

ORAL ARGUMENT HAS NOT BEEN SCHEDULED

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

No. 05-1435

**INDUSTRIAL ENERGY USERS-OHIO,
PETITIONER,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

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

**BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

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WASHINGTON, DC 20426**

AUGUST 28, 2006

FINAL BRIEF: OCTOBER 17, 2006

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

Except for the following, all parties, intervenors and amici appearing before the Commission and this Court are listed in Petitioner's Rule 28(a)(1) certificate:

Arkansas Cities and Cooperative
Conway Corporation
East Texas Electric Cooperative, Inc.
Electricity Consumers Resource Council
Farmer's Electric Cooperative Corporation
Hope Water & Light Commission
North Carolina Electric Membership Corporation
Northeast Texas Electric Cooperatives, Inc.
Oklahoma Municipal Power Authority
PJM Industrial Customer Coalition
PSEG Power LLC
PSEG Energy Resources & Trade LLC
West Memphis, Arkansas Utilities Commission
West Virginia Energy Users Group

B. Rulings Under Review

1. Order on Updated Market Power Analysis, Instituting Section 206 Proceeding and Establishing Refund Effective Date, *AEP Power Marketing, Inc.*, 109 FERC ¶ 61,276 (Dec. 17, 2004), JA 150.
2. Order Denying Rehearing, *AEP Power Marketing, Inc.*, 112 FERC ¶ 61,320 (Sept. 20, 2005), JA 184.

C. Related Cases

This case has not previously been before this Court or any other court.

Counsel is not aware of any other related cases pending before this or any other court.

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August 28, 2006
Final Brief: October 17, 2006

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GLOSSARY

AEP	American Electric Power Service Corporation, on behalf of AEP Power Marketing, Inc., AEP Service Corporation, CSW Power Marketing, Inc., CSW Energy Services, Inc., and Central and Southwest Services, Inc.
AEP-East	AEP's service territory in PJM that encompasses portions of Indiana, Kentucky, Michigan, Ohio, Tennessee, Virginia, and West Virginia
AEP-SPP	AEP's service territories in Arkansas, Louisiana, Oklahoma, and Texas
Commission or FERC	Federal Energy Regulatory Commission
Industrial Customers	Petitioner Industrial Energy Users-Ohio
Initial Order	Order on Updated Market Power Analysis, Instituting Section 206 Proceeding and Establishing Refund Effective Date, <i>AEP Power Marketing, Inc.</i> , 109 FERC ¶ 61,276 (Dec. 17, 2004)
Orders On Review	Collectively, Initial Order and Rehearing Order
Pet. Br.	Petitioner's Brief
PJM	PJM Interconnection, L.L.C.
Protest	Protest of the Industrial Energy Users-Ohio and PJM Industrial Customer Coalition
Rehearing Order	Order Denying Rehearing <i>AEP Power Marketing, Inc.</i> , 112 FERC ¶ 61,320 (Sept. 20, 2005)
Rehearing Request	Request for Rehearing of the Industrial Energy Users-Ohio and PJM Industrial Customer Coalition

Rulemaking Initiation Order	<i>Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities</i> , 115 FERC ¶ 61,210 (2006)
Screens Order	<i>AEP Power Marketing, Inc.</i> , 107 FERC ¶ 61,018 (2004)
Screens Orders	Collectively, Screens Order and Screens Rehearing Order
Screens Rehearing Order	<i>AEP Power Marketing, Inc.</i> , 108 FERC ¶ 61,026 (2004)

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**BRIEF FOR RESPONDENT
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STATEMENT OF THE ISSUES

The issues presented for review are:

1. Whether the Federal Energy Regulatory Commission (“FERC” or “Commission”) reasonably determined that an electric utility lacks market power in the relevant market and, therefore, may continue to charge market-based rates.
2. Whether the Commission reasonably concluded that further investigation or a trial-type hearing was unnecessary because the written record

was sufficient to resolve any material factual disputes concerning the relevant market.

STATUTORY AND REGULATORY PROVISIONS

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

INTRODUCTION

This proceeding involves the Commission’s review of an electric utility’s application to continue to sell power at negotiated market-based rates. Consistent with the Federal Power Act, the Commission allows electricity sales at market-based rates if the seller and its affiliates do not have, or have adequately mitigated, market power in generation and transmission and cannot erect other barriers to entry or engage in affiliate abuse. *See Consumers Energy Co. v. FERC*, 367 F.3d 915, 922-23 (D.C. Cir. 2004).

In compliance with the Commission’s screens for assessing generation market power, American Electric Power Service Corporation (“AEP”) submitted for Commission review an updated market power analysis. AEP’s analysis concentrated primarily on the three major areas in which AEP serves load and owns generation resources, and the control areas directly interconnected to those regions (“first-tier control areas”). R. 2 at 1, JA 18. The screen results indicated that AEP

failed the wholesale market share screen in one of the three regions in which it operates. *Id.* at 2, JA 19. For the regions in which AEP passed the screens, including the Pennsylvania-New Jersey-Maryland Interconnection, L.L.C., now known as the PJM Interconnection, L.L.C. (“PJM”), the Commission approved continuation of AEP’s market-based rate authority. For the region in which AEP failed the screen, the Commission established an investigation to determine whether AEP could continue to charge market-based rates in that market. *AEP Power Marketing, Inc., et al.*, 109 FERC ¶ 61,276 (“Initial Order”), R. 29, JA 151, *order denying reh’g*, 112 FERC ¶ 61,320 (2004) (“Rehearing Order”) R. 67, JA 186 (together, “Orders on Review”).

