ORAL ARGUMENT HAS NOT YET BEEN SCHEDULED

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

No. 07-1130

RICHARD BLUMENTHAL, ATTORNEY GENERAL
FOR THE STATE OF CONNECTICUT,
PETITIONER,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

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

BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION

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MAY 29, 2008
FINAL BRIEF: JULY 25, 2008

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties:

All parties, intervenors and amici appearing below and in this Court are listed in Petitioner's brief.

B. Rulings Under Review:

1. *Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.*, 117 FERC ¶ 61,038 (Oct. 11, 2006) ("Complaint Order"), JA 277.

2. *Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.*, 118 FERC ¶ 61,205 (Mar. 15, 2007) ("Rehearing Order"), JA 337.

C. Related Cases:

The Federal Energy Regulatory Commission ("FERC") orders under review in this appeal denied a complaint by Richard Blumenthal, Attorney General for Connecticut ("Attorney General"), regarding, generally, the competitiveness, and the FERC's continuing regulation, of New England's wholesale electricity market. In a decision issued after the filing of Attorney General's opening brief in this case, this Court rejected in most respects Attorney General's (and other petitioners') objections to the FERC's approval of a contested settlement governing future operation of the New England wholesale electricity market. *See Maine Pub. Utils. Comm'n v. FERC*, 520 F.3d 464, 470-77 (D.C. Cir. 2008).

Specifically, Attorney General's complaint in the instant case concerned the impact of the use of Reliability Must Run contracts on Connecticut's wholesale electricity market. In a set of four other orders issued contemporaneously, the Commission ruled on a Reliability Must Run contract filed by Milford Power Company, LLC, a generator serving Connecticut. Attorney General also petitioned for review of those orders in *Richard Blumenthal, Attorney General for the State of Connecticut v. FERC*, D.C. Cir. Case No. 07-1501 (filed Dec. 7, 2007). On March 17, 2008, the Court issued an order holding Case No. 07-1501 in abeyance, pending the outcome of the instant appeal and the FERC's action in a related complaint proceeding.

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Jennifer S. Amerkhail
Attorney

May 29, 2008
Final Brief: July 25, 2008

TABLE OF CONTENTS

PAGE

STATEMENT OF THE ISSUE…….1

COUNTERSTATEMENT OF JURISDICTION……...2

STATUTORY AND REGULATORY PROVISIONS……..2

INTRODUCTION……..2

STATEMENT OF FACTS…….5

I. Statutory And Regulatory Background……5

II. Development of New England Electricity Market……...5

III. Development of Must Run Agreements and Capacity Market in New England……7

IV. Challenged FERC Orders…….10

SUMMARY OF ARGUMENT……..14

ARGUMENT……..15

I. Standard of Review……...15

II. The Commission Reasonably Determined That Attorney General Failed to Make a *Prima Facie* Case for Modification of New England's Rate Structure……17

A. The Commission Reasonably Found that Attorney General Failed to Meet Its Burden of Showing That Existing Rates in New England Are Unjust and Unreasonable……...18

TABLE OF CONTENTS

PAGE

1. Cost-Based Must Run Contracts, for Select Generators, Are Just and Reasonable and Promote Reliability of Electric Service In New England…….18

2. The Commission Reasonably Determined that Market Prices in New England Continue to be Just and Reasonable……..21

3. The Commission Reasonably Could Rely on Continuing Oversight of Market Rates and Conditions in New England……25

4. The Commission Reasonably Concluded that Concurrent Use of Cost-Based Recovery and Market Prices is Just and Reasonable….31

5. Attorney General's Additional Argument is Jurisdictionally Barred……...34

B. The Commission Reasonably Found Attorney General Failed to Propose a Just and Reasonable Remedy…….36

III. The Commission's Decision Does Not Conflict with the FPA's Core Purposes……..38

CONCLUSION…….41

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

Allegheny Power v. FERC,
437 F.3d 1215 (D.C. Cir. 2006)……2, 25

Atlantic City Elec. Co. v. FERC,
295 F.3d 1 (D.C. Cir. 2002)……..17

California. ex rel. Lockyer v. FERC,
388 F.3d 1006 (9th Cir. 2004)……...22, 26, 27

Central Maine Power Co. v. FERC,
252 F.3d 34 (1st Cir. 2001)……6

Consolidated Edison Co. of New York, Inc. v. FERC,
510 F.3d 333 (D.C. Cir. 2007)……...38

Consumers Energy Co. v. FERC,
367 F.3d 915 (D.C. Cir. 2004)……...26

Edison Mission Energy, Inc. v. FERC,
394 F.3d 964 (D.C. Cir. 2005)……...23

Electricity Consumers Res. Council v. FERC,
407 F.3d 1232 (D.C. Cir. 2005)……16, 21, 39

ExxonMobil Gas Marketing Co. v. FERC,
297 F.3d 1071 (D.C. Cir. 2002)……16

FPC v. Hope Natural Gas Co.,
320 U.S. 591 (1944)……...21

_____

*** Cases chiefly relied upon are marked with an asterisk.**

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

**Interstate Natural Gas Ass'n of Am. v. FERC*,
285 F.3d 18 (D.C. Cir. 2002)……23, 24

Louisiana Energy & Power Auth. v. FERC,
141 F.3d 364 (D.C. Cir. 1998)……...26

Maine Pub. Utils. Comm'n v. FERC,
454 F.3d 278 (D.C. Cir. 2006)……6

**Maine Pub. Utils. Comm'n v. FERC*,
520 F.3d 464 (D.C. Cir. 2008)……3, 4, 6, 8, 9, 16, 19
22, 24, 27, 33, 36
37, 39-40

Mobil Oil Corp. v. FPC,
417 U.S. 283 (1974)……21, 22

New York v. FERC,
535 U.S. 1 (2002)……5

Northern States Power Co. v. FERC,
30 F.3d 177 (D.C. Cir. 1994)……..16

NSTAR Electric & Gas Corp. v. FERC,
481 F.3d 794 (D.C. Cir. 2007)……6, 22

Permian Basin Area Rate Cases,
390 U.S. 747 (1968)……16

Pub. Util. Dist. No. 1 v. FERC,
471 F.3d 1053 (9th Cir. 2006), *cert. granted sub nom. Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1*,
2007 U.S. LEXIS 9070 (U.S. Sept. 25, 2007)
(Nos. 06-1457, *et al.*). …….22

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

Sithe/Independence Power Partners, L.P. v. FERC,
165 F.3d 944 (D.C. Cir. 1999)…….15, 17

Sithe New England Holdings, LLC v. FERC,
308 F.3d 71 (1st Cir. 2002)……...6

ADMINISTRATIVE CASES:

AEP Power Marketing, Inc.,
109 FERC ¶ 61,276, *order on reh'g*,
112 FERC ¶ 61,320 (2005), *aff'd sub. nom.*
Industrial Energy Users-Ohio v. FERC,
D.C. Cir. No. 05-1435 (Feb. 16, 2007) ……28

Ameren Servs. Co. v. Midwest Indep. Transmission Sys.
Operator, Inc.,
121 FERC ¶ 61,205 (2007)……17

Bridgeport Energy, LLC,
112 FERC ¶ 61,077 (2005)……19

Connecticut Municipal Elec. Energy Coop. v.
Milford Power Co., LLC,
122 FERC ¶ 61,235 (2008)……30

