

**In the United States Court of Appeals
for the District of Columbia Circuit**

No. 09-1296

**MARYLAND PUBLIC SERVICE COMMISSION AND
NEW JERSEY BOARD OF PUBLIC UTILITIES,
*PETITIONERS,***

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
*RESPONDENT.***

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

**BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

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CIRCUIT RULE 28(A)(1) CERTIFICATE

A. Parties and Amici

To counsel's knowledge, the parties and intervenors before this Court and before the Federal Energy Regulatory Commission in the underlying docket are as stated in the Brief of Petitioners.

B. Rulings Under Review

1. Order Dismissing Complaint, *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,276 (Sept. 19, 2008) ("Complaint Order"), R. 75, JA 389; and
2. Order Denying Rehearing and Request for Oral Argument, *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, 127 FERC ¶ 61,274 (June 18, 2009) ("Rehearing Order"), R. 87, JA 457.

C. Related Cases

In the orders under review in this appeal, the Federal Energy Regulatory Commission ("Commission") denied a complaint by the New Jersey Board of Public Utilities ("New Jersey") and the Maryland Public Service Commission. The complaint concerned transitional auctions in an electricity capacity market, the Reliability Pricing Model, operated by PJM Interconnection, L.L.C. ("PJM") in 13 states and the District of Columbia.

This Court previously considered consolidated petitions for review of earlier Commission orders that established the rules for all auctions in this electricity

capacity market. Those appeals involved some of the same parties here, New Jersey and Intervenor-Petitioner PJM Industrial Customer Coalition. *See New Jersey Board of Public Utilities v. FERC*, D.C. Cir. No. 07-1414; *Office of People's Counsel for the District of Columbia v. FERC*, D.C. Cir. No. 08-1008. After full briefing, the petitioners in Nos. 07-1414 and 08-1008 withdrew their appeals. This Court addressed the remaining appeal, upholding the Commission's approval of the tariff rules for conducting all auctions in PJM's Reliability Pricing Model. *Public Service Electric & Gas Company v. FERC*, No. 07-1336, 2009 U.S. App. LEXIS 5699 (D.C. Cir. Mar. 17, 2009).

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GLOSSARY

<i>Blumenthal</i>	<i>Blumenthal v. FERC</i> , 552 F.3d 875 (D.C. Cir. 2009)
Brattle Report	The Brattle Group, Review of PJM’s Reliability Pricing Model (June 30, 2008), http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=11727810
Commission or FERC	Federal Energy Regulatory Commission
Complaint Order	Order Dismissing Complaint, <i>Maryland Public Service Commission v. PJM Interconnection, L.L.C.</i> , 124 FERC ¶ 61,276 (Sept. 19, 2008), R. 75, JA 389
Complaint Orders	Collectively, the Complaint Order and Rehearing Order
<i>Conn. DPUC</i>	<i>Connecticut Department of Public Utility Control v. FERC</i> , 569 F.3d 477 (D.C. Cir. 2009)
FPA	Federal Power Act
Initial Reliability Order	Initial Order on Reliability Pricing Model, <i>PJM Interconnection, L.L.C.</i> , 115 FERC ¶ 61,079 (Apr. 20, 2006)
ISO	Independent System Operator
Maryland	Petitioner Maryland Public Service Commission
<i>Me. PUC</i>	<i>Maine Public Utilities Commission v. FERC</i> , 520 F.3d 464 (D.C. Cir. 2008)
New Jersey	Petitioner New Jersey Board of Public Utilities

GLOSSARY

PJM	Intervenor PJM Interconnection, L.L.C., operator of the regional grid in 13 mid-Atlantic states and the District of Columbia
<i>PSE&G</i>	<i>Public Service Electricity & Gas Co. v. FERC</i> , D.C. Cir. No. 07-1336, 2009 U.S. App. LEXIS 5699 (D.C. Cir. Mar. 17, 2009), affirming the Reliability Orders
<i>PUC of Cal.</i>	<i>Public Utilities Commission v. FERC</i> , 254 F.3d 250 (D.C. Cir. 2001)
Rehearing Order	Order Denying Rehearing and Request for Oral Argument, <i>Maryland Public Service Commission v. PJM Interconnection, L.L.C.</i> , 127 FERC ¶ 61,274 (June 18, 2009), R. 87, JA 457
Reliability Market	Reliability Pricing Model
Reliability Orders	Collectively, the Initial Reliability Order, Reliability Settlement Order, and Reliability Rehearing Order
Reliability Settlement Order	Order Denying Rehearing and Approving Settlement Subject to Conditions, <i>PJM Interconnection, L.L.C.</i> , 117 FERC ¶ 61,331 (Dec. 22, 2006)
Reliability Rehearing Order	Order on Rehearing and Clarification and Accepting Compliance Filing, <i>PJM Interconnection, L.L.C.</i> , 119 FERC ¶ 61,318 (June 25, 2007)
RTO	Regional Transmission Organization
States	Petitioners Maryland and New Jersey

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**BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission (“Commission” or “FERC”) reasonably denied a complaint challenging the electricity capacity charges determined in transitional auctions consistent with the reliability pricing market provisions and market power mitigation measures in the regional transmission operator’s tariff.

STATUTORY PROVISIONS

The pertinent statutes are contained in the Addendum to this brief.

INTRODUCTION

This is the latest in a series of cases arising from the ongoing efforts of the Commission, regional transmission operators, and electricity market participants to create and implement rate designs that promote the development of sufficient capacity resources to ensure system reliability. *See infra* pp.6-9 (describing such efforts, and ensuing litigation, concerning markets in California, New York, and New England).

PJM Interconnection, L.L.C. (“PJM”), a regional transmission operator in certain mid-Atlantic states, and its market participants spent seven years developing a replacement rate design to ensure reliability, especially in capacity-deficient areas of New Jersey, Maryland, the District of Columbia, and the Delmarva Peninsula. Last year, this Court upheld the Commission’s approval of that forward-looking locational capacity market. *Pub. Serv. Elec. & Gas Co. v. FERC*, No. 07-1336, 2009 U.S. App. LEXIS 5699 (D.C. Cir. Mar. 17, 2009) (“*PSE&G*”). In the instant case, two states (of thirteen, plus the District of Columbia, within PJM’s system) challenge the results of auctions held by PJM to determine capacity prices during a transitional period leading up to full implementation of that capacity market.

After PJM held four auctions to determine capacity prices for each year of the 2007-2011 transitional period, Petitioners Maryland Public Service

Commission (“Maryland”) and New Jersey Board of Public Utilities (“New Jersey”) (together, “States”) filed a complaint under Section 206 of the Federal Power Act (“FPA”), 16 U.S.C. § 824e. They alleged that the resulting prices are unjust and unreasonable and proposed modified capacity charges in their place.

In this regard, the instant case is analogous to *Blumenthal v. FERC*, 552 F.3d 875 (D.C. Cir. 2009), in which this Court affirmed the Commission’s denial of a similar complaint raising challenges to interim measures used to ensure system reliability in New England energy markets while a forward capacity market was put into place. As in the orders that this Court upheld in *Blumenthal*, the Commission in the orders on appeal here concluded that States failed to meet their burden of proving that the transitional rates were unjust and unreasonable, as well as their additional burden of showing that their replacement proposal would produce just and reasonable rates. *Md. Pub. Serv. Comm’n v. PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,276 (2008) (“Complaint Order”), R. 75, JA 389, *reh’g denied*, 127 FERC ¶ 61,274 (2009) (“Rehearing Order”), R. 87, JA 457.¹

¹ “R.” refers to a record item. “JA” refers to the Joint Appendix page number. “P” refers to the internal paragraph number within a FERC order.

STATEMENT OF FACTS

I. STATUTORY AND REGULATORY BACKGROUND

A. Federal Power Act

Section 201 of the Federal Power Act gives the Commission jurisdiction over the rates, terms, and conditions of service for the transmission and sale at wholesale of electric energy in interstate commerce. 16 U.S.C. §§ 824(a)-(b). This grant of jurisdiction is comprehensive and exclusive. *See generally New York v. FERC*, 535 U.S. 1 (2002) (discussing statutory framework and FERC jurisdiction). It includes the power to set rates for electricity capacity, either directly or indirectly through a market mechanism, and to review capacity requirements that affect those rates. *Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477, 482-84 (D.C. Cir. 2009) (“*Conn. DPUC*”).

All rates for or in connection with jurisdictional sales and transmission services are subject to FERC review to assure they are just and reasonable, and not unduly discriminatory or preferential. FPA § 205(a), (b), (e), 16 U.S.C. § 824d(a), (b), (e). Courts addressing the issue, including this one, have consistently concluded that market-based rates, as well as cost-based rates, can satisfy the statutory standards. *See La. Energy & Power Auth. v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998); *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870-71 (D.C. Cir. 1993); *Cal. ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1013 (9th Cir. 2004).

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

B. Reliability Concerns And Capacity Markets

Having considered numerous appeals concerning new energy market rate designs over the last decade, this Court is well-acquainted with the problems of maintaining reliability of the transmission system, especially in areas of high demand along the Eastern Seaboard, and with the various mechanisms that the Commission has approved in regional markets for the purpose of ensuring reliability. Nevertheless, a brief overview of this series of cases provides context for the current dispute.

The Commission’s efforts to foster wholesale electricity competition over broader geographic areas in recent decades led to the creation of Independent System Operators (“ISOs”) and Regional Transmission Organizations (“RTOs”) (collectively, “regional entities”). *See Morgan Stanley Capital Group v. Pub. Util. Dist. No. 1*, 128 S. Ct. 2733, 2740-41 (2008). These independent regional entities operate the transmission grid on behalf of transmission-owning member utilities and are required to maintain system reliability. *See NRG Power Mktg., LLC v. Me.*

Pub. Utils. Comm'n, 130 S. Ct. 693, 697 & n.1 (2010) (explaining responsibilities of an ISO). As these regional entities restructured electricity supply options with greater reliance on auction-based electricity markets and price caps or market power mitigation in those markets, they developed different approaches to address reliability needs. *See generally Pub. Utils. Comm'n v. FERC*, 254 F.3d 250, 252 (D.C. Cir. 2001) (“*PUC of Cal.*”) (because of price caps in the California market, contracts were required to ensure that generators were available when needed); *Elec. Consumers Res. Council v. FERC*, 407 F.3d 1232, 1235 (D.C. Cir. 2005) (approach adopted with goal of benefiting customers through better price signals for new entrants and reduced incentives to exercise market power); *Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d 464, 467 (D.C. Cir. 2008) (“*Me. PUC*”) (“in a capacity market . . . the transmission provider compensates the generator for the option of buying a specified quantity of power irrespective of whether it ultimately buys the electricity”) (internal quotation marks, alterations, and citation omitted).