Petitioner Industrial Energy Users-Ohio (“Industrial Customers”), representing large industrial customers of AEP in Ohio, challenged the Commission’s determination that AEP lacks market power in PJM. After considering Industrial Customers’ contrary arguments and evidence, the Commission nevertheless concluded that AEP lacks market power in the PJM region, based on its independent evaluation of AEP’s market power analysis. The Commission further reasoned that PJM’s approved market monitoring and mitigation rules would provide an additional check on any potential future exercise of market power. Finally, the Commission determined that Industrial Customers’ general challenges to market monitoring and mitigation models, and to wholesale

market-based rates, were beyond the scope of this narrow market power update proceeding.

STATEMENT OF FACTS

I. Events Leading To The Challenged Orders

A. Market-Based Rate Authority

To qualify for market-based rate authority, the Commission must first determine that a market-based rate applicant passes the four prongs of the market-based rate test: the company must lack both generation and market power, and not be able to erect barriers to entry or engage in affiliate abuse. *See, e.g., Consumers Energy*, 367 F.3d at 917; *see also Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, 115 FERC ¶ 61,210 at P 5 (2006) (“Rulemaking Initiation Order”). Once an entity has obtained authorization to sell electricity at market-based rates, it is required to file with the Commission an updated market analysis every three years. *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 at P 7 n.3 (“Screens Order”), JA 204, *on reh’g*, 108 FERC ¶ 61,026 (2004) (“Screens Rehearing Order”), JA 295. The Commission uses the triennial review process to monitor the competitiveness of relevant markets and ensure that, consistent with the Federal Power Act, the originally approved market-based rates continue to fall within the zone of reasonableness. Screens Order at P 200, JA 275.

B. Orders Modifying the Commission's Generation Market Power Analysis

As part of its ongoing effort to refine market power assessment measures, in April 2004, the Commission modified, on an interim basis, its generation market power test and market power mitigation policy. Screens Order at P 1, JA 202. The revised interim analytical framework requires market-based rate applicants to use two indicative screens to assess generation market power: a pivotal supplier screen and a wholesale market share screen.

The pivotal supplier screen measures market power at peak times, particularly in spot markets. It evaluates an applicant's potential to exercise market power based on the control area market's annual peak demand. *Id.* at P 71, JA 227. A supplier is pivotal if its capacity is required to meet peak market demand. *Id.* at P 72, JA 227.

In contrast to the pivotal supplier screen, the wholesale market share screen is applied on a seasonal basis and evaluates the applicant's size in relation to others in the market. Screens Rehearing Order at PP 79 & n.82, 88, JA 324, 327. The wholesale market share analysis addresses the applicant's potential to exercise market power during non-peak conditions by measuring the applicant's share of uncommitted capacity available to the market during those times. Applicants with a wholesale market share of less than 20 percent for all seasons pass this screen. *Id.* at P 80, JA 324. Together, therefore, the screens enable the Commission to

measure generation market power both at peak and off-peak times and to assess the applicant's ability to exercise market power both unilaterally and in coordination with other sellers. *Id.* at P 88, JA 327 (citing Screens Order at P 72); *see also* Screens Order at P 72, JA 227. As the Commission explained, "the screens are conservatively designed to permit those applicants that clearly do not possess the potential to exercise market power to receive market based rate authority and to identify the subset of applicants who require closer scrutiny." Screens Rehearing Order at P 25, JA 303; *see also* Initial Order at P 26, JA 158.

Passage of both screens creates a rebuttable presumption that the company lacks market power. Screens Order at P 37, JA 213. While the potential for an applicant that passes both screens to exercise market power is "remote," Screens Rehearing Order at P 77, JA 323, intervenors are allowed to present evidence to attempt to rebut this presumption. Screens Order at P 37, JA 213. In contrast, failure to pass either screen provides the basis for instituting an investigation under Section 206 of the Federal Power Act, 16 U.S.C. § 824e, and creates a rebuttable presumption that the applicant possesses generation market power. Screens Order at PP 37, 201, JA 213, 275. The applicant then has three options: attempt to rebut the presumption; move straight to a mitigation phase; or adopt default cost-based rates or support alternative proposed cost-based rates. *Id.* at P 37, JA 213.

C. Ongoing Rulemaking on Market-Based Rates

Concurrent with its Screens Orders, the Commission issued a notice establishing a generic rulemaking (in Docket RM04-7) to undertake a comprehensive review of the appropriate analysis for granting market-based rate authority. *See* Rulemaking Initiation Order at P 1. In particular, the rulemaking concerns “the adequacy of the current four-prong analysis and whether and how it should be modified to assure that prices for electric power being sold under market-based rates are just and reasonable under the Federal Power Act.” *Id.* at P 4. Petitioner Industrial Customers, as well as numerous other parties, intervened and filed comments in that pending proceeding.¹

D. AEP’s Market-Based Rate Compliance Filing

In compliance with the Screens Orders, AEP submitted its updated market-based rate compliance filing with the Commission on August 9, 2004, amending it twice thereafter in response to Commission Staff requests for further documentation and data. Initial Order at P 1, JA 150. AEP’s analysis focused on the major regions where AEP serves load and generation resources and all of its “first tier” control areas (control areas to which AEP is directly connected): (1) AEP-East, covering service territories in Ohio, Tennessee, Virginia, and West

¹ *See* Motion to Intervene and Comments of the PJM Industrial Customer Coalition, *et al.*, Docket No. RM04-7-000 (filed Jan. 21, 2006); *see also, e.g.*, Comments on Behalf of Coalition of Midwest Transmission Customers, *et al.*, Docket No. RM04-7-000 (filed Aug. 7, 2006).

