ORAL ARGUMENT IS NOT YET SCHEDULED

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

No. 06-1400

AES BEAVER VALLEY, LLC,
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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WASHINGTON, DC 20426

SEPTEMBER 14, 2007
FINAL BRIEF: NOVEMBER 5, 2007

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties

To counsel's knowledge, all parties and amici are as stated in the brief of AES Beaver Valley, LLC.

B. Rulings Under Review

The rulings under review appear in the following orders issued by the Federal Energy Regulatory Commission:

1. *PJM Interconnection, LLC and Duquesne Light Co., et al.,* Docket Nos. ER05-85, *et al.,* 109 FERC ¶ 61,299 (December 20, 2004), J.A. 176-183 and

2. *PJM Interconnection, LL and Duquesne Light Co., et al.,* Docket Nos. ER05-85, *et al.,* 117 FERC ¶ 61,145 (November 1, 2006), J.A. 272-280.

C. Related Cases

This case has not previously been before this Court or any other court and there are no related cases.

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Joel M. Cockrell
Attorney

September 14, 2007
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GLOSSARY

AES	AES Beaver Valley, LLC
AES-Duquesne Agreement or 1985 Contract	1985 point-to-point firm transmission agreement between AES and Duquesne
Allegheny	Allegheny Power and Allegheny Energy Supply
Commission or FERC	Federal Energy Regulatory Commission
Duquesne	Duquesne Light Company
FPA	Federal Power Act
Initial Order	*PJM Interconnection, L.L.C., and Duquesne Light Col.*, 109 FERC ¶ 61,299 (2004); J.A. 176-183
Mobile-Sierra Doctrine	*United Gas Pipe Line Co. v. Mobile Gas Services Corp.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956)
PJM	PJM Interconnection, L.L.C.
PURPA	Public Utility Regulatory Policies Act of 1978
QF	Qualifying Facility
Rehearing Order	*PJM Interconnection, L.LC., and Duquesne Light Co.*, 117 FERC ¶ 61,245 (2006); J.A. 272-280
RTO	Regional Transmission Organization

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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 OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission ("Commission" or "FERC") acted reasonably in refusing to abrogate a contract for the long-term firm transmission of electric power nine years early where the services now being received by AES Beaver Valley, LLC ("AES") are commensurate with the services AES originally bargained for under the contract.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutes and regulations are contained in Addendum A to this brief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

In 1985, three utilities entered into transactions for the generation, purchase and transmission of electricity. AES generated the electricity. Allegheny Power and Allegheny Energy Supply (collectively "Allegheny") purchased AES's electricity at wholesale for a 30-year term. Since AES is not interconnected to Allegheny's system, AES entered into a 30-year contract with Duquesne Light Company ("Duquesne"), the intervening utility, to transmit its electricity to Allegheny's system.

The arrangement continues to this day, with one modification. In the intervening years, the Commission encouraged utilities to form Regional Transmission Organizations ("RTOs"). One such RTO, in certain mid-Atlantic and Midwestern states, is PJM Interconnection, L.L.C. ("PJM"). Allegheny and Duquesne are members of PJM.

AES asserts that since Allegheny can now obtain network service from PJM to transmit electricity from AES's generating facility to points on Allegheny's system, AES's contract with Duquesne is unnecessary and

should be abrogated. The Commission, however, denied AES's request to abrogate the contract. *PJM Interconnection, L.L.C., and Duquesne Light Co., et al.*, 109 FERC ¶ 61,299 (2004) ("Initial Order"), R. 15 at P 22, J.A. 181.[1] The Commission, however, required Duquesne to demonstrate that, following its integration into PJM, AES would receive services commensurate with the services it has historically received. *Id.* AES sought rehearing. R. 18. J.A. 184-191.

On rehearing, the Commission first approved a settlement between Duquesne and AES which ensured that AES would continue to receive certain energy balancing and banking services. *PJM Interconnection, L.L.C. and Duquesne Light Co., et al.*, 117 FERC ¶ 61,145 (2006) ("Rehearing Order"), R. 36 at P. 12, J.A. 276. The Commission further found that Duquesne had demonstrated that AES will continue to receive the same transmission services it received prior to Duquesne's integration into PJM and, accordingly, reaffirmed its denial of AES's request to abrogate the contract. *Id.* at P 13, P 17, J.A. 277-278.