Devon Power LLC,
103 FERC ¶ 61,082 (2003) ……9

Devon Power LLC,
115 FERC ¶ 61,340, *reh'g denied*,
117 FERC ¶ 61,133 (2006)……..9, 10

ISO New England, Inc. and New England Power Pool,
118 FERC ¶ 61,018 (2007)……..9-10

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES: **PAGE**

Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities,
Order No. 697, FERC Stats. & Regs. ¶ 31,252,
119 FERC ¶ 61,295 (2007), *order on reh'g*,
Order No. 697-A, 123 FERC ¶ 61,055 (2008)……26, 28

Milford Power Co., LLC,
110 FERC ¶ 61,299 (2005)…….8, 19

New England Power Pool,
79 FERC ¶ 61,374 (1997), *reh'g dismissed and denied*,
85 FERC ¶ 61,242 (1998)……6

New England Power Pool,
83 FERC ¶ 61,045 (1998), *reh'g denied*,
95 FERC ¶ 61,074 (2001)……6

**New England Power Pool*,
85 FERC ¶ 61,379 (1998), *reh'g denied*,
95 FERC ¶ 61,074 (2001)……7, 26, 27

New England Power Pool,
87 FERC ¶ 61,045 (1999), *reh'g denied*,
95 FERC ¶ 61,253 (2001)……7

**New England Power Pool and ISO New England, Inc.*,
100 FERC ¶ 61,287, *order on reh'g*,
101 FERC ¶ 61,344 (2002)……...7, 8, 29, 30

PPL Wallingford Energy LLC,
118 FERC ¶ 61,242 (2007)……...19

PSEG Power Connecticut LLC,
110 FERC ¶ 61,020 (2005)…….....19

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES: **PAGE**

Revised Public Utility Filing Requirements,
Order No. 2001, FERC Stats. & Regs. ¶ 31,127,
99 FERC ¶ 61,107, *reh'g denied*, Order No. 2001-A,
100 FERC ¶ 61,074, *reh'g denied*, Order No.
2001-B, 100 FERC ¶ 61,342 (2002)……28

Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.,
117 FERC ¶ 61,038 (2006)…….4, 8, 10, 12, 19, 20 23, 25, 28-33, 35, 35, 36, 38, 39

Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.,
118 FERC ¶ 61,205 (2007)…….4, 12, 13, 20-21 24, 26-29, 31-35, 39

STATUTES:

Administrative Procedure Act

5 U.S.C. § 706(2)(A)……..15

Federal Power Act

Section 201(b), 16 U.S.C. § 824b……5

Section 205(a)-(b), 16 U.S.C. §§ 824d(a)-(b)…….....5

Section 205(c), 16 U.S.C. § 824d(c)……5

Section 206, 16 U.S.C. § 824e…….5, 17, 36

Section 313(b), 16 U.S.C. § 825*l*(b)……16, 34

GLOSSARY

Attorney General	Petitioner Richard Blumenthal, Attorney General for the State of Connecticut
Br.	Petitioner's Brief
Commission or FERC	Federal Energy Regulatory Commission
Connecticut Department	Connecticut Department of Public Utility Control
Complaint Order	*Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.*, 117 FERC ¶ 61,038 (2006), JA 277
FPA	Federal Power Act
ISO	Independence System Operator
JA	Joint Appendix
Must Run contract	Reliability Must Run agreements
R.	Record Citation
Rehearing Order	*Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.*, 118 FERC ¶ 61,205 (2007), JA 337

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RICHARD BLUMENTHAL, ATTORNEY GENERAL
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FEDERAL ENERGY REGULATORY COMMISSION,
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ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission ("FERC" or "Commission") reasonably denied a complaint concerning the level of rates in New England's wholesale electricity market and, in so doing, reasonably addressed objections to the existence of both market-based rates and cost-based rates in a single market.

COUNTERSTATEMENT OF JURISDICTION

For the first time, on review to this Court, Richard Blumenthal, Attorney General for Connecticut ("Attorney General"), argues that Connecticut generators are exercising market power by withholding electricity production from the market in order to secure cost-based Reliability Must Run ("Must Run") contracts. Br. at 11, 33-34; *see infra* pp. 34-35. Attorney General did not raise this issue with sufficient specificity on rehearing below to the Commission to warrant judicial review by this Court. 16 U.S.C. § 825*l*(b); s*ee also, e.g.*, *Allegheny Power v. FERC*, 437 F.3d 1215, 1220 (D.C. Cir. 2006).

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutory and regulatory provisions are contained in the Addendum to this Brief.

INTRODUCTION

This case concerns the structure and regulation of the wholesale electricity market in New England. Over the last decade, the power market in New England has transformed from a simple market providing cost-based sources of wholesale electric energy to a collection of markets that provide for a full range of wholesale electricity needs, including energy, capacity and certain ancillary services at market-based prices. This Court has reviewed the Commission's regulation of the restructured New England electricity market on several occasions, most recently on

March 28, 2008, after the filing of Attorney General's opening brief in this case. *See Maine Pub. Utils. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008) (denying in most respects Attorney General's (and other petitioners') objections to the FERC's approval of a contested settlement governing future operation of the New England wholesale electricity market).

Like any reorganization, New England's electricity market restructuring has not been without its difficulties. Market-based prices were relatively low at first. Investment in transmission infrastructure and generation supply failed to keep up with rising demand driven in part by low prices. When this scarcity was not reflected in prices, existing generators started considering retirement. The generators, unable to recover their costs through the market-based energy or capacity markets, sought cost-based payments through Reliability Must Run ("Must Run") contracts in lieu of shutdown. (Must Run contracts are available in the New England market only for those generators needed to meet demand that cannot earn enough revenues to continue operation). In proceedings before the Commission on these contracts, the FERC determined that New England's capacity market needed to be redesigned. After several years of negotiation and litigation, and over the objection of Attorney General, this new capacity market, the Forward Capacity Market, is set to begin in 2010. *See id*. at 467-69 (explaining development of restructured New England market).

In a contemporaneous complaint before the Commission, Attorney General challenged the concurrent use of both cost-based Must Run contracts and market-based pricing in the New England market. It sought to have the Commission abandon a competitive market altogether and place all generators in Connecticut on cost-of-service regulation for an indefinite period.

In the orders on review, the Commission denied Attorney General's complaint, finding that the market structure in New England was (at least for an interim period) reasonable and that Attorney General had failed to meet its burden to prove otherwise. *See Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.*, 117 FERC ¶ 61,038 at P 57 (2006) ("Complaint Order"), JA 295; *Richard Blumenthal, Attorney General for the State of Connecticut, et al. v. ISO New England, Inc.*, 118 FERC ¶ 61,205 at P 11, JA 341-42 (2007) ("Rehearing Order"). The Commission also determined that Attorney General had not shown that its proposal to abandon the market structure, at least with regard to Connecticut, was reasonable. The Commission recognized the inefficiencies inherent in cost-based, out-of-market payments to generators needed for reliability and reiterated its plan to strengthen the existing market structure and opportunities for cost recovery through implementation of the Forward Capacity Market (upheld by this Court in *Maine Pub. Utils. Comm'n*).

STATEMENT OF FACTS

I. Statutory And Regulatory Background

Section 201(b) of the Federal Power Act ("FPA"), 16 U.S.C. § 824b, grants the FERC exclusive jurisdiction over transmission and wholesale sales of electric energy in interstate commerce by public utilities. *See, e.g.*, *New York v. FERC*, 535 U.S. 1 (2002) (discussing statutory framework and Commission jurisdiction under the FPA).

