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April 11, 2003

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: Fact-Finding Investigation Into Possible Manipulation of Electric and Natural Gas Prices
Docket No. PA02-2-005

Dear Secretary Salas:

Enclosed for filing are one original and fourteen copies of the Brief of the California Independent System Operator Corporation ("ISO") Addressing Staff's Interpretation of ISO and PX Tariff Authority, submitted in the above-captioned proceeding.

Also enclosed are two extra copies of the filing to be time/date stamped and returned to us by the messenger. Thank you for your assistance. Please contact the undersigned if you have any questions regarding this filing.

Sincerely,

J. Phillip Jordan

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(202) 295-8465

Counsel for the California
Independent System Operator Corporation

Enclosures

THE UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Fact-Finding Investigation Into Possible Manipulation of Electric and Natural Gas Prices	)))	**Docket No. PA02-2-005**

BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ADDRESSING STAFF'S INTERPRETATION OF ISO AND PX TARIFF AUTHORITY

Pursuant to the Commission's April 2, 2003 Order Providing for Submission of Briefs in this docket, 103 FERC ¶ 61,016 (2003) ("April 2 Order"), the California Independent System Operator Corporation ("ISO") submits the following brief addressing the Commission Staff's interpretation of the ISO and California Power Exchange's ("PX") Market Monitoring and Information Protocols ("MMIP")[1] that was contained in Chapter VI of Staff's Final Report on Price Manipulation in Western Markets, issued March 26, 2003 ("Final Report"). Staff's Final Report concludes that the MMIP prohibits certain behaviors, that Market Participants[2] were on sufficient notice of prohibited behavior to enable enforcement through sanctions, and that the Commission can impose sanctions for prohibited activity on its own initiative. For the reasons set forth below, the ISO believes Staff is correct on all points.

[1] For purposes of this brief, the ISO is only addressing the ISO Tariff and MMIP. However, as noted by Staff, the provisions of the ISO and PX MMIPs are substantially similar. Therefore, the arguments made herein apply with equal weight to the PX Tariff and MMIP.

I. THE TARIFF PROHIBITS CERTAIN ACTIVITIES BY IDENTIFYING THEM AND MAKING THEM SUBJECT TO CORRECTIVE ACTION WHEN THEY HAVE HAD SEVERE ADVERSE EFFECTS ON THE MARKET

In its responsive filing of March 20, 2003, in the 100-day manipulation proceeding (Docket Nos. EL00-95-075, et al.), the ISO presented an argument very similar to the one advanced by Staff. In that filing, the ISO argued that the MMIP does, in fact, *prohibit* forms of manipulation (referred to as "anomalous market behavior") and gaming by making both – as well as exercises of market power – subject to sanction and other corrective action when they adversely affect the markets. Refraining from such behavior amounts to a condition of service by the ISO and therefore a condition to the sellers' exercise of their market-based rate authority in the markets operated by the ISO; engaging in the behavior violates the terms of service and the sellers' market-based rate authority and subjects the sellers to sanctions and corrective action by both the ISO and FERC.

That the ISO's Tariff and MMIP prohibit certain behavior is evident from a review of the relevant provisions. Section 1.1 of the MMIP, entitled "Objectives" states that the MMIP is designed to provide for the protection of the ISO markets "from *abuses* of market power . . . and from other *abuses* that have the potential to undermine their efficient functioning or overall efficiency" (emphasis added). This section makes clear that the MMIP as a whole is aimed at preventing and remedying *abuses* of the ISO markets. The common meaning of the word *abuse*, according to Webster's Dictionary, is "to use wrongfully or improperly," or "misuse." Thus, the MMIP is aimed at preventing

[2] Capitalized terms not otherwise defined have the meaning set forth in the Master Definitions

and remedying practices that misuse the ISO markets. It should go without saying that practices that abuse, or misuse, the markets are prohibited.

It is clear from the remainder of the MMIP that practices that abuse, i.e., misuse the markets *are* prohibited. This is clear because the MMIP identifies abusive practices, sets out the circumstances under which those practices can lead to corrective actions, and includes among the potential corrective actions sanctions for past behavior. The following will explain each of these steps leading to the conclusion that abusive practices are prohibited.