II. STATEMENT OF FACTS

This case deals with a 1985 contract for the transmission of electricity

[1] "R." refers to a record item. "J.A" refers to the Joint Appendix page number. "P" refers to the internal paragraph number within a FERC order.

from a Qualifying Facility ("QF"), as defined by the Commission under the Public Utility Regulatory Policies Act of 1978, Pub. L. 95-617, 92 Stat. 3117 ("PURPA"). Effective January 1, 2005, the transmitting utility, Duquesne, was integrated into PJM, a Regional Transmission Organization. Allegheny, the purchaser of the electricity, had previously been integrated into PJM's system. Since the issue here is whether the integration of Duquesne warrants abrogation of the 1985 AES-Duquesne Agreement, this brief first discusses the PURPA regulatory framework and the development of Regional Transmission Organizations.

A. Statutory and Regulatory Background

1. PURPA

Section 210 of PURPA, 16 U.S.C. § 824a-3, encouraged the development of cogeneration and small power production facilities. *American Paper Institute, Inc. v. American Electric Power Service Corp.,* 461 U.S. 402, 404-05 (1983); *FERC v. Mississippi,* 456 U.S. 742, 750 (1982). A cogeneration facility, such as that owned and operated by AES, produces both electric energy and some other form of useful energy, such as heat. *See* Section 3(18)(A) of the Federal Power Act ("FPA"), 16 U.S.C. § 796(18)(A). **"**Congress believed that increased use of [nontraditional] sources of energy would reduce the demand for traditional fossil fuels."

Mississippi, 456 U.S. at 750. Since it thought "traditional electricity utilities were reluctant to purchase power from, and sell power to, the nontraditional facilities," *id.*, Congress directed FERC to prescribe "rules requiring electric utilities to deal with qualifying cogeneration and small power production facilities." *American Paper Institute*, 461 U.S. at 405.

The Commission regulations implementing PURPA govern transactions between traditional utilities and nontraditional cogeneration and small power production facilities, designated as "Qualifying Facilities." Among other things, the Commission requires utilities to purchase electricity from, and to interconnect with, qualifying facilities. *See* 18 C.F.R. § 292.303. An electric utility obligated to purchase electricity from a qualifying facility may, if the qualifying facility agrees, transmit that electricity for sale to another utility. See 18 C.F.R. § 292.303(d).

2. The Advent of Regional Transmission Organizations

Section 201(b) of the FPA, 16 U.S.C. § 824(b), grants the Commission exclusive jurisdiction over the transmission and wholesale sale of electricity in interstate commerce. Historically, "electricity generation, transmission, and distribution for a particular geographic area were generally provided by and under the control of a single regulated utility. Sales of those services were 'bundled,' meaning consumers paid a single price for

generation, transmission, and distribution." *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1363 (D.C. Cir. 2004). "[C]ompetition among utilities was not prevalent." *New York v. FERC*, 535 U.S. 1, 5 (2002).

In 1996, the Commission "introduced electric utility companies operating under its authority to a brave new regulatory world with its vanguard Order No. 888."[2] *East Kentucky Power Cooperative v. FERC*, 489 F.3d 1299, 1301 (D.C. Cir. 2007). Therein, the Commission required utilities owning transmission facilities to guarantee all market participants non-discriminatory access to those facilities. *Midwest ISO*, 373 F.3d at 1363. Specifically, the Commission "required public utilities to 'functionally unbundle' their wholesale generation and transmission services by stating separate rates for each service in a single tariff and offering transmission service under that tariff on an open-access, non-discriminatory basis." *Id.* at 1364.

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[2] *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, FERC Stats. & Regs. ¶ 31,036 (1996), *order on rehearing*, Order No. 888-A. FERC Stats. & Regs. ¶ 61,048 (1997), *order on rehearing*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on rehearing*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part and rev'd in part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

The Commission also encouraged the development of multi-utility, regional systems. It believed that segmentation of the transmission grid among different utilities contributed to inefficiencies that impeded free market competition. By combining the segments and placing control of the grid in one entity, a Regional Transmission Organization, the Commission sought to overcome these inefficiencies and promote competition. *Id.* at 1364-65. *See also Regional Transmission Organizations,* Order No. 2000, FERC Stats. & Regs. ¶ 31,089 (1999), *on rehearing*, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (2000), petitions for review dismissed *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001) ("Order No. 2000") (codified at 18 C.F.R. § 35.34). As defined and approved by the Commission, a Regional Transmission Organization must possess certain characteristics and functional capabilities. In particular, it must be regional in scope, "have operational authority for all transmission facilities under its control," be the sole provider of transmission service over facilities it controls, and "have the sole authority to receive, evaluate and approve or deny all requests for transmission service." *Midwest ISO*, 373 F.3d at 1365.

