

ORAL ARGUMENT IS NOT YET SCHEDULED

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

Nos. 06-1403, 06-1427 and 07-1193

**MAINE PUBLIC UTILITIES COMMISSION, RICHARD BLUMENTHAL,
ATTORNEY GENERAL FOR THE STATE OF CONNECTICUT, AND
MARTHA COAKLEY, ATTORNEY GENERAL FOR MASSACHUSETTS,
PETITIONERS,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

**ON PETITIONS FOR REVIEW OF AN ORDER OF THE
FEDERAL ENERGY REGULATORY COMMISSION**

**BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

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**FOR RESPONDENT
FEDERAL ENERGY REGULATORY
COMMISSION
WASHINGTON, D.C. 20426**

DECEMBER 31, 2007

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. *Devon Power LLC*, 115 FERC ¶ 61,340, R.1129, JA 2019 (2006) (“Settlement Order”).
2. *Devon Power LLC*, 117 FERC ¶ 61,133, R.1149, JA 2357 (2006) (“Settlement Rehearing Order”).
3. *ISO New England Inc. and New England Power Pool*, 117 FERC ¶ 61,132, R.1197, JA 2381 (2006).
4. *ISO New England Inc. and New England Power Pool*, 119 FERC ¶ 61,044, R.1203, JA 2388 (2007).

C. Related Cases:

The Federal Energy Regulatory Commission orders under review in these consolidated appeals accepted a contested settlement agreement establishing a new market for electric generating capacity in New England, the Forward Capacity Market.

In two subsequent orders, the Commission ruled on tariff filings made by ISO New England, Inc. to implement the settlement agreement. Those orders are currently under review in *HQ Energy Services (U.S.) Inc. and Brookfield Energy Marketing, Inc. v. FERC*, Case Nos. 07-1379 and 07-1380 (consolidated). On

November 27, 2007, the Court issued an order holding Case Nos. 07-1379 and 07-1380 in abeyance, pending the outcome of the instant appeals.

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December 31, 2007

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GLOSSARY

ALJ	Administrative Law Judge
Commission or FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
Industrial Customers	Intervenors Industrial Energy Consumer Group, NSTAR Electric & Gas Corporation and NEPOOL Industrial Customer Coalition
Initial Decision	<i>Devon Power LLC, et al.</i> , 111 FERC ¶ 63,063 (2005), JA 1185
ISO	Independent System Operator
JA	Joint Appendix
NEPOOL	New England Power Pool
Non-Settling States	Petitioners Maine Public Utilities Commission, Richard Blumenthal, Attorney General for Connecticut, and Martha Coakley, Attorney General for Massachusetts
R.	Record Citation
Settlement Order	<i>Devon Power LLC</i> , 115 FERC ¶ 61,340 (2006), JA 2019
Settlement Rehearing Order	<i>Devon Power LLC</i> , 117 FERC ¶ 61,133 (2006), JA 2357

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**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

**ON PETITIONS 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 (“FERC” or “Commission”) reasonably approved a contested settlement resolving long-running proceedings addressing flaws in New England’s installed capacity markets, and, in so doing, reasonably addressed objections to portions of the settlement based on substantial evidence.

COUNTERSTATEMENT OF JURISDICTION

As explained more fully *infra* (see pp. 50-53, 59), certain arguments raised by Petitioners and Intervenors were not presented to the Commission, and thus should be rejected pursuant to 16 U.S.C. § 825l(b).

STATUTES AND REGULATIONS

The relevant statutes and regulations are contained in the Addendum to this brief.

STATEMENT OF THE CASE

These consolidated cases concern the Commission's acceptance of a contested settlement agreement establishing a new market for installed electric generation capacity in New England.

For many years, the Commission has been addressing deficiencies in New England's installed capacity market. In 2003, the Commission established the proceedings underlying this appeal in response to the filing of utility-specific cost-of-service Reliability Must-Run contracts. FERC expressed concerns about the negative impact such contracts have on the region's competitive wholesale energy and capacity markets. To address these concerns, the Commission directed ISO New England, Inc., the independent system operator of the multi-state electrical grid in New England, to file revisions to its market rules.

ISO New England responded in 2004 by filing a proposed locational installed capacity market design. The Commission agreed with the broad outlines of ISO New England's proposal, but set the majority of it for hearing procedures. Following those hearing procedures, the administrative law judge issued an Initial Decision adopting a final market design that proved to be controversial, attracting opposition from many parties, including the New England States themselves.

To address the concerns of the States and other parties, the FERC Commissioners directly heard a full day of oral arguments. Following the oral arguments, the Commission established settlement procedures, facilitated by an ALJ, to give the region an opportunity to reach agreement on an alternative to the locational installed capacity market.

The result of those procedures was the settlement agreement at issue here, which was supported or not opposed by 107 of the 115 parties participating in settlement talks. The settlement described a new market design, the Forward Capacity Market, as an agreed-upon alternative to the locational installed capacity market proposal. The settlement also included a transition mechanism, to address the approximately three-year period between its effective date and the start of the new market.

As discussed in more detail below, in the orders on review, the Commission accepted the settlement, concluding that, as a package, it presented a just and

reasonable outcome that resolved the deficiencies in New England’s capacity markets. In accepting the settlement, the Commission addressed several objections raised by parties contesting the agreement, particularly with regard to the transition mechanism. *See Devon Power LLC*, 115 FERC ¶ 61,340 (2006), JA 2019 (“Settlement Order”), *order on reh’g*, 117 FERC ¶ 61,133 (2006), JA 2357 (“Settlement Rehearing Order”); *see also ISO New England Inc. and New England Power Pool*, 117 FERC ¶ 61,132 (2006), JA 2381, *order on reh’g*, 119 FERC ¶ 61,044 (2007), JA 2388 (accepting filing to implement transition mechanism).

STATEMENT OF FACTS

I. Statutory and Regulatory Background

Under Section 201(b) of the Federal Power Act (“FPA”), 16 U.S.C. § 824(b), the Commission has exclusive jurisdiction to regulate the transmission and sale at wholesale of electric energy in interstate commerce. 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 and terms of service, along with 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. The Commission may also institute investigations

of existing rates and services on complaint or on its own motion. *See* FPA § 206(a), 16 U.S.C. § 824e(a).

Historically, electric utilities were vertically integrated monopolies that owned electric generating facilities, transmission lines and distribution systems, and sold all of these services as a “bundled” package to their customers. *See Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1363 (D.C. Cir. 2004) (describing the historic structure of the electric utility industry). In recent years, however, the generation, transmission and distribution functions have become increasingly “unbundled,” leading to an increase in competitive markets for the sale of electric energy. *See New York v. FERC*, 535 U.S. 1, 5-14 (2002) (describing technological advances and legislative initiatives promoting competitive wholesale electric markets).

To foster the further development of competitive markets, the Commission issued Order No. 888, which directed utilities to offer non-discriminatory, open access transmission service.¹ To implement this directive, the Commission

¹ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs., Regs. Preambles ¶ 31,036 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1997), *order on reh’g*, Order No. 888-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,048, *order on reh’g*, Order No. 888-B, 81 FERC ¶ 61,248, *order on reh’g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff’d 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).

ordered “functional unbundling,” which required each utility to state separate rates for its wholesale generation, transmission and ancillary services, and to take transmission service used to transmit its own wholesale sales and purchases on a non-discriminatory basis under the same terms provided to others. *See New York*, 535 U.S. at 11.

As a potential means to accomplish the Commission’s open access goals, Order No. 888 encouraged, but did not direct, the formation of independent system operators (“ISOs”) to operate regional, multi-system transmission grids. *See* Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,730-32 (announcing certain principles to guide future consideration of ISO proposals).

After gaining experience with initial ISO proposals, the Commission issued Order No. 2000, which encouraged the formation of Regional Transmission Organizations (“RTOs”) to address regional reliability concerns and foster wholesale competition over broader geographic areas.² Order No. 2000 announced certain minimum characteristics and functions of an RTO. It also directed all transmission-owning utilities to make filings proposing to participate in an RTO or explaining their efforts to participate in an RTO. Order No. 2000 further directed

² *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs., Regs. Preambles ¶ 31,089 (1999), *order on reh’g*, Order No. 2000-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2000), *appeals dismissed sub nom. Public Utility District No. 1 of Snohomish County v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

the utility members of a Commission-approved ISO to make filings showing that the ISO meets the minimum characteristics and functions of an RTO.

II. Formation and Development of ISO New England

Utilities in New England have a long history of coordinated region-wide operation. In 1971, the New England Power Pool (“NEPOOL”) was formed. NEPOOL operated the bulk electric power system for the entire New England region, centrally dispatching generating units and transmission facilities to serve the load of the various utilities in the region. *See, e.g., New England Power Pool*, 79 FERC ¶ 61,374 at 62,576 (1997).

In 1996 and 1997, NEPOOL filed a comprehensive restructuring proposal in compliance with the requirements of Order No. 888. As part of that proposal, NEPOOL sought approval to establish an ISO, to which it would transfer operational control of the New England bulk electric power system. Additionally, *inter alia*, NEPOOL proposed that the new ISO would administer the NEPOOL open access transmission tariff. NEPOOL also proposed the development of competitive wholesale electricity markets in New England and the use of market-based rates. The Commission accepted these proposals in various orders issued between 1997 and 1999. *See id., 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

open-access transmission tariff); *New England Power Pool*, 85 FERC ¶ 61,379 (1998), *reh'g denied*, 95 FERC ¶ 61,074 (2001); *see also New England Power Pool*, 87 FERC ¶ 61,045 (1999) (approving market rules and request for market-based rates). FERC later approved a comprehensive redesign of the New England wholesale electricity markets. *See New England Power Pool and ISO New England, Inc.*, 100 FERC ¶ 61,287 (2002).