Section 205(c) of the FPA, 16 U.S.C. § 824d(c), requires public utilities to file tariff schedules with the Commission showing their rates, terms of service and related contracts, for service subject to FERC jurisdiction. When those tariff schedules are filed, Sections 205(a)-(b) of the FPA, 16 U.S.C. §§ 824d(a)-(b), direct the Commission to assure that the rates and services described in the tariff are just and reasonable and not unduly discriminatory.

Section 206 of the FPA, 16 U.S.C. § 824e, authorizes the Commission to investigate whether existing rates are lawful. If the Commission, on its own initiative or on third-party complaint, finds that an existing rate or charge is "unjust, unreasonable, unduly discriminatory, or preferential," it must determine and set the just and reasonable rate.

II. Development of New England Electricity Market

This Court is familiar with the development and regulation of the New

England wholesale electricity market. *See Maine Pub. Utils. Comm'n*, 520 F.3d at 467-69 (development of Forward Capacity Market and interim transitional payments); *NSTAR Electric & Gas Corp. v. FERC*, 481 F.3d 794 (D.C. Cir. 2007) (level of wholesale rates when local transmission constraints obstruct competitive market pricing); *Maine Pub. Utils. Comm'n v. FERC*, 454 F.3d 278 (D.C. Cir. 2006) (development of regional transmission organization in New England and incentive adjustment to transmission owners' rate of return); *see also Sithe New England Holdings, LLC v. FERC*, 308 F.3d 71 (1st Cir. 2002) (charge for surplus power (installed capacity) to ensure reliability of New England operations); *Central Maine Power Co. v. FERC*, 252 F.3d 34 (1st Cir. 2001) (same).

In short, in 1997 and 1998, the Commission approved proposals by New England Power Pool to establish an Independent System Operator ("ISO") to operate the New England transmission grid, administer a single transmission tariff, and maintain real-time and day-ahead electricity markets for the region. *See New England Power Pool*, 79 FERC ¶ 61,374 at 62,576 (1997), *reh'g dismissed and denied*, 85 FERC ¶ 61,242 (1998) (accepting establishment of ISO New England); *New England Power Pool*, 83 FERC ¶ 61,045 (1998), *reh'g denied*, 95 FERC ¶ 61,074 (2001) (approving transmission tariff). New England Power Pool also sought approval of market rules and requested market-based rates for its proposal

to move from cost-based pricing to market-based pricing with auction clearing prices.

Contemporaneously, the Commission granted market-based rates for public utility sellers in the markets administered by ISO New England and approved proposed market rules. *New England Power Pool*, 85 FERC ¶ 61,379 at 62,472-78 (1998), *reh'g denied*, 95 FERC ¶ 61,074 (2001); *New England Power Pool*, 87 FERC ¶ 61,045 at 61,192-97 (1999), *reh'g denied*, 95 FERC ¶ 61,253 (2001).

In 2002, the FERC approved a comprehensive redesign of the wholesale energy and capacity markets, establishing Market Rule 1, the tariff provision at issue in this proceeding. *See New England Power Pool and ISO New England, Inc.*, 100 FERC ¶ 61,287, *order on reh'g*, 101 FERC ¶ 61, 344 (2002). Market Rule 1 implemented Locational Marginal Pricing to account for transmission congestion and reflect the cost of using the last unit of generation needed to serve customer demand at different locations. *New England Power Pool*, 100 FERC ¶ 61,287 at P 2, n.2.

III. Development of Must Run Agreements and Capacity Market in New England

Market Rule 1 established authority for ISO New England to enter into Must Run contracts with financially-troubled generators that are needed for reliability. *See id*. at P 47. The Must Run contracts allow generators to recover up to a full cost-of-service rate from those customers directly benefiting from their continued

operation. *Id*. at PP 47, 57-62. These contracts also require that generators offer all of their capacity into the energy market at pre-determined levels representing their actual marginal costs. *See, e.g.*, *Milford Power Co., LLC*, 110 FERC ¶ 61,299 at P 7 (2005); s*ee also* Complaint Order at P 77 n.80, JA 304 (noting that other generators may bid $25/MWh above their marginal costs). Revenues from these energy sales in the market directly reduce the cost-based payments made pursuant to the Must Run contracts. *See, e.g., Milford Power Co.*, 110 FERC ¶ 61,299 at P 7.

ISO New England has always required entities serving load in the market to have, or otherwise acquire, sufficient capacity plus a reserve margin, *i.e.*, "more capacity than is necessary to meet their customer's demand for electricity." *Maine Pub. Utils. Comm'n*, 520 F.3d at 467; *ISO New England, Inc.*, 91 FERC ¶ 61,311 at 62,080 (2000) (describing the change from cost-based charges and penalties to charges determined through an auction mechanism). Because Market Rule 1 is in effect, a market participant can procure capacity through a monthly auction choosing among any generator located in New England, independent of whether the capacity can really reach its customers. *New England Power Pool*, 100 FERC ¶ 61,287 at P 91.

Starting in 2010, the Forward Capacity Market will replace the capacity procured through these Market Rule 1 auctions and provide, instead, annual

capacity auctions held three years in advance of the need for the capacity. *Devon Power LLC*, 115 FERC ¶ 61,340 at P 16, *reh'g denied*, 117 FERC ¶ 61,133 (2006); *see also Maine Pub. Utils. Comm'n*, 520 F.3d at 469. The Forward Capacity Market will mark a major change in capacity procurement, requiring location-specific delivery capability to customers at times when the transmission grid is the most constrained. *Devon Power LLC*, 115 FERC ¶ 61,340 at P 23. The market will set different prices for each location defined by these transmission constraints. *Id*.; *see also Maine Pub. Utils. Comm'n*, 520 F.3d at 469.

Asserting that the current absence of location-specific capacity prices, as well as other factors, would lead to insufficient market revenues, generators located in Connecticut began to file Must Run contracts with the Commission in 2003. *See, e.g.*, *Devon Power LLC*, 103 FERC ¶ 61,082 at P 7 (2003). The Commission expressed concern that the proliferation of Must Run contracts would "undermine[] effective market performance" by lowering energy market prices, increasing out-of-market payments and suppressing market entry. *Id*. at P 29. Thus, the Commission initially rejected the first of these agreements, instituting a proceeding to address the compensation problems faced by generators in New England and adopting temporary measures to provide generators with additional revenue opportunities to ensure their continued availability. *Id*. at PP 29-31, 33-37; s*ee also ISO New England, Inc. and New England Power Pool*, 118 FERC ¶

61,018 at PP 1-3, 50 (2007) (explaining history of Peaking Unit Safe Harbor bidding mechanism and terminating mechanism).

In 2005, ISO New England reported that "the state of Connecticut and Southwest Connecticut in particular has exhibited the 'most significant resource need in New England' in recent years, resulting from continued growth in electricity use, continued transmission bottlenecks and inadequate development of new resources." Complaint Order at P 79, JA 305 (citations omitted). Noting this development and the continued financial difficulties of existing generators, the FERC eventually approved Must Run contracts for certain generators in Connecticut, limiting the term of the agreements and requiring the generators to demonstrate insufficient revenues. *See id*. at P 5, JA 279. These existing Must Run contracts will terminate with the effectiveness of the Forward Capacity Market, on June 1, 2010. *Devon Power LLC*, 115 FERC ¶ 61,340 at PP 32, 166.