B. The Facts of this Case

1. The AES-Duquesne Agreement

AES owns a cogeneration facility in Monaca, Pennsylvania which meets the test of a "Qualifying Facility." R. 12 at 4, J.A. 140. In 1985, AES entered into a 30-year contract to sell capacity and energy to Allegheny. To accommodate that sale, on August 28, 1985, AES and Duquesne entered into a 30-year transmission contract ("AES-Duquesne Agreement" or "1985 contract.") Under the 1985 contract, Duquesne provides firm transmission service for up to 135 megawatts ("MWs") of AES's Net Generation from Duquesne's interconnection with AES to Duquesne's interconnection with Allegheny and charges AES the contract rate. R. 25, J.A. 222. Allegheny then transmits the energy on its system to where it is needed. The contract ends December 31, 2016. *Id.* Moreover, in Section 7 of the contract, the parties established an energy balancing and banking service to accommodate fluctuations in electric generation at AES's facility. This service enables the actual output from AES's facility to be 11% more or less than the scheduled amount, with Duquesne either absorbing any excess output or making up any shortfall. R. 23 at 2-3, J.A. 203-204.

Following execution of the AES-Duquesne Agreement, Duquesne, on November 1, 1985, filed the contract with the Commission. No responsive

pleadings were filed. On December 26, 1985, the Commission, acting through delegated authority, accepted the uncontested contract for filing (unpublished order attached as Addendum B).

2. The Integration of Duquesne into PJM

PJM has operated since 1956 as a power pool, with a single control area and free-flowing transmission lines. *See FPL Energy Marcus Hook, L.P. v. FERC,* 430 F.3d 441, 442 (D.C. Cir. 2005); *Atlantic City Electric Co. v. FERC,* 295 F.3d 1, 5 (D.C. Cir. 2002). After issuance of Order Nos. 888 and 2000, PJM reorganized as a Regional Transmission Organization and adopted an open access tariff and a regional energy market. *See FPL Energy*, 430 F.3d at 442, *PJM Interconnection, LLC*, 101 FERC ¶ 61,345 (2002), *order on rehearing*, 104 FERC ¶ 61,124 (2003), *order on rehearing*, 105 FERC ¶ 61,123 (2003), *order on rehearing*, 109 FERC ¶ 61,067 (2004).

In 2001, Allegheny and PJM filed an application to integrate Allegheny into PJM. Allegheny proposed to transfer operational control of its jurisdictional transmission facilities to PJM. The Commission approved the request. *PJM Interconnection LLC and Allegheny Power*, 96 FERC ¶ 61,060 (2001). Thereafter, AES's power was transmitted from Duquesne's border with Allegheny through PJM network service. R. 10 at 3 n.3, J.A. 135.

This case commenced October 28, 2004, when PJM and Duquesne filed an application pursuant to Section 205 of the FPA, 16 U.S.C. § 824d, to integrate Duquesne into PJM effective January 1, 2005. R. 1 at 1, J.A. 1. On November 19, 2004, PJM and Duquesne filed a supplement identifying the AES-Duquesne Agreement as a grandfathered agreement that would remain in place following Duquesne's integration. R. 10 at 1-2, J.A. 133-134.

PJM and Duquesne stated that this pre-Order No. 888 transmission service would not be subject to any charges under the PJM tariff; instead, AES would continue to pay Duquesne under the terms of the AES-Duquesne Agreement. *Id.* at 2-3, J.A. 134-135. Nonetheless, PJM would schedule and direct the transmission service to move AES's power from its generating station to Allegheny. *Id.* at 3 n.3, J.A. 135.

AES filed an intervention and protest. R. 12, J.A. 140-159. It asserted that, following Duquesne's integration into PJM, AES would pay a duplicative, "pancaked" rate. *Id.* at 4, J.A. 143. AES argued that once both Duquesne and Allegheny fell within the footprint of the Regional Transmission Organization, Allegheny could arrange for PJM network transmission service from the source of the power, *i.e.*, the AES Generating Station, to its ultimate destination on Allegheny's system where the power

would be used. In AES's view, its rate would be unjust and unreasonable since two different entities (AES and Allegheny) would be paying a charge for transmission. *Id.* at 7, J.A. 146.

