

ORAL ARGUMENT HAS NOT BEEN SCHEDULED

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

Nos. 07-1275, *et al.*

**AMERICAN ELECTRIC POWER SERVICE CORPORATION,
PETITIONER,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

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

**BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

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MAY 1, 2009

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

All parties appearing before the Commission and this Court are listed in Petitioner's Rule 28(a)(1) certificate.

B. Rulings Under Review:

1. *Calpine Oneta Power, L.P.*, 116 FERC ¶ 61,282 (September 26, 2006) ("Order on Initial Decision"), JA ____;
2. *Calpine Oneta Power, L.P.*, 119 FERC ¶ 61,177 (May 21, 2007) ("First Rehearing Order"), JA ____;
3. *Calpine Oneta Power, L.P.*, 121 FERC ¶ 61,189 (November 19, 2007) ("Second Rehearing Order"), JA ____; and
4. *Calpine Oneta Power, L.P.*, 124 FERC ¶ 61,193 (August 28, 2008) ("Third Rehearing Order"), JA ____.

C. Related Cases:

This case has not previously been before this Court or any other court. Another reactive power compensation case, *Union Power Partners, L.P. v. FERC*, Docket No. 08-1252, is currently pending before this Court. In that case, the Commission affirmed an Administrative Law Judge's determination that Union Power Partners, L.P., does not have a contractual

right under its Interconnection Agreement to compensation for reactive power.

Beth G. Pacella
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May 1, 2009

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GLOSSARY

AEP	American Electric Power Service Corporation
AEP Methodology	Methodology used to determine generators' annual reactive power revenue requirements
ALJ	Administrative Law Judge
Commission	Federal Energy Regulatory Commission
FERC	Federal Energy Regulatory Commission
First Rehearing Order	<i>Calpine Oneta Power, L.P.</i> , 119 FERC ¶ 61,177 (2007), JA ____
FPA	Federal Power Act
Initial Decision	<i>Calpine Oneta Power, L.P.</i> , 113 FERC ¶ 63,015 (2005), JA ____
Oneta	Calpine Oneta Power, L.P.
Order on Initial Decision	<i>Calpine Oneta Power, L.P.</i> , 116 FERC ¶ 61,282 (2006), JA ____
Power factor	The ratio of real power to reactive power produced at a given time, multiplied by 100. For example, A power factor of 1.0 (or 100%) means that all the output is real power. As a generator produces reactive power, the power factor decreases.
Second Rehearing Order	<i>Calpine Oneta Power, L.P.</i> , 121 FERC ¶ 61,189 (2007), JA ____
Third Rehearing Order	<i>Calpine Oneta Power, L.P.</i> , 124 FERC ¶ 61,193 (2008), JA ____

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**ON PETITION FOR REVIEW OF ORDERS OF THE
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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 determined that providing compensation only to generators affiliated with American Electric Power Service Corporation (“AEP”), but not to unaffiliated generator Calpine Oneta Power, L.P. (“Oneta”), for their capability to generate a certain type of electric power, violated the Commission’s comparability policy and precedent and was unduly discriminatory.

STATUTES AND REGULATIONS

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

INTRODUCTION

The instant proceeding involves the Commission's compensation comparability policy concerning a particular type of electric power -- "reactive" (as opposed to real) power necessary to maintain the stability of the electric grid. Specifically, Oneta filed, under Federal Power Act ("FPA") § 205, 16 U.S.C. § 824d, for recovery of its reactive power revenue requirement under Schedule 2 of Southwest Power Pool's Open Access Transmission Tariff. After a trial-type hearing, the Commission approved the rate filing, finding that it was just and reasonable, and would remedy the incomparable treatment and undue discrimination Oneta previously suffered when only AEP-affiliated generators were compensated for their reactive power capability. *Calpine Oneta Power, L.P.*, 116 FERC ¶ 61,282 (2006) ("Order on Initial Decision"), JA ____, *order on reh'g*, 119 FERC ¶ 61,177 (2007) ("First Rehearing Order"), JA ____, *order on reh'g*, 121 FERC ¶ 61,189 (2007) ("Second Rehearing Order"), JA ____, *order on reh'g*, 124 FERC ¶ 61,193 (2008) ("Third Rehearing Order"), JA ____.