A. The MMIP identifies specific practices

Section 2 of the MMIP sets out the specifics of the ISO's market monitoring regime. Section 2.1 provides for the ISO, through the Department of Market Analysis ("DMA," formerly the Market Surveillance Unit, or "MSU"), to monitor the markets for abuses. The types of abuses that may trigger action are referred to in Section 2.1 as "phenomena" and are described in the subparts of Section 2.1. The relevant phenomena for present purposes are three: "Anomalous Market Behavior," "Abuse of Reliability Must-Run Status," and "Gaming."

"Anomalous Market Behavior" is defined in Section 2.1.1 as "behavior that departs significantly from the normal behavior in competitive markets that do not require continuing regulation or . . . behavior leading to unusual or unexplained market outcomes." In that same section, the ISO's DMA is directed to continuously "evaluate . . . circumstances" to determine whether they "indicate[ ] the presence of behavior that is designed to or has the potential to distort the operation and efficient functioning of a

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Supplement (Appendix A) of the ISO Tariff.

competitive market," or whether circumstances "indicate[ ] the presence and exercise of market power or of other unacceptable practices." Some of the circumstances that could indicate the presence of such behavior or of market power are set forth in the subsections of Section 2.1.1:

- withholding of Generation capacity under circumstances in which it would normally be offered in a competitive market (Section 2.1.1.1);
- unexplained or unusual redeclarations of availability by Generators (Section 2.1.1.2);
- unusual trades or transactions (Section 2.1.1.3);
- pricing and bidding patterns that are inconsistent with prevailing supply and demand conditions, e.g., prices and bids that appear consistently excessive for or otherwise inconsistent with such conditions (Section 2.1.1.4); and
- unusual activity or circumstances relating to imports from or exports to other markets or exchanges (Section 2.1.1.5).

"Abuse of Reliability Must-Run Status" is defined in Section 2.1.2 as "circumstances that indicate that [units designated as Reliability Must-Run] are being operated in a manner that will adversely affect the competitive nature and efficient workings of the ISO markets."

And finally, "Gaming" is defined in Section 2.1.3 as

- Taking unfair advantage of the rules and procedures set forth in the PX or ISO Tariffs, Protocols or Activity Rules, or of transmission constraints in

periods in which exist substantial Congestion, to the detriment of the efficiency of, and of consumers in, the ISO Markets, [or]

- taking undue advantage of other conditions that may affect the availability of transmission and generation capacity, such as loop flow, facility outages, level of hydropower output or seasonal limits on energy imports from out-of-state, or
- actions or behaviors that may otherwise render the system and the ISO markets vulnerable to price manipulation to the detriment of their efficiency.

B. The identified practices can trigger corrective action if they abuse the ISO markets

Section 2.3 of the MMIP provides for corrective actions to be pursued to address the phenomena identified under Section 2.1 under two circumstances. First, Section 2.3.1 authorizes corrective actions when market monitoring activities reveal that there is "a significant possibility of the presence of or potential for the exercise of market power that would adversely affect the operation of the ISO Markets." And second, Section 2.3.2 provides for corrective action even when there may be no exercise or potential exercise of market power, but "activities or behavior of Market Participants in the ISO Markets have the effect of, or potential for, undermining the efficiency, workability or reliability of the ISO Markets to give or to serve such Market Participants an unfair competitive advantage over other Market Participants."

Both Section 2.3.1 and Section 2.3.2 apply to *all* the phenomena described in Section 2.1. This means that corrective actions may be taken against any anomalous

market behavior, abuse of Reliability Must-Run status, or gaming that either (i) shows the presence or potential for market power, or (ii) undermines or potentially undermines the efficiency, workability or reliability of the markets or confers or potentially confers an unfair competitive advantage to some Market Participants.

C. Corrective actions for practices that abuse the markets may include sanctions for past behavior

Sections 2.3.1 and 2.3.2 not only identify the circumstances under which corrective actions may be taken against anomalous market behavior, abuse of Reliability Must-Run status, or gaming; those sections also describe the types of corrective actions that may be taken:

- Section 2.3.1 provides that if investigation of anomalous market behavior, abuse of Reliability Must-Run status, or gaming reveals the exercise or potential exercise of market power, the DMA shall "take appropriate measures" under, *inter alia*, Section 7 of the MMIP "to institute the corrective action most effective and appropriate for the situation."

  Under Section 7.3, two of the specific actions that might be taken are (i) the imposition directly by the ISO of any sanctions or penalties provided in the Tariff, or (ii) referral to a regulatory or antitrust agency with a recommendation for sanctions and penalties.