The California ISO was an early adopter of “[reliability] contracts to ensure ancillary services, voltage support, and energy to support the reliability” of the grid it controlled. *PUC of Cal.*, 254 F.3d at 252. The California ISO paid the generator under contract to stand ready to deliver energy and passed the costs of these contracts to its member utilities and, by extension, their customers, through a formula rate. *Id.* at 252-53; *cf. W. Area Power Admin. v. FERC*, 525 F.3d 40, 44-

45, 53 (D.C. Cir. 2008) (upholding pass-through of ISO’s administrative costs, including the costs of securing reliability services).

The New York ISO took a different approach to reliability, requiring load-serving entities to procure sufficient capacity and assessing a charge for deficiencies. *Elec. Consumers*, 407 F.3d at 1234 (the deficiency rate was “three times the annualized cost of installing a new ‘peaker’ power plant”). But “[t]his rate design resulted in a vertical demand curve” for capacity that “caused extreme volatility in [capacity] prices, thus discouraging investment in new generation facilities” *Id.* In 2003, the New York ISO replaced this flawed rate design with a design based on an administratively-determined demand curve that specified the prices that must be paid for various quantities of capacity. *Id.* at 1235 (the maximum capacity price on this curve was “two times the annualized cost of a new peaker plant”). The New York ISO established monthly auctions to determine the price for capacity at the point where the supply curve, set by bids of capacity sellers, intersected this proxy demand curve. *Id.* The Court upheld the Commission’s approval of this experimental rate design. *Id.* at 1239-1242 (rejecting challenges that the capacity rates were too high and not properly designed to encourage investment in new generation capacity).

ISO New England, facing severe capacity shortages in 2003, first adopted reliability contracts with individual generators to meet reliability needs. *See Me.*

PUC, 520 F.3d at 467-68. Because the Commission disfavors reliability contracts, ISO New England proposed a new rate design: a proxy demand curve like that approved for New York plus a location component that would set prices “highest in the regions with the most severe capacity shortages” *Id.* at 468; *see NRG*, 130 S. Ct. at 697 (in orders approving the reliability contracts, “FERC directed the ISO to develop a new market mechanism that would set prices separately for various geographical sub-regions”).

After months of negotiations, ISO New England and other parties settled on a different rate design, the Forward Capacity Market, that did not include the proxy demand curve. *Me. PUC*, 520 F.3d at 469. Instead, the settling parties proposed a reliability auction with a three-year lead time and a location component to reflect scarcity of capacity in different sub-regions, and fixed payments to generators for the three-year transitional period. *Id.*; *see also Conn. DPUC*, 569 F.3d at 480 (detailing auction process). In June 2006, the Commission approved the settlement over strenuous objections to the transition payments. *See Me. PUC*, 520 F.3d at 469 (“[t]he most contentious issue regarding the Forward Capacity Market is the set of ‘transition payments’ that will be required”). This Court affirmed the Commission’s approval of the rate design, *id.* at 467-76,² and, in a later appeal,

² The Court reversed the Commission on a separate issue (burden applicable to third-party complaints) not relevant here, *id.* at 476-79; that holding was overturned by the Supreme Court in *NRG*, 130 S. Ct. 693.

rejected a challenge pertaining to high prices during the transitional period before that market took effect. *Blumenthal*, 552 F.3d at 885 (upholding FERC’s denial of complaint; “the Forward Capacity Market [] has met our approval and is being put into place”).

II. THE COMMISSION PROCEEDINGS AND ORDERS

A. Background Of PJM’s Reliability Pricing Market

1. History of PJM’s Capacity Requirements

Like other regional entities, PJM has tried several different mechanisms to address reliability on its system. Since its inception as a tight power pool, PJM has required member utilities to commit capacity in advance to support their customers’ electrical capacity needs or pay a deficiency charge based on the fixed costs of a new generator. *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257, at 62,276 n.197 (1997) (“deficiency charge is . . . based on the cost of installing a combustion turbine generator”). In 1999, PJM modified the reliability requirement to allow load-serving utilities to wait until the day before the operating day to procure needed capacity. *See PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 9 (2006) (“Initial Reliability Order”). At the same time, PJM instituted daily and monthly market opportunities for the purchase of capacity credits, in which a single clearing price was paid to all suppliers to meet each day’s capacity requirement. *See id.*; *see also Utilimax.com, Inc. v. PPL Energy Plus, LLC*, 378 F.3d 303, 305 (3d Cir. 2004) (describing ways a load-serving utility

could satisfy its capacity obligation and the method for determining prices in the capacity credit markets). PJM kept the deficiency charge for load-serving utilities that failed to procure sufficient capacity to meet peak demand plus a reserve margin. *See* Initial Reliability Order at P 9.

With about a year of experience under this new market, PJM found that the modifications it had made to the capacity market were creating supply insufficiencies and volatile capacity prices in certain locations. *See id.* at P 11 (“the limitations of PJM’s capacity construct will result in multiple reliability criteria violations in Eastern PJM, particularly in New Jersey, the Delmarva Peninsula and the Baltimore-Washington area”); *id.* at P 23 (“daily prices in the PJM capacity credit market have been at or near zero for most of the 2000 – 2004 period, with occasional spikes (some lasting multiple months) of well over \$100 per megawatt-day”); *see also Utilimax.com*, 378 F.3d at 305 (during the first quarter of 2001, the capacity deficiency rate was \$177.30 per megawatt-day and double that when there was an overall shortage).

2. Settlement Process and Tariff Provisions

In 2000, PJM responded to those problems by initiating negotiations with stakeholders and neighboring transmission grid operators to reform the capacity market. *See* Initial Reliability Order at P 12. After a prolonged period with lack of sufficient majority support, PJM submitted its own proposal for a new market in

2005. *Id.* at P 13. While the Commission found that the existing capacity market was unreasonable, it did not adopt PJM’s replacement proposal in full; instead, the Commission directed additional process to develop a just and reasonable capacity market. *Id.* at P 6. The Commission encouraged PJM to address the shortcomings in its existing market, including any need for location-specific capacity requirements and incentives to retain existing generation and attract new sources of supply through transmission expansion, demand response, and new generation resources. *Id.*

In 2005 and 2006, at the urging of the Commission, PJM market participants intensified debate on reform of the market, with at least three formal technical conferences and many informal discussions to consider multiple proposals. *See id.* at PP 11, 26; *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 at PP 21-22 (2006) (“Reliability Settlement Order”), *on reh’g*, 119 FERC ¶ 61,318 (“Reliability Rehearing Order”), *reh’g denied*, 121 FERC ¶ 61,173 (2007) (collectively, the “Reliability Orders”). At the request of parties, an Administrative Law Judge facilitated a settlement agreement (“Settlement”) that resolved all remaining issues regarding implementation of the Reliability Market. Reliability Settlement Order at PP 22-24.

The parties supporting or not opposing the Settlement represented a broad group of interests, including generators, customers, retail suppliers, and six state

utility commissions. *Id.* at P 5. In fact, only 11 of the 89 parties that intervened in the original proceeding filed comments opposing the Settlement. *Id.* at P 24. Petitioner New Jersey filed comments opposing the Settlement, while Petitioner Maryland took no position. *Id.* at Appendix B, C.

The Reliability Market proposed in the Settlement, approved by the Commission, and incorporated into PJM's tariff contains features approved for other regional entities' markets. A proxy demand curve, developed by the same methodology and similar in its numerical values to that approved for New York, is used to set the price and amount of annual capacity needed for each sub-region in PJM. *See Elec. Consumers*, 407 F.3d at 1234-35. The proxy curve adopted in the Settlement is lower, yielding the same or lower prices at varying capacity levels, than the curves first proposed by PJM or adopted in New York. Reliability Settlement Order at PP 25-26, 101 (maximum capacity price is 1.5 times the cost of a new peaker power plant). Utilities can opt out of the reliability auctions by supplying sufficient capacity from their own generation or through bilateral contracts with suppliers. *Id.* at P 6.

PJM's market design also incorporates a deliverability requirement, ensuring that generators committing capacity can deliver that capacity to the load, even in the presence of transmission constraints. This provides a possibility for 23 different annual capacity prices in the Reliability Market when transmission

constraints limit the amount of generation that can be imported into each of PJM's 23 sub-regions. *Id.* at PP 14, 30. And like New England's capacity market, the Reliability Market also provides for auctions to be conducted every year to procure capacity three years in advance of the year in which the capacity will be provided. *Id.* at P 6.

Unlike New York's approach, the PJM Reliability Market proposal incorporated a transitional period in the move from a vertical demand curve to the downward-sloping proxy curve. The four auctions for Delivery Year 2007-2008 through Delivery Year 2010-2011 were performed on an accelerated schedule with less than a three-year forward commitment. The Reliability Market proposal phased in sub-regional pricing with a maximum of four divisions in the first three auctions and the full complement of 23 divisions possible thereafter. Reliability Settlement Order at P 59. To further limit price fluctuations during the transitional period, the settling parties agreed on the number that would represent the costs of a peaker plant, the "Cost of New Entry," which sets the maximum price for capacity for the duration of the transitional period. *Id.* at P 26; *see* Complaint, Att. A-2, 2, R. 1, JA 180 (the value of the net cost of new entry for the first three auctions was \$148 to \$159 per megawatt-day in constrained sub-regions, making the maximum capacity price in these regions between \$223 and \$239 per megawatt-day).