Virginia prior to integration in PJM; (2) PJM, because AEP planned to become a member of PJM on October 1, 2004;² and (3) remaining service territories in Arkansas, Louisiana, Oklahoma, and Texas. R. 2 at 1, JA 18.

AEP recognized that in the AEP-East region it passed the pivotal supplier screen but failed the generation market power screen. R. 2 at 1-2, JA 18-19. For that reason, AEP submitted additional data to rebut any presumption of market power. *Id.* at 2, JA 19. AEP asked the Commission to continue its market-based rate authorization in all markets without instituting an investigation or setting a refund date. *Id.*

Fifteen parties intervened in the proceeding. Industrial Customers, along with the PJM Industrial Customer Coalition, jointly protested AEP's filing, claiming that the Commission must institute an investigation and hold a trial-type evidentiary hearing because: (1) AEP's capacity in AEP-East is dominated by nuclear, coal, and hydroelectric units and, if oil and gas-fired capacity were to become uneconomical, AEP may be able to exercise market power in the AEP-East region, even after joining PJM; (2) PJM's market power monitoring and mitigation regime is based on a flawed market behavior model and cannot adequately protect customers against market power; and (3) the Commission must

² PJM coordinates electricity transmission in parts of Delaware, Illinois, Indiana, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

consider “customer concerns about barriers to competition and struggling retail markets.” R. 15 at 4-6, 6-11, 11-27, JA 99-101, 101-106, 106-122.

E. AEP Becomes a Member of PJM

On October 1, 2004, AEP became a participating transmission owner in PJM. Initial Order at P 5, JA 152. All of the participating transmission owners in PJM currently have market-based rate authority.

II. The Challenged Orders

The Commission issued its Initial Order on December 17, 2004, approximately ten weeks after AEP became a member of PJM. After reviewing AEP’s support for its market-based rates and considering the matters raised by all parties, the Commission approved AEP’s authority to charge market-based rates in the relevant markets for which AEP passed the interim generation market power screens, including Ohio and other portions of PJM. Initial Order at P 18, JA 156. Finding that AEP failed the wholesale market share screen for all four seasons in the Southwest Power Pool region (“SPP”), in portions of Arkansas, Louisiana, Oklahoma and Texas, however, the Commission initiated a Section 206 proceeding to determine whether AEP may continue to charge market-based rates in that region. The Commission explicitly limited the Section 206 proceeding, including any resulting mitigation or refunds, to the AEP-SPP control area because that was the region in which AEP’s compliance filing indicated that the utility failed the

wholesale market share screen. *Id.* at P 2, JA 151.

Industrial Customers challenged the Commission's finding that AEP passed the generation market power screens after AEP-East's integration into PJM. The Commission, however, expressly found their arguments unpersuasive.

Specifically, the Commission rejected Industrial Customers' argument that an evidentiary hearing was required to determine whether AEP controls such a large quantity of baseload generation in PJM that AEP can dictate the price of power during off-peak hours. Rehearing Order at P 23, JA 195. The Commission explained that it had reviewed AEP's pivotal supplier screen and wholesale market share screen for the PJM market and found that AEP passed the generation market power screens for that market. *Id.* (citing Initial Order at P 18), JA 195. Citing the Screens Orders, the Commission-approved Attachment M (PJM Market Monitoring Plan) to the PJM Open Access Transmission Tariff, and the PJM Operating Agreement, Schedule I (PJM Interchange Energy Market), the Commission reiterated its opinion that "[regional transmission organizations] such

as PJM with Commission-approved market monitoring and mitigation provide a check on the exercise of generation market power.” *Id.* at P 23 & n.49, JA 195-96.

Next, the Commission explicitly addressed Industrial Customers’ assertion that market power detection and mitigation are based on a flawed model. The Commission stated that Industrial Customers “specifically argue that because supply function equilibriums are difficult to calculate, current market modeling methods are, as a general matter, incapable of reliably identifying market power.” *Id.* at P 24, JA 196. The Commission found these arguments to be “misplaced, as they are beyond the scope of this case.” *Id.* The Commission pointed out that this proceeding concerns the market power analysis that AEP had submitted to support continuation of its market-based rate authorizations. *Id.* The generation market power analysis that AEP used to prepare its filing, noted the Commission, resulted from a comprehensive proceeding in which all interested persons were afforded an opportunity to participate. Recognizing the generic nature of Industrial Customers’ objections, the Commission further reasoned that the question whether the Commission should revise its approach for granting market-based rate authority is more appropriately raised in the generic rulemaking proceeding concerning market-based rate analysis, in Docket RM04-7-000. *Id.*

The Commission then considered Industrial Customers’ argument that, as a general matter, market-based rates are adversely affecting retail customers.

