.[16] So too here. FERC assumes that by requiring LSEs to provide a detailed explanation for

[16] In Order 890 the Commission noted that the then existing pro forma OATT failed to "counteract these [anticompetitive] incentives in the planning area because there are no clear criteria regarding the transmission provider's planning obligation," Order 890 ¶ 424, with the result that "disputes over access and discrimination occur primarily after-the-fact," *id.* ¶ 425. Thus reform was necessary to "limit the *potential* for undue discrimination and anticompetitive conduct . . . ." *Id.* ¶ 426 (emphasis added).

their votes, anticompetitive behavior may be detected. But the evaluation of legitimate costs and benefits is sure to involve a significant range of uncertainty, as FERC itself acknowledged.[17] Indeed, neither FERC nor NYISO has fully specified what counts as a legitimate cost or benefit under the voting procedure, as "additional benefit metrics" not identified in the tariff are permitted, and "uncertainties, and/or alternative scenarios and other qualitative factors [may be] considered, including state public policy goals." N.Y. Indep. Sys. Operator, Inc. & the N.Y. Transmission Owners, Compliance Filing, Dec. 11, 2009, Attachment I (OATT, Attachment Y, § 15.6(e)), *available at* http://www.nyiso.com/public/markets_operations/documents/legal_regulatory/index.jsp. Moreover, LSEs are given the latitude to decide by how the much the benefits must exceed the costs for a project to go forward. *See* First Order ¶ 116 ("The voting requirement allows identified beneficiaries to conduct their own cost/benefit analyses and determine for themselves whether to support construction of a particular project.").

Given these uncertainties, it is doubtful that anticompetitive voting behavior will be detected, especially when the incentives of an LSE may be as subtle as a bias against supporting "a transmission project when the ownership benefits go to its competitor." *NYISO White Paper* 5-6. At the very least, FERC should have

[17] Indeed, FERC maintained that the difficulty of accurately measuring benefits was a main reason to *allow* LSE voting. *See* Second Order ¶ 22 ("parties that will actually have to pay for the project . . . should have the greatest incentive to estimate benefits and burdens accurately").

considered whether the combination of incumbent utilities' anticompetitive incentives and the limited ability of *post hoc* review to police anticompetitive voting behavior creates sufficient uncertainty to discourage independent transmission developers from making the significant investment necessary to develop proposals for economic transmission projects. The Commission emphasized that "the details of proposed cost allocation methodologies must be clearly defined" up front because "[p]articipants seeking to support new transmission investment need some degree of certainty regarding cost allocation to pursue that investment." Order 890-A ¶ 251; *see also* Order 890 ¶ 561; *NYISO White Paper* at 5-1 ("The fear of protracted regulatory proceedings over [cost allocation] has discouraged transmission builders from even initiating multi-jurisdictional projects."). Yet the Commission entirely ignored the chilling effect on transmission investment that is likely to result from the uncertainty created by the supermajority-voting requirement.

Even if the voting requirement had a strong rationale, the Commission would be required to weigh its anticompetitive effects against its benefits, for FERC must determine whether it "will do more good than harm." *Maryland People's Counsel*, 761 F.2d at 789 (internal quotes omitted); *see also N. Natural Gas Co.*, 399 F.2d at 961 ("Commission was obliged to make findings related to the pertinent antitrust policies, draw conclusions from the findings, and weigh

these conclusions along with other important public interest considerations."). However, the rationale for the voting requirement is weak. Voting, as opposed to reasoned argument and economic analysis, is a peculiar way to ensure "that NYISO's estimate of benefits is accurate," particularly since NYISO itself purports to be an uninterested party. It is also an odd substitute for a cost-benefit multiplier that other RTOs and ISOs have adopted to ensure that benefits exceed costs by a sufficient margin. *See* First Order ¶¶ 114-16.[18] And insofar as the voting process is premised on the "right" of beneficiaries to veto projects they would be obligated to pay for, Second Order ¶ 36, it is inconsistent with the entire premise of regulated transmission projects, which is that beneficiaries have "free rider" incentives not to voluntarily agree to participate in funding upgrades. *See* Transmission Planning NOPR ¶ 142 ("[I]f the Commission were limited to allocating costs only to beneficiaries that voluntarily accept those costs, then the Commission could not fulfill its responsibilities under the FPA.").

[18] The Commission's recent NOPR proposes to allow a cost benefit multiplier to be used to "account for uncertainty in the calculation of benefits and costs," but "it must not be so high that facilities with significant positive net benefits are excluded from cost allocation," i.e. presumptively no more than 1.25. Transmission Planning NOPR ¶ 164(3).

CONCLUSION

The antitrust laws provide private and public remedies for violations of the Sherman Act. But they ordinarily act retrospectively and are often a blunt instrument for resolving anticompetitive problems in an industry. Regulatory application of competition norms can be superior to antitrust enforcement, as the Supreme Court has recently emphasized, *see Verizon Communs., Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 413-15 (2004), precisely because prophylactic rules and market structures can be adopted to limit the ability and incentive of firms to exercise market power in the first place. The Commission erred by failing to take into account the competitive benefits of economic transmission projects to limit the ability of wholesale generation suppliers to exercise market power, and then by allowing transmission owners with potential interests in maintaining congestion and other anticompetitive incentives to veto such projects.

Accordingly, FERC's order approving NYISO's requirements for cost recovery of economic transmission upgrades should be reversed as arbitrary and capricious and inconsistent with reasoned decisionmaking.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6753 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman type style.

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CERTIFICATE OF SERVICE

Pursuant to Rule 25 of the Federal Rules of Appellate Procedure and the D.C. Circuit, I hereby certify that on this 29th day of July, 2010, I caused a copy of the foregoing Brief For the American Antitrust Institute as Amicus Curiae in Support of the Petitioner to be served electronically on the following persons:

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