The Reliability Market also includes measures to mitigate any supplier market power identified by PJM’s independent Market Monitor. *See Reliability Settlement Order at PP 33-35.* The tariff prevents existing capacity resources from physically withholding their supply by requiring “that all available capacity must be offered in the Base Residual Auction and incremental auctions” *Id.* at P 33 (explaining that the Commission will halt auction processes if the Market Monitor suspects physical withholding). To prevent suppliers from driving prices to non-competitive levels through bidding strategies, the tariff specifies rules for capping bids in noncompetitive conditions at a supplier’s avoidable or opportunity cost. *Id.* To reflect these difficult-to-measure costs, during the first three transitional auctions, the Settlement allows avoidable cost default bids to include a specified dollar adder for a portion of a supplier’s capacity. *Reliability Rehearing Order at P 157.*

3. The Reliability Orders

The Commission largely approved the Settlement, finding that the proposal was a just and reasonable means of resolving the deficiencies in PJM’s existing capacity market. *Reliability Settlement Order at P 1.* Noting the actual occurrence of reliability violations in New Jersey due to generation retirements and expected reliability problems for the Baltimore-Washington area, *id.* at P 11, the Commission concluded that “the Settlement is expected to provide greater

incentives for new generation, transmission, and demand response, while also providing sufficient revenues to retain existing resources that are needed.” *Id.* at P 6.

Further, the Commission rejected arguments that the proxy demand curve would create price volatility, “in that a small change in the amount of capacity in the market could significantly change the price at which the market will clear” (Reliability Settlement Order at P 79), responding that the sloped rather than the current vertical curve would result in comparatively less volatile prices. *Id.* at P 86. Over objections of capacity suppliers that the mitigation rules were too punitive and concerns of capacity buyers that mitigation would not prevent the exercise of market power and uncompetitive prices, *id.* at PP 94-99, the Commission approved the market mitigation rules, with small changes to eliminate potentially discriminatory provisions. *Id.* at PP 100-01 (noting that the mitigation rules addressed the area of greatest concern, the ability of existing resources to raise prices in areas with long-standing transmission constraints).

The Commission also approved the transitional auction proposal. *See id.* at PP 60-73. The Commission was aware that there would be comparatively little new entry during the transitional auctions, but found the transitional design reasonable based on the phased implementation of the deliverability requirement and the protections offered by the mitigation rules. *Id.* at PP 68, 105. As relevant

here, no party requested that the Commission institute fixed payments for suppliers in the manner of the highly-contested New England transition pricing mechanism. *See id.* at PP 60-65 (detailing requests for fewer sub-regions, more sub-regions and a more gradual transition period). The Commission concluded that the transition was valuable in that it would allow market participants a period of time to understand and become accustomed to the dynamics of the new capacity market prior to its full implementation. *Id.* at P 68.

On rehearing of the Reliability Settlement Order, the Commission granted New Jersey's request for additional monitoring of the performance of the Reliability Market and additional process on inclusion of energy efficiency in the market. Reliability Rehearing Order at PP 194, 204. New Jersey also objected to the deliverability requirement in the Reliability Market, arguing that the rate design would increase prices in sub-regions without adding reliability for those sub-regions. *See id.* at P 185. The Commission denied rehearing on that issue, responding that the previous capacity market failed to provide sufficient capacity to transmission-constrained areas like New Jersey because it did not have a deliverability requirement. *Id.* at P 190 (without the deliverability requirement of the Reliability Market, "PJM will be forced to resort to out-of-market Reliability Must Run contracts simply to keep necessary capacity in operation"). Admitting there was no absolute certainty that the Reliability Market would procure the

needed capacity for New Jersey, the Commission approved the market based on models showing that it would result in a more reliable system. *Id.* at P 191 & n.144 (Reliability Market is “forecasted to enable PJM to meet its reliability obligations 95 percent of the time, as compared with a forecast of only 52.2 percent under its existing market structure”).

The Commission issued a second rehearing order to address the contention by New Jersey and others that the Commission cannot rely on a market in which all suppliers have market power and all bids are mitigated to provide competition that results in a just and reasonable rate. *See* 121 FERC ¶ 61,173 at P 19.

Concluding again that the Reliability Market ensures just and reasonable prices, the Commission explained that “mitigation measures will constrain sellers to submit bids that prevent the exercise of market power, with the result that prices will approximate those of a competitive market.” *Id.* at P 24.

4. Affirmance of Reliability Orders (*PSE&G*)

Petitioner New Jersey, Intervenor PJM Industrial Customer Coalition, and other parties appealed the Reliability Orders to this Court in Case Nos. 07-1414 and 08-1008. On February 3, 2009, after full briefing, the Commission filed a letter informing the Court that the issues decided 11 days earlier in *Blumenthal* were controlling in resolving the same issues raised in those appeals. On February

27, 2009, the petitioners in Nos. 07-1414 and 08-1008 moved to withdraw their appeals. The Court granted the motion on March 4, 2009.

Two days later, the Court heard oral argument in a related appeal, in Case No. 07-1336, of the Reliability Orders by a capacity provider, Public Service Electric and Gas Company. The Court affirmed the Reliability Orders later that month, in *PSE&G*.

5. Ongoing Consideration of Revisions

On March 19, 2008, after the first four reliability auctions had been completed, several capacity buyers, including Maryland and New Jersey, requested that the Commission convene a technical conference to evaluate the performance of the Reliability Market. *PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,272 at P 1 & n.1 (2008). In April 2008, PJM requested that the Commission delay any technical conference until after completion of a broad review of the Reliability Market by an independent consultant. *Id.* at P 5. This report was filed with the Commission on June 30, 2008. *Id.* at P 10; The Brattle Group, Review of PJM's Reliability Pricing Model (June 30, 2008) ("Brattle Report"), <http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=11727810>.

In response to these filings, the Commission encouraged PJM and its stakeholders to evaluate the Reliability Market design with the intention of making changes to prospective auctions. 124 FERC ¶ 61,272 at P 52. The Commission

directed PJM to file proposed tariff modifications or a progress report regarding prospective changes with the Commission. *Id.*

PJM, in conjunction with its stakeholder group, is continuing to consider and propose reforms to the Reliability Market. These reforms, which will apply to future auctions, are currently ongoing in proceedings before the Commission. *See PJM Interconnection, L.L.C.*, 126 FERC ¶ 61,275 (Mar. 26, 2009) (accepting modifications to cost of new entry and directing changes to incremental auctions), *on clarification and reh'g*, 128 FERC ¶ 61,157 (Aug. 14, 2009) (clarifying cost of new entry determinations), *order on compliance*, 129 FERC ¶ 61,090 (Oct. 30, 2009) (accepting changes to incremental auctions and ordering further justification of proposed payments), *denying reh'g and ordering compliance*, 131 FERC ¶ 61,168 at PP 39, 86 (May 20, 2010) (accepting tariff changes to allow the purchase and sell back of capacity in incremental auctions and directing further changes to the rate design).

B. The Challenged Orders

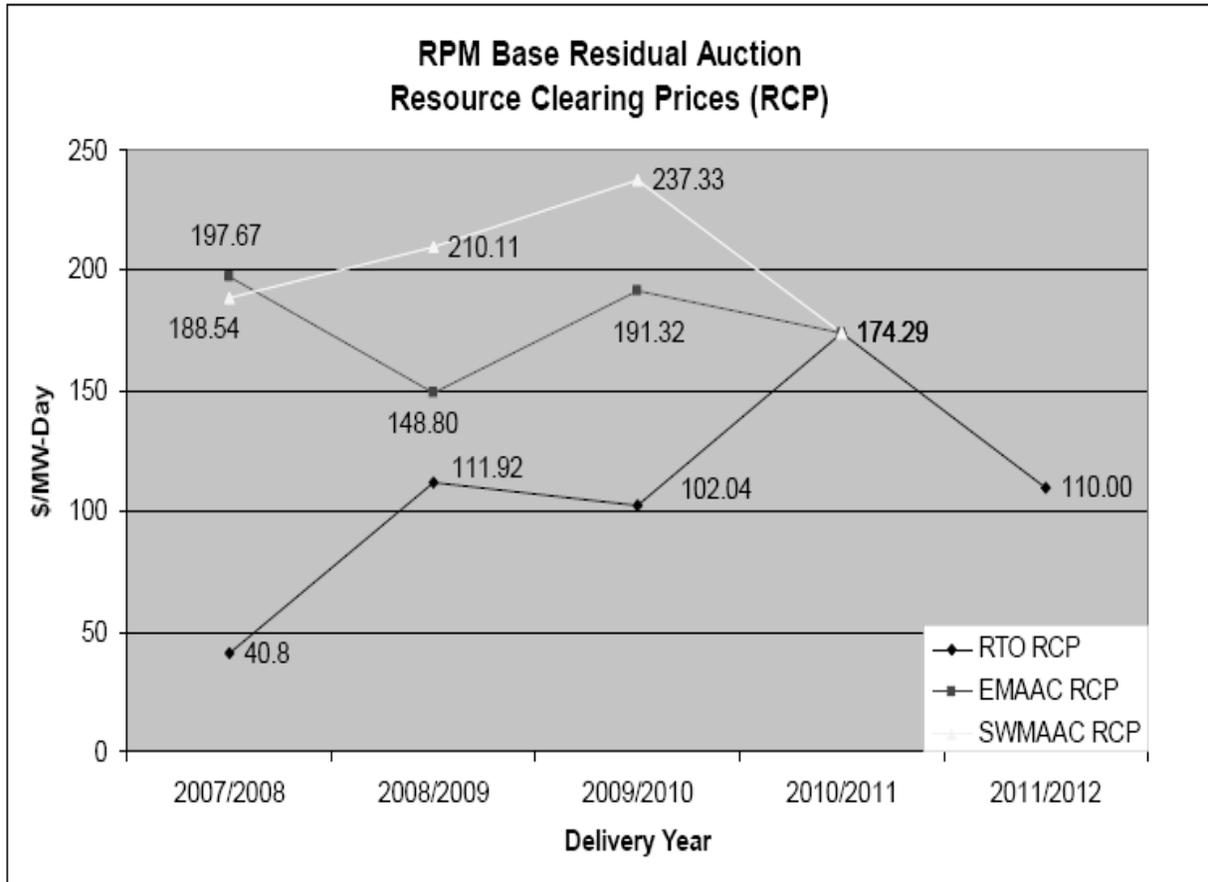
1. Reliability Auction Results

Between April 2007 and May 2008, PJM held five Reliability Auctions for Delivery Years 2007-2008 through 2011-2012. Pursuant to Commission directives in the Reliability Rehearing Order, PJM posted the results of the Delivery Year 2011-2012 auction (the first to procure capacity under a full three-year forward

commitment) and compared these results with the results from the previous four (transitional) auctions. *See* 2011/2012 RPM Base Residual Auction Results (May 15, 2008), <http://www.pjm.com/~media/markets-ops/rpm/rpm-auction-info/20080515-2011-2012-bra-report.ashx>.