STATEMENT OF FACTS

I. Real Power Versus Reactive Power

Electric power consists of both real power and reactive power. Real power is the active force that causes electrical equipment to work, and is measured in watts. Reactive power maintains adequate voltage levels so real power can be transmitted, and is measured in volt-amperes reactive. *Alabama Power Co. v. FERC*, 220 F.3d 595, 596-97 (D.C. Cir. 2000) (citing *Southern Co. Servs., Inc.*, 80 FERC ¶ 61,318, 62,080 (1997)); *Calpine Oneta Power, L.P.*, 113 FERC ¶ 63,015 PP 5-6, 112 (2005) (“Initial Decision”), JA ____, ____. To maintain the proper voltage levels for power to flow on a transmission system, reactive power must be supplied or absorbed by generators or transmission equipment. *Alabama Power*, 220 F.3d at 597.

II. Order No. 888¹ Rulemaking Requiring Open Access Transmission Service

“Historically, electric utilities were vertically integrated, owning generation,

¹ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, 61 Fed. Reg. 21,540 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996), *on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, 62 Fed. Reg. 12,274, *clarified*, 79 FERC ¶ 61,182 (1997), *on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248, 62 Fed. Reg. 64,688 (1997), *on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd, New York v. FERC*, 535 U.S. 1 (2002).

transmission, and distribution facilities and selling those services as a ‘bundled’ package to wholesale and retail customers in a limited geographical area.” *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607, 610 (D.C. Cir. 2001). Significant economic changes and technological advances in generation and transmission, however, fostered the introduction of new generators which, because of their efficient operations, could generate energy at lower costs than many existing utilities. *Id.*

Nonetheless, “a persistent barrier to the development of a competitive wholesale power sale market remained.” *Transmission Access*, 225 F.3d at 682.

As this Court has explained, traditional utilities enjoyed a competitive advantage over new market entrants:

Entry into the transmission market is difficult and restricted, so those utilities that already own transmission facilities enjoy a natural monopoly over that field. The transmission-owning utilities can use their position to favor their own generated electricity and to exclude competitors from the market, whether by denying transmission access outright, or by providing transmission to competitors only at comparatively unfavorable rates, terms, and conditions. Utilities that own or control transmission facilities naturally wish to maximize profit. The transmission-owning utilities thus can be expected to act in their own interest to maintain their monopoly and to use that position to retain or expand the market share for their own generated electricity, even if they do so at the expense of lower-cost generation companies and consumers.

Id. at 683-84; *New York*, 535 U.S. at 9 (“Public utilities retain ownership of the transmission lines that must be used by their competitors to deliver electric energy

to wholesale and retail customers. The utilities' control of transmission facilities gives them the power either to refuse to deliver energy produced by competitors or to deliver competitors' power on terms and conditions less favorable than those they apply to their own transmissions.”).

Finding this situation unduly discriminatory and anti-competitive, in 1996, the Commission issued Order No. 888. That rulemaking “established the foundation for the development of competitive wholesale power markets by requiring nondiscriminatory open access transmission services by public utilities.” *Snohomish*, 272 F.3d at 610 (citing *Transmission Access*, 225 F.3d at 682). Since Order No. 888, “utilities must now provide access to their transmission lines to anyone purchasing or selling electricity in the interstate market *on the same terms and conditions as they use their own lines.*” *Transmission Access*, 225 F.3d at 681 (emphasis added).

III. Commission Precedent Regarding Reactive Power

Under Order No. 888, reactive power supplied by generation facilities must be provided as an ancillary service in Schedule 2 of transmission providers' open access transmission tariffs. Order on Initial Decision P 4 and n.4, JA _____. In subsequent orders, the Commission determined that, to recover their costs for reactive power, all generators that have actual cost data should use a method originally proposed by the petitioner here (“AEP methodology”) to determine their

annual reactive power revenue requirements. *Id.* at P 5, JA ____ (citing *WPS Westwood Generation, LLC*, 101 FERC ¶ 61,290 at P 14 (2002), and *American Electric Power Service Corp.*, Opinion No. 440, 88 FERC ¶ 61,141 at 61,456-57 (1999)). Furthermore, the Commission allowed non-transmission owner generators' revenue requirements to be included in a Regional Transmission Organization's reactive power charges. *Id.* at P 6, JA ____ (citing *PJM Interconnection LLC*, Docket No. ER00-3327-000 (Sept. 25, 2000)).