- Section 2.3.2 provides that if investigation of anomalous market behavior, abuse of Reliability Must-Run status, or gaming

reveals that the behavior undermines or potentially undermines the efficiency, workability or reliability of the markets or confers or potentially confers an unfair competitive advantage to some Market Participants, the DMA may recommend actions by the ISO or "by other entities," and those recommended actions may include "fines or suspensions, against specific entities in order to deter such activities or behavior."[3]

The sum and substance of Sections 2.3.1 and 2.3.2, as shown immediately above, is that the ISO may impose sanctions or penalties, or recommend that an agency do so, any time an investigation of anomalous market behavior, abuse of Reliability Must-Run status, or gaming shows the potential or actual exercise of market power or the undermining of the efficiency, workability or reliability of the markets, or a potential or actual competitive advantage for some Market Participants.

[3] While "gaming" is subject to corrective action under Sections 2.3.1 and 2.3.2 when the standards of those sections are met, it is also separately addressed in Section 2.3.3. That section provides that the MSU, if it discovers evidence of gaming, shall review the relationship between the gaming activities "and/or the relationship between system conditions and market behavior and pricing in order to assess the potential for and impact of such gaming behavior" with a view towards making changes, if necessary, in the structure of the ISO itself, or changes to the ISO Tariff, Protocols, or Activity Rules, or to proscribe the specific gaming behavior. Unlike the previous two sections, Section 2.3.3 limits the scope of responsive actions to prescriptive ones. Section 2.3.3 is essentially an additional backstop with respect to gaming; that is, if evidence of gaming is uncovered, but it does not rise to the levels necessary to trigger Sections 2.3.1 (market power) or 2.3.2 (undermining the ISO markets or providing an unfair competitive advantage), a remedy is still available, albeit it in the more limited form of a prescriptive, forward-looking one, rather than one that might be punitive in nature. However, if the "gaming" behavior does evidence the impacts (or potential impacts) described in Sections 2.3.1 and 2.3.2, then the avenues for corrective action are unlimited and may include sanctions for past conduct.

D. Identified practices that abuse the markets are, therefore, prohibited

The above analysis of Section 2.1, Section 2.3.1 and Section 2.3.2, shows that the ISO is permitted to impose penalties or sanctions for past behavior, or recommend that a regulatory or antitrust agency impose penalties or sanctions, to address specifically described behavior that is harmful to the ISO markets, either because it evidences the exercise or potential exercise of market power, or because it undermines the markets' efficiency, workability or reliability, or gives some Market Participants an unfair competitive advantage. If the ISO has the power to take or recommend corrective action for past activities, then the activities are, in fact, *prohibited* under the Tariff. The MMIP prohibits these activities, by identifying them (in Section 2.1), describing two thresholds of impact (in Sections 2.3.1 and 2.3.2), one of which must be met before corrective action is to be taken, and then including penalties and sanctions for past activities among the corrective actions that might be taken or recommended. The Tariff may not contain the words "activities A, B, and C are unlawful," but it contains the functional equivalent of such an explicit prohibition. It would be illogical to maintain that, although the ISO has the power to impose sanctions and penalties for past activities, or recommend that a regulatory agency do so, those activities nevertheless violated nothing. Taking that position would be the equivalent of saying the MMIP provides remedies, but does not define the wrong that warrants the remedy. The very fact that the MMIP contemplates penalties and sanctions, and defines both the activities subject to potential penalties and the circumstances under which they may be imposed, means that the underlying behavior that triggers this corrective action was prohibited.

In fact, any argument that the MMIP does not expressly "prohibit" activities amounts to a red herring. The MMIP expressly states that certain conduct potentially subjects Market Participants to corrective actions, which expressly can include penalties and other sanctions, whether imposed by the ISO or by a regulatory agency. That is all that is necessary for the Commission now to impose sanctions; every Market Participant was on notice that certain conduct could lead to those sanctions.[4]

E. The MMIP is more than a set of procedures for the ISO to follow, and the absence of Commission-approved penalties to be imposed by the ISO does not vitiate the prohibitions in the MMIP