IV. Challenged FERC Orders

The issues now before the Court arise out of a complaint filed jointly in 2005 by Attorney General, Connecticut Office of Consumer Counsel, Connecticut Industrial Energy Consumers, and Connecticut Municipal Energy Electric Cooperative, challenging the justness and reasonableness of the concurrent use of cost-based Must Run contracts and market-based rates in the New England market. Complaint Order at P 1, JA 277. In the Complaint Order, the Commission found

that the four complainants had not met their burden of proof to show that the existing rates were unjust and unreasonable, nor had they shown that their proposed remedy (cost-of-service rates for all Connecticut generators) was just and reasonable. *Id*. at P 57, JA 295-96. The Commission denied the complaint, concluding that "[Must Run] contracts, bilateral contracts and market-based rates under [Locational Marginal Pricing] are all Commission-approved mechanisms, and their simultaneous use does not, without further proof, amount to unjust and unreasonable rates." *Id*.

The Commission reexamined the validity of the challenged mechanisms, finding each important, at least in the interim, for reliable service and the function of the market and determining that "the current rates in Connecticut are just and reasonable." *Id*. at P 72, JA 302; s*ee also id.* at PP 59-60, 65-74, JA 296, 299-302 (Must Run contracts); PP 61-64, JA 297-98 (Peaking Unit Safe Harbor bidding protocols); P 75, JA 303 (bilateral contracts); PP 76-81, JA 303-06 (single market clearing price auctions). Notably, the Commission found that the "flawed capacity market and the inadequate transmission infrastructure in Connecticut" created the short-term need for Must Run contracts "to preserve reliability in severely-constrained areas within the state." *Id*. at P 66, JA 299. To this end, the Commission noted that existing plans for transmission infrastructure expansion and implementation of programs "to encourage new generation and demand response"

(*Id*. at P 80, JA 306), as well as the reforms to the capacity market incorporated in the then recently-approved Forward Capacity Market settlement, would have a beneficial effect on future prices. *Id*. at PP 87, JA 309.

Complainants' proposed remedy – that all generators in Connecticut be required to adopt cost-of-service rates for an unspecified period – was deemed unjustified by the Commission. *Id*. at 57, JA 295-96. Because the complaint did not show that generators exercised any form of market power, the Commission explained that it had no basis for withdrawing the generators' market-based rate authority, a prerequisite to limiting their allowable cost recovery to cost-of-service rates. *Id*. The Commission concluded that the implementation of the Forward Capacity Market and the concurrent termination of existing Must Run agreements, developed after years of efforts by over 100 market participants throughout New England, was a superior solution to rate and reliability concerns than that offered by the few complainants. *Id*. at P 87, JA 309.

Of the four original complainants, only Attorney General requested rehearing of the Complaint Order. Rehearing Order at P 1, JA 337. (Two of the original complainants, Connecticut Office of Consumer Counsel and Connecticut Municipal Energy Electric Cooperative, had previously joined the Forward Capacity Market settlement that contained provisions for terminating the Must Run contracts at issue in the underlying complaint. Complaint Order at P 9, JA 341.)

On March 15, 2007, the Commission denied rehearing of Attorney General's continued objections to the New England market structure. Rehearing Order at PP 19-23, JA 346-48 (providing additional legal support), PP 27-29, JA 349-51 (addressing allegations about now-terminated Peaking Unit Safe Harbor mechanism), 32-33, JA 352-53 (addressing allegation that the FERC found rates unjust and unreasonable in short term), 36-38, JA 354-355 (addressing alleged abandonment of market price signals and role of Forward Capacity Market).

SUMMARY OF ARGUMENT

On appeal, Attorney General challenges a combination market-based/cost-based rate-setting structure temporarily in place in the New England wholesale electricity market. It does not challenge the reasonableness of cost-based Must Run contracts. Nor does it challenge the level of prices resulting from New England's single market-clearing price energy auctions for all classes of generators. Rather, Attorney General contends that the Commission acted arbitrarily and capriciously in failing to find that these two means of determining rates, which are just and reasonable alone, are unjust and unreasonable when allowed together in a single market. Based on a snapshot in time, when supply is particularly scarce and cost-based rates may be lower than market-based rates, Attorney General seeks reform of New England Market Rule 1 to require that all generators in Connecticut return to cost-of-service rate recovery.

In denying Attorney General's complaint, the Commission applied the correct standard, reviewed the evidence presented and reasonably determined that Attorney General had failed to meet its burden to show that rates in New England's market are unjust and unreasonable or that its proposed remedy would be just and reasonable.

While acknowledging the inefficiency inherent in the use of cost-based out-of-market payments to ensure that select generators continued to provide reliable

service, the Commission reasonably found these short-term Must Run contracts were just and reasonable and important to the preservation of adequate service. The Commission also relied on substantial evidence in the record to support its conclusion that the market rates earned by generators in New England are just and reasonable. The Commission acknowledged that during times of scarcity and severe transmission congestion, market rates temporarily may exceed cost-of-service rates. Satisfied that the market rates in New England were just and reasonable, in the short- and long-term, and in light of the imminent termination of the hybrid market structure and the adoption of a replacement structure favored by most New England market participants (but not by Attorney General) and recently upheld by this Court, the Commission reasonably rejected Attorney General's particular market structure preference.

ARGUMENT

I. Standard of Review

The Court reviews Commission orders under the Administrative Procedure Act's arbitrary and capricious standard. 5 U.S.C. § 706(2)(A); *see also*, *e.g.*, *Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under this standard, review is limited to whether the Commission has "examined the relevant data and articulated a satisfactory explanation for its action, including a 'rational connection between the facts found and the choices made.'"

Electricity Consumers Res. Council v. FERC, 407 F.3d 1232, 1236 (D.C. Cir. 2005) (citations omitted); *see also, e.g., ExxonMobil Gas Marketing Co. v. FERC*, 297 F.3d 1071, 1083 (D.C. Cir. 2002) (court considers whether there has been a clear error of judgment and "[t]he court is not empowered to substitute its judgment for that of the agency").

The Commission's decisions regarding rate issues are entitled to broad deference, because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); *see also, e.g., Northern States Power Co. v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994) ("our review of whether a particular rate design is 'just and reasonable' is highly deferential"); *Electricity Consumers*, 407 F.3d at 1236 (deference is warranted because "issues of rate design are fairly technical and, insofar as they are not technical, involve policy judgments that lie at the core of the regulatory mission").

The Commission's factual findings are conclusive if supported by substantial evidence. FPA § 313(b), 16 U.S.C. § 825*l*(b). "When the record would support more than one outcome," the court upholds the Commission's order because the relevant question to answer "is not whether record evidence supports [the petitioner's desired outcome], but whether it supports FERC's." *Maine Pub. Utils. Comm'n*, 520 F.3d 470 (alteration in original, citation omitted).

II. The Commission Reasonably Determined That Attorney General Failed to Make a *Prima Facie* Case for Modification of New England's Rate Structure

Persons alleging harm from unjust and unreasonable rates may file a FPA § 206 complaint with the Commission. The complainant has the burden of proof in a § 206 proceeding. 16 U.S.C. § 824e(b); *see also, e.g.*, *Sithe/Independence Power Partners*, 165 F.3d at 949 (complainant has burden to establish *prima facie* case).