Highlighting an example Industrial Customers proffered to support their argument, a retail case pending before the Public Utilities Commission of Ohio, in which AEP sought to increase retail rates, the Commission found Industrial Customers' arguments beyond the scope of this proceeding. *Id.* at P 25, JA 197. As the Commission explained, "in this proceeding the Commission is considering AEP's updated market analysis, and not market-based rates for wholesale electricity sales as a general matter." *Id.*

Finally, the Commission addressed Industrial Customers' argument that AEP's lower-cost, depreciated generating units enable AEP to "undercut competitiveness of new generation considering [entry into] a service territory." *Id.* at P 26, JA 197. The Commission found that, without additional evidence or analysis, it was unclear why AEP's lower operating costs would enable AEP to charge unjust and unreasonable rates. *Id.*

Having carefully evaluated the evidence and arguments concerning generation market power, the Commission addressed the remaining three prongs of the market-based rate test. Initial Order at PP 30-36, JA 159-60; Rehearing Order at PP 10-22, JA 189-95. The Commission found that AEP lacked transmission market power, and presented no concerns regarding barriers to entry. Initial Order at PP 30-31, JA 159; Rehearing Order at P 12, JA 190-91. In addition, the Commission found that AEP satisfied all affiliate abuse concerns, but nevertheless

directed AEP to file revised market-based rate tariffs including both market behavior rules and codes of conduct. Initial Order at PP 36-37, JA 160-61.

This petition for review followed.

SUMMARY OF ARGUMENT

This case simply involves the Commission's review of a compliance filing made by a single utility, AEP, to support its application for continued authority to charge market-based rates. Based on substantial record evidence, and responding to the concerns raised by Industrial Customers and other parties, the Commission reasonably determined that AEP lacks market power in Ohio and other portions of PJM. Therefore, the Commission reasonably granted AEP authority to charge market-based rates in PJM.

Based on its independent review, the Commission found that AEP passed the generation market power screens upon integration into PJM. The Commission further relied on PJM's FERC-approved market monitoring and mitigation rules to provide an additional check on market power. Under these circumstances, there was no need for the Commission to institute the additional evidentiary hearing procedures requested by Industrial Customers. The Commission also reasonably determined that an investigation into PJM's market monitoring and mitigation rules was beyond the scope of this limited proceeding. The Commission viewed Industrial Customers' claim that PJM's market power detection and mitigation model is "fatally flawed" as a collateral attack on its final and binding generation market power analysis, which does not require assessment of market monitoring and mitigation rules or models. Exercising reasonable discretion over its dockets,

the Commission suggested that it would be more appropriate to raise this generic concern in the ongoing rulemaking proceeding concerning the Commission's multi-pronged market-based rate analysis.

Similarly, the Commission also reasonably exercised its discretion when it found general assertions that market-based rates are adversely impacting retail customers to be beyond the scope of this proceeding. As the Commission emphasized, this proceeding concerns the narrow issue of AEP's updated market power analysis, and the consistency of AEP's application with previously-established standards, not wholesale market-based rates in general or the adequacy of those standards.

ARGUMENT

I. STANDARD OF REVIEW

The Court's review of the Commission's grant of market-based rate authority is "limited to determining whether FERC's decision was 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law.'" *Louisiana Energy & Power Auth. v. FERC*, 141 F.3d 354, 366 (D.C. Cir. 1998); 5 U.S.C. § 706(2)(A). Under this deferential standard, review is limited to whether the Commission has "examined the relevant data and articulated a satisfactory explanation for its action, including a 'rational connection between the facts found and the choice made.'" *Electricity Resources Council v. FERC*, 407 F.3d 1232,

1236 (D.C. Cir. 2005) (citation omitted). The Commission’s finding of facts, if supported by substantial evidence, is conclusive. Federal Power Act § 313(b), 16 U.S.C. § 825l(b). The substantial evidence standard “requires more than a scintilla” but “can be satisfied by less than a preponderance of the evidence.” *B&J Oil & Gas v. FERC*, 353 F.3d 71, 77 (D.C. Cir. 2004) (citation omitted).

II. THE COMMISSION REASONABLY DETERMINED THAT AEP LACKS MARKET POWER IN PJM

The scope of this proceeding is narrow. It is not about the broader question of what would constitute the best test for market power; the Commission is still in the process of evaluating that question in a separate rulemaking proceeding and applied here its existing test. This case is not about fine-tuning the parameters of market monitoring models; the Commission has already approved PJM’s market monitoring and companion mitigation rules. Nor does this case concern the wisdom or desirability of market-based rates for wholesale electricity sales as a general matter, or their impact on retail sales.

Rather, all that was before the Commission in this proceeding was an updated compliance filing AEP submitted in support of continued market-based rate authorization. The Commission’s approval of AEP’s application to charge market-based rates in Ohio and other portions of PJM was based on substantial evidence in the record, was fully responsive to the concerns raised by all parties, including Industrial Customers, and thus reflects reasoned decisionmaking.

A. The Commission Reasonably Considered All Evidence And Arguments Concerning AEP's Potential To Exercise Market Power

Industrial Customers contend that the Commission gave only “token consideration” to the “genuine issues of fact” it raised concerning AEP’s potential to exercise market power in Ohio and elsewhere in PJM. Pet. Br. at 6. This contention misses the mark; the Commission explicitly considered and explained its rejection of contrary evidence and assertions, including all those submitted by Industrial Customers.