3. The Challenged FERC Orders

In its Initial Order, the Commission accepted and suspended the proposed tariff revisions, subject to refund and conditions. Initial Order at P 21, J.A. 181. The Commission denied AES's request to abrogate the AES-Duquesne Agreement. *Id.* at P 22, J.A. 181. The Commission recognized that AES pays Duquesne an agreed rate for firm transmission service which enables AES to have the energy output of its facility transmitted from its point of interconnection with Duquesne to Duquesne's border with Allegheny. *Id.* The Commission stressed that it has consistently held that "the integration of a utility into an RTO does not constitute a sufficient basis for abrogating a pre-existing service agreement, provided that the customer continues to receive service commensurate with the service to which it is entitled under that contract." *Id.* (footnote omitted). The Commission explained that, here, where AES will pay only its historic rate for its firm transmission service, AES is not entitled to abrogate its contract simply because Allegheny, its sales customer, "will pay network access charges under a separate agreement." *Id.* at 23, J.A. 182. The Commission required

Duquesne and PJM to demonstrate that, after Duquesne's integration into PJM, AES will receive service "commensurate with the service to which AES is entitled under the [AES-Duquesne] Agreement." Initial Order at P 25, J.A. 182.

AES sought rehearing. R. 18, J.A. 184-191. PJM and Duquesne made their required filing. R. 19, J.A. 192-201. Thereafter, AES and Duquesne entered into lengthy negotiations which led to the filing of a partial settlement with the Commission on May 3, 2006. R. 34, J.A. 245-271. The parties therein agreed to replace the physical balancing and banking agreement set forth in Section 7 of the AES-Duquesne Agreement with a financial arrangement under which AES will receive the financial equivalent of the amount of energy scheduled for a given hour and a bank and separate financial account will be established to reflect the difference between the amount of energy generated and the amount of energy scheduled. R. 34 at 11-13, J.A. 255-257. The issue of commensurate transmission service was left for the Commission to resolve. *Id.* at 2, J.A. 247.

On November 1, 2006, the Commission issued its Rehearing Order, J.A. 272-280. The Commission approved the partial settlement without modification. *Id.* at P 12, J.A. 276. It stressed that the financial energy

balancing and banking service agreed to in the settlement "ensures that AES will continue to receive the benefits of this service within the context of Duquesne's integration into PJM." *Id.*

The Commission then addressed AES's argument that the 1985 contract should be abrogated. The Commission reiterated that integration of a utility into a Regional Transmission Organization "does not constitute a sufficient basis for abrogating a pre-existing service agreement, 'provided that the customer continues to receive service commensurate with the service to which it is entitled under [its] contract.'" Rehearing Order at P 13, J.A. 277, quoting Initial Order at P 22, J.A. 181. The Commission acknowledged the argument that AES and Allegheny would be part of a single transaction chain, allegedly rendering the transmission service performed by Duquesne unnecessary from AES's standpoint. Rehearing Order at P 15, J.A. 277-278. But the Commission rejected this contention, reiterating that it has consistently ruled, when addressing the integration of new members into PJM, that existing point-to-point transmission service should not be abrogated. *Id.* at P 16, J.A. 278.

The Commission explained that AES will continue to receive the firm transmission service it contracted for under the AES-Duquesne Agreement. Rehearing Order at P 17, J.A. 278. It held that Duquesne was "entitled to

the benefits of its bargain." *Id.* at P 18, J.A. 278. The Commission stressed that it had determined in Order No. 888 that in implementing industry restructuring, "customers would not be permitted to cancel or reduce contract levels, because that would result in utilities under-recovering their costs-of-service and possibly shifting costs to other customers." *Id.* (footnote omitted). It explained that, in this case, permitting AES to abrogate its contract would "reduce Duquesne's revenue expectations and possibly shift costs to other Duquesne customers." *Id.* Accordingly, the Commission ruled that where Duquesne was prepared and able to honor its contract obligations, there was no basis for abrogating the 1985 contract. *Id.*

Finally, the Commission rejected AES's argument that, in refusing to abrogate the 1985 contract, it had failed to determine whether the contract should be judged under the "just and reasonable" standard of Sections 205 and 206 of the FPA, 16 U.S.C. §§ 824d and 824e, as AES claimed, or under the more restrictive *Mobile-Sierra* "public interest" standard.[3] The Commission ruled that "[r]egardless of which standard applies, AES has not demonstrated that an abrogation of the parties' agreement would be

[3] *See United Gas Pipe Line Co. v. Mobile Gas Services Corp.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). *See also, e.g., Atlantic City*, 295 F.3d at 13-15 (describing standards of review, including the *Mobile-Sierra* standard, applicable to existing contracts).

warranted where, as here, AES will continue to receive the service to which it is entitled under its agreement." Rehearing Order at P 22, J.A. 280.