In 2003, ISO New England and New England's transmission-owning utilities jointly filed a request for approval to reorganize their arrangements to establish the ISO as an RTO pursuant to Order No. 2000. The Commission approved the RTO proposal in 2004. *ISO New England Inc. et al.*, 106 FERC ¶ 61,280, *order on reh'g*, 109 FERC ¶ 61,147 (2004), *aff'd, Maine Pub. Utils. Comm'n v. FERC*, 454 F.3d 278 (D.C. Cir. 2006).

III. History and Development of the Installed Capacity Requirement and Installed Capacity Markets in New England

For many years, NEPOOL, and now ISO New England, have established installed capacity requirements as a “first line reliability measure to cover electric load.” *ISO New England, Inc.*, 91 FERC ¶ 61,311 at 62,080 (2000); *see also Settlement Order at P 4, JA 2019*. Such requirements obligate load-serving utilities in a power pool (and later in ISOs and RTOs) to acquire a specific amount of capacity based on their peak load, plus a reserve margin. *Id.* As the Commission noted in 2000:

A utility with load responsibility needed to have electric plant to serve [its] load. If a utility had an [installed capacity] deficiency, it could either obtain its requirements from an entity having a surplus or be subject to a deficiency charge from the pool. The pool charge for deficiencies was generally determined on the basis of the regulated cost of the electric facilities.

ISO New England, Inc., 91 FERC at 62,080; *see also Municipalities of Groton v. FERC*, 587 F.2d 1296, 1300-01 (D.C. Cir. 1978) (describing installed capacity mechanism then in effect in NEPOOL). The amount of capacity each load-serving utility must purchase is a portion of the total installed capacity requirement, which is ISO-NE's calculation of the minimum amount of generation needed to reliably serve load. *See Conn. Dep't of Pub. Util. Control v. FERC*, 484 F.3d 558, 559-60 (D.C. Cir. 2007).

Until 1998, load-serving utilities who failed to satisfy their installed capacity requirements were subject to a deficiency charge, set by NEPOOL. *Id.* The installed capacity requirements were retained when ISO-NE was formed in 1998, but the single deficiency charge was replaced with a bid-based market for capacity, with market prices capped at the deficiency charge. *See New England Power Pool*, 83 FERC at 61,262-63.

Following separate proceedings in 2000 and 2002 addressing, *inter alia*, the structure of the installed capacity mechanism, New England ultimately adopted the auction mechanism that existed at the time the instant proceedings began. *See ISO New England, Inc.*, 91 FERC at 62,080-81 (order eliminating bid-based capacity

auction and returning to single deficiency charge); *Central Maine Power Co. v. FERC*, 252 F.3d 34, 38-40 (1st Cir. 2001) (discussing same); *New England Power Pool*, 100 FERC ¶ 61,287 at PP 88-98 (order reinstating bid-based capacity auction, as part of comprehensive redesign of New England electricity markets). Under that mechanism, modeled after the system then in place in New York, ISO New England administered both a monthly auction, to allow participants to procure capacity to meet their requirement for the next month, and a separate deficiency auction, through which ISO New England would procure capacity for those who did not satisfy their monthly requirement by a specified time. *New England Power Pool*, 100 FERC ¶ 61,287 at P 91.

IV. Underlying FERC Proceedings

The specific proceedings on review here began in early 2003 when a group of generators in Connecticut filed Reliability Must-Run agreements with the Commission. *See* Filing of Devon Power LLC *et al.*, R.1, JA 198. ISO New England has authority under its tariff to enter into such contracts with financially-troubled units that are needed to maintain reliability, and would otherwise be shut down or retired. *See* ISO-NE FERC Electric Tariff No. 3, Market Rule 1, Section III, Appendix A, Exhibit 2, Section 2 (current rules for negotiating agreements with units needed for reliability); *see also* *New England Power Pool*, 100 FERC ¶ 61,287 at P 47.

The agreements filed in the instant proceedings covered 1,728 megawatts (MW) of generating capacity, most of which was located within Southwest Connecticut, an area with severe and well documented electric transmission constraints. *See* Filing of Devon Power LLC *et al.*, JA 198. The applicants contended that they could not recover sufficient revenues in the market to maintain their generating units, but were required to stay in operation to support reliability. *Id.* at 3-7, JA 200-204.

In an April 25, 2003 order, the Commission rejected the reliability agreements and denied the generators' request to recover their full cost of service, but did allow them to recover certain maintenance costs on a going-forward basis. *See Devon Power LLC et al.*, 103 FERC ¶ 61,082, JA 522, *order on reh'g*, 104 FERC ¶ 61,123 (2003), JA 531. In rejecting the agreements, the Commission expressed concern about the effect that the widespread use of such contracts would have on the competitive wholesale electric market. *See Devon Power*, 103 FERC ¶ 61,082 at PP 29-31, JA 526-27.

To address those concerns, the Commission instituted proceedings under FPA § 206, 16 U.S.C. § 824e, to revise the New England market rules to address the compensation problems faced by electric capacity suppliers in the region. *Id.* at PP 33-37, JA 527; *see also order on reh'g*, 104 FERC ¶ 61,123 at PP 33-34, JA 535 (clarifying institution and scope of proceedings under FPA § 206). The

Commission directed temporary short-term measures intended to provide suppliers of capacity with a better opportunity to recover revenues. *Devon Power*, 103 FERC ¶ 61,082 at PP 33-34, JA 527. FERC also directed that ISO New England file, by March 1, 2004, a permanent mechanism to “implement[] location or deliverability requirements” in the installed capacity market so that generators providing capacity in areas with transmission congestion “may be appropriately compensated for reliability.” *Id.* at P 37, JA 527; *see also New England Power Pool*, 100 FERC ¶ 61,287 at P 101 (discussing location requirements).

A. ISO New England’s Proposed Capacity Market Redesign and the Commission’s Response

In response to the Commission’s directive, ISO New England filed a proposal to redesign the wholesale capacity market, and in particular to establish a locational installed capacity market. *See Compliance Filing of ISO New England Inc.*, FERC Docket No. ER03-563-030, R.70, JA 545.

Under that proposal, four separate installed capacity sub-regions would have been established within New England, each with separate requirements and a separate auction to price the installed capacity product. *See Devon Power LLC, et al.*, 107 FERC ¶ 61,240 at PP 9-10 (2004), JA 827-28. Further, ISO New England proposed to use a downward-sloping demand curve in monthly capacity auctions, instead of the vertical demand curve created by the deficiency charge, to establish the price and amount of capacity that must be procured in each sub-region for the

following month. *Id.* at PP 10-13, JA 828-29. This proposed demand curve was similar to that considered and affirmed by this Court for use in New York. *See Electricity Consumers Res. Council v. FERC*, 407 F.3d 1232, 1234-35 (D.C. Cir. 2005) (describing the vertical demand curve created by a fixed deficiency charge and the mechanics of a downward-sloping demand curve).

The Commission addressed ISO New England's proposal in a June 2, 2004 order. *Devon Power*, 107 FERC ¶ 61,240, JA 826. While the Commission expressed agreement with some of the broad outlines of the locational installed capacity market proposal, it set the majority of the proposal for hearing procedures before an administrative law judge, and also set a portion of the proposal for a paper hearing directly before the Commission. In particular, the Commission agreed that establishing installed capacity sub-regions was appropriate, and agreed with the "overarching concept" of the use of a downward-sloping demand curve to price capacity. *Id.* at PP 2-3, JA 826. The Commission noted, however, several important questions raised by intervening parties regarding the proposed demand curve parameters (which would determine its slope and height, and thus the rates for capacity), and set them for hearing before an administrative law judge. *Id.* at PP 58-59, JA 837-38.

The Commission addressed requests for rehearing and clarification of the June 2, 2004 order, as well as an additional compliance filing submitted by ISO

New England in response to that order, in several additional orders. *See Devon Power LLC, et al.*, 109 FERC ¶ 61,154 (2004), JA 858, *order on reh’g and clarification*, 110 FERC ¶ 61,315 (2005), JA 1174 (orders on rehearing and clarification of the June 2, 2004 order); *see also Devon Power LLC, et al.*, 109 FERC ¶ 61,156 (2004), JA 846, *order on reh’g*, 110 FERC ¶ 61,313 (2005), JA 1165 (orders on compliance filing).

B. Initial Decision

On June 15, 2005, the Presiding ALJ issued her initial decision on the appropriate parameters to determine the slope and height of the demand curve. *See Devon Power LLC, et al.*, 111 FERC ¶ 63,063 (2005), JA 1185 (“Initial Decision”). That decision largely adopted the proposed demand curve design put forth by ISO New England in its initial testimony filed at the hearing, and rejected several alternative designs put forth by other parties.

The demand curve adopted in the Initial Decision, which was to be the centerpiece of the locational installed capacity market, provoked significant controversy among market participants in New England. Pursuant to the Commission’s Rules of Practice and Procedure, parties filed briefs on exceptions to the Initial Decision on July 15, 2005, and briefs opposing exceptions on August 4, 2005. *See* 18 C.F.R. § 385.711. Representatives of regulatory agencies and

elected officials of the New England States, among other parties, expressed significant opposition in their briefs to the conclusions in the Initial Decision.

Further, state regulators and other opponents of the locational installed capacity mechanism requested oral argument before the Commission concerning the Initial Decision, pursuant to Rule 711(c) of the Commission's Rules of Practice and Procedure. 18 C.F.R. § 385.711(c); *see* Connecticut Parties' Request for Oral Argument (July 15, 2005), R.895; Motion of New England Conference of Public Utilities Commissioners *et al.* for Oral Argument (July 28, 2005), R.918.