Generally, under Commission precedent, transmission owners need not compensate generators for their reactive power capability within a “dead band” or established “power factor range,”² *i.e.*, to maintain appropriate voltage levels for energy entering the grid during normal operations. *Michigan Electric Transmission Co.*, 97 FERC ¶ 61,187 at 61,852-53 (2001); *see also* Order on Initial Decision P 26, JA ____; First Rehearing Order P 10 and nn.12-13, JA _____. To ensure that transmission owners offer unaffiliated generators the same terms and conditions they offer their affiliated generators, however, the Commission determined that, if a transmission owner reimburses its affiliate generators for their reactive power capability within the dead band, it also must compensate

² “‘Power factor’ depicts the ratio of real power to reactive power being produced at a given time, multiplied by 100. . . . A power factor of 1.0 (or 100%) means that all the output is real power. As a generator produces reactive power, the power factor decreases.” AEP Br. at 39 n.6.

unaffiliated generators for that capability. *Michigan Electric*, 97 FERC at 61,853; *see also* Order on Initial Decision P 6, JA ____; Initial Decision P 62, JA ____.

Thus, the Commission determined that generators could file rate schedules, as necessary, to be compensated for reactive power. *Michigan Electric*, 97 FERC at 61,853. The Commission reaffirmed its reactive power compensation comparability policy in the Order No. 2003 Rulemaking.³ Order on Initial Decision P 7, JA ____.

IV. Oneta, AEP, and Southwest Power Pool

Independent power producers (also known as merchant generators) generate electric power but do not own transmission facilities. Initial Decision P 62, JA _____. Thus, independent power producers have to use transmission facilities owned by traditional utilities to deliver their power. *Id.* Generally, those transmission facilities are operated and controlled by regional organizations (such as

³ *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, 104 FERC ¶ 61,103 (2003), *on reh'g*, Order No. 2003-A, 106 FERC ¶ 61,220 at P 416 (2004) (if the transmission provider pays its own or its affiliated generators for reactive power within the established power factor range, it must also pay an unaffiliated interconnecting generator for reactive power within the established power factor range), *on reh'g*, Order No. 2003-B, 109 FERC ¶ 61,287 at PP 113, 119 (2004) (same), *on reh'g*, Order No. 2003-C, 111 FERC ¶ 61,401 (2005), *aff'd*, *National Association of Regulatory Utility Commissioners v. FERC*, 475 F.3d 1277 (D.C. Cir. 2007).

Independent System Operators or Regional Transmission Organizations) and control area operators. *Id.*

Southwest Power Pool is an independent Regional Transmission Organization that provides regional transmission service over systems owned by AEP, a traditional utility, and other transmission owners. Order on Initial Decision P 10, JA _____. Oneta is an independent power producer that interconnects with AEP's transmission system in the Tulsa, Oklahoma area. *Id.*; R.1, Oneta's Rate Filing at Transmittal Letter p.2, JA _____. Thus, Southwest Power Pool is the transmission provider, AEP is the control area operator, and Oneta is an independent power producer. Order on Initial Decision P 10, JA ____; Initial Decision PP 62, 63, JA _____, _____.

V. Events Leading To The Challenged Orders

A. Oneta's Reactive Power Rate Filing

This case involves a historical, locked-in period from June 21, 2003 (the effective date of Oneta's reactive power rate) through February 28, 2007 (the effective date of Southwest Power Pool's proposal to revise Schedule 2 to no longer provide compensation to any generator for its reactive power capability within the dead band). Second Rehearing Order P 16 and n. 23, JA ____; Third Rehearing Order P 5 and n. 7, JA ____; *see also Southwest Power Pool, Inc.*, 119

FERC ¶ 61,199, *order on reh'g*, 121 FERC ¶ 61,196 (2007) (approving Southwest Power Pool's revised Schedule 2).

Under the Southwest Power Pool Schedule 2 that was in effect during the historical, locked-in period at issue in this case, R. 214, Exh. SPP-11, JA ___-___, only traditional utilities, like AEP, were eligible to receive compensation for reactive power. First Rehearing Order PP 4, 29, JA ___, ___; Order on Initial Decision P 35, JA ___; Initial Decision P 63, JA ___.