SUMMARY OF ARGUMENT

AES seeks to abrogate the terms of its 1985 contract with Duquesne, nine years before the scheduled termination date, despite the fact that, as AES readily admits, it will continue to receive the services it contracted for: (1) transmission service from its plant to Duquesne's border with Allegheny; and (2) an energy balancing and banking service. AES's pretext for abrogating its contract is that Duquesne's act of joining PJM, a Regional Transmission Organization, enables Allegheny, another PJM member, to obtain the necessary network service to transmit energy from the AES plant to the point on Allegheny's system where the energy is needed. The Commission first ensured that AES will continue to receive services commensurate with those it bargained for under the 1985 contract. Only then did it reject AES's arguments, holding that it has consistently ruled that the integration of a utility into a Regional Transmission Organization does not constitute grounds to abrogate a pre-existing service agreement.

AES's first two contentions on appeal can be summarily rejected. Misreading the orders under review, AES asserts that the Commission has shielded the AES-Duquesne agreement from scrutiny under either the FPA

"just and reasonable" standard or the more restrictive *Mobile-Sierra* "public interest" standard. It then argues that the Commission should be required to review the 1985 contract under the "just and reasonable" standard. In point of fact, the Commission clearly explained in its Rehearing Order that under either review standard, abrogation of the 1985 contract was simply not warranted.

In reaching its substantive determination, the Commission correctly rejected AES's arguments, finding that AES will continue to receive the same services it bargained for in 1985. Furthermore, Duquesne will not sit idly by and merely collect a paycheck as AES suggests. First, Duquesne will still provide a valuable energy balancing and banking service to AES. Second, while PJM will schedule and direct the network service from the AES plant to Duquesne's border with Allegheny, the transmission of the energy still takes place over wires owned and maintained by Duquesne.

In short, the Commission rationally denied a request to abrogate the contracted-for transmission service because Duquesne is entitled to the benefits of the 1985 contract and, as AES does not deny, abrogation of that agreement would reduce Duquesne's revenue expectations and possibly shift costs to other customers. Finally, AES's argument that the Commission

reached a different result in two other cases is not sound, as those other cases are easily distinguishable on their facts.

ARGUMENT

I. STANDARD OF REVIEW

This Court reviews "FERC's orders by applying the Administrative Procedure Act's 'arbitrary and capricious' standard." *See* 5 U.S.C. § 706(2)(A); *Wisconsin Public Power Inc. v. FERC,* 493 F.3d 239, 256 (D.C. Cir. 2007); *Midwest ISO,* 373 F.3d at 1368. Under this deferential standard, this Court must affirm the Commission's orders so long as the agency has "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.,* 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States,* 371 U.S. 156, 168 (1962)); *Wisconsin Public Power,* 493 F.3d at 256.

The Commission's factual findings are treated as conclusive if they are supported by substantial evidence. *See* § 313(b) of the FPA, 16 U.S.C. § 825*l*(b). The substantial evidence standard "'requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.'" *Florida Municipal Power Agency v. FERC,* 315 F.3d 362, 365

(D.C. Cir. 2003) (quoting *FPL Energy Maine Hydro LLC v. FERC,* 287 F.3d 1151, 1160 (D.C. Cir. 2002)). Moreover, the burden "is on the petitioners to show that the Commission's choices are unreasonable and its chosen line of demarcation is not within a zone of reasonableness as distinct from the question of whether the line drawn by the Commission is precisely right." *Wisconsin Public Power,* 493 F.3d at 260, (quoting *ExxonMobil Gas Mktg. Co. v. FERC,* 297 F.3d 1071, 1084 (D.C. Cir. 2002) (internal quotation marks omitted).

As explained below, the Commission's determination not to abrogate the AES-Duquesne Agreement was reasonable, responsive to the arguments made by AES, and supported by substantial evidence in the record.

II. THE FIRST TWO ISSUES RAISED BY AES, CONCERNING THE STANDARD FOR CONTRACT ABROGATION, ARE BASED ON A MISREADING OF THE COMMISSION'S ORDERS

AES seeks review of three issues. First, it asserts (Brief at 3, 14) that by "grandfathering" the AES-Duquesne Agreement, the Commission rendered that contract "exempt from scrutiny" under either the FPA just and reasonable standard or the *Mobile-Sierra* public interest standard. Second, AES argues (Brief at 4, 14-16) that if the contract is not exempt from scrutiny, it should be reviewed under the just and reasonable standard. Finally, AES asserts (Brief at 4, 17-20) that if the just and reasonable

standard applies, this Court should abrogate the 1985 contract and set the contract rate to zero since Duquesne, allegedly, is no longer providing the services it contracted to provide.