Figure 1, taken from that report, shows the prices resulting from the five years of auctions by sub-region. *Id.* at 4. For the first three years, prices differed in the Eastern Mid-Atlantic Area Council (“EMACC”), consisting of utilities in New Jersey, Southeast Pennsylvania, and the Delmarva Peninsula, and the Southwestern Mid-Atlantic Area Council (“SWMAAC”), consisting of utilities in Maryland and the District of Columbia, as compared with lower prices for the rest of PJM (shown below as “RTO”). For the fourth year prices were substantially identical throughout PJM, near \$175 per megawatt-day. Because of added capacity from transmission expansions planned for 2011, there were no sub-regional auctions for the fifth year and prices for capacity converged at \$110 per megawatt-day for all of PJM. *Id.* at 2.

Fig. 1: Capacity Prices by Sub-Region for 2007-2012 Auctions



PJM’s independent Market Monitor, Joseph Bowring, conducted market power analyses following each auction and made the results available through PJM’s website. See Answer of PJM, Att. A at P 4 n.1 (“Market Monitor Declaration”), R. 62, JA 266. In these various reports, the Market Monitor explained that all participants had failed the market power test and, thus, “all sell offers . . . except sell offers for new units” were capped at the marginal cost of capacity (the avoidable cost rate) in all five auctions. *Id.* at P 5, JA 266. In a

compilation of his analyses of the five auctions, the Market Monitor declared that “the results of the [Reliability Market] auctions to date were competitive,” *id.* at P 9, JA 268, and that “there was no physical withholding in any . . . auction to date.” *Id.* at P 4, JA 266; *see id.* at P 11 (citing 2009-10 Market Monitor Report to explain that “increased forced outage rates . . . [do] not constitute evidence of the exercise of market power”), JA 268.

In another review of the results of the first five auctions, independent consultants concluded that all auctions had met the reliability and economic goals of the Reliability Market. Brattle Report at 2. Specifically, the consultants found that “[t]he increase in generation, demand response, and transmission capacity committed to serve” the Maryland/District of Columbia region and the New Jersey/Southeast Pennsylvania/Delmarva Peninsula region “has integrated these regions into the RTO-wide capacity market and improved reserve margins within these regions” from one to two percent below target reliability levels to the RTO-wide levels of one to two percent above target levels. *Id.* at 3. Further, the report found that “customers have paid capacity prices that are consistent with resource adequacy conditions” in each sub-region. *Id.* The Brattle Report also explained the substantial price drop for the 2011-2012 Delivery Year as a result of one load-serving utility’s planned exit from PJM and the continued participation of generation resources that had served that load in the Reliability Auction. *Id.* at 3-4

(“If Duquesne had not withdrawn its load from PJM, however, or generation in the Duquesne zone had chosen not to offer its capacity into [Reliability Market], the 2011/12 clearing prices would have been approximately \$150 [per megawatt-day]”).

2. Complaint Order

The issues now before the Court arise from a complaint filed in May 2008 by Petitioner States and other parties representing buyers of capacity in PJM. Complaint, R. 1, JA 1. The complainants challenged the reasonableness of prices resulting from the transitional auction held in July 2007 and reserved their right to challenge the results of the remaining auctions. *Id.* at 72-73, JA 72-73.³

The Commission found that the complainants had not met the burden of showing that the Reliability Market prices were unreasonable or in violation of PJM’s filed tariff. *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,276 at P 23 (2008) (“Complaint Order”), R. 75, JA 399-400. Nor had they shown that their proposal to revise auction-determined rates and obligations was just and reasonable. *Id.* at P 29, JA 403. Because the transitional

³ When States filed their complaint, PJM had completed five auctions. *See supra* pp.19-21 & fig. 1. The first four of these were transitional in that they were conducted without a full three-year forward commitment. On appeal, States seek a remedy for the results from the second (Delivery Year 2008-2009), third (Delivery Year 2009-2010) and fourth (Delivery Year 2010-2011) auctions. Br. 21, 50.

auctions were determined in accord with the tariff provisions (*id.* at P 25, JA 401), and because the application of mitigation measures prevented the exercise of market power by suppliers (*id.* at P 31, JA 404), the Commission concluded that prices in the transitional auctions were just and reasonable.

Conducting a broad review of the first four completed auctions (the auctions held for Delivery Years 2007-2008 through 2010-2011), the Commission found that the complaint was, at bottom, a challenge to elements of the tariff that were challenged in the Reliability Orders and accepted by the Commission. *Id.* at P 25, JA 401. After examining reports from the Market Monitor and others on the competitiveness of the market, the Commission found the complaint's allegation that sellers, in general, exercised market power, was unfounded and refuted by the findings in these reports. *Id.* at P 30 & nn.43-44 (“[t]here was no physical withholding in any [Reliability Market] auction” and “offers were not above avoidable costs”) (citing 2009-2010 Market Monitor Report), JA 403-04.

Although it was difficult to determine the exact remedy that complainants requested (Complaint Order at P 18, JA 398), the Commission determined that any changes to the auction prices would undermine the principal focus of the Reliability Market: preservation of system reliability. *Id.* at P 29, JA 403. The Commission denied the request to set new prices in the market and calculate corresponding seller obligations, finding that the denial was “consistent with the

[Federal Power Act], and the structure of [the Reliability Market], [and] in accord with Commission precedent” *Id.* at P 32, JA 404.

3. Rehearing Order

On June 18, 2009, the Commission issued its Order Denying Rehearing and Request for Oral Argument, *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, 127 FERC ¶ 61,274 (2009) (“Rehearing Order”), R. 87, JA 457. The Commission reiterated its finding that complainants had failed to meet their dual burden under FPA § 206 to show that the transitional auction rates are unjust and unreasonable, and that complainants’ proposed remedy, based in part on reliability contracts, was just and reasonable. *Id.* at PP 10, 17 & n.18 (citing *Blumenthal*, 552 F.3d at 885), JA 460-61, 464-65.

The States petitioned the U.S. Court of Appeals for the Fourth Circuit for review. Over opposition of the States, the Fourth Circuit granted PJM’s motion to transfer the case to this Court.

SUMMARY OF ARGUMENT

The Commission approved the Reliability Market to address a fatal flaw in the prior capacity regime — it was not attracting or retaining enough generation to keep every area within the PJM system operating reliably. The transitional Reliability Market auctions, at issue here, succeeded in reversing that situation.

States were aware that, under the new Reliability Market, prices would be higher in areas with scarce supplies. New Jersey asked the Commission to delay or change the market, but failing that, it awaited the results of the auctions. After customers and suppliers had secured their obligations in the first five auctions, States sought to undo the approved market rules, alleging unexpected market outcomes and market manipulation on the part of suppliers. Like the petitioner in *Blumenthal*, States sought to replace the market outcomes, during the period prior to full operation of capacity market, with a less expensive, location-neutral pricing structure.

Just as it did in *Blumenthal*, the Commission reasonably determined that there was no assurance that these newly-proposed prices would deliver the reliability that States needed. Again, as it did in *Blumenthal*, the Commission reasonably rejected States' proposed remedy, which included the negotiation and litigation of cost-based reliability contracts, a solution disfavored by the Commission.

But the Commission did not rest entirely upon these determinations about the proposed remedy, as it takes seriously any allegation of market manipulation. Relying on reports from PJM's Market Monitor, an independent consulting firm hired to analyze the effectiveness of the Reliability Market, and even States' witness, the Commission properly determined that all supplier offers in all of the Reliability Market auctions had been mitigated to a competitive level in order to address market power concerns. It further found that no unlawful withholding had occurred during the transitional auctions.

Finding that States' other allegations went to the sufficiency of the approved tariff provisions, and that neither PJM nor any market participant had violated those provisions, the Commission concurrently instituted a proceeding to address prospective improvements. Satisfied that the transitional auction rates in PJM were reasonable and met the principal focus of maintaining reliable service to protect customers, the Commission left the prices unchanged to serve the important dual purpose of preserving customer and supplier expectations and signaling the need for capacity in future Reliability Market auctions.

In denying States' complaint, the Commission applied the correct standard, reviewed the evidence presented, and reasonably determined that States had failed to meet their burden to show that capacity rates in PJM's Reliability Market were unjust and unreasonable or that their proposed remedy would be just and

reasonable. In these circumstances, just as in other circumstances meeting this Court's approval (most recently in *Blumenthal*), the Commission's actions here to preserve regional system reliability, satisfying all statutory and regulatory responsibilities, are similarly worthy of judicial respect.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *See, e.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). A court must satisfy itself that the agency "articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

The Commission's decisions regarding rate issues are entitled to broad deference, because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); *see also PUC of Cal.*, 254 F.3d at 254 ("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, our review of whether a particular rate design is just and reasonable is highly deferential.”) (internal quotation marks and citations omitted); *accord Elec. Consumers*, 407 F.3d at 1236. *See also Morgan Stanley*, 128 S. Ct. at 2738 (“The statutory requirement that rates be ‘just and reasonable’ is obviously incapable of precise judicial definition, and we afford great deference to the Commission in its rate decisions.”); *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 951 (D.C. Cir. 2007) (“In reviewing FERC’s orders, we are ‘particularly deferential to the Commission’s expertise’ with respect to ratemaking issues.”) (citation omitted).