In order to make this *prima facie* case, the party seeking to change the rate has a dual burden – it must first prove that the existing rate is unjust, unreasonable or unduly discriminatory, and then demonstrate that the proposed replacement rate is just, reasonable and not unduly discriminatory. *See Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002). The Commission takes a hard look at the evidence presented even when the existing rate has only recently been approved. *Ameren Servs. Co. v. Midwest Indep. Transmission Sys. Operator, Inc.*, 121 FERC ¶ 61,205 at P 33 (2007) ("The mere fact that a tariff provision implementing a particular rate was at one time found to be just and reasonable does not preclude" FPA § 206 review.).

A. The Commission Reasonably Found that Attorney General Failed to Meet Its Burden of Showing That Existing Rates in New England Are Unjust and Unreasonable

1. Cost-Based Must Run Contracts, for Select Generators, Are Just and Reasonable and Promote Reliability of Electric Service in New England

The foundation of Attorney General's argument is that requiring customers to pay for both cost-based and market-based services is unjust and unreasonable. *See, e.g.*, Br. at 31-35 ("ratepayers are . . . penalized twice, once for the [Must Run] fixed cost charges and again for the excess returns earned by generators opting out of [Must Run] coverage"). In this appeal, Attorney General does not challenge the justness and reasonableness of cost-based Must Run contracts operating alone. *But see Richard Blumenthal, Attorney General for the State of Connecticut v. FERC*, D.C. Cir. No. 07-1501 (filed Dec. 7, 2007) (pending appeal, in abeyance, challenging the reasonableness of the FERC's approval of Must Run contract and contract rates for a new baseload generator).[1] Rather, Attorney General seeks to have the Commission order that all generators in Connecticut uniformly enter into these cost-based Must Run contracts. Br. at 41.

Attorney General's requested remedy is not only inconsistent with the position it has taken in a subsequent appeal, but at odds with the path the

[1] *See* Non-Binding Statement of Issues To Be Raised By Petitioner at 1-2 (filed Jan. 7, 2008) (issues (1), (2) and (5) challenge the generator's eligibility for a Must Run contract; issue (4) challenges the recovery of fixed and variable costs).

Commission reasonably chose to follow in addressing the twin problems of inadequate revenue for needed generators and the dwindling supply of reliable power in New England. The Commission found that Must Run contracts are acceptable only for select generators that meet a two prong test: (1) ISO New England must determine the generator is necessary to maintaining system reliability; and (2) the generator must meet the burden to establish financial need for the agreement. Complaint Order at P 70, JA 301. In initially modifying the first set of Must Run contracts requested by generators, the Commission expressed concern that its approval of many Must Run contracts could "distort market clearing prices in a way that understates the value of resources necessary to reliably serve load." *Id*. at P 58, JA 296; *see also Maine Pub. Utils. Comm'n*, 520 F.3d at 468 (describing initial Must Run contracts as allowing for recovery of maintenance cost, but not full cost-of-service). Ultimately, after failing to address potential shortages through bidding protocol experiments, the Commission accepted several limited-term Must Run contracts that allow an opportunity for recovery of fixed and marginal costs. *See, e.g.*, *PPL Wallingford Energy LLC*, 118 FERC ¶ 61,242 (2007); *Milford Power Co.*, 110 FERC ¶ 61,299; *PSEG Power Connecticut LLC*, 110 FERC ¶ 61,020 (2005); *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077 (2005).

The Commission accepted these contracts on the condition that they terminate with the implementation of a redesigned capacity market, the Forward Capacity Market, in 2010 (*see supra* at p. 10), addressing the underlying problems of short supply and inadequate revenues. Complaint Order at PP 2-3, JA 278. Additionally, the Commission ensured that the contracts are not stand-alone cost-of-service agreements; rather, they are integrated into the existing market structure. Must Run generators compete in the market and receive a market price for their energy. *Id*. at PP 57, 68, 73, 77, JA 295, 300, 302, 304 (noting the contract requirement to submit bids reflecting competitive offers). Their bids into the market serve to lower prices resulting from the energy auctions (*Id*. at PP 57, 68, JA 295, 300) and offset the payments they receive under the cost-based provisions of the contracts. Rehearing Order at P 22, JA 347-48. Thus, customers make "out-of-market" payments for this reliability service only to the extent market revenues are insufficient to keep these generators operating.

Contrary to the view of Attorney General (*see* Br. at 31), under the market structure and market rules approved the Commission, owners of high-cost generators cannot choose at will, depending on prevailing market conditions, to move in and out of cost-based Must Run contracts. Rather, the generators must remain in the contracts until they expire on their own terms or until ISO New England cancels the contract with 120-days advance notice. Complaint Order at P

69, JA 301. In finding the contracts just and reasonable, the Commission considered the relevant factors and reasonably determined that the integration of Must Run contracts in the market structure for a limited period would best serve consumers' dual interests in reliable service and lower prices in the short-term without undermining necessary market entry in the long run. *See* Rehearing Order at PP 32-33, JA 352-353; *see also Electricity Consumers*, 407 F.3d at 1239 (agency entitled to rely on its predictive judgment about the future operation of markets it regulates, as long as it articulates reasoning).

2. The Commission Reasonably Determined that Market Prices in New England Continue to be Just and Reasonable

Attorney General contends that the Commission acts arbitrarily and capriciously in allowing market prices for certain low-cost generators that exceed cost-of-service rates. Br. at 28-29. Specifically, it argues that rates for these generators do not reflect marginal costs and produce above-normal returns in violation of court-imposed standards for just and reasonable rates. Br. at 29-30.

The courts have repeatedly rejected any requirement that just and reasonable rates must reflect costs or be the product of a cost-of-service formula. In *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944), for example, the Supreme Court held that rates may be determined by a variety of formulae and need not rely, entirely or in part, on historical costs. More explicitly, the Supreme Court in *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 316 (1974), rejected the notion that rates

"must be based entirely on some concept of cost plus a reasonable rate of return." *See also, e.g., NSTAR Elec. & Gas Corp. v. FERC*, 481 F.3d 794, 804 (D.C. Cir. 2007) (just and reasonable prices need not track historical accounting costs); *California. ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1011-13 (9th Cir. 2004) (before-the-fact FERC authorization of market-based rates, followed by effective after-the-fact reporting and review, satisfies statutory Federal Power Act requirements). Most recently, this Court rejected this same petitioner's argument that just and reasonable capacity prices must reflect existing generators' actual costs. *Maine Pub. Utils. Comm'n*, 520 F.3d at 471 ("FERC is correct that it need not rely on generators' costs to determine rates.") (citing *Hope Natural Gas Co.*, *Mobil Oil Corp.*, and other cases).

Consistent with the premise that just and reasonable rates need not reflect actual costs, the Commission examined cost-based evidence presented by Attorney General and reasonably found it insufficient to prove that market rates for the low-cost coal and nuclear generators in Connecticut were no longer just and reasonable. Rehearing Order at P 32, JA 352. For sellers with market-based rates, the relevant issue is whether sellers are exercising market power. *See Pub. Util. Dist. No. 1 v. FERC*, 471 F.3d 1053, 1060 (9th Cir. 2006), *cert. granted sub. nom. Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1*, 2007 U.S. LEXIS 9070 (U.S. Sept. 25, 2007) (Nos. 06-1457, *et al.*) (in evolving regulatory regime, the

Commission changed "its inquiry from the permissible cost-basis of rates to the determination of a seller's market power."). Significantly, the Commission concluded that, despite a temporary rise in market prices, Attorney General did not demonstrate that the low-cost generators were exercising market power or bidding non-competitively. Complaint Order at PP 79, 86, JA 305, 309. The Commission concluded that the current market rates are just and reasonable even though they may at times exceed the estimates of cost-of-service rates for these low-cost generators. *Id*. at P 72, JA 302.