AES's first two arguments should be summarily rejected. Contrary to AES's argument (Brief at 14), the Commission did not shield the AES-Duquesne Agreement from scrutiny by affording it grandfathered status. Rather, the Commission explicitly ruled in its Rehearing Order that "[r]egardless of which standard applies, AES has not demonstrated that an abrogation of the parties' agreement would be warranted where, as here, AES will continue to receive the service to which it is entitled under its agreement." Rehearing Order at P 22, J.A. 280. *See, e.g.*, *Save Our Sebasticook v. FERC*, 431 F.3d 379, 381 (D.C. Cir. 2005) (the rehearing requirement "enables the Commission to correct its own errors, which might obviate the need for judicial review, or to explain why in its expert judgment the party's objection is not well taken, which facilitates judicial review").

In short, the Commission plainly told AES that applying the review standard most favorable to it – the just and reasonable standard -- AES is not entitled to the relief it seeks. Indeed, the Commission's analysis tracks precisely the type of analysis AES is seeking under the just and reasonable standard. As AES correctly points out (Brief at 16), the just and reasonable

standard set forth in Section 205(d) of the FPA, 16 U.S.C. § 824d(d), obligates the Commission to consider changes in "rates, charges, classification or service" to ensure that "the new rate, charge, classification or service was just and reasonable."

The alleged change advanced by AES (Brief at 17-20) is a change in the services Duquesne will provide AES after integration into PJM. The Commission specifically examined those services in its orders here. Thus, the Commission, in its Initial Order, stated that it would not abrogate a pre-existing service agreement, "provided that the customer continues to receive *service commensurate* with the *service* to which it is entitled under that contract." Initial Order at P 22, J.A. 181 (emphasis added) (footnote omitted). At the same time, the Commission charged PJM and Duquesne with demonstrating that AES, after Duquesne's integration, would still receive the services to which it was entitled under the contract.

On rehearing, the Commission again examined the quality of the services AES would receive after Duquesne's integration into PJM. It first accepted, without modification, a settlement between AES and Duquesne that will provide AES with a financial energy balancing and banking service

that will allow AES to "continue to receive the benefits of this service."[4] Rehearing Order at P 12, J.A. 276. Next, the Commission found that "AES will continue to receive firm transmission service under the AES Agreement." Rehearing Order at P 17, J.A. 278.

In short, the Commission did not exempt the AES-Duquesne Agreement from scrutiny. Instead, it applied the review standard most favorable to AES and still found its arguments wanting.

III. THE COMMISSION REASONABLY DECLINED TO ABROGATE THE AES-DUQUESNE AGREEMENT SINCE AES WILL CONTINUE TO RECEIVE SERVICES COMMENSURATE WITH THOSE IT CONTRACTED TO RECEIVE UNDER THE AGREEMENT

As discussed, in this case, the Commission, applying the review standard most favorable to AES, found that there was no basis for abrogating the longstanding AES-Duquesne Agreement since AES will receive all of

[4] In its recitation of the facts, AES seems to assert (Brief at 11) that although the energy balancing and banking settlement was "acceptable" to it, the services to be provided after Duquesne's integration into PJM will not be "as beneficial to AES as the original balancing and banking arrangement." AES does not advance this contention elsewhere in its brief, or otherwise explain the deficiency. If AES is attempting to challenge the substance of the Commission's approval of the settlement, it is statutorily barred from doing so because it failed to preserve its rights by filing for rehearing with the Commission. *See* FPA Section 313(a), 16 U.S.C. § 825*l*(a). *See also, e.g., California Dep't of Water Resources v. FERC,* 306 F.3d 1121, 1125 (D.C. Cir. 2002); *ASARCO, Inc. v. FERC,* 777 F.2d 764, 774 (D.C. Cir. 1985).

the services it has historically received. Rehearing Order at P 17, J.A. 278. AES concedes this point, first admitting (Brief at 11) that it reached an "acceptable" settlement with Duquesne regarding the balancing and banking services and then further admitting (Brief at 12) that the transmission services it receives under the agreement "did not change" after Duquesne's integration into PJM. In short, the electricity AES generates at its plant will still be transmitted to Duquesne's interconnection with Allegheny, and from there to the point on Allegheny's system where the electricity is needed.