C. Sense of Congress

While the Initial Decision and requests for oral argument were pending before the Commission, Congress enacted the Energy Policy Act of 2005. Pub. L. No. 109-58, 119 Stat. 594. In Section 1236 of that Act, Congress noted the concerns expressed by the New England States regarding the locational installed capacity mechanism, including concerns that it did not adequately ensure that needed new capacity would be built, and that its cost would have a significant negative economic impact. Pub. L. No. 109-58, § 1236, 119 Stat. at 961. Accordingly, Congress declared its sense that the Commission "should carefully consider the States' objections." *Id.*

D. All-Day Oral Argument Before the Full Commission and Settlement Procedures

The Commission granted the requests for oral argument, and delayed the potential implementation of the locational installed capacity mechanism until at least October 1, 2006. *See Devon Power LLC, et al.*, 112 FERC ¶ 61,179 (2005), JA 1476.

The all-day oral argument before the full Commission addressed both the locational installed capacity market itself and potential alternative market designs. *See Notice Scheduling Oral Argument* (Aug. 25, 2005), JA 1478. The Commission allowed for the presentation of alternatives in pre-oral argument briefs. *Id.*

Following the oral argument, the Commission established settlement procedures, guided by an ALJ, to enable the parties to pursue agreement on an alternative market structure. *See Devon Power LLC, et al.*, 113 FERC ¶ 61,075 (2005), JA 1637.

E. The Settlement

After more than 30 formal settlement conferences were held over a four-month period, involving over 100 parties, a proposed settlement agreement (“Settlement”) resolving all issues in the proceeding was filed with the Commission on March 6, 2006. *See Explanatory Statement and Settlement*, R.1071, JA 1640. The Settlement was either supported or not opposed by 107 of

the 115 parties participating in the settlement proceedings. *See* Settlement Order at P 15, JA 2022.

The Settlement set forth the framework of a new long-term capacity market structure, the Forward Capacity Market, as an alternative to the locational installed capacity mechanism. The new market uses a forward-looking capacity auction to establish the price of capacity, instead of a downward-sloping demand curve, as the locational installed capacity market would have done. Settlement Order at PP 15-29, JA 2022-24. That auction is conducted yearly, and generators selected to supply capacity are committed to do so for a one-year period. *Id.* at P 16, JA 2022. Under the locational installed capacity mechanism, in contrast, the demand curve would have set the price and quantity of capacity for one-month periods. Further, rather than establishing pre-defined installed capacity sub-regions as in the original proposal, the settlement provided for the creation of separate sub-regions prior to each yearly auction based on identifiable transmission constraints that are expected to restrict the delivery of energy. *Id.* at P 23, JA 2023.

Under the auction format established by the Settlement, capacity is priced and procured three years in advance of the one-year period for which it is purchased. As a result, the one-year period beginning June 1, 2010 was identified as the first period for which the Forward Capacity Market auction would procure capacity. *Id.* at P 30, JA 2024. To address the period between December 1, 2006 –

the effective date of the settlement – and June 1, 2010, the Settlement included a transition mechanism. *Id.* This mechanism provides, *inter alia*, a set of fixed transition payments to generators supplying capacity. *Id.* at PP 30-31, JA 2024.

V. Challenged FERC Orders

A. Orders Accepting the Settlement

As noted above, of the 115 parties to the settlement proceedings, eight filed comments and protests formally opposing the Settlement. In the Settlement Order, the Commission addressed the issues raised by the opposing parties in detail and approved the settlement agreement, concluding that “as a package, it presents a just and reasonable outcome for this proceeding consistent with the public interest.”

Id. at P 2, JA 2019.

To rule on the Settlement, the Commission employed the “broad authority and discretion” afforded it under 18 C.F.R. § 385.602(h) to address contested settlements. Settlement Order at P 58, JA 2029-30. The Commission followed the standards and procedures for ruling on contested settlements outlined in *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 (1998), *order on reh’g*, 87 FERC ¶ 61,110 (1999). *See* Settlement Order at PP 59-61, JA 2030.

Pursuant to *Trailblazer*, the Commission determined, for several reasons, that the Settlement is consistent with the public interest, and that the overall result of the Settlement, viewed as a package (as the settling parties intended), achieves a

just and reasonable result. *Id.* at PP 62-73, JA 2030-2033. Furthermore, applying the guidance previously announced in *Trailblazer*, the Commission concluded that the parties objecting to the settlement “would be in no worse position under the terms of the settlement than if the case were litigated.” *Id.* at P 70, JA 2032 (citing *Trailblazer*, 87 FERC at 61,339).

To ensure the justness and reasonableness of the Settlement as a package, the Commission went further and responded in detail to the issues raised by those opposed to the settlement. Settlement Order at P 74, JA 2033. In particular, the Commission analyzed the transition mechanism and transition payments included in the Settlement. While noting that it did not consider the transition payments “ideal as a single market design element,” the Commission concluded that, as a component of the larger package embodied by the Settlement, the payments were just and reasonable. *Id.* at P 89, JA 2035. To reach this conclusion, the Commission analyzed record evidence regarding the cost of capacity in New England, developed during the year-long evidentiary hearing on the ISO-proposed locational demand curve, to find that the transition payments fall within the “zone of reasonableness,” and that those objecting to the payments would not likely achieve a better result through continued litigation. *Id.* at PP 90-101, JA 2035-37.

The Commission also addressed several other issues raised by objecting parties, including issues regarding certain design elements of the Forward Capacity

Market (*id.* at PP 109-160, JA 2038-47), the relationship of the settlement to Reliability Must-Run contracts (*id.* at PP 161-169, JA 2047-48), application of the *Mobile-Sierra* “public interest” standard to limited portions of the Settlement (*id.* at PP 172-186, JA 2048-52), and the Commission’s jurisdiction to approve the Settlement (*id.* at PP 192-205, JA 2053-2056).

The Commission denied requests for rehearing of the Settlement Order, and granted one minor clarification of that order, on October 31, 2006. *See* Settlement Rehearing Order, JA 2357.

B. Related Implementation Orders

In Docket No. ER06-1465-000, ISO New England and NEPOOL jointly filed revisions to the ISO New England tariff that were necessary to implement the transition provisions of the settlement agreement. *See* Filing Implementing Transition Provisions (Sept. 1, 2006), R.1177, JA 2143.

On October 31, 2006, the Commission accepted the revised tariff sheets. *ISO New England Inc.*, 117 FERC ¶ 61,132, JA 2381. As relevant to this appeal, the Commission rejected a protest filed by Maine regarding the justness and reasonableness of the transition mechanism, stating that Maine’s objections had already been addressed in the Settlement Rehearing Order. *Id.* at P 45, JA 2387. The Commission later denied rehearing of this ruling. *ISO New England Inc.*, 119 FERC ¶ 61,044, JA 2388.

SUMMARY OF ARGUMENT

In the challenged orders, the Commission reasonably exercised the significant discretion afforded by its regulations to address contested settlements. Closely following its own precedent to guide its discretion, the Commission provided a reasoned decision supported by substantial evidence, and fully considered each of the issues raised by the parties opposing the Settlement.

Petitioners Maine Public Utilities Commission, Richard Blumenthal, Attorney General for Connecticut, and Martha Coakley, Attorney General for Massachusetts (“Non-Settling States”) and Intervenors Industrial Energy Consumer Group, NSTAR Electric & Gas Corporation and NEPOOL Industrial Customer Coalition (“Industrial Customers”) focus on FERC’s consideration and acceptance of the transition mechanism in the Settlement. In so doing, they ignore the many other considerations the Commission balanced in finding that the Settlement, as a package, provided a just and reasonable outcome for these proceedings consistent with the public interest.

Significantly, the Commission weighed the fact that the ultimate outcome of the Settlement, the Forward Capacity Market (which no party objects to here), fully addressed the deficiencies identified in New England’s capacity markets. FERC also reasonably considered the fact that the new market design included features that many of the New England States (including some Petitioners here)

argued were crucial to proper capacity market design. Finally, while not finding it dispositive, the Commission appropriately took into account the broad support for the Settlement among the diverse parties, and the fact that it resolved difficult, contentious and lengthy proceedings.

Additionally, while acknowledging that the transition payments might not be ideal, or even just and reasonable, standing alone, the Commission reasonably concluded, based on substantial evidence, that the payments were just and reasonable as one component of the broad settlement package. Closely following its standards for addressing contested settlements, FERC reviewed relevant, substantial evidence in the record to determine that the transition payment fell within a “range of reasonableness,” and that those objecting to the settlement would not fare better through continued litigation.

The Commission also reasonably exercised its discretion to accept the limited *Mobile-Sierra* provision in the Settlement. That provision is fully consistent with Commission policy, does not operate to the detriment of non-settling parties, and appropriately balances the need for revenue stability with the requirement that rates be just and reasonable. Moreover, the rights of non-settling parties are fully protected, both by the limited nature of the application of the “public interest” standard and by the fact that the Commission retains full authority to protect third parties from unlawful rates.

Finally, the Commission holds jurisdiction under the FPA to accept the Settlement. The Settlement establishes a new mechanism and market structure to determine charges for installed capacity, the regulation of which this Court has previously found within the Commission’s jurisdictional mandate. The Settlement does not impose a generation adequacy requirement on the New England States, or alter the method for determining installed capacity requirements, as Non-Settling States contend.

ARGUMENT

I. Standard of Review

The Commission’s orders are reviewed under the arbitrary and capricious standard of the Administrative Procedure Act. *See, e.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under this standard, the court “will affirm the Commission’s orders so long as FERC ‘examined the relevant data and articulated a . . . rational connection between the facts found and the choice made.’” *Midwest ISO Transmission Owners*, 373 F.3d at 1368 (quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

“[The Court’s] review of whether a particular rate design is just and reasonable is highly deferential 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.” *Electricity Consumers*, 407 F.3d at 1236; *see also Sithe/Independence Power Partners*, 165 F.3d at 948.