The Commission’s factual findings are conclusive if supported by substantial evidence. FPA § 313(b), 16 U.S.C. § 825l(b). The substantial evidence standard “requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.” *La. Pub. Serv. Comm’n v. FERC*, 522 F.3d 378, 395 (D.C. Cir. 2008) (quoting *FPL Energy Me. Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002)). Substantial evidence means “such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.” *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 477 (1951) (internal quotation marks and citation omitted); *accord Consol. Oil & Gas, Inc. v. FERC*, 806 F.2d 275, 279 (D.C. Cir. 1986). If the evidence is susceptible of more than one rational interpretation, the Court must uphold the agency’s findings. *See Consolo v. Fed.*

Mar. Comm'n, 383 U.S. 607, 620 (1966); accord *Fla. Mun. Power Agency v. FERC*, 315 F.3d 362, 368 (D.C. Cir. 2003) (“The question we must answer . . . is not whether record evidence supports [petitioner]’s version of events, but whether it supports FERC’s.”).

II. STATES FAILED TO SHOW THAT TRANSITIONAL CAPACITY PRICES DETERMINED BY PJM’S RELIABILITY MARKET PROCESS WERE UNJUST AND UNREASONABLE

As complainants under FPA § 206, States bore the burden of proof to show that PJM’s existing rates, rules, or practices were unjust and unreasonable. 16 U.S.C. § 824e(b); *Blumenthal*, 552 F.3d at 881. In a § 206 proceeding, the Commission takes a hard look at the evidence presented even when the existing rate has only recently been approved. See *Ameren Servs. Co. v. Midwest Indep. Transmission Sys. Operator, Inc.*, 121 FERC ¶ 61,205 at P 33 (2007) (“The mere fact that a tariff provision implementing a particular rate was at one time found to be just and reasonable does not preclude” FPA § 206 review.). Here, in satisfaction of its § 206 responsibilities, the Commission reasonably concluded that States had failed to meet their burden of showing that the results of the transitional auctions were unjust and reasonable.

A. The Transitional Auctions Were Conducted In Accordance With The Process Previously Approved In The Reliability Orders And PSE&G

1. PJM’s Reliability Market, Including The Transitional Procedures, Has Already Been Approved

The core purpose of the Federal Power Act is not only “preventing excessive rates,” but also “protecting against inadequate service” and “promoting the orderly development of plentiful supplies of electricity.” *Consol. Edison Co. of N.Y., Inc. v. FERC*, 510 F.3d 333, 342 (D.C. Cir. 2007) (internal quotation marks and citations omitted); *Blumenthal*, 552 F.3d at 879 (system reliability is “a primary goal”). Facilitation of stable supply arrangements benefits buyers as well as sellers. *NRG*, 130 S. Ct. at 701 (“promotion of ‘the stability of supply arrangements . . . is essential to the health of the [energy] industry’”) (citing *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 344 (1956)).

In accord with these statutory purposes, as discussed above, the Commission has approved, and this Court has affirmed, a variety of innovative, market-based approaches to the problem of capacity shortages that threaten system reliability. *See supra* pp.6-9; *e.g.*, *Conn. DPUC*, 569 F.3d 477 (New England: forward capacity market); *Me. PUC*, 520 F.3d at 471-76 (New England: transition capacity payments and a descending clock auction); *Elec. Consumers*, 407 F.3d 1232 (New York: capacity auctions with a sloping proxy demand curve); *PUC of Cal.*, 253 F.3d 251 (California: reliability contracts). *Cf. Blumenthal*, 552 F.3d at 884-85

(noting ““presumption of validity”” afforded to ““each exercise of the Commission’s expertise,”” especially in light of electricity market’s ““intensely practical difficulties’ demanding a solution from FERC,” and latitude necessarily given to FERC “to balance the competing considerations and decide on the best resolution”) (quoting *Permian Basin*, 390 U.S. at 767, 790).

PJM’s Reliability Market adopted these established approaches, using auctions to provide price incentives to develop and maintain capacity resources in the proper locations and forward binding commitments to ensure stability. *See Reliability Orders, aff’d in PSE&G*, 2009 U.S. App. LEXIS 5699, at *7 (citing “FERC’s purpose, based on past experience, to enhance stability and predictability in the electricity capacity market”); Complaint Order at P 29 (“principal focus” of PJM’s Reliability Market is preservation of system reliability in order to protect customers), JA 403; *see supra* pp.12-14 (describing Reliability Market mechanism). The Commission and this Court have approved the Reliability Market over objections similar to those raised on appeal here. *See supra* pp.15-17 (describing concerns regarding auction function), 17-18 (describing appeals from Reliability Orders). PJM’s approved tariff included interim procedures that applied during a four-year transitional period, building to auctions conducted to allow for full three-year forward commitments. *See supra* pp.13-14. The Commission approved these interim procedures with capacity price protections

given the inability of new generators to participate fully in these auctions and the potential for existing resources to exercise market power in transmission-constrained areas. *See supra* pp.15-17.

On appeal, States begin by challenging the Commission’s analysis of their complaint under FPA § 206 as a matter of statutory interpretation — specifically, States claim that the Commission “precluded all challenges” to capacity prices because those rates were “set” on the date of the auctions, and determined by the operation of the Reliability Market tariff. Br. 25.⁴ States also appear to believe that the Commission deemed their complaint untimely. Br. 26-27; *cf.* Intervenors in Support of Pet’rs Br. 4, 6.

But States miss the point of the Complaint Orders. The Commission did not treat the auction results as static or inviolate; nor did it hold that those results could not be modified, if warranted. Rather, as detailed below, the Commission appropriately considered the conduct of the transitional auctions, including whether they had followed the carefully designed process and mitigation rules set forth in PJM’s tariff. It also reviewed the auction results, considering the findings of PJM’s Market Monitor, an independent consultant, and States’ witness, as well as the Commission’s own experience with capacity markets in other regions, and

⁴ States never raised this statutory interpretation issue before the Commission and thus are barred from introducing it on appeal. *See* FPA § 313(b), 16 U.S.C. § 825l(b).

the purpose and effects of the forward capacity commitments set by the auctions. That comprehensive review reflects the agency’s commitment to active oversight of market-based rate designs — hardly the “automatic pilot with no real checks or controls” that States claim (Br. 20).

2. The Transitional Auctions Followed The Tariff Process

The Commission began its analysis of States’ complaint with the tariff, finding, upon review, that “no party violated PJM’s tariff and the prices determined during the auctions were in accord with the tariff provisions governing the auctions.” Complaint Order at P 23, JA 399-400; *see also id.* at P 25, JA 401; Rehearing Order at PP 10-11, 21, 31, JA 460-61, 466, 471; Br. 15 (complaint did not “focus on any tariff violations”).

Capacity prices under PJM’s Reliability Market process are developed using “a thorough tariff process that not only governs the manner in which offers are considered, but includes detailed mitigation procedures to ensure that market power is not exercised.” Rehearing Order at P 30, JA 470; *cf. Blumenthal*, 552 F.3d at 884 (upholding interim measures in New England market, in part because “price caps and mitigation rules remain in place to protect against anticompetitive behavior and excessive rates”). The process set forth in the tariff is akin to a formula rate. *Cf. Consol. Edison Co. of N.Y., Inc. v. FERC*, 347 F.3d 964, 966 (D.C. Cir. 2003) (“Unlike tariffs for traditional cost-of-service rates, the filed

tariffs at issue here contain no precise prices; instead, they set standards for . . . administration of . . . markets”); *see also* Intervenor’s Br. 6 (PJM’s Reliability Market rules “are essentially a formula rate”).

The Commission deems failure to adhere to a formula in a filed tariff to be a violation of the tariff. *Cf., e.g., Consol. Edison*, 510 F.3d at 337-38 (FERC considers whether “unjust enrichment” results from tariff violations, and orders refunds as appropriate); *see also Duke Power Co. v. FERC*, 864 F.2d 823, 831 (D.C. Cir. 1989) (refund of charges inconsistent with the filed rate is not impermissible retroactive ratemaking). In evaluating a challenge to the application of a formula rate, the Commission examines inputs to the rate formula and violations of the procedures in the tariff. *See PUC of Cal.*, 254 F.3d at 254 (“the utility’s rates, then, can change repeatedly, without notice to the Commission, provided those changes are consistent with the formula”) (internal quotation marks, emphasis, and citation omitted).⁵

Several of States’ objections to the transitional auction results centered on elements of the formula itself, such as the phasing-in of the capacity pricing process during the transitional period, the steepness of the proxy demand curve, the

⁵ The formula rate itself can, of course, be challenged under FPA § 206, on a prospective basis. *See id.* at 258. But “because the formula itself is the rate, not the particular components of the formula, periodic adjustments made in accordance with the Commission-approved formula do not constitute changes in the rate itself” *Id.* at 254 (internal quotation marks, alteration, and citation omitted).

methodology for determining Net Cost of New Entry, the fact that certain resources could not participate in the auctions, and the manner in which PJM determines reliability parameters. *See* Complaint Order at PP 12, 25, JA 394-95, 401; Rehearing Order at PP 38-39, JA 473-74. But the Commission rejected those collateral attacks on the tariff: “each of these elements of [the Reliability Market] was part of the . . . Settlement and was explicitly incorporated into the [Reliability Market] provisions of PJM’s tariff” that the Commission and this Court previously approved. Complaint Order at P 25, JA 401.

States also attacked the mitigation procedures established in the tariff to ensure just and reasonable rates under the Reliability Market. In accord with the requirements of this Court, the Commission instituted mitigation rules to protect against the exercise of market power *at any time* when capacity in the RTO or a sub-region was concentrated in the hands of too few suppliers. Rehearing Order at P 4 & n.3 (describing three pivotal supplier test), JA 458; *see also id.* at P 15 (“we have instituted mitigation procedures that are designed to limit the potential to exercise market power in these auctions”), JA 463; *Blumenthal*, 552 F.3d at 882 (explaining that a grant of market-based rates requires a finding that sellers do not have or have adequately mitigated market power); *Wis. Pub. Power, Inc. v. FERC*, 493 F.3d 239, 257-58 (D.C. Cir. 2007) (in the past, FERC has supported, but not required, this type of market concentration test).