In accordance with the Commission's determination that generators could file rate schedules, as necessary, to be compensated comparably for reactive power, *Michigan Electric*, 97 FERC at 61,853, on April 22, 2003, Oneta filed a proposed rate schedule setting out its reactive power revenue requirement, which was calculated using the AEP methodology. R. 1, Oneta's Rate Filing, at transmittal letter and Appendix A, JA ___-___; *see* Initial Decision P 65, JA ___ (“Oneta now asks for treatment comparable to that afforded traditional utilities using [Southwest Power Pool] transmission facilities, to recover in Schedule 2 of [Southwest Power Pool]'s [Open Access Transmission Tariff] the percentage of the fixed costs of its generators that are allocable to reactive power capability as calculated under the AEP methodology.”).

AEP and Southwest Power Pool protested the filing, arguing that Oneta's reactive power capability must pass a “needs” test to be eligible for compensation

and that it would fail that test because it was not needed on the transmission system. Protests, R. 3, 4; *see* Initial Decision P 65, JA ____ (same). The Commission set the matter for trial-type hearing before an Administrative Law Judge (“ALJ”), and accepted the rate schedule effective June 21, 2003, subject to refund. R. 9, *Calpine Oneta Power, L.P.*, 103 FERC ¶ 61,338 (2003), JA ____-____.

B. The Administrative Law Judge’s Decision

The ALJ found that Commission reactive power compensation precedent did not focus on need, but rather on comparability. Initial Decision, PP 62, 76, JA ____, _____. Thus, the “critical question with regard to the transmission provider and control area operator” is “what their practices are with regard to traditional utilities. If they pay those generators for reactive power service, they must do no less for merchant generators.” *Id.* at P 82, JA _____.

The record established that AEP-affiliated generators were compensated for their reactive power capability regardless of need and usability. Initial Decision PP 76, 85-96, JA ____, ____-____. As Oneta’s reactive power capability was “in every way comparable to the reactive power capability of AEP’s generators,” the ALJ concluded that, “under Commission policy and precedent, [Oneta] should be comparably compensated.” *Id.* P 83, JA _____. “To treat [Oneta] differently is undue discrimination.” *Id.* P 105, JA ____; *see also id.* P 107, JA ____ (“It is clear from the foregoing discussion of the evidence in this case, that Oneta’s generating

units would not be given comparable treatment if they, but not AEP's units, are subjected to a 'needs' test.").

VI. The Challenged Orders

The Commission found Oneta's proposed reactive power rate "just and reasonable because it compensates Oneta comparably, as other generators are compensated." Order on Initial Decision P 16, JA _____. In making its determination, the Commission "affirm[ed] the ALJ's findings that requiring a needs test would be contrary to Commission precedent, would deny Oneta comparable treatment, and would constitute undue discrimination." *Id.* The Commission further explained and reaffirmed its determinations in three rehearing orders. First Rehearing Order, 119 FERC ¶ 61,177, JA ____; Second Rehearing Order, 121 FERC ¶ 61,189, JA ____; Third Rehearing Order, 124 FERC ¶ 61,193, JA ____.

SUMMARY OF ARGUMENT

Consistent with its reactive power comparability policy and precedent, the Commission determined that, since AEP's affiliated generators were eligible for compensation for their reactive power capability during the historical, locked-in period at issue, then Oneta must be compensated for that capability during that period as well. The record established that Oneta's reactive power was just as

needed by, and useful to, the transmission system as the AEP-affiliates' reactive power.

The record also established that Oneta and the AEP-affiliated generators were similarly situated for reactive power compensation purposes. Consistent with undue discrimination policy and precedent, therefore, the Commission reasonably found that it was unduly discriminatory for AEP-affiliated generators to be compensated for their reactive power capability within the dead band, but for the similarly situated Oneta facility to be denied compensation for that capability.

In making its determinations, the Commission reasonably interpreted the FERC-jurisdictional Interconnection Agreement entered into by AEP and Oneta. The Commission found that the Interconnection Agreement contemplated comparable treatment in the standards and procedures applied to Oneta and AEP-affiliated generators. Thus, if AEP generators were compensated for their reactive power capability, Oneta must be compensated for that capability as well.