The Court upholds the Commission’s factual findings if supported by substantial evidence. *See Florida Municipal Power Agency v. FERC*, 315 F.3d 362, 365 (D.C. Cir. 2003); FPA § 313(b), 16 U.S.C. § 825l(b). Substantial evidence is “such ‘relevant evidence as a reasonable mind might accept as adequate to support [a] conclusion.’” *Consol. Oil & Gas, Inc. v. FERC*, 806 F.2d 275, 279 (D.C. Cir. 1986) (quoting *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 477 (1951)). “The ‘substantial evidence’ standard requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.” *FPL Energy Maine Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002). Where the evidence might support more than one rational interpretation, the Court upholds the Commission’s findings: “‘the question we must answer . . . is not whether record evidence supports [the petitioner’s] version of events, but whether it supports FERC’s.’” *B&J Oil and Gas v. FERC*, 353 F.3d 71, 78 (D.C. Cir. 2004) (quoting *Florida Municipal*, 315 F.3d at 368).

II. The Commission Reasonably Concluded, Consistent with its Regulations and Precedent, That the Settlement, as a Package, is Just and Reasonable

The Settlement at issue here was reached following several years of comprehensive, contentious proceedings regarding the deficiencies in New

England’s wholesale electric capacity markets, and the appropriate market design to correct those deficiencies. Following a year-long hearing before an administrative law judge, the Commission faced an Initial Decision adopting a market design that was vigorously opposed by many parties, most notably several of the New England States.

At the request of these States, and consistent with the direction of Congress,³ FERC took the rare step of scheduling an all-day oral argument before the Commissioners, both to debate the Initial Decision and to give the States an opportunity to advance alternative market designs. Comprehensive settlement procedures followed, allowing the region to decide on an alternative capacity market design.

The result of this process was a settlement supported or not opposed by nearly all of the participants that would establish a new market design, the Forward Capacity Market. This market design is not opposed here, and in fact was explicitly supported by Maine. *See infra* p. 33.

In the challenged orders, the Commission concluded that, as a package, the settlement represented a just and reasonable outcome for these difficult

³ As discussed above (*supra* p. 15), in Section 1236 of the Energy Policy Act of 2005, Congress declared that the Commission “should carefully consider the States’ objections” to the then-pending locational installed capacity market proposal. Pub. L. No. 109-58, § 1236, 119 Stat. at 961. No party on appeal questions the agency’s compliance with that directive.

proceedings. The Commission reached this conclusion despite its misgivings about the transition mechanism included in the Settlement package. *See* Settlement Order at P 89, JA 2035 (noting that the Commission did not find the transition payments ideal).

In this appeal, Non-Settling States and Industrial Customers now focus on the transition mechanism in isolation, failing to acknowledge the Commission's overarching finding, made consistent with its regulations and precedent, that the entirety of the Settlement, presented and considered as a package, is just and reasonable. Their arguments misapprehend the task before the Commission when confronted with a contested settlement, and should be rejected.

A. The Commission Has Considerable Discretion Under Its Regulations When Reviewing Contested Settlements

Under Rule 602(h) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602(h), FERC has "broad authority and discretion . . . to address contested settlements." Settlement Order at P 58, JA 2029-30; Settlement Rehearing Order at P 31, JA 2363. Pursuant to this regulation, the Commission may take any number of approaches to addressing contested settlements. For example, the Commission may make a determination on the merits regarding the contested issue or issues if it finds that the record contains substantial evidence or that there are no issues of material fact. 18 C.F.R. § 385.602(h)(1)(i). If the Commission concludes that the record lacks substantial evidence, or that the

contesting parties or disputed issues cannot be severed from the settlement for further proceedings, it may either establish procedures to gather further evidence concerning the contested issues, *id.* § 385.602(h)(1)(ii)(A), or “[t]ake other action which the Commission determines to be appropriate,” *id.* § 385.602(h)(1)(ii)(B).

It is well-settled that the Commission has the authority, and in fact the obligation, to consider contested settlements. *See* Settlement Order at P 58, JA 2029-30; *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 312-13 (1974); *Penn. Gas & Water Co. v. FPC*, 463 F.2d 1242, 1249-50 (D.C. Cir. 1972) (citing *Mich. Consol. Gas Co. v. FPC*, 283 F.2d 204, 224 (D.C. Cir. 1960)). This Court has confirmed the Commission’s significant discretion under its regulations to determine how it will evaluate the justness and reasonableness of proposed settlements that are contested. *Arctic Slope Reg. Corp. v. FERC*, 832 F.2d 158, 164 (D.C. Cir. 1987) (concluding that “[t]he breadth of discretion trumpeted by Rule 602(h)(1)(ii)(B) is manifest”); *see also United Mun. Distributions Group v. FERC*, 732 F.2d 202, 208 (D.C. Cir. 1984) (observing the Commission’s broad authority under its regulations to “take other action” that it deems appropriate when addressing contested settlements, and rejecting arguments that would limit FERC’s options under its regulations).

The Commission may approve a contested settlement if it determines that the proposal will establish just and reasonable rates. Settlement Order at P 58, JA

2029-30; *see also Mobil Oil Corp., supra; Tejas Power Corp. v. FERC*, 908 F.2d 998, 1003 (D.C. Cir. 1990); *New Orleans Pub. Serv., Inc. v. FERC*, 659 F.2d 509, 511-12 (5th Cir. 1981). FERC must supply “a ‘reasoned decision’ that is supported by ‘substantial evidence,’” *NorAm Gas Transmission Co. v. FERC*, 148 F.3d 1158, 1162 (D.C. Cir. 1998) (citing Rule 602(h)), and must “support [its] decision with sufficient attention to the issues raised.” *Laclede Gas Co. v. FERC*, 997 F.2d 936, 948 (D.C. Cir. 1993).

B. *Trailblazer* Guides the Commission’s Exercise of Discretion With Regard to Contested Settlements

The Commission’s review of contested settlements like the one at issue here is guided by *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 (1998), *order on reh’g*, 87 FERC ¶ 61,110 (1999). Settlement Order at P 59, JA 2030; Settlement Rehearing Order at PP 32-33, JA 2363-64. In *Trailblazer*, the Commission reviewed judicial precedent as well as its own regulations and precedent regarding contested settlements, and set forth a framework to guide its significant discretion to address such settlements. *See* 85 FERC at 62,339-45.

Under these well-established procedures, the Commission first determines “whether the settlement presents an acceptable outcome for the case that is consistent with the public interest.” *Id.* at 62,341; Settlement Order at P 59, JA 2030. If the Commission can affirmatively make that determination, it will choose

an approach to address the contested issues. *Trailblazer*, 85 FERC at 62,342;

Settlement Order at P 60, JA 2030. *Trailblazer* outlines four approaches:

(1) the Commission addresses each issue raised by the objecting parties on the merits; (2) the Commission approves the contested settlement as a package, finding that it provides an overall just and reasonable result; (3) the Commission approves the settlement based on a determination that the interests of the objecting parties are too attenuated, and that the benefits of the settlement to the settling parties outweigh the nature of the objections; and (4) the Commission approves the settlement as uncontested as to the settling parties, and severs the contesting parties so that they can continue to litigate the contested issues.

Settlement Order at P 50 n.39, JA 2027-28; *see also id.* at PP 60-61, JA 2030;

Trailblazer, 85 FERC at 62,342-45.

It is notable that, other than a brief unsupported assertion that the Commission used “the second prong of *Trailblazer* as a shield” (*see* Pet. Br. at 41), Non-Settling States and Industrial Customers advance no argument challenging the Commission’s decision to follow *Trailblazer* – in particular, its second approach – to guide its review of the Settlement.

C. The Commission Closely Followed its *Trailblazer* Policy Here

1. The Settlement Provides an Outcome Consistent With the Public Interest

Non-Settling States and Industrial Customers wholly ignore the Commission’s first determination under *Trailblazer* – that the Settlement, as a package, presents a just and reasonable outcome for this case consistent with the public interest. *See* Settlement Order at PP 62-67, JA 2030-32. At several points

in their opening brief, Non-Settling States suggest that the Commission has not explained how the entirety of the package embodied in the Settlement justifies its approval. *See, e.g.*, Pet. Br. at 36, 50 (asserting that FERC failed to explain how entirety of the settlement compensated for the less than ideal nature of the transition mechanism).

To the contrary, and as discussed below, the Commission adequately explained the many considerations it took into account in approving the Settlement, and its orders should be upheld. *See Wisconsin Pub. Power Inc. v. FERC*, 493 F.3d 239, 276 (D.C. Cir. 2007) (upholding FERC’s approval of contested settlements where it provided a reasonable “qualitative” explanation of the benefits and costs of the settlements).

a. The Settlement Addresses Long-Standing Deficiencies in the Capacity Market

In particular, the Commission found that the Settlement was consistent with the public interest because the overall package resolved previously-identified deficiencies in New England’s installed capacity market. Settlement Order at PP 62-65, JA 2030-31. Non-Settling States and Industrial Customers completely ignore these findings.

In New England, the Commission has been addressing problems in the installed capacity market and issues regarding compensation of installed capacity resources for many years. *See, e.g., Central Maine Power Co.*, 252 F.3d 34; *Sithe*

New England Holdings, LLC v. FERC, 308 F.3d 71 (1st Cir. 2002); *see also New England Power Pool*, 100 FERC ¶ 61,287 at P 101 (2002 order identifying the failure of the capacity market to account for location as a significant market flaw).

These proceedings began in 2003, when the Commission responded with concern to the filing of Reliability Must-Run agreements covering a significant amount of generation. *Devon Power*, 103 FERC ¶ 61,082, JA 522. In particular, the Commission noted that an escalation of such contracts could harm New England's energy and capacity markets, because they can artificially suppress market prices and make it difficult for new generators to enter the market, and for existing suppliers to recover their costs. *Id.* at PP 29-31, JA 526-27. To address its concerns, the Commission directed, *inter alia*, that ISO New England file a "location-specific capacity requirement"⁴ or a "deliverability requirement" as a long-term solution to the pitfalls of individual reliability agreements, "so that energy markets alone" were not the only source of revenues for generators. *Id.* at P 31, JA 526-27.