Further, the Commission examined each element of the method for limiting suppliers' bids to marginal cost, by substitution of either a proxy bid or a unit-specific cost-based bid representing avoidable cost. *See supra* pp. 12-14; Complaint Order at P 5, JA 391; *see also* Reliability Settlement Order at P 115 (requiring fast-track FERC review procedures for default bids and individual cost-justified bids determined by the Market Monitor during the first auctions). The Commission also approved measures in PJM's tariff to distinguish between legitimate reasons for not bidding capacity, for example, to account for outages, and unwarranted withholding of capacity from the market. Reliability Settlement Order at P 33 ("the Tariff gives . . . guidance on identifying physical withholding"). The Commission concluded that each element of the formula, including the mitigation measures, had been followed as set forth in the tariff. Complaint Order at P 30, JA 403-04.

Additionally, States focused their complaint on the only inputs into the Reliability Market formula rate, the supply offers. *See* Intervenor in Support of Pet'rs Br. 6 ("mitigated offers[] are funneled through the [Reliability Market] rules"); *PUC of Cal.*, 254 F.3d at 255 (state could challenge inputs into California ISO's formula rate by challenging costs in each reliability contract). The Commission found that all supply offers were mitigated to a competitive level and there was no evidence that suppliers exercised market power. Rehearing Order at

P 13, JA 462. Accordingly, the Commission reasonably denied State’s challenge to the inputs to the formula.

Thus, finding no violation of the formula rate and no unlawful inputs into the formula, the Commission properly found that the tariff had functioned as intended.

3. Ongoing Consideration Of Prospective Revisions To The Tariff Does Not Undermine The Current Process

The fact that the Commission found the tariff functioned as intended does not make the tariff inviolate. *PUC of Cal.*, 254 F.3d at 257 (if petitioner showed that the “formula rate was defective . . . the remedy . . . would be the development of a better formula”). Indeed, PJM and its stakeholders, together with the Commission, are considering tariff modifications to implement lessons learned from the transitional auctions and analyses presented by the Brattle Report and PJM’s Market Monitor, among others. *See supra* at pp.18-19, *see also* Complaint Order at P 24, JA 400-01.

The Commission did not suggest that such prospective changes were the remedy for unjust and unreasonable results of past auctions, as States contend (Br. 32). As explained below, the Commission found that the results of the transitional auctions were not, in fact, unjust and unreasonable. *See infra* Part II.B.

But the ongoing process of revising the procedures demonstrates that the Commission does not simply rest on its initial approval of the Reliability Market,

but continues to monitor and seek to improve the procedures to ensure just and reasonable results in the future. While not treating the Reliability Market as an experiment given the basic design’s proven record in New York, Reliability Settlement Order at P 76 & n.64, “[t]he Commission along with PJM and the parties will be monitoring the performance of [the Reliability Market] to determine whether adjustments need to be made to ensure that prices remain just and reasonable.” Reliability Rehearing Order at P 194. *See* Complaint Order at P 24 (“the design and implementation of a forward market should be continually evaluated and changes made when necessary”), JA 400; *see also* Rehearing Order at P 37 (“the Commission was and remains open to proposed prospective changes resulting either from PJM or through complaints”), JA 473; *accord* Reliability Settlement Order at P 147. For that reason, States’ reliance (Br. 34) on *Lockyer* — which faulted the Commission for approving market-based tariffs without subsequent monitoring of rates and uses of market power (383 F.3d at 1014-15) — is misplaced. *See* Rehearing Order at PP 29-31 (distinguishing ratemaking under Reliability Market, which uses a detailed tariff process that includes mitigation procedures to prevent exercise of market power), JA 470-71.

This Court has made clear that it expects such oversight, at least for experiments: “[T]he deference the court affords the Commission is based on the understanding that the Commission will monitor its experiment and review it

accordingly.” *Elec. Consumers*, 407 F.3d at 1239. The Court has likewise anticipated that the Commission will continue to fine-tune market mechanisms. *See, e.g., id.* (noting that requiring annual evaluations of the Demand Curve would provide FERC and the New York ISO “the information needed to determine whether the rate design requires modification should their predictions fail to be borne out by experience”); *Blumenthal*, 552 F.3d at 884 (deferring to Commission’s reliance on transitional processes even though “FERC acknowledge[d] the imperfections of these interim solutions”); *cf. PSE&G*, 2009 U.S. App. LEXIS 5699, at *8 (“there is ample reason to think that the § 205 adjustment [to the cost of new entry variable] will adequately offset any deficiencies in the automatic mechanism”).

The Commission’s commitment to monitor and adjust capacity market processes reflects responsible policymaking and regulatory oversight — but it does not render previously-approved tariff provisions unjust and unreasonable. *See* Complaint Order at P 24 (“the fact that certain [Reliability Market] provisions are being examined for future changes does not justify” altering the results of the past transitional auctions), JA 401; *see also* Rehearing Order at P 30 (even if some procedures need to be revised, “such changes should not operate to invalidate previous auctions and the rates produced by such auctions”), JA 470-71; *id.* at P 42 (“[though] tariff provisions applied during the transitional auctions are subject to

revision on a forward basis to improve the performance of the [Reliability Market] auctions, we do not find that the possibility of such changes is sufficient to undo the results of past auctions”), JA 476.

In fact, judging current processes against prospective changes would be counterproductive: “It would inhibit the ability to improve the [Reliability Market] process if whenever PJM and its stakeholders propose changes to improve [the Reliability Market], such changes can be used as evidence that the prior tariff is unjust and unreasonable, requiring that the prices from already conducted auctions be redetermined.” *Id.* at P 30 n.33, JA 471; *accord Consol. Edison*, 510 F.3d at 340 (“[T]he fact that FERC approved prospective filings by the [New York ISO] to change aspects of the reserves market in response to the market irregularities of early 2000 does not mean that it is also required to order retroactive relief Concluding otherwise would . . . open the gates to retroactive changes in tariffs any time the power markets’ rules were adjusted.”).

B. The Commission Reviewed The Auction Results And Found No Basis To Conclude They Were Unjust And Unreasonable

Of course, the Commission’s consideration of States’ complaint did not end with its finding of compliance with the tariff. The Commission did not, as States contend (*e.g.*, Br. 17), rest on its previous approval of the Reliability Market process or limit remedies to prospective tariff revisions. To the contrary, the

Commission examined the actual results of the transitional auctions and reasonably found no basis to conclude that the capacity rates were unjust and unreasonable.

1. The Commission Reasonably Found That PJM’s Mitigation Measures Successfully Controlled Any Exercise Of Market Power

States argue that the Commission ignored a “mountain of evidence showing that [the Reliability Market]’s mitigation rules were wholly ineffective” during the first four Reliability Auctions, allowing existing generators to bid at prices greater than competitive offers. Br. 31; *see id.* 33. But the Commission found no such evidence, after considering not only States’ allegations, but also evidence presented in analytical reports from States’ consultant, PJM’s Market Monitor, and a consulting group hired by PJM to propose improvements to the Reliability Market. Complaint Order at P 24 & nn.34-36, JA 400-01. Reviewing all of this evidence, the Commission properly concluded that no seller violated the mitigation rules, that sellers’ bids were not above competitive levels as measured by marginal costs, and that, as a result, the prices in the transitional auctions were reasonable. *Id.* at PP 30-31, JA 403-04; Rehearing Order at P 13 & n.12, JA 462.

Because it was judged that suppliers would otherwise have the opportunity to exercise market power in the transitional auctions, “every offer by capacity resources was subject to these mitigation procedures.” Complaint Order at P 30, JA 403. This came as no surprise in the constrained sub-regions that were already

experiencing capacity shortages, like those that include Maryland and New Jersey, because every existing generator in such situations is pivotal. Reliability Settlement Order at P 101 (“mitigation is primarily targeted to existing capacity resources in constrained Locational Delivery Areas”); *see also Me. PUC*, 520 F.3d at 473 (FERC can reasonably rely on its findings in its earlier orders).

Nor were mitigation measures ineffective at limiting bids to competitive levels, as States claim (Br. 36-37). In the Reliability Market, the Commission adopted mitigation rules that define a competitive capacity bid as each generator’s avoidable costs: the costs it would avoid “if it does not commit to supplying capacity in the delivery year.” Reliability Rehearing Order at P 138; *see* Rehearing Order at P 13 (“generators’ offers are limited to competitive offers”), JA 462. Recognizing that these costs are hard to quantify, especially during the transitional period when many suppliers would be submitting, and the Market Monitor would be reviewing, cost justifications for default bids, the Commission approved transitional measures allowing for “limited safe harbor increment[s],” or “bid adders,” in certain limited circumstances. Reliability Settlement Order at P 113 (finding that “the bid adder will not raise significant market power concerns”).

Contrary to States’ characterization as “makeshift” measures (Br. 18), the Commission appropriately balanced the need to retain generation in the transitional period with the need for strict price controls on default bids in addition to the other

price protections afforded customers. Reliability Settlement Order at P 113 (concluding, over capacity buyers' objections, that the "adder will serve as an incentive to existing generators to remain in service during the limited three-year transition period, after which it is more likely that new entry will be available"); *see supra* p.12 (customers will pay no more than 1.5 times the cost of new entry, if they choose to participate in the auctions); *see also Consol. Edison*, 510 F.3d at 341 (as here, FERC "balanc[ed] the several interests at stake, including the . . . high [market] prices paid, expectations of affected entities, various tariff provisions, and the need to balance fair prices and system reliability").

On complaint below, and here on appeal, States attempt to revive that debate. They allege that the ability of suppliers to have higher default bids during the first three auctions of the transitional period, and lower default bids in the fourth auction, proves the exercise of market power. *See* Br. 36-37. Given that these differences in default bids were expected, and having already balanced customer interests in reliable supply and fair prices, the Commission properly concluded that prices were reasonable for the transitional period. Rehearing Order at P 13, JA 462; *see PSE&G*, 2009 U.S. App. LEXIS 5699, at *7 ("[petitioner] has failed to show that [the adjustments] render the resulting rates unreasonable, given FERC's purpose, based on past experience, to enhance stability and predictability in the electricity capacity market"); *cf. Elec. Consumers*, 407 F.3d at 1240 ("the

balancing of short-term costs against long-term benefits is within the Commission's discretion").