In its Protest and Petition for Rehearing, Industrial Customers’ asserted that AEP’s filing indicated that capacity in AEP-East (Ohio and other portions of PJM) is predominately baseload nuclear, coal, and hydroelectric units, with marginal costs below the oil- and gas-fired capacity in the expanded PJM footprint. Protest, R. 15 at 5, JA 100; Rehearing Request, R. 38 at 8, JA 172. Without submitting any supporting study or data or expert testimony, Industrial Customers speculated that: “If the oil- and gas-fired capacity were found to be uneconomic under certain circumstances, AEP could fail portions of the [Delivered Price Test].” *Id.* Industrial Customers argued that, in this hypothetical situation, there was a “strong potential for AEP to maintain and exercise market power, particularly during off-peak periods.” *Id.*

In the Rehearing Order, the Commission specifically addressed Industrial

Customers’ concern that “an evidentiary hearing process is required to determine whether AEP controls such a large quantity of baseload generation in electrically defined areas within PJM that AEP can dictate the price of power during off-peak hours.” *Id.* at P 23, JA 195. The Commission rejected Industrial Customers’ request, explaining that, in the Initial Order, the Commission “reviewed AEP’s pivotal supplier screen and wholesale market share screens for the PJM market and found that AEP passed the generation market power screens for the market.” *Id.* Significantly, the Commission further reasoned that, “as it stated in the [Screens Orders], the Commission believes that [regional transmission organizations] such as PJM with Commission-approved market monitoring and mitigation provide a check on the exercise of generation market power.” *Id.* at P 23 & n.49 (citing Screens Order at PP 190-91; PJM Open Access Transmission Tariff, Attachment M; and PJM Operating Agreement, Schedule 1), JA 195-96. Accordingly, the Commission reasonably dismissed Industrial Customers’ speculation because: (a) its independent review confirmed that AEP passed the interim generation market power screens; and (b) if Industrial Customers’ speculation were to come to fruition, it would be “checked” by PJM’s approved market power monitoring and mitigation rules. *Id.* at P 23, JA 195-96.

Passage of Interim Screens. The market power screens are “conservatively designed to permit those applicants that clearly do not possess the potential to

exercise market power to receive market based rate authority” Screens Rehearing Order at P 25, JA 303; *see also* Initial Order at P 26, JA 158. The Commission believed the screens would only “pass those utilities where the potential for market power is *remote*.” Screens Rehearing Order at P 77 (emphasis added), JA 323. Consistent with Department of Justice guidelines, a wholesale generation market share of less than 20 percent is the threshold for passing the wholesale market share screen. Screens Order at PP 102 & n.86, 104 (finding that “[a] seller that does not have a 20 percent market share in any season would be unlikely to hold a dominant position in the market”), JA 238, 240. AEP easily passed this screen in PJM with a wholesale market share well below 20 percent. Initial Order at PP 5, 18, JA 152, 156; *see also* R. 2, Pace Aff. at 28, JA 50.

Significance of PJM’s Market Monitoring and Mitigation Rules. Passing the conservative generation market power screens, however, does not guarantee that AEP or any other entity that passes the screens could never exercise market power under any circumstances. The screens are an indicative snapshot, not a definitive test, of competitive market conditions. Screens Order at PP 6, 118, JA 204, 245. To assure that a utility with market-based rate authority does not later gain market power, the Commission engages in a market power analysis every three years, as in this case, and requires entities with market-based rates to file quarterly reports

detailing their transactions.³ Significantly, as the Commission points out in the Orders on Review, regional transmission organizations like PJM with Commission-approved market monitoring and mitigation provide additional checks on market power. Rehearing Order at P 23, JA 195-96. Those checks include continuous market oversight and mitigation tailored to specific markets. Screens Order at PP 190-191, JA 270-71.

The Screens Orders highlighted the “pro-competitive benefits of [a regional transmission organization like PJM,] including a market of appreciable size and scope that is subject to market monitoring and mitigation.” Screens Order at P 186, JA 269. In particular, the Commission emphasized the fact that PJM and other regional transmission organizations:

undertake daily and hourly oversight of seller[s'] pricing behavior to ensure, consistent with clearly established Commission-approved rules, that prices do not exceed competitive levels. The evaluation and mitigation of market power in markets with Commission-approved market monitoring and mitigation does not depend upon a snapshot test of the size or concentration of ownership of any seller. Such mitigation is typically implemented in real-time and in advance of any market price impact. All sellers' interactions with the market are required to comply with predetermined bidding restrictions and Commission-approved rules and mitigation protocols. High locational prices or binding transmission constraints can trigger the market monitor into further examining market outcome.

Id. at P 190 (emphases added), JA 270.

³ See *Revised Public Utility Filing Requirements*, Order No. 2001, 67 Fed. Reg. 31,043 (2002), FERC Stats. & Regs. ¶ 31,127 (2002) (setting forth required contents of quarterly reports).

Accordingly, the Commission reasonably could rely on PJM's market monitoring and mitigation rules to provide an additional check on the exercise of market power in PJM. When the Commission approved PJM's markets back in 1999, it also approved PJM's market monitoring and mitigation proposals.⁴ This included the establishment of an independent PJM Market Monitoring Unit, responsible for monitoring PJM markets on an ongoing basis for potential exercise of market power to ensure just and reasonable rates. *See generally* PJM Open Access Transmission Tariff, Attachment M (PJM Market Monitoring Plan). The PJM Market Monitoring Unit is required to submit annual reports on the overall competitiveness of the markets, and to bring to the Commission's attention any potential problem that warrants further investigation. Further, the Commission has ensured that PJM has a variety of mitigation tools at its disposal, including various bid caps, to address the different circumstances in which the potential for market power may materialize. *See* Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., Schedule I, § 1.10.1A(d)(viii) (system-wide energy bid cap); PJM Open Access Transmission Tariff, Attachment K, § 6.4.1(e) (hourly offer capping).⁵

⁴ *See Pennsylvania-New Jersey-Maryland Interconnection, L.L.C.*, 86 FERC ¶ 61,247 at 61,890-91(1999).