Furthermore, the Commission reasonably found that comparability required that Oneta be allowed to recover its full reactive power revenue requirement. By choosing to self-supply its reactive power, the Commission explained, AEP chose not to exercise its opportunity to recover that portion of its revenue requirement under Schedule 2. Moreover, the Commission added, AEP could have avoided any under-recovery of Schedule 2 revenues it might have experienced due to third-

party self-supply if it had asked Southwest Power Pool to change the billing determinants under Schedule 2 to reflect that self-supply. It would be unfair to limit Oneta's recovery of its revenue requirement because of AEP's actions or inactions.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *E.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under that standard, the Commission's decision must be reasoned and responsive. *East Texas Elec. Coop., Inc. v. FERC*, 218 F.3d 750, 753 (D.C. Cir. 2000). For this purpose, the Commission's factual findings are conclusive if supported by substantial evidence in the record. *Id.*; FPA § 313(b), 16 U.S.C. § 825l(b). Substantial evidence "requires more than a scintilla," but "can be satisfied by something less than a preponderance of the evidence." *B&J Oil & Gas Co. v. FERC*, 353 F.3d 71, 77 (D.C. Cir. 2004); *FPL Energy Me. Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002).

The Court is "particularly deferential to the Commission's expertise in ratemaking cases, which involve complex industry analyses and difficult policy choices." *North Baja Pipeline, LLC v. FERC*, 483 F.3d 819, 821 (D.C. Cir. 2007) (quoting *Exxon Mobil Corp. v. FERC*, 430 F.3d 1166, 1172 (D.C. Cir. 2005)). *See*

also *Blumenthal v. FERC*, 552 F.3d 875, 881 (D.C. Cir. 2009) (“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”) (quoting *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1*, 128 S. Ct. 2733, 2738 (2008)).

Furthermore, “[i]n evaluating FERC’s interpretation of its own order[s], [the Court] afford[s] the Commission substantial deference, upholding the agency’s decision ‘unless its interpretation is plainly erroneous or inconsistent’ with the order[s].” *Consumers Energy Co. v. FERC*, 428 F.3d 1065, 1067-68 (D.C. Cir. 2005). The Court gives substantial deference to the Commission’s interpretation of FERC-jurisdictional agreements as well. *Old Dominion Elec. Coop., Inc. v. FERC*, 518 F.3d 43, 48-49 (D.C. Cir. 2008).

II. THE COMMISSION REASONABLY FOUND THAT COMPENSATING ONLY AEP-AFFILIATED GENERATORS, BUT NOT ONETA, FOR THEIR REACTIVE POWER CAPABILITY VIOLATED THE COMMISSION’S COMPARABILITY POLICY AND PRECEDENT AND WAS UNDULY DISCRIMINATORY

The Commission’s reactive power comparability policy and precedent require that, if a transmission provider’s affiliated generators are compensated for their reactive power capability within the dead band, then unaffiliated generators also must be compensated for that capability. Order on Initial Decision P 6 (citing *Michigan Electric*, 97 FERC at 61,853), P 26, n.62, JA ____, ____, ____; *see also*

First Rehearing Order P 27, JA ___; Second Rehearing Order P 15, JA ___; Initial Decision PP 62, 76, 82, JA ___, ___, ___. As AEP's affiliated generators were compensated for their reactive power capability within the dead band during the historical, locked-in time period at issue in this case, the Commission reasonably determined, consistent with Commission policy and precedent, that Oneta also must be compensated for that capability during that period. Order on Initial Decision PP 27, 73, 74, JA ___, ___, ___; First Rehearing Order PP 4, 10, 29, JA ___, ___, ___.

Likewise, the Commission reasonably determined that it was unduly discriminatory for AEP-affiliated generators to be compensated based on their capability to provide reactive power, but to deny the similarly situated Oneta generation facility compensation for that same capability. Order on Initial Decision PP 35-36, 48-49, JA ___-___, ___; First Rehearing Order PP 22-26, 29-31, 35-37, 64, JA ___-___, ___-___, ___, ___; Third Rehearing Order P 17 and n.22, JA ___-___. As the ALJ and the Commission found, the AEP-affiliated generators provided no more of a reactive power service than Oneta did, and Oneta's reactive power capability was comparable to and no less usable and needed than the AEP affiliates'. First Rehearing Order P 25, JA ___-___.

AEP raises several challenges to the Commission's determinations. As the Commission found, however, none of those challenges has merit.