ISO New England filed its locational installed capacity market proposal in response to this directive. Ruling on that proposal (and setting much of it for hearing), the Commission again identified significant and growing problems of

⁴ A location requirement requires load-serving utilities to purchase or hold a certain amount of their installed capacity within their local area, to take into account transmission system constraints and to ensure that the price of capacity accurately reflects supply conditions in the area.

compensation for generators needed to maintain system reliability. *See Devon Power*, 107 FERC ¶ 61,240 at PP 35-36, JA 833-34 (identifying both short-term and long-term issues regarding the compensation of generating resources needed for reliability).

As the proceedings further developed, the Commission noted additional evidence of broader market problems, beyond just the locations with transmission constraints that it focused on at the outset, that were preventing New England from developing needed new infrastructure. *See Settlement Order* at P 63, JA 2030-31; *see also Devon Power*, 109 FERC ¶ 61,154 at P 65 & n.59, JA 870-71 (noting problems “both system-wide and in . . . load pockets”); *Settlement Order* at P 204, JA 2055 (noting rise in filing of Reliability Must-Run agreements). In particular, the record of the all-day oral argument before the Commission produced evidence showing that New England’s generation capacity was “barely adequate” with “deficits predicted in the very near future,” that existing generators needed for reliability were losing money, and that new infrastructure was needed soon to avoid reliability problems. *Settlement Order* at P 63, JA 2030-31, citing ISO-NE Regional System Plan 2005, R.981, JA 1497; Tr. of Oral Argument at 36:21-24, 44:7-11, 76:6-22, 150:9-151:6, 167:1-4; 237:9-12, JA 1526; 1527; 1529; 1532-33; 1549; 1619. The overwhelming consensus of the parties was that “the status quo

presents significant problems that the Commission must address.” Settlement Order at P 63, JA 2030-31; Tr. of Oral Argument at 252:8-12, JA 1634.

In concluding that the Settlement was consistent with the public interest, the Commission appropriately gave significant weight to the fact that the settlement package as a whole, and particularly the Forward Capacity Market, provided solutions to address these market problems. *See* Settlement Order at PP 65, 71, JA 2030, 2032 (listing the solutions provided by the settlement package). The Commission was well within its discretion to consider the long-term benefits this settlement would bring to the New England capacity market. *See Wisconsin*, 493 F.3d at 276; *see also Electricity Consumers*, 407 F.3d at 1240 (balancing of short-term costs against long-term benefits is within the Commission’s discretion).

Representatives of Maine, in fact, agreed with the Commission’s assessment of the benefits of the Forward Capacity Market, stating in a filed affidavit that the market is “well designed and deserving of the Commission’s endorsement.” Comments of the Maine Public Utilities Commission and Maine Public Advocate Contesting Proposed Settlement (March 27, 2006), Affidavit of Thomas D. Austin at 9, R.1078, JA 1853.

b. The Settlement Includes Features That Representatives of the New England States Argued Were Crucial

Non-Settling States and Industrial Customers also fail to acknowledge that the Settlement includes many of the components that representatives of the New England States argued were critical to proper capacity market design and lacking in the ISO-proposed locational installed capacity mechanism. *See* Settlement Order at P 64 & n.71, JA 2031 (citing Tr. of Oral Argument at 148 *et seq.*, JA 1530 *et seq.*, and Pre-Oral Argument Briefs of several New England States).

The Commission fairly recognized in approving the Settlement that it (1) incorporated a forward auction format, (2) utilized a descending-clock auction (rather than a demand curve), (3) included penalties for capacity suppliers who fail to meet their obligations, and (4) included a phase-in or transition period – all components the States asserted were crucial to a workable capacity market. Settlement Order at P 64, JA 2031; *see also Arizona Corp. Comm'n v. FERC*, 397 F.3d 952, 955 (D.C. Cir. 2005) (Court reluctant to second-guess FERC where petitioners themselves had moved for the relief ultimately granted, but objected to the precise remedy chosen).

c. The Settlement Was Broadly Supported and Brought an End to Lengthy and Difficult Proceedings

Non-Settling States and Industrial Customers also ignore that, in making its public interest determination under *Trailblazer*, the Commission appropriately took

into account the broad support the Settlement garnered among the diverse New England stakeholders, and the fact that the Settlement resolved a difficult, contentious and lengthy proceeding.

While broad support for a settlement is not conclusive, “the Commission is clearly entitled to give weight to the support of customers when deciding to approve a settlement offer.” *NorAm Gas Transmission*, 148 F.3d at 1164-65; *see also Laclede*, 997 F.2d at 946. Here, the Commission noted that the Settlement was either supported or not opposed by 107 of the 115 parties in the underlying proceeding, which it characterized as “quite extraordinary and . . . noteworthy” given the difficulty of the litigation that preceded the agreement. Settlement Order at P 73, JA 2033.

Moreover, “substantial public interest considerations” can support the approval of a settlement in “extraordinarily complex and burdensome proceedings” like those underlying the Settlement in the instant case. *Arctic Slope*, 832 F.2d at 165 (noting the “general policy favoring settlement of administrative proceedings”); *see also, e.g., Idaho Power Co.*, 109 FERC ¶ 61,308 at P 5 (2004) (stating that the Commission is “strongly in favor of settlements, particularly in cases [that are] hotly contested and complex”).

Here, FERC justifiably weighed “[t]he fact that this Settlement resolves all of the outstanding issues in a difficult, contentious and lengthy matter.” Settlement

Order at P 66, JA 2031 (noting the “difficult compromises” reached by the over 175 representatives who participated in settlement negotiations, and reasoning that “if found just and reasonable, [they] should be honored”). The Commission also fairly reasoned that ending the “protracted litigation” would bring needed stability to New England’s wholesale electric markets and allow it to move forward on other market improvements. *Id.*; *see Laclede*, 997 F.2d at 947 (Commission may take prospect of further litigation into account in deciding whether to accept settlement); *see also Wisconsin*, 493 F.3d at 276 (FERC is not required to *quantify* the length and nature of proceedings to be avoided through settlement).

2. While Not Ideal, the Transition Payments, as a Part of the Settlement Package, are Just and Reasonable

Having found that the Settlement presented an acceptable outcome for this case consistent with the public interest, as explained above, the Commission proceeded to the second step of *Trailblazer* – choosing an approach to address the contested issues, particularly the transition payments. *See Trailblazer*, 85 FERC at 62,342.

The Commission chose the second approach outlined in *Trailblazer*. Settlement Order at PP 68-69, JA 2032 (setting forth basis for choosing the second approach). Under that approach, “even if some individual aspects of a settlement may not be just and reasonable standing alone, the Commission may approve a contested settlement as a package if the overall result of the settlement is just and

reasonable.” Settlement Order at P 60, JA 2030; *see also Trailblazer*, 85 FERC at 62,342.

Closely following that approach here, the Commission concluded that the Settlement, as a package, provided “an overall just and reasonable outcome within a zone of reasonableness,” and that those objecting to the settlement would not fare better through continued litigation. *See* Settlement Order at PP 70-73, JA 2032-33 (noting that it reached these conclusions for many of the same reasons it articulated in finding that the settlement provided an outcome consistent with the public interest).

The Commission went on to address each of the contested issues to validate its conclusion that the overall settlement package produced a just and reasonable result, consistent with *Trailblazer*. *Id.* at P 74, JA 2033.

a. The Commission Reasonably Applied *Trailblazer* to Address the Transition Payments

The Commission readily acknowledged that the transition payments are not ideal, and might not be just and reasonable alone. *See* Settlement Order at P 89, JA 2035. However, adhering closely to *Trailblazer*, the Commission concluded that they could be accepted as a “component of the overall package embodied in the Settlement,” *id.*, primarily because it found that the payments “fall within the ‘range of reasonableness,’” and “that those objecting to the [transition payments]

would not reach a more favorable result through continued litigation.” Settlement Order at P 100, JA 2037.

FERC reached these findings by comparing the level of the transition payments against evidence in the record projecting a range of prices for installed capacity that could have resulted from continued litigation over the ISO-proposed locational installed capacity market. *See id.* at PP 90-100, JA 2035-37. While several demand curves were offered at hearing, the Commission chose two for comparison: the curve proposed by ISO New England and adopted in the Initial Decision, and a lower curve proposed by representatives of Maine and Vermont. *Id.* at P 91, JA 2035-36; Settlement Rehearing Order at P 41, JA 2365. The comparison showed that the transition payments (set at \$3.05/kilowatt-month in 2007-2008 and rising to \$4.05/kW-month in 2010) were at the “very low end” of the range of prices that could have resulted from continued litigation. *See* Settlement Order at PP 92-99, JA 2036-37 (particularly P 98, JA 2037, charting the range of potential prices, as well as the transition payments for comparison). FERC reasoned that even if it had adopted elements from other, lower demand curves (like that proposed by Maine/Vermont) after further litigation, the transition payments “would still be comparable if not significantly lower.” *Id.* at P 100, JA 2037; Settlement Rehearing Order at P 38, JA 2364-65.

As additional evidence that the transition payments fall within the “range of reasonableness,” FERC also noted that they were significantly lower than the cost of new entry figure used as a starting point for the Forward Capacity Market auction, “accurately reflecting market conditions” during the transition period. Settlement Order at PP 89, 101, JA 2035, 2037; *see also id.* at P 130, JA 2042 (finding cost of new entry figure reasonable, particularly because it was not a substantial increase over the existing capacity deficiency charge, in place since 2002). The Commission also stated, following its analysis, that the transition payments “were reasonable rates for existing generators” during the transition period. *Id.* at P 102, JA 2037-38.