⁵ *See PJM Interconnection, L.L.C.*, 116 FERC ¶ 61,038 (2006) (modifying PJM Market Monitor's enforcement powers to conform with Commission policy), *compliance pending*; *PJM Interconnection, L.L.C.*, 107

Consequently, if Industrial Customers’ speculation – that, if oil and gas were to become uneconomic, AEP “may control such a large quantity of baseload generation . . . that it can dictate the price of power during off-peak hours” (Pet. Br. at 13) – were to come to fruition, this is precisely the type of market power event that PJM market monitoring and mitigation tools are designed to detect and remedy. Accordingly, the Commission sufficiently addressed Industrial Customers’ contrary evidence, conjecture, and arguments, and rationally explained its determination that AEP lacks market power in Ohio and the rest of PJM. The Commission’s reasoning is sufficient on its own, and particularly sufficient given the cursory nature of Industrial Customers’ argument. *Cf. City of Vernon v. FERC*, 845 F.2d 1042, 1047 (D.C. Cir. 1988) (noting that FERC “cannot be asked to make silk purse responses to sow’s ear arguments”).

B. The Commission Rationally Concluded That Industrial Customers’ Challenges To PJM’s Market Monitoring And Mitigation Model Are Beyond The Scope Of This Proceeding

Industrial Customers complain that the Commission “swept under the rug” their evidence concerning the “effectiveness of PJM’s market monitoring and mitigation construct.” Pet. Br. at 6. This claim lacks merit. The Commission considered the evidence Industrial Customers presented to assail market monitors

FERC ¶ 61,112 (2004), *order on reh’g and compliance*, 110 FERC ¶ 61,053 (modifying offer bid caps), *order on reh’g*, 112 FERC ¶ 61,031 (2005); *see also PJM Interconnection, L.L.C.*, 114 FERC ¶ 61,076 (2006) (accepting settlement concerning reliability pricing).

in general and, by extension, the PJM market monitor, and reasonably found this evidence “beyond the scope of this proceeding.” Rehearing Order at P 24, JA 196.

It is well-settled that a federal agency has broad discretion over the scope of inquiry in a particular proceeding, and may determine whether certain issues are better addressed in a separate proceeding. *See, e.g., Mobil Oil Exploration v. United Distrib. Cos.*, 498 U.S. 211, 239 (1991) (“An agency employs broad discretion in determining how to handle related, yet discrete, issues in terms of procedures . . . [such as] where a different proceeding would generate more appropriate information and where the agency was addressing the question.”) (citations omitted). *See also, e.g., Tennessee Gas Pipeline Co v. FERC*, 972 F.2d 376, 381 (D.C. Cir. 1992) (“The agency is entitled to make reasonable decisions about when and in what type of proceeding it will deal with an actual problem”); *Nadar v. FCC*, 520 F.2d 182, 195 (D.C. Cir. 1975) (“[T]his court has upheld in the strongest terms the discretion of regulatory agencies to control the disposition of their caseload.”).

Here, in their Protest and Rehearing Request, Industrial Customers mention a few scholarly articles, relying primarily on an excerpt from economists Baldick and Hogan to support the contention that “[c]redible record evidence indicates that market power detection and mitigation are based on a fatally flawed market behavior model and, as a result of that fatal flaw, PJM cannot adequately protect

customers against the exercise of market power.” Rehearing Request, R. 38 at 9, JA 173; *see also* Protest, R. 15 at 7-9, JA 102-04. The central point of the excerpt is that different assumptions used in market models result in different outcomes. Simply stated, this alleged “fatal flaw” reduces to a general critique of all market models; namely, that it is difficult to identify the precise structural conditions, or the degree of market concentration, that will give rise to market power.

The Commission specifically addressed this submission and reasonably found that it was “beyond the scope of this proceeding.” Rehearing Order at P 24, JA 196. The “evidence” Industrial Customers presented to assail the PJM market monitor was ostensibly generic, and could be applied to critique any spot market model used anywhere. *Id.* Furthermore, the orders approving PJM’s market monitoring and mitigation scheme are final and binding. *See supra* pages 21-22. In contrast, this proceeding narrowly “concerns AEP’s market power analysis, which AEP has submitted in support of its market-based rate application.” Rehearing Order at P 24, JA 196. Recognizing that AEP’s challenge presented a collateral attack on its existing generation market power analysis, the Commission noted that its market power screens were adopted “following a comprehensive proceeding in which all interested persons were invited to participate.” *Id.* The Commission reasonably found that “the question whether it should revise its approach for granting market-based rate authority to any market participant is more

appropriately addressed in the generic rulemaking proceeding” concerning the best test for market power scrutiny. *Id.* (Indeed, Industrial Customers have intervened and filed comments in that ongoing proceeding, *see supra* page 7.)

Given the narrow purpose of this proceeding, the broad discretion the Commission has to oversee matters of procedure, and the fact that Industrial Customers’ objections can be raised in a more appropriate forum, the Commission acted reasonably in reviewing AEP’s filing.

C. The Commission Reasonably Concluded Industrial Customers’ Assertion That Market-Based Rates Are Generally Harming Retail Customers Is Beyond The Scope Of This Proceeding

Further, Industrial Customers chide the Commission for “failing to take reasonable steps to counteract the negative impact that wholesale market experiments are having on retail customers.” Pet. Br. at 22. To support this contention, Industrial Customers catalogued various complaints and observations about competitive markets and competition in general, focusing on the impact of on state retail customers. Among their complaints, Industrial Customers: (1) bemoaned the perceived lack of effective retail competition in electricity distribution in Ohio and other states; (2) cited general testimony on vertically-integrated utility rates culled from a technical conference in the generic rulemaking proceeding on market-based rates; and (3) discussed a retail rate proceeding before Ohio state regulators. Protest, R. 15 at 17-27, JA 112-22.