A. FERC Appropriately Applied Its Reactive Power Comparability Policy In This Historical, Locked-In Period

AEP contends the Commission should not have applied its reactive power comparability policy in this case because Oneta's reactive power was not needed or used or useful on Southwest Power Pool's transmission system. Br. at 30, 32-33, 41-46. As the ALJ and Commission found, however, the record established that Oneta's reactive power was just as needed by, and useful and beneficial to, the transmission system as the AEP-affiliated generators' reactive power. Order on Initial Decision P 48, JA ___; First Rehearing Order PP 23, 25, 44, 48, 49, n.92, JA ___, ___, ___-___, ___; Third Rehearing Order P 17 and n.22, JA ___-___; Initial Decision PP 85-86, 88, 89, 96, JA ___-___.

First, the evidence established that Oneta's reactive power has helped maintain proper voltage levels and, therefore, service reliability in the AEP control area. First Rehearing Order n.96, JA ___; Third Rehearing Order P 17 and n.22, JA ___-___. For example, the record showed that, when the Oneta facility operated, it produced 155.1 megavolt amperes reactive out of the total 344.1 megavolt amperes reactive of reactive power produced in the Tulsa area. First Rehearing Order nn.96, 134, JA ___, ___; Third Rehearing Order P 17 and n.22, JA ___-___; Initial Decision P 88, JA ___ (citing R. 73, July 20, 2005 Hearing Transcript, at 324-25, JA ___-___; R. 153, Exh. KZ-21 at 6, JA ___).

In addition, while AEP requires Oneta to be able to operate at a .85 power factor, it requires its own affiliates to be able to operate at only a .95 power factor. Order on Initial Decision PP 40, 47-48, 69, JA ____, ____-____, ____; First Rehearing Order PP 39, 48, JA ____, _____. Thus, Oneta is required to be capable of providing a higher ratio of reactive-to-real power than the AEP-affiliated facilities (*i.e.*, AEP requires that 15 percent of Oneta's generation be able to be in the form of reactive power, while it requires that only five percent of the generation produced by AEP-affiliates be able to be in the form of reactive power). Order on Initial Decision PP 40, 47-48, 69, JA ____, ____-____, ____; First Rehearing Order PP 39, 48, JA ____, _____.

Moreover, while Oneta's generation is on-line only 8.4 percent of the time, half of AEP's affiliated generators (for which AEP is compensated on a capability basis) are on-line less often than Oneta's generation; in fact, some of AEP's generators are never on-line. Order on Initial Decision P 48, JA ____; First Rehearing Order PP 23, 25, 49, JA ____, ____, ____; Initial Decision PP 85-86, JA _____. Additionally, although Oneta never operated outside of its power factor range, none of the AEP-affiliated generators did either. First Rehearing Order PP 48-49, JA ____-____; Initial Decision PP 88, 96, JA _____. Furthermore, the record showed that AEP's voltage schedules for AEP-affiliated generators mirrored

AEP's voltage schedules for Oneta. First Rehearing Order P 48 n.104, JA ____; Order on Initial Decision P 48, JA ____; Initial Decision P 96, JA ____.

AEP claims that its engineering analyses showed that Oneta's reactive power was not needed. Br. at 43. The ALJ found these analyses unpersuasive, however, as they were conducted assuming Oneta was either off-line or simply meeting its voltage schedule. Initial Decision P 87, JA ____; R. 198, Exh. AEP-6, JA ____; R. 200, Exh AEP-8, JA ____; R. 194, Exh. AEP-2 at 15, 18, 22, JA ____, ____, _____. "In that almost all generating units of any significant size have Automatic Voltage Regulator equipment (AVR) and can meet their own voltage schedules ([R. 73, Transcript at] 208), it would be unlikely that modeling a system with *any* generator off-line would show a need for that generator's reactive power." Initial Decision P 87, JA ____.

Furthermore, the Commission pointed out, under Commission precedent "a generator is 'used and useful' if it is *capable* of providing reactive power." Order on Initial Decision P 28, JA ____ (citing *Midwest Independent Transmission System Operator, Inc.*, 114 FERC ¶ 61,192 at P 19 (2006)); First Rehearing Order P 22, JA _____. Thus, the AEP methodology, which the Commission has determined all generators should use to calculate their reactive power revenue requirements, does not include a "needs" test but, rather, measures a generator's maximum capability

to produce reactive power. Order on Initial Decision P 28, JA ____; *see also id.* P 49, JA ____; First Rehearing Order P 26, JA ____.