This analysis not only closely followed Commission precedent, but was a reasonable exercise of the Commission’s discretion. *See, e.g., Laclede*, 997 F.2d at 947 (FERC may take prospects for further litigation into account); *Petal Gas Storage, L.L.C. v. FERC*, No. 04-1166, slip. op. at 14 (D.C. Cir. Aug. 7, 2007), quoting *Balt. Gas & Elec. Co. v. Natural Res. Defense Council, Inc.*, 462 U.S. 87, 103 (1983) (where an agency is “making predictions, within its area of special expertise, . . . a reviewing court must generally be at its most deferential.”) FERC’s decision to compare the transition payments to both the rates that might have resulted from adopting a market design already approved by an ALJ, and to rates that might have applied if the Commission had adjusted the ALJ’s decision

downward, was a reasonable exercise of FERC’s discretion in matters of rate design that is entitled to deference. *See Electricity Consumers*, 407 F.3d at 1236, 1239-40; *see also, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) (“[C]ourts are without authority to set aside any rate selected by the Commission which is within a ‘zone of reasonableness’”).

**b. Non-Settling States and Industrial Customers
Misunderstand the Second *Trailblazer* Approach**

As an initial matter, while Non-Settling States and Industrial Customers do not present any fundamental objections to using *Trailblazer* as a discretion-guiding tool, many of their arguments fundamentally misunderstand the Commission’s use of it here. Two arguments stand out in particular: (1) their contention that the Commission could not approve the transition payments without *specific* evidence of the costs of existing generators that might receive them (*see, e.g.,* Pet. Br. at 30-37; Interv. Br. at 4-6); and (2) their assertion that the Commission could not compare the transition payments to record evidence of the prices that might have been produced by two locational installed capacity demand curves without first specifically adopting the curves as just and reasonable (*see* Pet. Br. at 38-40; Interv. Br. at 6-7).

As the Commission explained on rehearing, application of the second approach “does not necessarily result in a binding merits determination on the individual issues” or in a finding that the settlement rate is the *precise* rate the

Commission would have approved after litigation. Settlement Rehearing Order at P 37, JA 2364; *see also Trailblazer*, 87 FERC at 61,440. Rather, the Commission analyzes the specific issues raised to ensure that the result of the settlement is not worse for the non-settling parties than the *likely results* of continued litigation. *Id.*

Non-Settling States and Industrial Customers would require the Commission to both find that the transition payments are the *specific* rates it would approve if those payments stood alone, and to make a merits decision on the underlying litigation over the ISO-proposed locational installed capacity mechanism. The Commission's *Trailblazer* precedent does not require it to do either, and, moreover, such requirements would undermine the policies of both this Court and the Commission that encourage the settlement of administrative proceedings, particularly complex and difficult cases like this one. *See Arctic Slope*, 832 F.2d at 165; *Idaho Power Co.*, 109 FERC ¶ 61,308 at P 5.

c. The Commission Relied on Substantial, Relevant Evidence

Non-Settling States and Industrial Customers contend that the Commission's conclusion regarding the transition payments is not supported by substantial evidence, asserting that FERC could have "no reasonable basis" to approve the payments without specific evidence of the costs of existing generators. *See* Pet. Br. at 31; Interv. Br. at 4-6. They also argue that the "cost of new entry" is

irrelevant to assessing the reasonableness of the transition payments. Pet. Br. at 37-38; Interv. Br. at 8-9.

As explained above, substantial evidence is “such relevant evidence as a reasonable mind might accept as adequate to support [a] conclusion.” *See, e.g., Consol. Oil & Gas*, 806 F.2d 275, 279 (D.C. Cir. 1986) (citation and internal quotations marks omitted). “The ‘substantial evidence’ standard requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.” *See FPL Energy* 287 F.3d at 1160.

The Commission met this standard in approving the transition payments as one component of the settlement package. As discussed above, the Commission relied on record evidence projecting the capacity prices that would have resulted from the proposed locational installed capacity market, both under the demand curve design approved in the Initial Decision, and a lower demand curve offered by representatives of Maine and Vermont. *See supra* pp. 37-39.

Challenging this evidence on rehearing, Non-Settling States and Industrial Customers argued that the testimony of Maine’s witness, Dr. Austin, was “the only relevant evidence” regarding whether the transition payments were reasonable for existing generators. Request for Rehearing of Industrial Energy Consumer Group at 12-13, JA 2070-71; *see also* Request for Rehearing of Maine Parties at 17-18, JA 2099-2100. The Commission disagreed, explaining that cost of new entry

evidence is “a key factor in determining appropriate rates for capacity,” and that such evidence formed the basis for “the demand curves and resulting estimated prices presented at hearing and ultimately used to determine a reasonable range of prices” in the Settlement Order.⁵ Settlement Rehearing Order at P 35, JA 2364; *see also, e.g.*, Exh. ISO-3 (Prepared Direct Testimony of ISO witness John J. Reed) at 4, R.1157, JA 1000; Exh. ISO-17 (Prepared Direct Testimony of Steven E. Stoft), R.1171, JA 884. The Commission thus found such evidence “directly relevant to determining just and reasonable rates for capacity” – making no distinction between *new* or *existing* capacity, as Non-Settling States and Industrial Customers suggest. Settlement Rehearing Order at P 35, JA 2364.

FERC’s view of the relevance of that evidence to determining appropriate capacity prices comports with the general agreement of the parties *on the record* that the cost of new entry establishes a just and reasonable market price for installed capacity. *See* Answer of Connecticut Department of Public Utility Control (July 31, 2006) at 5-6, R.1137, JA 2136-37, citing Tr. of Oral Argument at 239:5-8, JA 1621 (testimony of ISO-NE representative) and 158:9, JA 1540 (testimony of representative for coalition of parties including the Massachusetts Attorney General). Its determination also makes sense given that in both the proposed locational installed capacity market and the Forward Capacity Market, all

⁵ The cost of new entry is also a key price-determining factor in the Forward Capacity Market. *See* Settlement Order at PP 125-132, JA 2041-42.

generators supplying capacity, whether new or existing, are paid the same market clearing price.

Equally important, record evidence established that existing generators in New England were losing money and required additional revenue to ensure that they remained in operation. *See* Settlement Order at P 204, JA 2055, citing Reply Comments of Capacity Suppliers (April 5, 2006) at 18, R.1096, JA 1991 and Exh. ISO-23 (Rebuttal Testimony of David LaPlante), R.1177, JA 1006 (*see in particular* 49:1-17, JA 1060); *see also* Settlement Order at PP 63, 65, JA 2030-2031 (“The record from the oral argument is replete with virtually unchallenged statements that existing generators needed for reliability are not earning sufficient revenues (and are in fact losing money)”). The substantial increase in the filing of reliability agreements by generators in financial distress provided the Commission with further “substantial evidence that generators are failing to recover their costs and require additional revenues.” Settlement Order at P 204, JA 2055.

The Commission reasonably chose to rely on all of the record evidence discussed above, and “its decision does not lack substantial evidence simply because petitioners offered ‘some contradictory evidence.’” *Arizona Corp. Comm’n*, 397 F.3d at 954 (citing *Florida Mun. Power Agency*, 315 F.3d at 368). “[T]he question . . . is not whether record evidence supports [petitioners’] version of events, but whether it supports FERC’s.” *Id.*

Finally, Non-Settling States mistakenly rely on this Court’s recent decision in *NSTAR Electric & Gas Corp. v. FERC*, 481 F.3d 794 (D.C. Cir. 2007), to support their substantial evidence claim. *See* Pet. Br. at 31-32. In *NSTAR*, the Court remanded Commission orders approving contracts between ISO New England and specific individual generators for providing reliability service, because while FERC accepted the contracts as just and reasonable on the basis that they provided compensation to the individual generators at a percentage of fixed and variable costs, it had no evidence in the record of those costs. *Id.* at 803. Unlike *NSTAR*, here the Commission approved a contested settlement under Rule 602(h) of its regulations (rather than individual contracts for service), and accepted a set of fixed payments negotiated by the parties on the basis of substantial evidence *in the record* before it. Thus, the “critical gap” the Court found there is filled here. *Id.* Moreover, *NSTAR* does not require that the Commission only approve prices that exactly track the cost of service, as Non-Settling States suggest. *Id.* at 804 (“Nor, of course, do we mean to suggest that only prices in line with historic accounting costs would qualify as just and reasonable”).

d. The Commission Meaningfully Responded to Objections to the Transition Payments

In addition to addressing the evidence and arguments noted above, the Commission also fully responded to other objections to the transition payments, contrary to Non-Settling States’ assertions. *See* Pet. Br. at 34-35 (listing certain

additional objections). For example, the Commission (1) noted that the transition payments are adjusted to account for reliability contributions, and require a longer commitment from the supplier, both significant improvements over the current installed capacity market (Settlement Order at PP 103-104, JA 2038; Settlement Rehearing Order at P 45, JA 2366); and (2) explained that its analysis of the transition payments, and the record evidence of projected prices, took into account a reasonable Peak Energy Rent adjustment (Settlement Rehearing Order at P 75, JA 2370).

These responses, and the Commission’s thorough discussion of the transition payments as a component of the overall settlement package, met FERC’s obligation under Rule 602(h) to “support [its] decision with sufficient attention to the issues raised.” *Laclede*, 997 F.2d at 948.

e. The Commission Reasonably Addressed and Rejected Arguments that the Short-Term Transition Payments Should be Locational

Contrary to the assertions of Non-Settling States (*see* Pet. Br. at 42-51), the Commission thoroughly addressed arguments below that the transition payments should have a locational component. In this regard, the Commission supplied “a ‘reasoned decision’ supported by ‘substantial evidence.’” *NorAm Gas Transmission*, 148 F.3d at 1162.