Focusing on the identify of the provider of that service, now that both Duquesne and Allegheny fall within the footprint of a Regional Transmission Organization, AES asserts (Brief at 18) that Allegheny can now arrange for network services and have PJM schedule and direct the electricity from the AES generation facility to points on the Allegheny system. AES reasons that since the same services Duquesne contracted to provide in 1985 can now be provided by PJM through network transmission, the 1985 contract should be abrogated so that AES does not have to pay for transmission service necessary to accommodate its sales to Allegheny. There are multiple problems with this analysis.

A. Duquesne Still Performs Necessary Functions To Transmit AES's Power After Its Integration Into PJM

First, AES wholly misunderstands the purpose and function of a Regional Transmission Organization like PJM. In Order No. 2000, *see supra* page 7, the Commission explained that when a public utility like Duquesne joins an RTO, that utility transfers operational control of its transmission facilities to the RTO. 18 C.F.R. § 35.34(f). Here, exercising that control, PJM schedules and directs the network to transmit electricity from AES's generating plant to the point on Allegheny's system where the electricity is needed.

However, AES is incorrect in stating (Brief at 17) that Duquesne plays no role in providing the services covered by the 1985 contract "except sending out invoices and recording the transfers of money into its account." First, Duquesne will continue to provide the balancing and banking services contemplated under the contract. *See,* Rehearing Order at P 12, J.A. 276. Second, while PJM will schedule and direct transmission from AES to Allegheny at no network charge to AES, physical control of the first leg of the service will remain in Duquesne's hands since the service still takes place over wires owned and maintained by Duquesne. *See*, *e.g.*, *PJM Interconnection,* 96 FERC at 61,212 (physical control of transmission assets remains with transmission owners); *Pennsylvania-New Jersey-Maryland*

Interconnection, 103 FERC ¶ 61,170 at 61,632 n. 28 (2003) ("the transmission owner may be the entity that 'physically throws the switch'").

At bottom, Duquesne will perform necessary functions to ensure that electricity generated at AES's facility reaches its destination. As the Commission stated, "Duquesne is prepared and able to honor its contractual obligations." Rehearing Order at P 18, J.A. 278. *See also, Atlantic City,* 295 F.3d at 11 (PJM transmission owners retain "physical control of their facilities") and 13 (while PJM exercises supervision over scheduling and dispatching, transmission owners "make decisions about the operational control of their facilities on a regular basis" though a variety of means).

B. The Commission Will Not Abrogate Transmission Contracts When The Power Transmitter Joins A Regional Transmission Organization So Long As Customers Receive Commensurate Service

The Commission has consistently held that "it would not terminate a transmission service contract simply because a party to that contract could also avail itself of another transmission arrangement covering the transmission need at issue." Rehearing Order at P 14, J.A. 277. Indeed, in its order accepting earlier filings as part of the PJM restructuring, the Commission addressed this issue. *Potomac Electric Power Co.,* 83 FERC ¶

61,162 at 61,688-89 (1998).[5] There, PECO Energy Company had a bilateral, pre-PJM restructuring transmission agreement with American Ref-Fuel of Delaware County, L.P., to transmit the output of its PURPA Qualifying Facility to Atlantic City Electric Company. The latter two parties requested that the Commission direct PECO to eliminate its contractual transmission charge now that network transmission service is available on the PJM system. 83 FERC at 61,688.

The Commission rejected that request, ruling that it only modifies existing bilateral transmission agreements to prevent customers from paying multiple charges, such as "taking transmission service from more than one RTO under a series of bilateral agreements or by taking service under a bilateral agreement as well as under the PJM tariff." *Id.* at 61,688-89. The Commission concluded that the transmission customer was paying for only one transmission service and that there was no basis for treating different parties in a transaction chain as if they were one. *Id.* at 61,689.

[5] *Potomac Electric Power Co.*, 83 FERC ¶ 61,162 at 61,688-89 (1998), *order on rehearing*, 93 FERC ¶ 61,111 at 61,314-15 (2000), *rev'd in part on other grounds, Atlantic City Electric Co. v. FERC*, 295 F.3d 1 (D.C. Cir. 2002). Duquesne cited this line of FERC authority in its initial response to AES's protest, R.13 at 3-4, J.A. 162-163, and the Commission cited it in support of its decision in both the Initial Order (at P 23, J.A. 182) and the Rehearing Order (at P 14, J.A. 277).