This finding is consistent with the principle, also expressed by this Court, that market rates may vary from cost-of-service rates to reflect changing market conditions, including times of scarce supply. *Interstate Natural Gas Ass'n of Am. v. FERC*, 285 F.3d 18, 31-34 (D.C. Cir. 2002); *see also id*. at 34 (noting the inefficiency of cost-of-service rates at addressing "congestion in the peaks"); *id*. at 32 (noting that price increases reflecting scarcity are "completely consistent with competition"); *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964, 968-69 (D.C. Cir. 2005) (criticizing price mitigation program that could "curtai[l] price increments attributable to genuine scarcity"). Accordingly, the Commission reasonably concluded that conditions in Connecticut, driven by lack of investment in transmission infrastructure and prior insufficient market revenues, may result in higher revenues for existing low-cost generators for some period. Complaint

Order at P 79, JA 305 ("As system conditions in Connecticut have grown tighter in recent years, combined with the increase in fuel price for marginal units, it is not surprising to see higher [locational marginal] prices."). The Commission added that such revenues are required to send correct price signals to build new generation and transmission facilities, as well as provide an incentive for customers to adjust their demand. *Id*. at P 80, JA 306; *see also* Rehearing Order at P 32, JA 352; *Maine Pub. Utils. Comm'n*, 520 F.3d at 473 (noting with approval that the FERC sets rates to ensure, *inter alia*, that prices support new entry when needed).

This is more than mere market theory, as there is evidence that market prices are driving Connecticut's construction of transmission upgrades and increasing interest in new generation and customer demand reduction. Complaint Order at P 80, JA 306. The Commission acted reasonably in refusing to dissolve a market structure that has reflected and continues to reflect changing market conditions, to the benefit of electricity consumers in Connecticut and elsewhere.

The Court allows for market rates that "approximate costs" over the long run. *Interstate Natural Gas*, 285 F.3d at 33. The Court found it reasonable for the Commission to consider "degree, volume and duration" in determining whether market-based rates would "not materially . . . exceed the 'zone of reasonableness.'" *Id*. In focusing its complaint on a snapshot of market revenues, for three

generators during a 12-month period immediately preceding the 2005 filing of its complaint, Attorney General failed to show that market rates in degree, volume and duration materially exceeded the zone of reasonableness. *See* Complaint Order at P 79, JA 305-06 (ISO New England's reports show that: (1) as supplies tightened between 2000 and 2005, average prices rose 74 percent; and (2) the New England market produced insufficient, and at times severely insufficient, revenue to support investment in new generators in periods prior to 2005). In failing to acknowledge earlier periods of lower prices and returns and in failing to take into account the temporary nature of the present higher returns (given, at a minimum, the then-occurring expansion of the Connecticut transmission system), Attorney General presented an inaccurate picture of what is, in reality, a dynamic market situation.

3. The Commission Reasonably Could Rely on Continuing Oversight of Market Rates and Conditions in New England

Attorney General's corollary argument, that the Commission may allow market-based rates only if it continually makes findings that the New England market remains competitive (Br. at 25-27), is also flawed.

Courts have never required the Commission to make an explicit finding that a workably competitive market exists as a condition for granting market-based rates. Rather, courts have held that the Commission meets its statutory Federal Power Act obligations with respect to market-based rates if it finds that an

individual seller lacks (or has effectively mitigated) market power and if there is meaningful subsequent oversight. *See Lockyer*, 383 F.3d at 1013-14 (denying facial challenge to electric market-based rate tariffs); *Consumers Energy Co. v. FERC*, 367 F.3d 915, 922-23 (D.C. Cir. 2004) (noting this "long-standing approach"); *Louisiana Energy & Power Auth. v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998) (discussing the FERC standard for granting market-based rates). Consistent with this line of authority, the Commission, in ensuring market-based rates are just and reasonable in electric markets, has relied primarily on an analysis of individual seller market power in addition to mitigation and cost-capping measures in regional markets. *See Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, 119 FERC ¶ 61,295 (2007), *order on reh'g*, Order No. 697-A, 123 FERC ¶ 61,055 at P 425 (2008) (adopting screens for determining individual seller market power).

Here, the Commission, relying on record evidence, made an *ex ante* finding that there was an absence of market power by individual public utility sellers in the regional New England market before granting those sellers market-based rates. Rehearing Order at P 20, JA 346 (citing *New England Power Pool*, 85 FERC ¶ 61,379 at 62,477-78 (1998)). Contrary to Attorney General's assertion (Br. at 32), this grant of market-based rates is relevant to the issues raised because the 1998

order marked the first time of many that the Commission would analyze individual seller market power against the backdrop of New England market conditions. *See New England Power Pool*, 85 FERC at 62,476-78 (finding any generation dominance among sellers is addressed by low overall market concentration levels, prices disciplined by the potential for new generation entry, and proposed monitoring and mitigation plans); s*ee also Maine Pub. Utils. Comm'n*, 520 F.3d at 473 (the FERC reasonably can rely on its findings in its earlier orders).

Once the Commission grants market-based rates to sellers in wholesale electricity markets, it has an oversight obligation to "gauge the just and reasonable nature of the rates" as long as the market-based rates remain in effect. *Lockyer*, 383 F.3d at 1015. At a minimum, the FERC must do so by enforcing the requirement that sellers report their transactional data. *Id*. at 1013. The Commission did not simply "defer to a market" (Br. at 26) or assume ISO New England would satisfy the agency's obligation to ensure just and reasonable rates. Br. at 33. The Commission continues to meet its ongoing obligation in New England by enforcing the filing of quarterly transactional reports from ISO New England and each seller with market-based rates in the market and reviewing annual reports from ISO New England's market monitor concerning the competitiveness of the market. Rehearing Order at P 20, JA 346-47. As with any grant of market-based rate authority, the Commission collects information from

New England sellers, conducts its own review and analysis of the data, and makes the data available electronically to the public. *See Revised Public Utility Filing Requirements*, Order No. 2001, FERC Stats. & Regs. ¶ 31,127, 99 FERC ¶ 61,107 at PP 29-32, 44-46 (describing the use of electronic data by the Commission and others), *reh'g denied*, Order No. 2001-A, 100 FERC ¶ 61,074, *reh'g denied*, Order No. 2001-B, 100 FERC ¶ 61,342 (2002).

The Commission supplements these measures with requirements that sellers update their market power analyses on a regularly scheduled basis, approximately every three years, and report any changes in the facts relied upon by the Commission when granting market-based rate authority, including the acquisition of generation. *See Market-Based Rates*, 119 FERC 61,295 at PP 882-885; *see also, e.g.*, *AEP Power Marketing, Inc.*, 109 FERC ¶ 61,276 at PP 18-29, 38-39 (2004) (reviewing updated market power analysis, requiring further analysis and change of status reporting), *order on reh'g*, 112 FERC ¶ 61,320 (2005), *aff'd sub. nom. Industrial Energy Users-Ohio v. FERC*, D.C. Cir. No. 05-1435 (Feb. 16, 2007) (unpublished).