The Commission distilled Industrial Customers’ complaints down to the challenge that, “as a general matter, market-based rates are adversely impacting retail customers.” Rehearing Order at P 25, JA 197. After noting some specific complaints, the Commission reasonably concluded that Industrial Customers’ arguments were “beyond the scope of this proceeding.” *Id.* As the Commission explained, this proceeding involves “AEP’s updated market power analysis, and not market-based rates for wholesale sales as a general matter.” *Id.* Issues involving state retail competition and retail rates are simply not relevant to determining whether, employing the Commission’s existing four-part market-based rate analysis, AEP lacks market power in Ohio and elsewhere in PJM. Moreover, in finding these concerns outside the scope of this proceeding, the Commission implicitly recognized that Industrial Customers’ retail ratemaking concerns, in particular perceived lack of effective state retail competition, are more appropriately raised before the pertinent state public utility commission with jurisdiction over retail rates and practices.

D. The Commission’s Finding That AEP Lacks Market Power In PJM Determined The Competitiveness Of The Market

Industrial Customers argue that the Commission erroneously presumed that a competitive market exists when it authorized AEP to charge market-based rates in Ohio and elsewhere in the PJM region. Specifically, Industrial Customers contend that the Commission committed reversible error in the orders on review by

not making a specific finding that PJM is a competitive market. Pet. Br. at 16-19. According to Industrial Customers, this is an essential prerequisite for granting market-based rates.

Industrial Customers' fundamental premise, that "[t]he duty to determine that a competitive market exists is separate and independent of the determination that an application lacks, or has adequately mitigated, market power," *id.* at 17, is flawed. This Court has never required the Commission to make an explicit finding that a competitive market exists as a pre-condition to granting market-based rates. Rather, courts have permitted the Commission to grant market-based rate authority to applicants that lack or have adequately mitigated market power.⁶ Through application of its four-pronged market power test, including its generation market power screens, the Commission determines that a seller lacks market power. Rulemaking Initiation Order at P 3.⁷

Industrial Customers seek to splinter the market-based rate analysis where there is only one test: A competitive market is one in which the seller lacks market

⁶ See, e.g., *Louisiana Energy*, 141 F.3d at 365-66 (citing *Heartland Energy Servs., Inc.*, 68 FERC ¶ 61,223 at 62,060 (1994); and *Louisville Gas & Elec. Co.*, 62 FERC ¶ 61,016 at 61,143-44 (1993); *California ex. rel. Lockyer v. FERC*, 383 F.3d 1006, 1012 (9th Cir. 2004).

⁷ See generally B. Tennenbaum and J. Stephen Henderson, *Market-Based Pricing of Wholesale Electric Services*, 4 *Electricity J.*, No. 10, at 38 (Dec. 1991) ("The Commission has generally examined the seller's ability to exercise market power in gauging the effectiveness of competition.").

power. An applicant cannot pass the market-based rate scrutiny unless the market is competitive with respect to that applicant. Indeed, the generation market power prong of the four-pronged test, in particular, is designed to assess the market-based rate applicant's competitive position with respect to other competitors in the market. Screens Order at P 72, JA 227.

Further, the Commission clearly did not rely on "presumed market forces" (Pet. Br. at 18) in granting AEP authorization to charge market-based rates in PJM. Rather, the Commission independently evaluated AEP's updated market power analysis, twice requesting more information so that it could fully comprehend the test results. Rehearing Order at P 23, JA 195. Satisfied that AEP lacks market power, the Commission reasonably relied on the additional check provided by PJM's approved market monitoring and mitigation rules. *Id.*

In addition, as the Commission noted in the Rehearing Order, PJM's electricity products are separated into tradable components with distinct markets like energy, installed capacity and various ancillary services. *Id.* at n.49 (citing Screens Order at PP 190-91; JA 270-71), JA 196. This segmentation of electricity into individually traded components "facilitates a competitive market for each of the subcomponents" and "permits more competition in markets with Commission-approved market monitoring and mitigation and diffuses any generation market power of sellers" compared to vertically-integrated markets. Screens Order at P

191, JA 270. It also allows mitigation tailored to each specific market. *Id.*

Finally, this discussion is purely academic because the Commission, in contemporaneous decisions, has found the PJM market to be competitive. *See, e.g., PJM Interconnection, LLC*, 112 FERC at P 44 (“[T]he Commission has found that overall the PJM marketplace is sufficiently competitive to grant market-based rates.”); *Allegheny Power*, 115 FERC ¶ 61,291 at PP 13-14 & n.29 (2006) (noting that “the PJM Market Monitor’s annual reports continually find that the market results in PJM are competitive”).

III. THE COMMISSION WAS NOT REQUIRED TO LAUNCH AN INVESTIGATION OR HOLD A TRIAL-TYPE HEARING

Industrial Customers insist the Commission erred by finding that an investigation under Section 206 of the Federal Power Act (16 U.S.C. § 824e) and trial-type hearing were not necessary to resolve their various complaints. On the contrary, the Commission was not required to initiate a Section 206 proceeding because it found that AEP passed the generation market power screens in the PJM region. Rehearing Order at P 23, JA 195; Initial Order at P 18, JA 156; *see also id.* at P 2 (citing Screens Order at P 201 for the proposition that failure of at least one screen provides the basis for instituting a section 206 proceeding), JA 151. Nor was the Commission required to hold a trial-type evidentiary hearing, where there were no genuine issues of material fact in dispute that the Commission could not resolve on the basis of the written record. *See, e.g., Louisiana Energy*, 141 F.3d at

371.