The ISO anticipates that other parties may make two arguments against the interpretation of the MMIP set forth above. First, they may say that the MMIP is only a set of procedural directions to the ISO and specifically to the ISO's DMA; that is, the MMIP simply describes how the DMA is to monitor the markets, what it is to look for, and the actions it is to take when it observes certain phenomena. A corollary of that argument may well be that the MMIP does not expressly prohibit any activity. The corollary has been dispensed with in the previous paragraph: the MMIP prohibits activity by providing remedies for its occurrence. As to the argument that the MMIP is only a set of procedures for the ISO itself, it is both that and more. It *does* describe how

[4] In fact, attorneys for Enron, analyzing the provisions of the ISO's MMIP in the now infamous "Enron memoranda," explicitly concluded that the ISO Tariff prohibited "gaming" and "anomalous market behavior." See Memorandum from Richard Sanders to Christian Yoder and Stephen Hall, dated December 6, 2000 at 8, and Memorandum from Richard Sanders to Christian Yoder and Stephen Hall, dated December 8, 2000 at 8. These memoranda are available on the Commission's website at http://www.ferc.gov/Electric/bulkpower/PA02-2/pa02-2.htm.

the DMA is to proceed under various circumstances, but as explained above, it *also* makes clear that certain activities *by Market Participants* are prohibited. [5]

The second anticipated argument is that the absence of Commission-approved penalties or sanctions that the ISO can impose renders nugatory any "prohibition" of certain activities by the MMIP that might exist if there were such approved penalties and sanctions. The prohibition is established by the MMIP's clear statement that the activities *may* be subject to sanction, either by the ISO or by a regulatory agency acting on the ISO's recommendation. The fact that there may exist no remedy for the ISO to impose does not affect the prohibition established by the MMIP's allowance for a remedy.

II. MARKET PARTICIPANTS HAD SUFFICIENT NOTICE OF THE PROHIBITED ACTIVITIES THAT COULD SUBJECT THEM TO SANCTIONS

Based on arguments in previous filings by other parties during the 100-day discovery proceeding and in this docket, the ISO anticipates that some Market Participants may contend that the MMIP did not provide sufficient notice of *which* activities could subject them to sanctions. This argument is spurious.

The Staff in its Final Report captured the essence of why such an "inadequate notice" argument fails. As Staff noted,

> [o]ne key function of the MMIP is to put market participants on notice as to the "rules of the road" for them so that the markets operated by the Cal ISO are free from abusive conduct and can function as efficiently and competitively as possible. . . .
>
> . . . Staff believes that Market participants cannot reasonably argue that they were *not* on notice that misconduct that arose from abuses of

[5] As Staff notes, *see* Final Report at VI-7, the MMIP states that it applies not only to the ISO and the PX, but to "all ISO Market Participants." MMIP § 1.3.1.1.

> market power and that adversely affected the efficient operations of the Cal ISO and CAL PX markets (as delineated in the MMIP) would be a violation of the Cal ISO or CAL PX tariffs.

Final Report at VI-7. As Staff succinctly put it, Market Participants cannot credibly argue they were not on notice that certain types of conduct, having certain effects, could subject them to certain consequences.

Statutes and regulations that could infringe on a constitutional right (*e.g.*, freedom of expression) are subject to exacting scrutiny for potential vagueness. *Kolender v. Lawson*, 461 U.S. 352, 103 S.Ct. 1855 (1983). For a statute or regulation that does not potentially infringe a constitutional right, *e.g.*, one regulating economic conduct, the level of scrutiny is far lower: the fundamental principle is that such statutes or regulations must not be so vague as to leave one to guess as to what they forbid. *U.S. v. Lanier,* 520 U.S. 259, 264-65, 117 S. Ct. 1219, 1224-25 (1997). The Supreme Court has explained as follows the hurdle faced by someone challenging the notice provided by such a statute or regulation:

> [T]o sustain such a challenge, the complainant must prove that the enactment is vague not in the sense that it requires a person to conform his conduct to an imprecise but comprehensible normative standard, but rather in the sense that no standard of conduct is specified at all.