The Commission further found that sellers did not violate the mitigation provisions that it approved for the Reliability Market transitional period. Complaint Order at P 31, JA 404; Rehearing Order at P 13 & n.12, JA 462. At bottom, States have failed to show that the methods for calculating default bids do not "reflect legitimate methods of quantifying generator costs." *Id.* n.12, JA 462; *see also* Reliability Rehearing Order at P 139 (Commission expected that suppliers would sometimes bid below their proxy for a competitive bid; but if suppliers had market power, they would not be allowed to bid *above* this default bid level).

Furthermore, the Commission found that States' allegations of physical withholding were merely descriptions of the incentives to withhold, without any supporting evidence that individual generators actually violated the tariff's withholding provisions. Rehearing Order at P 13 (complaint based on "unsubstantiated suggestions"), JA 462. This was incentive without means, because the Market Monitor "checked every [megawatt] of capacity in the PJM footprint and validated . . . that there was a valid reason" for each megawatt not offered into each auction. Complaint Order at P 30 (quoting Market Monitor Decl. at P 4, JA 265-66), JA 403; *see also* Brattle Report at 73 & Table 15 (showing capacity excluded from each auction due to "environmental restrictions" and

explaining that a “state regulator” kept capacity from being bid into the first three auctions based on those environmental restrictions).

As demonstrated, though the Commission relied on the mitigation provisions to ensure reasonable results, it did not rely on those measures alone. *See* Rehearing Order at P 30 (“not one offer in the auctions being challenged was determined unilaterally by the seller”), JA 470. It also relied on real-time review of the offers by the Market Monitor, *id.*, as well as after-the-fact evaluations of the auction results by the Market Monitor, PJM’s consultant, and States’ consultant. Complaint Order at P 24 & nn.34-36, JA 400-01. ““The Market Monitor reviewed [suppliers’] offers in detail and the offers were not above avoidable costs.’ [He] thus concluded that the results of the [Reliability Market] auctions were competitive. . . .” *Id.* at P 30 (quoting Market Monitor Decl. at P 12, JA 269), JA 404; *id.* at P 24 n.34 (citing report of States’ consultant, James F. Wilson), JA 400; Rehearing Order at P 13 (citing Market Monitor’s conclusion), JA 462; *see also* Market Monitor Decl. at PP 14-17 (citing Aff. of James F. Wilson at para. 90, JA 141-42, to show inclusion of emission-related capital costs in avoidable costs is appropriate and consistent with “economic logic”), JA 270-71.

The Reliability Market simulated the rates produced in a competitive market because each supplier’s offer into the transitional auctions was mitigated to a competitive level. The Commission looked for violations of the mitigation rules

by suppliers. Finding none, it reasonably determined that suppliers had not exercised market power.

2. States Failed To Show That The Resulting Capacity Prices Were Outside The Zone Of Reasonableness

The Commission also properly rejected States' argument that the auction-based capacity prices must be re-examined in comparison to prices that would be produced in a hypothetical market or by cost-based regulation. Rehearing Order at P 14, JA 462-63; *see* Rehearing Request at 14, JA 422.

First, the Commission noted that it was “not clear exactly” how States believed the auction rates differed from rates that would be produced in a competitive market. Rehearing Order at P 15, JA 463. The auction process was designed to simulate the rates produced in a competitive market. *Id.* Moreover, the Commission had already determined that the auction methodology would produce rates that send “appropriate price signals” for encouraging construction of new facilities. *Id.* (quoting Reliability Settlement Order at P 68). *Cf. Blumenthal*, 552 F.3d at 883 (emphasizing “critical [price-]signaling function” of capacity rates). The Commission further noted the role of mitigation procedures in limiting the potential to exercise market power. Rehearing Order at P 15, JA 463.

Second, as to cost-based rates, the Commission acknowledged that the auction rates “would not be expected to be the same as those produced through a traditional individual cost-of-service rate proceeding using average costs” —

though, again, because every offer in the transitional auctions was subject to the tariff's mitigation procedures (setting rates by reference to each generator's avoidable costs), the resulting prices were, in fact, cost-based (or, at least, cost-constrained). Rehearing Order at P 16 & n.15, JA 463. In any event, auction-determined rates need not track cost-based rates to be just and reasonable. *Id.* at P 16 (“The fact that rates determined through a market mechanism such as an auction deviate from the average cost-based rates does not demonstrate that such rates are unjust and unreasonable.”) (citing *FPC v. Texaco, Inc.*, 417 U.S. 380, 387 (1974)), JA 463; *id.* at P 16 & n.17 (citing additional cases, including *Blumenthal and Me. PUC*), JA 464. *See generally Permian Basin*, 390 U.S. at 797 (FERC may, “within a ‘zone of reasonableness’ . . . employ price functionally in order to achieve relevant regulatory purposes”) (citation omitted).

C. The Commission Appropriately Found That Overturning Market Participants' Reliance On The Transitional Auction Results Would Undermine The Purpose And Operation Of The Reliability Market

The Commission further determined that the transitional capacity auctions had, in fact, served the primary goal of the Reliability Market to promote development of capacity resources and that reliance by capacity suppliers and other market participants weighed against disturbing the auction results. Complaint Order at PP 26, 29, JA 402, 403; Rehearing Order at PP 17-18, 23, JA 464-65, 467. States argue that the Commission's findings of reliance are speculative and

unsupported, given the short forward periods used in the transitional auctions and the participation of relatively little new capacity in the bidding. Br. 38-45; *see also* Rehearing Order at P 22, JA 467. But the Commission supported its findings with evidence of actual reliance as well as its experience with forward markets.

First, the Commission did find record evidence of actual reliance on the transitional auction results: “The Brattle Group report found [that] evidence did suggest that [the Reliability Market] has both attracted new investment and retained capacity” Rehearing Order at P 23 & n.25 (citing Brattle Report’s findings regarding capacity that was retained rather than retired, commitments of incremental capacity, requests for new generation interconnections, and decreases in power exports), JA 467; *see also* Complaint Order at P 26 n.39 (noting that, because of auctions, capacity resources “must start to make whatever commitments are needed so they will be available on the delivery date”; thus, “parties have relied” on tariff provisions), JA 402. *Cf. Borough of Chambersburg v. PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,219 at P 1 (2006) (finding PJM had correctly applied tariff and declining to re-run allocation of auction revenue rights “after parties have already made commitments based on that allocation”), *cited in* Complaint Order at P 32, JA 405.

Second, the Commission rejected States’ claim (Br. 43) that the participation of little new capacity in the transitional auctions showed a lack of reliance by

capacity providers. Regardless of whether a supplier had invested in new facilities at that point, “each supplier of necessity would have had to forgo other opportunities to use its generating capacity” due to its commitment to PJM; such lost opportunities included bilateral sales or participation in other regional capacity markets. Complaint Order at P 28, JA 402; *see also id.* (PJM and capacity resources had right to rely on auction prices and obligations from that point, including in making capacity commitments and investment decisions); *accord* Rehearing Order at P 24 (quoting Complaint Order), JA 467-68. The Commission had previously found that market participants — not only capacity providers, but also buyers — rely on PJM’s auction process “in a variety of ways,” ranging from business and contracting decisions to financial commitments and hedging strategies. *See Duquesne Light Co.*, 122 FERC ¶ 61,039 at P 92 (2008), *cited in* Rehearing Order at P 25, JA 468. Given the Commission’s longstanding expertise in rate design and its growing experience with forward capacity markets in different regions, its informed expectations of market participants’ behavior are beyond mere speculation. *See PSE&G*, 2009 U.S. App. LEXIS 5699, at *7 (noting “FERC’s purpose, based on past experience, to enhance stability and predictability in the electricity capacity market”); *Blumenthal*, 552 F.3d at 884-85 (court defers to Commission’s expertise when addressing practical complexities of electricity market); *Elec. Consumers*, 407 F.3d at 1238-39 (deferring to Commission’s policy

judgment in formulating rate design); *cf.* Reliability Rehearing Order at P 191 (“In approving new rate design initiatives, the Commission must rely on economic theory and evidence as to how rate designs will perform.”).

Finally, reliance on auction results goes to the very purpose of the Reliability Market: to provide incentives for capacity suppliers to make forward binding commitments, whether to construct new facilities, or to improve efficiency of existing resources, or to forgo other economic opportunities. “[T]he purpose of [the Reliability Market] was to obtain forward binding commitments from capacity resources to be available in order to ensure reliability, and to create sufficient incentives for new generation projects and demand resources to participate in the program.” Complaint Order at P 26, JA 401-02; *accord* Reliability Rehearing Order at P 191 (“The binding one-year commitment coupled with three-year advanced notice provides greater assurance of performance, enforceable through standard contract enforcement measures, and greater opportunity for new entrants to compete with existing capacity providers, than anything in the current capacity construct.”). Therefore, changing rates and quantities that have been determined in accordance with a clear, settled tariff process “would defeat the purpose of the forward binding commitment and undo the incentives for new capacity resources.” Complaint Order at P 26, JA 402; *accord* Rehearing Order at P 18 (“[States’] proposal would undercut the very reliance on prices that [the Reliability Market]

was designed to produce, so as to induce capacity suppliers to enter PJM and stay in PJM . . .”), JA 465.

III. STATES ALSO FAILED TO MEET THEIR BURDEN UNDER FPA § 206 TO PROPOSE A JUST AND REASONABLE REPLACEMENT RATE

A complainant under FPA § 206 also must “prove . . . that its proposed alternative . . . would be just and reasonable.” *Blumenthal*, 552 F.3d at 885.

Again, States failed to satisfy their burden. As in *Blumenthal* (*id.*), the Commission made its § 206 inquiry, determining not only that the capacity prices set by the transitional auctions are not unjust and unreasonable, but *also* that States’ proposed replacement rates are not just and reasonable. Rehearing Order at PP 17-18, 21, 27, JA 464-65, 466, 469; *cf. Blumenthal*, 552 F.3d at 885 (holding FERC’s rejection of complainant’s proposal was not arbitrary and capricious where FERC “reasonably concluded that the current market structure is the superior interim solution to ensure the workability of . . . electric power markets until the Forward Capacity Market takes effect”). Indeed, the Commission concluded that States’ proposed replacement rates would undercut the principal purpose of the Reliability Market. Rehearing Order at P 18, JA 465.