In any event, the Commission explained, “compensation for reactive power within the established power factor is based on comparability and thus, if the transmission provider compensates its own or its affiliated generators for reactive power *within* the established range, it *must* also pay the interconnecting generator.” Order on Initial Decision P 26, JA ____ (citing, *e.g.*, *Michigan Electric*, 97 FERC at 61,852-53 (given “the need to treat all generation interconnection customers comparably[,] . . . it is hardly consistent to allow an affiliate to have different and/or superior terms and conditions for interconnecting than non-affiliates”; “we direct Michigan Electric to compensate Generators for providing reactive power to the same degree that it will compensate its affiliate, Consumers, for providing reactive power. To the extent that Michigan Electric is treating reactive power as an ancillary service provided by its affiliate and thus reimbursing its affiliate, it must compensate the Generators.”)); *see also* First Rehearing Order P 47, JA ____ (same).

Because AEP-affiliated generators were compensated for their reactive power capability within the established power factor range during the historical, locked-in period at issue here, the Commission reasonably concluded that, “[c]onsistent with the Commission’s reactive power comparability standard, Oneta

must also receive compensation.” Order on Initial Decision P 27, JA ____; *see also id.* P 28, JA ____ (same); *id.* n.62, JA ____ (“emphasiz[ing] that a generator is only allowed to receive compensation for providing power within its power factor range if another generator within the control area is already receiving compensation for it.”).

The Commission recognized, nonetheless, that there was far more reactive power capability in the Tulsa area than was needed. Order on Initial Decision P 50, JA ____ . Thus, the Commission determined that, “[g]oing forward, parties may propose a rate for all generators that compensates them comparably for the level of reactive power actually needed and used, so as to avoid remuneration in excess of those levels.” *Id.*; *see also id.* (“[Southwest Power Pool] (and other parties) may develop criteria, including a needs test, to be applied comparably and prospectively, that would determine which generators would receive reactive power compensation. . . . Any such proposal should be advanced in a separate [FPA] section 205 proceeding.”); First Rehearing Order P 24, JA ____ (same); *id.* P 26 and n.49, JA ____ (changes in rate design can be applied only prospectively and therefore could not be applied to Oneta for prior periods).

Southwest Power Pool acted on the Commission’s suggestion. Specifically, while the instant FERC proceeding was ongoing, Southwest Power Pool filed in a separate proceeding, under FPA § 205, 16 U.S.C. § 824d, to prospectively revise

Schedule 2 of its Tariff to no longer provide compensation to any generator for its reactive power capability within the dead band. Second Rehearing Order P 16 and n.23, JA ____; Third Rehearing Order P 5 and n. 7, JA ____.

The Commission approved Southwest Power Pool’s proposal, and the revised Schedule 2 became effective on February 28, 2007. *Southwest Power Pool, Inc.*, 119 FERC ¶ 61,199, *order on reh’g*, 121 FERC ¶ 61,196 (2007) (approving Southwest Power Pool’s revised Schedule 2). Accordingly, as noted above, this case involves a historical, locked-in period from June 21, 2003 (the effective date of Oneta’s reactive power rate schedule) through February 28, 2007, (the date Southwest Power Pool’s proposal to revise Schedule 2 became effective). Second Rehearing Order P 16 and n.23, JA ____; Third Rehearing Order P 5 and n.7, JA ____.

B. FERC Reasonably Affirmed The ALJ’s Determination That It Was Unduly Discriminatory For AEP-Affiliated Generators To Be Compensated Based On Their Capability To Provide Reactive Power, But For The Similarly Situated Oneta Generation Facility To Be Denied Compensation For That Same Capability

1. The Commission Acted Consistently With Undue Discrimination Policy And Precedent

AEP claims that the Commission “failed to follow undue discrimination precedent.” Br. at 35-36 (capitalization in heading altered). AEP is incorrect.