Village of Hoffman Estates v. Flipside, 455 U.S. 489, 495 n.7, 102 S.Ct. 1186, 1191 n.7 (1982) (internal quotation marks and citations omitted). As one standard treatise has summed up the cases: "It is rare that a statue that does not regulate a fundamental constitutional right would be found to be void-for-vagueness because individuals may have to exercise a high degree of carefulness when engaging in activities that do not relate to fundamental constitutional rights." Rotunda and Nowak, Treatise on Constitutional Law § 17.8 at 105, n. 31 (1999) (discussing leading Supreme Court

cases). One Court of Appeals has recently explained the rationale behind this approach to statues and regulations that do not potentially infringe constitutional rights:

> This court . . . recognizes that regulations cannot specifically address [an] infinite variety of situations . . . and that by requiring regulations to be too specific we open loopholes, allowing conduct which the regulations is intended to address to remain unregulated. . . . Accordingly, regulations will be found to satisfy due process so long as they are sufficiently specific that a reasonably prudent person, familiar with the objectives the regulations are meant to achieve, would have fair warning of what the regulations require.

Walker Stone Co., Inc. v. Secretary of Labor, 156 F.3d 1076, 1083 (D.D.C. 1998) (internal quotation marks and citations omitted).

Market Participants cannot credibly argue that the provisions of the MMIP are so vague as require one to guess at what they prohibit, or that they give no standard of conduct at all. Rather, those provisions give the reasonably prudent person, aware that the intent of the MMIP is to protect the markets, fair warning of what is prohibited. The MMIP describes specific behaviors that could lead to sanctions. As discussed in Part I, above, the behaviors are anomalous market behavior, abuse of reliability must-run units, and gaming. If the MMIP simply named those three types of prohibited behavior, without any more, Market Participants might have an argument that they had insufficient notice as to what was prohibited. But the MMIP contains much more guidance than that. It *defines* all three types of behaviors at some length, and in the case of anomalous market behavior it also provides five specific examples of the type of activity that could evidence such behavior. *See* Part I, above. Moreover, the MMIP creates a "filter" of a certain level of actual or potential market impact that must be established before sanctions can be imposed: corrective action is called for only when the anomalous market behavior, abuse of reliability must-run status, or gaming either

reveals the exercise or potential exercise of market power, or undermines or potentially undermines the efficiency, workability or reliability of the markets or confers or potentially confers an unfair competitive advantage to some market participants. This is far from a regulatory scheme in which Market Participants must guess at what conduct is prohibited. All they need do is read, and apply reasonable prudence based on knowing that the MMIP is aimed at protecting the markets against abuse.

Market Participants who contend otherwise almost surely will argue that the MMIP must *even more minutely* describe prohibited conduct in order to be enforceable. They will be contending, in essence, for the type of attempt to describe an "infinite variety" of situations that the court in *Walker Stone, supra*, recognized was unnecessary and in fact counter-productive of effective regulation. Such micro-regulation, at the risk of creating loopholes, is not required.

The MMIP is intended to protect the competitive markets against abuse. To grasp the spuriousness of any "vagueness" claim against the terms of the MMIP one need only consider the terms of the over-arching competition-protection statue, the Sherman Act. Section 1 of that Act states that "restraints of trade" are unlawful, with no further definition. This is a far more general prohibition than is contained in the MMIP. Yet, the Supreme Court, speaking through Justice Holmes, upheld the application of Section 1, *even in the criminal context*, against a claim that it was unconstitutionally vague. *Nash v. United States,* 229 U.S. 373, 33 S.Ct. 780 (1913). Justice Holmes stated that "the law is full of instances where a man's fate depends on his estimating rightly, that is, as the jury subsequently estimates it, some matter of degree." *Id.* at 377, 33 S.Ct. at 781. The Supreme Court has subsequently noted that the prohibition of

Section 1 is so broadly worded that "the behavior proscribed by the Act is often difficult to distinguish from the gray zone of socially acceptable and economically justifiable business conduct." *United States v. U.S. Gypsum Co.*, 438 U.S. 422, 440-41, 98 S.Ct. 2864, 2875 (1978) (holding that criminal intent must be shown in a criminal prosecution under Section 1).[6]

Rather than describing every hue and shade of prohibited behavior, the MMIP describes the three *types* of behavior which are abusive of the ISO's markets. These descriptions provide Market Participants with substantial guidance as to specific activities that are prohibited. This broadly descriptive approach is far from unusual in regulatory regimes, *viz.* the Sherman Act, and was necessitated by the fact that it would have been impossible for the ISO or the Commission to identify before-the-fact each and every specific activity that would have severe adverse effects on the operation of the ISO's markets. It is only recently, with the evidence uncovered in this proceeding,