Moreover, low-cost generators are not, as Attorney General submits, entirely "freed from regulation to charge whatever the market will bear." Br. at 26. Instead, all generators must abide by the market rules (Rehearing Order at 22, JA 348 (describing energy price caps)) and mitigation measures (Complaint Order at P

60, JA 296) approved by the Commission when it authorized the current structure of the New England market. *See New England Power Pool*, 100 FERC ¶ 61,287 at P 1 (accepting Market Rule 1 instituting, *inter alia*, Locational Marginal Pricing markets and Must Run contracts). The market power mitigation measures ensure that a generator's bids represent "what a profit-maximizing resource would offer if it had no market power." *Id*. at P 30; Complaint Order at PP 73-74, JA 302-03 (mitigation restricts bids to a measure of each generator's marginal costs). The Commission reevaluated the market structure in light of these market power mitigation measures, found that Attorney General failed to account for their impact on market rates, and concluded that the measures, along with select Must Run agreements, "help ensure that rates in Connecticut and New England remain just and reasonable." Complaint Order at P 74, JA 303; *see also* Rehearing Order at P 20, JA 347 (agency receives periodic reports assessing competitiveness of New England's market).

Finally, Attorney General has not pointed to any market circumstances in 2005 that were not anticipated by New England market participants or the agency when the Commission approved the market structure in 2002. The Commission's approval of Market Rule 1 established the current market structure that allows for generators with low marginal costs to recover revenues above these costs (at the level of the market clearing prices) in order to attract new efficient generators and

thus meet consumer demand for reliable supply. *See generally New England Power Pool*, 100 FERC ¶ 61,287; *see also* Complaint Order at PP 80-81, JA 306 (noting that revenues above an individual generator's marginal costs and insufficient transmission infrastructure do not validate "the elimination of the competitive market in Connecticut"). Market Rule 1 also allowed for cost-based Must Run contracts for higher-cost generators needed for reliability with those costs paid by the customers benefiting from assured reliability. *See New England Power Pool*, 100 FERC ¶ 61,287 at PP 47-62. The market structure of which Attorney General now complains was contemplated by the FERC in its approval of Market Rule 1, and it has not become unjust and unreasonable simply because more Must Run agreements than Attorney General originally contemplated are now (temporarily) in place. Further, as Attorney General recognizes, additional regulatory advancements, such as the termination of Peaking Unit Safe Harbor bidding, continue to improve the operation of the New England market in a direction favorable to Connecticut consumers. Br. at 16; *see also Connecticut Municipal Elec. Energy Coop. v. Milford Power Co., LLC*, 122 FERC ¶ 61,235 at PP 27-33 (2008) (on complaint of Attorney General and others, establishing settlement and hearing proceedings to determine the need for a Must Run contract prior to its 2010 expiration).

4. The Commission Reasonably Concluded that Concurrent Use of Cost-Based Recovery and Market Prices is Just and Reasonable

At its core, Attorney General's argument is a challenge to the concurrent use of two just and reasonable pricing mechanisms. It contends that the mere existence of a hybrid market structure, in which some generators have cost-based contracts for reliability services and others receive a market-based price for energy, is sufficient to prove unjust and unreasonable rates. Br. at 23. The Commission reasonably determined that, without more, two just and reasonable compensation methods do not result in unjust and unreasonable rates when combined in the same market. Complaint Order at P 57, JA 295 (Attorney General, as complainant, failed to meet its burden of demonstrating unreasonableness of multiple compensation methods); Rehearing Order at P 21, JA 347 (noting the lack of evidence of failure to enforce reporting requirements or any demonstration of market power to support claim). Based on evidence that New England's auction-based markets were functioning correctly and adequately mitigated against exercises of market power (Complaint Order at PP 78-81, JA 304-07), and that limited-term Must Run contracts were just and reasonable and necessary for reliable service to Connecticut consumers (*Id*. at P 74, JA 303), the Commission reasonably denied Attorney General's complaint.

The Commission disagreed that evidence of higher returns for low-cost generators was any indication that a "hybrid" market structure was unjust and unreasonable. *See supra* pp. 22-25 (discussing temporary nature of higher returns for generators). The Commission noted that the "units in question would have earned higher revenues during this period even without [Must Run] contracting, as these coal and nuclear units represent the lowest cost generation in the market." Complaint Order at P 77, JA 304. In a market like New England's with supply shortages, low-cost generators are price takers in many hours, benefiting from the price set in the market clearing price auction by natural-gas fired generators with higher marginal costs. *Id*. at P 79, JA 305. Finally, noting that other sellers' rate status – whether cost-of-service or market-based rates – is irrelevant to the Commission's approval of market-based rates for any individual seller (Rehearing Order at P 22, JA 347), the Commission reasonably upheld its initial finding that current rates in Connecticut remain just and reasonable. *See id*. at P 32, JA 352.

For comparison with earlier periods, the Commission reviewed available market price data for the period that Market Rule 1 was in effect, and reasonably determined that the data showed not only that the higher returns referenced by Attorney General are transient over the long term, but that the prices in earlier periods produced insufficient revenues to support generator entry. Complaint Order at P 79, JA 305 (referencing ISO New England reports on average market

prices between 2000 and 2005 and fixed cost recovery in 2003); *id*. at P 83, JA 307-08 (referencing ISO New England report showing market prices, adjusted for fuel costs, declined 11 percent from 2001 to 2004). Given this evidence, the Commission concluded that Attorney General was seeking to benefit from market prices when they were low and switch to cost-of-service rates when market prices rose. *Id*. at P 79, JA 305-06; *see also* Rehearing Order at P 33, JA 353 (noting that Attorney General did not dispute that cost-of-service rates would have been higher than market prices in several prior periods during New England's market operations).

Further, the Commission examined Attorney General's evidence of unreasonable rates and found that the return calculations were based on a "single point in time" and "numerous assumptions," and that projected customer savings, repeated by Attorney General on appeal (Br. at 28), were based on an incorrect future price assumption. Complaint Order at P 83, JA 307 (noting that Attorney General assumed an average market price $20/MWh higher than actual prices in 2006, an assumption that was off by almost 30 percent). Based on all of this evidence, the Commission reasonably could conclude that rates remain just and reasonable in Connecticut. *Id*. at P 72, JA 302; s*ee also Maine Pub. Utils. Comm'n*, 520 F.3d at 472-73 (upholding, in relevant part, the FERC's approval of settlement, over Attorney General's objection, establishing non-cost-based

transitional payments to generators, that were responsive to the parties' agreements and based on record evidence).

5. Attorney General's Additional Argument is Jurisdictionally Barred

On appeal, Attorney General raises a new argument concerning the exercise of market power through withholding that was neither raised in the initial complaint, nor on rehearing. As a result, this argument is jurisdictionally barred under 16 U.S.C. § 825*l*(b).