Here, the Commission noted that, since *Potomac Electric,* it has consistently denied requests for the abrogation of long-term point-to-point transmission contracts on PJM where "the customer continues to receive service commensurate with the service to which it is entitled under that contract." Initial Order at P 22, J.A. 181. *See PJM Interconnection, L.L.C.*, 106 FERC ¶ 61,253 at P 40-41 (2004) (PJM should either provide its customers with firm transmission rights for a comparable level and term or explain why the Commission should not give existing customers the opportunity to terminate their existing firm reservations); *PJM Interconnection, L.L.C.,* 108 FERC ¶ 61,246 at P 32-33 (2004) (customers can terminate long-term point-to-point contracts only when they are unable to obtain firm transmission rights commensurate with their previous contracts); *PJM Interconnection, L.L.C.*, 109 FERC ¶ 61,012 at P 55-57 (2004) (pre-existing contracts not abrogated).

The Commission reiterated that position in this case. It emphasized that "AES will continue to receive its firm transmission service under the AES agreement, including those rights as implemented pursuant to the partial settlement approved here." Rehearing Order at P 17, J.A. 278. Moreover, the Commission concluded that Duquesne was entitled to the benefits of its 1985 bargain. *Id.* at P 18, J.A. 278. FERC explained that, in

Order No. 888, it had determined that "customers would not be permitted to cancel or reduce contract levels, because that would result in utilities under-recovering their costs-of-service and possibly shifting costs to other customers." *Id.* (citing Order No. 888, FERC Stats. and Regs. ¶ 31,036 at 31,663-64). The Commission found that, in this case, "permitting AES to terminate its contract would serve to reduce Duquesne's revenue expectations and possibly shift costs to other customers." *Id.*

In response, AES asserts (Brief at 18), without support, that the Commission's position has no statutory basis. However, the Commission fully explained why the rate charged AES under the AES-Duquesne Agreement satisfies the statutory just and reasonable standard of review. First, the Commission has consistently held that it will not abrogate pre-Order No. 888 point-to-point transmission service when transmission utilities join Regional Transmission Organizations, so long as transmission customers are afforded commensurate service and are not paying twice for that service. Similarly, AES will receive commensurate service after Duquesne's integration into PJM, both with respect to the transmission service and the energy balancing and banking service. Rehearing Order at P13-18, J.A. 277-278. Finally, AES does not challenge the Commission's

reasoning that abrogation of the contract will reduce Duquesne's revenue expectations and possibly shift costs.

C. The Commission Orders Relied On By AES Are Consistent With The Holding In This Case

AES's final argument (Brief at 18-20) is that even if the Commission is relying on *Potomac Electric*, that holding is inconsistent with two subsequent orders. Those orders are *Ameren Servs. Co.*, 105 FERC ¶ 61,216 (2003) (*"Ameren")*, and *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,168 (2004) (*"Midwest").* In actuality, these cases are factually different from *Potomac Electric* and the instant case and thus lend no support to AES.

As the Commission pointed out here, Rehearing Order at P 20, J.A. 279, the policy goal at issue in *Midwest* and *Ameren* – dealing with seams between two Regional Transmission Organizations – was not at all at issue in the instant case. Rather, *Midwest* and *Ameren* deal with rate design underlying open access tariffs of two RTOs and individual non-RTO members in the same regions. *Id. Potomac Electric* and the instant case deal with the wholly separate question of the proposed abrogation of contracts for point-to-point transmission service entirely within a single RTO. *Id.*

Moreover, the remedy sought by AES in this case -- the abrogation of a contract the parties had entered into well before Order No. 888 – was not at all an issue in either *Midwest* or *Ameren.* Thus, as the Commission pointed out, in neither *Midwest* nor *Ameren* did it "modify the rates, terms, or conditions of transmission service under grandfathered transmission service agreements such as the contract AES proposes to modify here." *Id.* at P 19-20, J.A. 278-279.

AES fails to confront these differences. Contrary to its claim (Brief at 19-20), there is no improper "pancaking" of rates in either *Potomac Electric* or this case. AES will pay the same rate it has always paid under the 1985 contract and, in return, it will receive the same services. AES's argument (Brief at 20) that its rate before Duquesne's integration "might" have been unjust and unreasonable is pure speculation since it never made that claim nor ever asserted that it has had to pay "pancaked" rates for this service. Most critical to its case, AES cannot point to another case in which the Commission has successfully abrogated an existing point-to-point transmission contract where the customer is receiving the same services. *See Atlantic City*, 295 F.3d at 15 (overturning a FERC effort to modify a contract executed prior to PJM restructuring and reminding the agency to "not take contract modification lightly," especially where the case "involves

little more than a party to a contract seeking to avail itself of a lower rate than it was entitled to under the terms of its original agreement").

CONCLUSION

For the reasons stated herein, the petition for review should be denied and the challenged Commission orders should be affirmed in all respects.

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