In its first order, the Commission rejected arguments advanced by Maine that the transition payments necessarily should account for locational differences, and that Maine should be assessed lower transition payments because it has a surplus of capacity. *See* Settlement Order at P 105, JA 2038. The Commission noted that the most recent price projections entered into the record showed that, during the time period covered by the transition mechanism, prices for installed capacity were largely the same for all regions within New England. *Id.* Moreover, the Commission explained that in areas of the region where transmission constraints create a stronger need for additional capacity, RMR contracts have been approved, and the additional costs of those contracts are paid by ratepayers in those areas. *Id.*; *see also* Settlement Filing at 39, JA 1681.

The Commission did not “abandon” these findings and conclusions on rehearing, as Non-Settling States suggest. Pet. Br. at 45. Rather, in that order the Commission addressed Maine’s “fundamental argument” on rehearing – “that Maine is export-constrained and, as such, should not be required to pay the full transition payment.” Settlement Rehearing Order at P 71, JA 2370. The Commission found this argument unconvincing and irrelevant to the task at hand – determining whether the Settlement as a package, including the transition mechanism, is just and reasonable. *Id.* at PP 71-72, JA 2370. That finding did not, however, result in the Commission abandoning its earlier reliance on record

evidence of region-wide uniformity in capacity prices during the transition period (rather than evidence offered by Dr. Austin regarding differences in energy market prices), the presence of reliability contracts in constrained areas, or the fact that the Forward Capacity Market includes a long-term locational feature. *See* Settlement Order at PP 105, 122-24, JA 2038, 2041.

Further, the Commission reasonably exercised its discretion to reject Maine's motion to lodge certain portions of a Department of Energy transmission congestion study. *See* Settlement Rehearing Order at P 76, JA 2370. That motion was filed on September 8, 2006, well after the Commission issued its order approving the Settlement. The Commission reasonably held that it would be inappropriate to accept new evidence at such a late date in the proceeding, since it would "effectively deny parties the opportunity to respond." *Id.* This conclusion was consistent with the Commission's handling of other late-filed motions in this proceeding, particularly motions to intervene out-of-time filed on August 9, 2006, nearly a month before Maine's motion to lodge. *See id.* at P 17, JA 2361; *see also, e.g., Mich. Consol. Gas Co. v. FERC*, 883 F.2d 117, 125 (D.C. Cir. 1989) (noting the Commission's broad discretion in such matters).

Non-Settling States also assert that the Commission acted arbitrarily and capriciously in accepting the non-locational transition payments when it had previously found location requirements "absolutely necessary." Pet. Br. at 48,

citing *Devon Power*, 109 FERC ¶ 61,154 at P 32. This assertion ignores the Commission’s conclusion that the Forward Capacity Market, the ultimate end product of the settlement package, includes an appropriate locational feature satisfying its earlier directives that a new capacity market take location into account. Settlement Order at P 105, JA 2038; *see also id.* at PP 122-24, JA 2041 (accepting the locational feature of the Forward Capacity Market); Settlement Rehearing Order at P 47, JA 2366. Non-Settling States do not challenge the Commission’s acceptance of that locational feature.

Moreover, by the very nature of the Forward Capacity Market design, capacity is purchased three years in advance of the year-long period it is committed to be in place and available to support reliability. Settlement Order at P 30, JA 2024. As Maine and other parties acknowledged when they asked the Commission to consider a forward market design as an alternative to the ISO-proposed locational installed capacity mechanism, the three-year forward-looking design means that suppliers of capacity will not receive prices generated in the auction until 2010. *See Four State Commissions’ Proposed Alternative*, JA 1480.⁶ As a result, the Commission is not changing course and “allow[ing] an even longer

⁶ In that pleading, the State commissions did make the unsupported assertion that they would “expect” any transition payments to existing generation to have a locational component. *Id.* As discussed above (*supra* pp. 46-47), the Commission fully explained in the Settlement Order why a locational component was not necessary for the limited transition period.

delay of locational pricing” than it had previously rejected (*see* Pet. Br. at 49); rather, the forward-looking nature of the Forward Capacity Market doesn’t permit full implementation of all of its features (including the locational feature) until 2010. Settlement Rehearing Order at P 47, JA 2366.

f. The Commission Reasonably Rejected Calls To Sever Maine’s Transition Payment

Non-Settling States suggest that short of rejecting the Settlement in its entirety, the Commission should have held further hearings to determine the appropriate transition payment for Maine alone. Pet. Br. at 50-51. The Commission reasonably held, however, that severing the amount of Maine’s transition payment would not be appropriate, since (1) the Settlement is intended to apply uniformly throughout New England, (2) the transition payments are an essential part of the settlement package, and (3) the level of transition payments was negotiated at arms-length among all the settling parties, and severing one State’s level of payment would undoubtedly impact the negotiated amount for other parties. Settlement Order at PP 69, 106, JA 2032, 2038; Settlement Rehearing Order at P 74, JA 2370; Settlement Filing at 5-6, JA 1647-48 (explaining same); *see also United Mun. Distribs. Group*, 732 F.2d at 211 (FERC reasonably declined to sever issue from settlement it viewed as an “inseparable package”).

g. Certain Claims Raised by Non-Settling States and Industrial Customers Were Not Preserved Below, and Otherwise Lack Merit

In two respects, Non-Settling States and Industrial Customers seek to raise arguments on appeal that they did not present to the Commission. As a result, the Court should not consider those arguments here. FPA § 313(b), 16 U.S.C. 825l(b) (“No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing”); *see also, e.g., Constellation Energy Commodities Group v. FERC*, 457 F.3d 14, 21 (D.C. Cir. 2006).

First, both Non-Settling States and Industrial Customers argue that the Settlement, and particularly the transition mechanism, are “an overbroad remedy to the problem FERC identified.” Pet. Br. at 41; *see also* Interv. Br. at 15-16. None of these parties made this argument to the Commission. The Attorneys General of Connecticut and Massachusetts and the NEPOOL Industrial Customer Coalition (Petitioners and an Intervenor here) came the closest, asserting generally that the Commission had not found the existing installed capacity markets unjust and unreasonable under FPA § 206, but had instead focused on capacity suppliers in congested areas. *See* Application for Rehearing of Attorney General of Massachusetts *et al.* at 12-13, JA 2119-20. This contention, however, is far different than the argument presented here, and was fully addressed on rehearing.

Settlement Rehearing Order at PP 99-100, JA 2374-75; *Allegheny Power v. FERC*, 437 F.3d 1215, 1220 (D.C. Cir. 2006) (“Under [FPA] § 313(b) an objection cannot be preserved indirectly, but must be raised with specificity”).

In any event, this assertion lacks merit. As explained above (*supra* pp. 30-33), as these proceedings developed, the Commission found that problems in the installed capacity market were having a market-wide impact. *See, e.g.*, Settlement Order at PP 14, 63, JA 2022, 2030-31. As a result, the Commission had sufficient basis to approve a settlement package providing market-wide solutions, as well as targeted solutions (*e.g.*, the locational feature of the Forward Capacity Market) to those problems. Moreover, Non-Settling States’ suggestion that the Commission should have eliminated Reliability Must-Run agreements (Pet. Br. at 42) was fully addressed below: the Commission explained that the transition payments are deducted from payments made to generators with reliability contracts to protect against over-recovery, and that market participants retain the right to challenge a generator’s need for a special reliability agreement in light of changes in its revenues. *See* Settlement Order at P 166, JA 2048; Settlement Rehearing Order at P 53, JA 2368.

Second, Industrial Customers assert that the transition mechanism is unjust and unreasonable because it does not include “an oversight mechanism to ensure just and reasonable rates.” Interv. Br. at 13-14. This argument was not even

arguably brought to the Commission, and thus should be rejected under FPA § 313(b).

Regardless, this contention also lacks merit. The only authority cited by Industrial Customers (*Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1485 (D.C. Cir. 1984)) involved a rate-setting methodology approved by FERC that would permit oil pipelines to charge any rate they wished, subject only to a cap set to prevent “egregious exploitation and gross abuse.” 734 F.2d at 1502. Here, in contrast, the Commission found just and reasonable, as one component of a package of reforms, a set of *fixed* transition payments negotiated as part of a black-box settlement. Unlike the charges at issue in *Farmers Union*, these are fixed rates already found just and reasonable by the Commission, and thus do not require an oversight mechanism beyond the usual oversight and enforcement powers afforded the Commission under the FPA.

III. The Commission Reasonably Accepted the Limited *Mobile-Sierra* Provision in the Settlement

Section 4.C of the Settlement applies the high *Mobile-Sierra*⁷ “public interest” standard of review to (1) the final prices produced by the Forward Capacity Market auction (including any “reconfiguration” auctions), after those prices have been reviewed by the Commission under the lower just and reasonable

⁷ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (“*Mobile*”), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (“*Sierra*”).

standard, and (2) the transition mechanism. *See* Settlement, Section 4.C, JA 1695-96. Reasonably exercising its discretion, the Commission rejected arguments that it revise or eliminate this provision, explaining that it is fully consistent with Commission policy, does not operate to the detriment of non-settling parties, and appropriately balances the need for rate stability with the legal requirement that rates be just and reasonable. Settlement Order at PP 182-186, JA 2051-52; Settlement Rehearing Order at PP 88-95, JA 2372-74; *see generally* *Maine Pub. Util. Comm'n* 454 F.3d at 282-87 (addressing FERC's ability to accept or reject *Mobile-Sierra* clauses in tariffs it reviews in the first instance).

Non-Settling States and Industrial Customers argue that this provision broadly deprives them of their rights under the FPA. Pet. Br. at 51-53; Interv. Br. at 23-28. As an initial matter, Industrial Customers' contentions that Section 4.C deprives them of an opportunity to challenge the substantive provisions of the Settlement under the "just and reasonable" standard lack merit. Interv. Br. at 25. Non-settling parties had the opportunity to challenge the settlement under the just and reasonable standard in this case, and the Commission fully considered their objections. While it is true that they cannot later challenge the settlement itself,

once approved, it is the Commission’s approval here of the settlement that limits that challenge,⁸ not the narrow *Mobile-Sierra* clause.