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[6] In addition to the Sherman Act, the courts have rejected claims of vagueness or lack of notice mounted against other statutes that provide far less specific guidance than the MMIP. For example, the Supreme Court has held that the Robinson-Patman Act , which makes it a crime to sell goods at "unreasonably low prices for the purpose of destroying competition or eliminating a competitor" is not too vague and indefinite. *United States, v. National Dairy Products Corp.*, 372 U.S. 29, 83 S.Ct. 594 (1963). In its decision, the Court described why the judicial approach to such statues is less exacting:

> ... we also note that the approach to 'vagueness' governing a case like this is different from that followed in cases arising under the First Amendment. There we are concerned with the vagueness of the statute 'on its face' because such vagueness may in itself deter constitutionally protected and socially desirable conduct. No such factor is present here where the statute is directed only at conduct designed to destroy competition, activity which is neither constitutionally protected nor socially desirable.

Id. at 372 U.S. 36, 83 S.Ct. 599-600 (citations omitted). Section 5 of the Federal Trade Commission ("FTC") Act prohibits "unfair methods of competition" and "unfair or deceptive acts or practices," prohibitions lacking in specificity, but sufficient for the Supreme Court to hold that the FTC has "broad powers" to find violations, *Federal Trade Commission v. Brown Shoe Co.*, 384 U.S. 316, 320-321, 86 S.Ct. 1501, 1504 (1966), and may rely on "common sense and economic theory" to support its findings. *Federal Trade Commission v. Indiana Federation of Dentists*, 476 U.S. 447, 456, 106 S.Ct. 2009, 2016-17 (1986). Moreover, many courts have held that they can order restitution or other monetary relief *for past activity* if they find that it violated these prohibitions. *E.g., Federal Trade Commission v. GEM*

that a comprehensive understanding has been gained of the various specific activities that can meet the descriptions in Section 2.1 and cause severe harm to the operation of the ISO's markets.

The implementation of more open and competitive electricity markets (as with any market), results in an increase of the number of potential strategies to abuse those markets. As a result, oversight mechanisms must be flexible, within the constraints of due process, in order to effectively combat such abuses. The MMIP is drafted consistently with this theory; it provides definitions of types of prohibited behavior rather than fruitlessly attempting to identify each specific activity that would meet those definitions. This approach is a necessary outgrowth of a de-regulated environment, and so long as Market Participants had the notice required by due process of what types of behavior were prohibited, that is enough. Of course, Market Participants may need to exercise vigilance and caution in what activities they undertake, but that is true of any unregulated activity – for example, all businesses must take care not to engage in conduct that runs afoul of the Sherman Act's prohibition against "unreasonable restraints of trade." Requiring that Market Participants exercise vigilance and caution is far preferable, from the standpoint of society, to employing an approach under which market participants are held to have sufficient notice of a prohibition only when someone has previously engaged in injurious behavior and the ISO, or the Commission, has expressly held that that specific activity constitutes, for example, "gaming." The latter approach would constitute a license for Market Participants to run roughshod over de-regulated energy markets with no fear of sanction for any behavior engaged in prior

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Merchandising Corp., 87 F.3d 466, 470 (11th Cir. 1996); *see generally Federal Trade Commission v. Mylan Laboratories*, Inc., 62 F.Supp.2d 25, 36-38 (D.D.C. 1999) (discussing several similar cases).

to the point at which a market monitor or regulator puts all the pieces together; even then, any entities that engaged in the behavior prior to the time all the pieces came together, and some regulator announced that the specific behavior constituted gaming, would get off free. Such an approach would mean, in effect, that the markets are essentially unprotected. Due process does not require such an abdication of effective enforcement .

III. THE COMMISSION MAY ENFORCE THE PROHIBITIONS OF CERTAIN ACTIVITIES FOUND IN THE MMIP

Staff in its Final Report stated its view that the Commission may order remedies to enforce the provisions of the MMIP against past conduct. *See* Final Report at VI-9. Staff is clearly correct.