Section 206 Proceeding. The Commission reasonably decided not to initiate a Section 206 proceeding to evaluate AEP's ability to exercise market power in Ohio and other portions of the PJM region. To reiterate, *see supra* page 6, the Screens Orders require the Commission to establish a Section 206 investigation only if an applicant fails one of the two screens in the relevant market. Screens Order at P 201, JA 275; *see also* Initial Order at P 2, JA 151. Once AEP joined PJM, AEP became part of the PJM market, and PJM became the only relevant market for assessing AEP's potential to exercise market power in Ohio and the rest of PJM. *Id.* at P 18, JA 156; *cf.* Screens Order at P 187, JA 269. AEP passed both generation market power screens in PJM. Initial Order at P 18, JA 156. No evidence presented rebutted the presumption that AEP lacks market power in PJM. Rehearing Order at PP 23-26, JA 195-97.

Therefore, the Commission, once it found that AEP lacks market power in PJM, was not required to institute a Section 206 proceeding. Such additional process, to confirm the Commission's analysis of AEP's inability to exercise market power in the PJM market, would have served only to prolong this proceeding needlessly. In contrast, in another market (Southwest Power Pool), where AEP failed the screen and failed to convince the Commission that it lacks market power in that region, *see supra* pages 9-10, the Commission satisfied its

obligation to investigate the matter further in a separate, discrete Section 206 proceeding. Initial Order at P 2, JA 151.

Trial-Type Hearing. Finally, in arguing that “[i]t is well-established that FERC must hold a hearing when presented with disputed issues of fact,” Pet. Br. at 14, Industrial Customers omit a crucial predicate of the standard. The Commission must hold a trial-type evidentiary hearing “only when a genuine issue of material fact exists, and even then, FERC need not conduct such a hearing if [the disputed issues] may be resolved on the written record.” *Louisiana Energy*, 141 F.3d at 371 (citation omitted). Further, to demonstrate the existence of a genuine dispute concerning material issues of fact, the proponent of an evidentiary hearing must proffer specific supporting evidence, rather than mere allegations or speculation. *Pennsylvania Pub. Util. Comm’n v. FERC*, 881 F.2d 1123, 1126-27 (D.C. Cir. 1989).

Here, Industrial Customers’ “evidence” consisted of: (a) speculation about what might happen if oil and gas prices were to become uneconomic, without any concrete study to back up their assumptions (Protest, R. 15 at 5, JA 100; Rehearing Request, R. 38 at 8, JA 172; Rehearing Order at P 23, JA 195); (b) excerpts from scholarly articles’ general musings on market model shortcomings (Protest, R. 15 at 7-9, JA 102-04; Rehearing Request, R. 38 at 10, JA 174; Rehearing Order at P 24, JA 196); and (c) complaints about market-based rates in general and their

impact on retail rates (Protest, R. 15 at 11-27, JA 106-22; Rehearing Request, R. 38 at 15-18, JA 179-82; Rehearing Order at P 25, JA 197). Industrial Customers' evidence amounted to mere conjecture and allegations. They failed to present any concrete evidence to rebut the presumption that AEP lacked market power, such as the type of evidence suggested by the Screens Order (at P 37, JA 213): historical wholesale sales data, or transmission constraints.

Even assuming Industrial Customers raised a genuine issue of material fact, they failed to justify the necessity for a trial-type evidentiary hearing. As this Court has explained, “[t]rial-type proceedings . . . are necessary only when a witness’ motive, intent or credibility needs to be considered or where the issue involves a dispute over a past occurrence.” *Louisiana Ass’n of Indep. Producers & Royalty Owners v. FERC*, 958 F.2d 1101, 1113 (D.C. Cir. 1992) (internal quotation marks and citation omitted). This was not the case here. This proceeding involved the Commission’s determination whether AEP lacks market power in the relevant markets. Like the question whether additional capacity is necessary to meet future demand, this is a “purely technical issue capable of being resolved not on the basis of a witness motive or memory, but rather upon an analysis of the conflicting data and a reasoned judgment as to what the data shows.” *Id.* (internal quotation marks and citation omitted).

As the Orders on Review demonstrate, the Commission fully analyzed the

data and rationally explained its determination that AEP lacks market power in PJM. AEP submitted a robust filing to supplement its already pending three-year market power update analysis. This filing included the results of the market power screens, supporting workpapers, and explanatory testimony. FERC Staff twice requested, and AEP provided, further data and information. Over a dozen parties made evidentiary submissions in this proceeding, in the form of affidavits from experts and/or extensive written argument. Given the Commission's broad discretion over procedural matters as well as technical issues, *see Louisiana Public Service Commission v. FERC*, 184 F.3d 892, 895 (D.C. Cir. 1999), Industrial Customers' claim that the Commission erred by not affording them additional process should be denied.

CONCLUSION

For the foregoing reasons, the petition for review should be denied 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 Federal Energy Regulatory Commission contains 7,132 words, not including table of contents and authorities, the glossary, the certificates of counsel and the addendum.

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I hereby certify that I have, this 17th day of October, 2006, served the foregoing by causing copying of it to be mailed to the counsel listed below.

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