A. States Had The Burden Of Showing Their Replacement Rate Would Be Just And Reasonable

States dispute that they are required to show that their proposed replacement is appropriate. Br. 48-49. But the Commission evaluates FPA § 206 complaints to

determine whether complainants have met a dual showing, both that existing rates are unreasonable and that proposed replacement rates are reasonable. *See, e.g., Am. Elec. Power Serv. Corp.*, 113 FERC ¶ 61,050 at PP 18, 22, 28, 31 (2005) (repeatedly reminding complainants of their burden in hearing to show that replacement rate proposed for PJM was reasonable); *Xcel Energy Servs., Inc.*, 121 FERC ¶ 61,284 at P 72 (2007) (“the proponent of a change . . . bears the burden under section 206 of the FPA to show that the existing [return on equity] is unjust and unreasonable and that a different [return on equity] and capital structure are just and reasonable”); *La. Pub. Serv. Comm’n v. Entergy Corp.*, 123 FERC ¶ 61,188 at P 31 & n.39 (2008) (citing *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002), for proposition that “party advocating a change” bears dual FPA § 206 burden).

This Court in *Blumenthal* affirmed that approach in addressing a complaint that mirrors the one here. *See Blumenthal v. ISO New England, Inc.*, 117 FERC ¶ 61,038 at P 56 (2006) (rejecting proposed market redesign to add new reliability contracts based on prior approval of capacity market design), *order on reh’g*, 118 FERC ¶ 61,205 at P 11 (2007), *aff’d in Blumenthal*, 552 F.3d at 881, 886. *Blumenthal*, in turn, relied (at 885) on *Atlantic City* for the proposition that the advocate of change, even when that advocate is the Commission which is already tasked with determining and fixing the reasonable rate, “must show that its

proposed changes are just and reasonable.” 295 F.3d at 10. Thus, the Commission properly followed its own and this Court’s precedent in requiring States to show the reasonableness of their proposed replacement rate. Complaint Order at P 29, JA 403; Rehearing Order P 17 & n.18, JA 464.

B. States Failed To Propose A Just And Reasonable Replacement Rate

Before the Commission, the scope of relief sought by States, in terms of which delivery years they sought to re-price, was “not entirely clear.” Complaint Order at P 18, JA 398. States clarify, on appeal, that they seek to reform the prices for the second, third, and fourth reliability auctions to mimic the transition structure in New England. Br. 16. States propose reliability contracts for some generators that reflect each supplier’s individual costs and fixed prices for all other suppliers, regardless of location. Br. 50-51. But the Commission found that this proposed remedy would unreasonably undermine the goals of the Reliability Market, creating the potential to “jeopardize PJM’s ability to provide reliable service” in the near term and the long run. Rehearing Order at P 18, JA 465.

Further, the Commission determined that the proposed remedy would “undercut . . . reliance on prices” that were used to signal the need for retention of existing generators and investment in new or expanded capacity. *Id.*; *see also supra* Part II.C. Finding that the Reliability Market had operated to increase new supplies and retain needed existing resources, the Commission reasonably

concluded that the first five auctions had met this important long-term goal. Rehearing Order at P 23 & n.25 (citing Brattle Report at 1), JA 467; *cf.* *Blumenthal*, 553 F.3d at 883 (“high rates . . . serve a critical signaling function: encouraging new development that will increase supply”); *id.* at 885 (finding cost-based remedy “would stifle the necessary price-signaling function served by market-based rates”).

States’ proposal also failed to provide price signals that distinguished between transmission-constrained and unconstrained sub-regions. Rehearing Order at P 17 (proposal uses “rates determined for the unconstrained (RTO) region of PJM”), JA 465. The Commission’s capacity market policy does not support this proposed remedy; rates should address the scarcity of supply on a sub-regional basis so that all resources are deliverable to customers when transmission is limited. *See* Initial Reliability Order at P 49. To that end, the Commission was aware of evidence that customers in areas like New Jersey without sufficient resources would pay higher capacity prices than the rest of PJM. Reliability Settlement Order at P 74 & n.60 (commenter estimates \$95 spread between prices in New Jersey and rest of PJM); *cf.* *Blumenthal*, 552 F.3d at 883 (“market rates are expected and permitted to be higher than marginal costs during times of scarce supply”).

Finally, States' proposal relied on disfavored cost-of-service reliability contracts "to prevent high-cost generators from shutting down" in transmission-constrained areas. *Blumenthal*, 552 F.3d at 879; *cf. Conn. DPUC*, 569 F.3d at 480 (contracts are disfavored because "they 'suppress market-clearing prices . . . and make it difficult for new generators to profitably enter the market'") (quoting *Me. PUC*, 520 F.3d at 468). The Commission had already determined, on an earlier complaint against New England's transitional payments, that this remedy "would unreasonably 'restrain legitimate market revenues earned by some generators' without a finding that those generators are exercising market power" *Blumenthal*, 553 F.3d at 885. Furthermore, the Commission had already "acknowledge[d] the imperfections" of a remedy like that proposed by States, *i.e.*, reliability contracts for some generators and fixed rates for others. *Id.* at 884 (where FERC had already approved a proliferation of reliability contracts in New England, it accepted such "hybrid" rates as an "interim solution").

On appeal, States argue that their remedy is reasonable because their lowest proposed price is more than double the highest price in the prior capacity regime. Br. 45; *see* Br. 50 (States' proposed replacement "prices . . . increasing to \$85.20/megawatt-day for 2010-2011 . . . far exceed the pre-[Reliability Market] levels of much less than \$20/megawatt-day"). But that claim is factually flawed, as States' own witness demonstrated that, during the prior capacity regime,

capacity payments were above \$80 megawatt-day in 2001. Wilson Supp. Aff. at para. 126 fig. 2, JA 366; *accord* Initial Reliability Order at P 23 (daily price spikes during same period were “well over \$100 per megawatt-day”). It is true that, when there was an excess of capacity during the three years prior to the Reliability Market auctions, prices were lower. Wilson Supp. Aff. at para. 113 (2003 to 2006 was “a period during which there was substantial excess capacity in the PJM RTO”), JA 359. But, at other times, when capacity was scarce relative to demand, as in the New Jersey and Maryland transitional auctions at issue here, the previous capacity regime produced relatively high prices. *Id.* at paras. 125-27 & fig. 2 (capacity payments were higher before a “large amount of new generation came on line”), JA 366; *see Utilimax.com*, 378 F.3d at 305 (noting that, in 2001, some PJM customers paid capacity rates of \$177 megawatt-day); *see generally Blumenthal*, 552 F.3d at 883 (high rates “reflect existing scarcity”).

“Changing a rate and quantity already determined in accordance with existing tariff provisions on which parties have relied would defeat the purpose of the forward binding commitment” (Complaint Order at P 26, JA 402), “undo the incentives” for retention and expansion of capacity resources (*id.*), and “jeopardize PJM’s ability to provide reliable service” Rehearing Order at P 18, JA 465. Indeed, the Commission noted that States proposed to change the auction-based capacity rates without giving the affected capacity resources “the opportunity to

reevaluate their decision to commit capacity to PJM.” Complaint Order at P 29, JA 403. In other words, States would alter the Reliability Market’s pricing incentives without accounting for the corresponding changes in suppliers’ decisionmaking.

Nor did States’ proposal to reimburse individual capacity providers, on a showing of actual reliance, ameliorate its flaws; in fact, it would make matters worse. First, it would further undermine the Reliability Market by removing the necessary “assurance to both suppliers and buyers, on a forward basis, as to what their capacity obligations, costs and revenues will be” — the auction “mechanism would be rendered ineffective if . . . those expectations could be upset by a showing that one or more suppliers did not specifically rely on the auction results in its business planning.” Rehearing Order at P 27, JA 469. Second, the process of establishing each party’s actual reliance would be “extraordinarily time-consuming and litigious” for market participants and the Commission. *Id.* Therefore, the Commission reasonably concluded that States’ proposed modification of auction results would not be just and reasonable.

CONCLUSION

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

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CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C)(i), I certify that the Brief of Respondent contains 13,108 words, not including the tables of contents and authorities, the glossary, the certificates of counsel, and the addendum.

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ADDENDUM
STATUTES

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Section 201, of the Federal Power Act, 16, U.S.C. § 824(a)-(b) provides as follows:

(a) Federal regulation of transmission and sale of electric energy - It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce - (1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

Section 205(a), (b), (e) of the Federal Power Act, 16 U.S.C. § 824d(a), (b), (e) provides as follows:

(a) Just and reasonable rates - All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful - No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission,
(1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or
(2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules - Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes - Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five-month period - Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon

Section 205(a), (b), (e) of the Federal Power Act, 16 U.S.C. § 824d(a), (b), (e) provides as follows:

reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; “automatic adjustment clause” defined - (1) Not later than 2 years after November 9, 1978, and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and –

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

Section 205(a), (b), (e) of the Federal Power Act, 16 U.S.C. § 824d(a), (b), (e) provides as follows:

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or
(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term “automatic adjustment clause” means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

Section 206 of the Federal Power Act, 16 U.S.C. § 824e provides as follows:

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues - Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affected such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest - Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the refund effective date or by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, whichever is earlier, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust,

Section 206 of the Federal Power Act, 16 U.S.C. § 824e provides as follows:

unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order the public utility to make refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: Provided, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; “electric utility companies” and “registered holding company” defined -

Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: Provided, That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission’s order. For purposes of this subsection, the terms “electric utility companies” and “registered holding company” shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C. 79 et seq.].

Section 206 of the Federal Power Act, 16 U.S.C. § 824e provides as follows:

(d) Investigation of costs - The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

Section 313(b) of the Federal Power Act, 16 U.S.C. § 8251(b) provides as follows:

(b) Judicial review - Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States court of appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. 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 unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

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