Attorney General argues for the first time that generators exercise market power by withholding their supply from the market in order to secure cost-based Must Run contracts. Br. at 11, 33. In its rehearing request to the Commission, Attorney General focused on market failure and only made a single passing reference to the exercise of market power by generators bidding pursuant to the Peaking Unit Safe Harbor mechanism. Attorney General Rehearing Request, R.40 at 12-13, JA 324-25 (arguing that generator operation under new bidding rules "reflects the exercise of unrestrained market power"); *see also* Rehearing Order at PP 27-29, JA 349-51 (addressing market power allegation); Br. at 16 (explaining that Peaking Unit Safe Harbor bidding was terminated and no longer at issue in this appeal). While Attorney General argued, on complaint and rehearing before the Commission, that the New England market structure was driving rates above reasonable levels, it failed to argue that generators, as a class or individually, were

withholding supply or violating market rules to raise market prices. *See, e.g.*, Complaint Order at P 57, JA 295 (noting that complaint "does not demonstrate that generators have exhibited any form of market power"); Rehearing Order at P 27, JA 349 (Attorney General "has not offered any specific evidence of withholding or any other demonstration of market power"). Because Attorney General failed to raise this argument with specificity before the Commission on rehearing, it is not properly before this Court. *See, e.g., Allegheny Power*, 437 F.3d at 1220 (noting that objections must be raised with specificity in a rehearing request before the Commission or they are waived on appeal).

In any event, Attorney General's allegation of withholding by generators to secure cost-based Must Run agreements and "forc[e] market prices upwards" (Br. at 34) is without merit. Generators cannot take independent action to secure Must Run agreements; rather, ISO New England must first determine the generator is needed for reliability and then the generator must meet the burden before the Commission of establishing financial need for the agreement. *See supra* p. 19. Furthermore, because Must Run agreements actually lower prices in New England's auction-based markets through submission of pre-determined marginal cost bids (Rehearing Order at P 22, JA 347 (Must Run generators are required to offer all of their capacity into the energy markets at their marginal cost)), generators cannot be raising market prices through the use of Must Run contracts.

B. The Commission Reasonably Found Attorney General Failed to Propose a Just and Reasonable Remedy

On appeal, Attorney General seeks to have the Commission modify Market Rule 1 and place all generators in Connecticut under cost-based Must Run contracts for an unspecified duration. Br. at 41. The scope of this remedy has narrowed with time. The relief requested was already limited to prospective remedies as originally requested by Attorney General and other complainants. *See* Complaint, R.1 at 33-35, JA 42-44. As discussed above, the Must Run contracts driving Attorney General's complaint will terminate in two years by the terms of the Forward Capacity Market settlement with the commencement of this new capacity market. *See Maine Pub Utils. Comm'n*, 520 F.3d at 470 (upholding, in relevant part, FERC orders accepting settlement). Attorney General's requested prospective remedy is now limited to a locked-in period ending in 2010 when the existing Must Run contracts expire.

In an FPA § 206 complaint, a complainant must show that its proposed replacement rates are just and reasonable and not unduly discriminatory. *See supra* p. 17. The Commission reasonably concluded that Attorney General failed to make this requisite showing. Complaint Order at P 57, JA 295-96.

The Commission found that the proposed remedy would unreasonably "restrain legitimate market revenues earned by some generators" (*Id*. at P 58, JA 296), without a corresponding finding that those generators had the ability to

exercise, or had in fact exercised, market power. *Id*. at P 79, JA 305. The Commission examined Attorney General's complaint and ISO New England market reports for evidence that the low-cost generators were violating bidding rules or bidding anti-competitively and, finding none, reasonably determined that these generators should retain their market-based rates. *Id*. Further, the Commission found that "mandating a switch to cost-of-service compensation stifles efficiency and creates tremendous regulatory uncertainty." *Id*. at P 85, JA 308. After examining the proposed remedy and comparing it with the Forward Capacity Market solution supported by most market participants and two of the parties to the complaint (later upheld by this Court in *Maine Pub. Utils. Comm'n*, over Attorney General's objection), the Commission reasonably found that implementation of the Forward Capacity Market, and concurrent termination of existing Must Run agreements, was the superior solution to the issues raised by Attorney General. *Id*. at P 87, JA 309-10.

Notably, the Connecticut Department of Public Utility Control ("Connecticut Department"), the entity charged with oversight of retail electricity rates for Connecticut customers (Connecticut Department Comments, R.22 at 2, JA 111), did not support the "Draconian step of cost-of-service treatment for every generator" in Connecticut. *Id*. at 7, JA 116. Indeed, the Connecticut Department and the FERC expressed similar concerns about the impact of the proposed blunt

cost-of-service remedy on Connecticut ratepayers. Complaint Order at P 85, JA 308-09. These concerns included the need for incentives to make much needed improvements to Connecticut's electric generation infrastructure, continued operation of "old, inefficient and extremely expensive" generators and barriers to entry erected by the cost-of-service contracts. R.22 at 5, JA 114.

III. The Commission's Decision Does Not Conflict with the FPA's Core Purposes

Attorney General argues generally that the Commission's decision not to order cost-based agreements for all generators in Connecticut conflicts with the primary purpose of the Federal Power Act, to protect customers from excessive rates. Br. at 24. The Court has recognized that "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.'" *Consolidated Edison Co. of New York, Inc. v. FERC*, 510 F.3d 333, 342 (D.C. Cir. 2007) (citations omitted). As explained above, the Commission concluded that the concurrent use of both cost-based Must Run agreements and market prices was producing just and reasonable prices in Connecticut that accurately reflected Connecticut's lack of investment in transmission infrastructure. The Commission explained that Must Run contracts were necessary in the short term precisely because they ensured the availability of generation

resources and thus system reliability, to the benefit of Connecticut consumers of electricity. Complaint Order at P 58, JA 296.

The Commission also concluded that Attorney General's proposed remedy of cost-of-service contracts for all generators in Connecticut would stifle efficiency and likely produce even greater supply imbalances in Connecticut. *Id*. at P 85, JA 308-09. The Commission also balanced short-term costs against long-term benefits, stating that:

> When market-based rates exceed cost-based rates, it is not market failure but rather a signal for the construction of new generation and/or transmission, as well as the implementation of demand-side solutions. Over time, addition of these new resources will drive the marginal costs to reliably serve load, and thus [Locational Marginal Prices], lower.

Id.; s*ee also Electricity Consumers*, 407 F.3d at 1240 (Commission acts within its discretion in balancing short-term costs against long-term benefits). On appeal, Attorney General misconstrues this statement by focusing on the alleged impossibility of new baseload generation entry (Br. at 36-38), to the exclusion of the other means of addressing supply inadequacies, *e.g.*, transmission infrastructure construction, programs to solicit and encourage customer response to prices, and increasing the efficiency of existing generators. *See* Rehearing Order at P 32, JA 352.

The Commission's explanation provides a reasoned basis for its decision not to modify New England's market structure. In these circumstances, the

Commission reasonably could conclude – agreeing with most market participants (but not Attorney General) – that the superior long-term solution for addressing inadequate service and supply shortages in New England was the comprehensive Forward Capacity Market settlement, recently upheld, in relevant respect, by this Court in *Maine Pub. Utils. Comm'n*.

CONCLUSION

For the foregoing reasons, the petition for review should be denied, and the Commission's orders should be upheld in all respects.

Respectfully submitted,

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Richard Blumenthal, Attorney General of Connecticut v. FERC **Docket Nos. EL05-150 *et al.***
D.C. Cir. No. 07-1130

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C)(i), I certify that the Brief of Respondent Federal Energy Regulatory Commission contains 8,662 words, not including the tables of contents and authorities, the certificates of counsel, or the addendum.

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