As Staff notes, the MMIP has been part of the ISO's filed rate schedule since the ISO, at the Commission's direction, filed it pursuant to Section 205 of the Federal Power Act on June 1, 1998. Final Report at VI-9, -10. Thus, the provisions of the MMIP, which apply to all ISO Market Participants, *see* MMIP § 1.3.1.1, and which include prohibitions of certain conduct by those Market Participants, are part of a Tariff on file with and approved by the Commission. Moreover, because the provisions of the MMIP prohibit certain conduct by sellers in the ISO's markets, they are terms and conditions on file with the Commission that affect the market-based rates charged by sellers into those markets.[7] Therefore, if a seller has engaged in anomalous market behavior, abuse of reliability must-run status, or gaming, and had the effects described in MMIP

[7] The Commission has held that the ISO Tariff, rather than a seller's individual market-based rate tariff, establishes the terms and conditions of the seller's transactions in the ISO markets. *See El Segundo Power, LLC,* 91 FERC ¶ 61,110 (2000).

§§ 2.31 or 2.3.2 (concerning market power, undermining the markets, or gaining an unfair competitive advantage), that seller has violated the terms and conditions applicable to its sales of energy for resale under the applicable tariff on file with the Commission, namely, the ISO Tariff.

It is undisputed that the Commission can remedy violations of filed tariffs or terms and conditions affecting rates under those tariffs. *See, e.g., Washington Water Power Co.,* 83 FERC ¶ 61,282 (1998) (requiring disgorgement of profits earned from violation of affiliate conduct rules in market-based rate tariff). The Commission has indicated in the Refund Proceeding its agreement with the proposition that "the Commission may take retroactive action to address circumstances where a seller did not charge the filed rate or violated statutory or regulatory requirements *or rules in applicable rate tariffs.*" *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Service*, 96 FERC ¶ 61,120, at 61,507-61,508 (2001). At that point, the Commission noted the absence of a "basis for finding that the sellers acted inconsistently with Commission-filed tariffs or with specific requirements in their filed rate authorizations." *Id.* at 61,508. Since that point, the Commission has instituted the investigation in this docket, and has acted to remedy what it terms "inappropriate behavior by market participants" when it has been able to uncover it. *See* "Order Denying Interventions," in this docket, issued April 9, 2003, 103 FERC ¶ 61,019 at ¶ 19 and n.17 (discussing consent agreement with various Reliant companies and noting in footnote 17 previous remedial actions during 2003 involving several other companies).

The fact that the MMIP provides for the ISO to refer matters to the Commission for enforcement action does not mean that the Commission can only act after such a

referral. As explained in previous sections, the MMIP prohibits certain conduct. Violation of those prohibitions is violation of a filed tariff and filed terms and conditions affecting rates, and is therefore a violation of the Federal Power Act. As the Commission has reiterated within the last few days, "the Commission has exclusive authority to enforce the Act." *Id.* at ¶ 15. Staff, in the Final Report, has it exactly right: while the procedural provisions of the MMIP provide a means for the ISO to *assist* the Commission in enforcing the Act, they do not affect in any way the Commission's fundamental authority to enforce the Act on its own motion. *See* Final Report at VI-9. The Commission has recently stated as much itself, in Order 2000:

> In response to commenters' arguments that RTO market monitoring results in an impermissible shift of Commission authority to other entities, we emphasize that performance of market monitoring by RTOs is not intended to supplant Commission authority. Rather it will provide the Commission with an additional means of detecting market power abuses, market design flaws and opportunities for improvements in market efficiency.

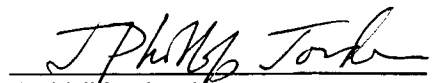
FERC Stats. & Regs. ¶ 31,089 at 31,156-57 (2000).[8]

[8] While no referral by the ISO is necessary before the Commission acts, the ISO has in fact effectively made such a referral. In addition to the multitude of ISO filings concerning market power and other abuses since mid-2000, Dr. Hildebrandt testified, in the ISO's March 20, 2003 filing in the 100-day discovery proceeding in the Refund Docket (EL-00-95) docket, that numerous practices identified in the California Parties' March 3 submission constituted the types of behavior subject to corrective action under the MMIP, and proposed that the Commission adopt certain remedies to address those behaviors.

CONCLUSION

For the foregoing reasons, the ISO urges the Commission to adopt Staff's view that the MMIP prohibits certain conduct by Market Participants and gives such Market Participants sufficient notice of the prohibited conduct, and that the Commission can impose sanctions for instances of the prohibited conduct.

Respectfully submitted,



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April 11, 2003

CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing document to be served by first class mail, postage prepaid, upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. this 11th day of April, 2003.

Michael N. Kunselman