The rights of non-settling parties are fully protected here. As noted above, Section 4.C only applies the “public interest” standard to challenges to the transition mechanism, which the Commission approved (as part of the broader settlement package) under the “just and reasonable” standard in the instant proceedings, and to the *final* prices produced by the Forward Capacity Market auctions. As the Commission explained, those prices do not become final until ISO New England has made both an informational filing prior to the auction, and a post-auction filing under FPA § 205, 16 U.S.C. § 824d, containing the results. Settlement Order at P 185, JA 2051; Settlement Rehearing Order at P 93, JA 2373. Both filings will be addressed under the just and reasonable standard *before* the public interest standard attaches, and contrary to Non-Settling States’ assertion (Pet. Br. at 53), parties will be able to challenge the auction clearing prices. *Id.*

Moreover, consistent with judicial authority, the Commission made clear that, while it consented to a limited application of the public interest standard, it retained full authority to protect third parties and the public. Settlement Order at P 184, JA 2051; Settlement Rehearing Order at P 94, JA 2373. As Industrial

⁸ The Commission also applied the “just and reasonable” standard to the market rules filed to implement the transition mechanism. *See ISO New England Inc. and New England Power Pool*, 117 FERC ¶ 61,132 at P 26, JA 2384.

Customers recognize (*see* Interv. Br. at 26), the Supreme Court explained in *Sierra* that the public interest standard permits the Commission to take action when rates, terms and conditions of service are “unduly discriminatory” or may place an “excessive burden” on consumers. 350 U.S. at 355. This Court has made clear that the Commission retains an “indefeasible right” under FPA § 206 to address rates, terms or conditions of service that are “unduly discriminatory or preferential” to the detriment of third parties. *Papago Tribal Utility Auth. v. FERC*, 723 F.2d 950, 953 & n.4 (D.C. Cir. 1983); *see also Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937, 961 (1st Cir. 1993) (“The *Mobile-Sierra* doctrine itself allows for intervention by FERC where it is shown that the interests of third parties are threatened”).

Non-Settling States and Industrial Customers also assert that Section 4.C improperly applies to non-settling parties. The Commission explained, however, that its policy has allowed the use of similar provisions in both contested and uncontested settlements. Settlement Order at P 183, JA 2051 (citing cases); Settlement Rehearing Order at P 92, JA 2373. Industrial Customers note that the Commission has agreed with their position on “numerous occasions,” citing orders from 1994 to 2002. Interv. Br. at 21-22. As they admit, however, those orders do not reflect current Commission policy. *See* Settlement Rehearing Order at P 92, JA 2373.

Moreover, the general assertions of Non-Settling States and Industrial Customers ignore another important purpose of the *Mobile-Sierra* doctrine – promoting “the stability of supply arrangements.” *Mobile*, 350 U.S. at 344; *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000). The Commission found stability “particularly important” in this case, given that its genesis was, in part, the unstable nature of revenues available to generators, and the impact it has on wholesale markets. Settlement Order at P 186, JA 2051-52. FERC concluded that this limited *Mobile-Sierra* clause balanced the need for stability – critical “to the health of New England’s electricity infrastructure” – with the legal requirement that rates be just and reasonable. *Id.*

Additionally, while the Commission’s current policy has engendered dissent from one Commissioner (*see* Interv. Br. at 22), that Commissioner did not dissent here, concluding that the “broad support among varied parties for the settlement and the constrained and time-limited application of the ‘public interest’ standard” warranted approval. *See* Settlement Rehearing Order, Commissioner Kelly Concurrence at 2, JA 2379.

Finally, the Commission reasonably addressed on rehearing Industrial Customers’ contention (Interv. Br. at 18-20) that the *Mobile-Sierra* clause must be rejected because it applies to market rules (or tariffs) of general applicability, rather than contracts between specific parties. *See* Settlement Rehearing Order at P

90, JA 2373. This contention, like others discussed above, simply ignores the global, consensual resolution of this difficult, protracted proceeding through a settlement of general (but not universal) agreement. As the Commission explained, it “has on many occasions accepted the application of the ‘public interest’ standard to settlement agreements and contracts setting forth rates.” *Id.* (citing cases). Also, as explained above, the *Mobile-Sierra* clause does not apply to ISO New England’s filing of market rules implementing the settlement or the rates under it. *Id.* Contrary to Industrial Customers’ assertion, then, any objection they have “to a market rule or rate of general application” (Interv. Br. at 19) will be subject to the “just and reasonable standard” (or, in the case of the transition payments, was already considered under the just and reasonable standard). *Id.*

IV. The Commission has Jurisdiction under the FPA to Accept the Settlement and the Forward Capacity Market

The Commission’s jurisdiction over the Settlement and the Forward Capacity Market is explained in its orders. *See* Settlement Order at PP 201-202, JA 2054-2055; Settlement Rehearing Order at PP 108-112, JA 2376-77.

Non-Settling States’ argument that the Commission lacks jurisdiction to approve the Settlement proceeds entirely from the false premise that the Forward Capacity Market is “a mechanism to force utilities in New England to purchase certain FERC-approved generation capacity,” and thereby “implements a FERC-ordered resource adequacy determination.” Pet. Br. at 54-55. As the Commission

explained, however, “[t]he settlement does not in any way alter the method by which resource adequacy requirements (particularly the installed capacity requirement) are determined or direct that a particular amount of capacity be installed.” Settlement Order at P 201, JA2054-55. Moreover, participation in the new market is not mandatory, as parties have the ability to self-supply their capacity obligation. *Id.*; Settlement Rehearing Order at P 110, JA 2376.

Non-Settling States contend that the settlement implements a resource adequacy requirement because it is driven by the determination of the installed capacity requirement. Pet. Br. at 55. However, neither the Settlement nor the Forward Capacity Market “alter [the installed capacity requirement] or in any way determine the appropriate amount of capacity that must be available.” Settlement Rehearing Order at P 108, JA 2376. The determination of the capacity requirement, and the Commission’s jurisdictional role in that determination, are the subject of separate proceedings previously before this Court in *Connecticut Department of Public Utility Control v. FERC*, 484 F.3d 558, and subsequent FERC orders, two of which are now on appeal in *Connecticut Department of Public Utility Control v. FERC*, No. 07-1375 (D.C. Cir. filed Sept. 19, 2007).

Those raising jurisdictional arguments below pointed to no provision in the Settlement establishing a resource adequacy requirement. *See* Settlement Order at P 201, JA 2054-55. For the first time on appeal, Non-Settling States point to the

locational aspect of the Forward Capacity Market, which, if triggered, would establish a separate capacity zone with a separate auction for installed capacity. *See* Pet. Br. at 56. Since this issue was not presented to the Commission, the Court should not entertain it here. *See, e.g., Constellation*, 457 F.3d at 21 (finding an argument waived where the parties “did not make [it] before the agency and in fact never even cited the sections of the tariff on which they now rely”); FPA § 313(b), 16 U.S.C. § 825l(b).

In any event, as the Commission explained in the challenged orders, the Forward Capacity Market is simply a mechanism for determining charges for the installed capacity product. Settlement Order at P 201, JA 2054-55; Settlement Rehearing Order at P 108, JA 2376. This Court has determined that FERC has jurisdiction under the FPA to regulate such charges. *Id.*, citing *Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978), and *Mississippi Industries v. FERC*, 808 F.2d 1525, *vacated in part on other grounds*, 822 F.2d 1104 (D.C. Cir. 1987).

In *Groton*, for example, the Court held that the Commission had jurisdiction over NEPOOL’s installed capacity deficiency charge (the precursor to today’s installed capacity market, *see supra* pp. 8-9), reasoning that the charge falls within “the Commission’s inclusive jurisdictional mandate” under FPA §§ 205 and 206, 16 U.S.C. §§ 824d-e. 587 F.2d at 1302; *see also* FPA §§ 201(b)(1) and 205(a), 16

U.S.C. §§ 824(b)(1) and 824d(a) (granting FERC jurisdiction over rates for “transmission of electric energy in interstate commerce and the sale of electric energy at wholesale in interstate commerce,” and rules and practices affecting those rates). Similarly, *Mississippi Industries* upheld Commission orders reallocating capacity costs among four tightly-integrated utility companies, observing that such costs “are a large component of wholesale rates,” and as a result, “FERC’s jurisdiction . . . is unquestionable.” 808 F.2d at 1541-42. The Court also noted that regulating capacity charges does not result in the assertion of jurisdiction over generating facilities in violation of FPA § 201(b), 16 U.S.C. § 824(b). 808 F.2d at 1543-45.

To distinguish *Groton* and *Mississippi Industries*, Non-Settling States merely reassert their factually incorrect premise that FERC’s action here establishes an installed capacity requirement for the New England States. Pet. Br. at 60-61. As explained above, however, the Settlement does not alter the method by which the installed capacity requirement is established. *See supra* pp. 58-59. Here, like in *Groton* and *Mississippi Industries*, the Commission is only regulating wholesale charges for capacity paid to electric generating facilities in interstate commerce, an area where it has “undisputed authority.” *Mississippi Industries*, 808 F.2d at 1544.

Non-Settling States also read more into this Court's recent decision in *Connecticut Department of Public Utility Control v. FERC* than is warranted. Pet. Br. at 61. There, the FERC orders under review asserted jurisdiction to approve the installed capacity requirement, which, as explained above, the Commission is not doing here. Moreover, those orders were remanded to the Commission because the agency failed to provide an explanation of the statutory basis for its jurisdiction, and *not* because the Court agreed with petitioner's jurisdictional claim. *Conn.*, 484 F.3d at 561.

CONCLUSION

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

Respectfully submitted,

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December 31, 2007

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 13,789 words, not including the tables of contents and authorities, the certificates of counsel, or the addendum.

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