As the Commission explained, the “history of reactive power pricing beg[an] with the Commission’s Order No. 888 issued in April 1996.” Order on Initial

Decision P 4, JA _____. In that rulemaking, to remedy undue discrimination resulting from public utilities that owned or controlled transmission favoring their own generation over other utilities' generation (either by denying transmission access altogether or by providing transmission to other generators on less favorable terms and conditions than those they applied to their own generation), the Commission required nondiscriminatory, *i.e.*, comparable, open access transmission services by public utilities. *New York*, 535 U.S. at 9; *Snohomish*, 272 F.3d at 610 (citing *Transmission Access*, 225 F.3d at 682); *Transmission Access*, 225 F.3d at 683-84; Order No. 2003, 104 FERC at P 19. Since Order No. 888, therefore, utilities have been required to “provide access to their transmission lines to anyone *purchasing or selling* electricity in the interstate market *on the same terms and conditions as they use their own lines.*” *Transmission Access*, 225 F.3d at 681 (emphases added); *see also* Order No. 2003, 104 FERC at P 6 (explaining that Order No. 888 “required public utilities to provide other entities comparable access” to their transmission facilities).

Consistent with this, in *Michigan Electric*, the Commission determined that it would be unduly discriminatory for a transmission provider to compensate its affiliated generators, but not independent power producers, for reactive power within the dead band. *Michigan Electric*, 97 FERC at 61,852-53, *cited in* Order on Initial Decision P 6 and n.13, P 26 and n.30, JA _____, _____; First Rehearing Order P

10 and n.16, P 47 and n.101, JA ____, ____; Second Rehearing Order P 15 and n.21, JA ____.

As the Commission explained, “[u]nder § 205 of the Federal Power Act, rates, terms and conditions cannot be unduly discriminatory or preferential,” and, “it is hardly consistent to allow an affiliate to have different and/or superior terms and conditions for interconnection than non-affiliates.” *Michigan Electric*, 97 FERC at 61,852. Accordingly, the Commission “direct[ed] Michigan Electric to compensate Generators for providing reactive power to the same degree that it will compensate its affiliate, Consumers, for providing reactive power. To the extent that Michigan Electric is treating reactive power as an ancillary service provided by its affiliate and thus reimbursing its affiliate, it must compensate the Generators.” *Id.* at 61,853.⁴

In the instant case, following its Order No. 888 and *Michigan Electric* policy, the Commission affirmed the ALJ’s determination that it was unduly discriminatory for AEP-affiliated generators to be compensated based on their capability to provide reactive power, but to deny the similarly situated Oneta generation facility compensation for that same capability. Order on Initial

⁴ AEP criticizes the Commission for citing to *Bluegrass Generation Co., L.L.C.*, 118 FERC ¶ 61,214 (2007), for the proposition that “its ruling was consistent with ‘well settled’ precedent.” Br. at 35 (citing First Rehearing Order P 36, JA ____). In *Bluegrass*, 118 FERC at PP 2, 5, just like in the orders challenged here, however, the Commission cited to both Order No. 888 and *Michigan Electric*.

Decision PP 35-36, 48-49, JA ___-___, ___; First Rehearing Order PP 22-26, 29-31, 35-37, 64, JA ___-___, ___-___, ___, ___; Third Rehearing Order P 17 and n.22, JA ___-___; Initial Decision PP 66-96, 105, JA ___-___, ___. In doing so, the Commission simply applied its reactive power comparability policy to cure the undue discrimination it found in the historical, locked-in period here. *See, e.g., Sacramento Mun. Util. Dist. v. FERC*, 474 F.3d 797, 802 (D.C. Cir. 2007) (undue discrimination established when similarly situated parties receive dissimilar treatment) (citing *Ohio Power Co. v. FERC*, 744 F.2d 162, 165 n.3 (D.C. Cir. 1984)).

This reasonable exercise of the Commission’s “wide discretion in fashioning remedies for undue discrimination,” First Rehearing Order P 37, JA ___ (citing, *e.g., Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967)), should be upheld. *See Braintree Elec. Light Dep’t v. FERC*, 550 F.3d 6, 15 (D.C. Cir. 2008) (the Court “approach[es] agencies’ decisions on remedies with exceptional deference”); *Louisiana Pub. Serv. Comm’n v. FERC*, 522 F.3d 378, 393 (D.C. Cir. 2008) (the Court “owe[s] FERC great deference in reviewing its selection of a remedy, for ‘the breadth of agency discretion is, if anything, at [its] zenith when the action assailed relates primarily . . . to fashioning policies, remedies and sanctions’”) (quoting *Niagara Mohawk*, 379 F.2d at 159); *see also Louisiana*, 522 F.3d at 386-94 (affirming FERC’s remedy to prevent undue

discrimination among similarly situated sellers of electric generation and transmission).

2. The Commission's And ALJ's Finding That Oneta And The AEP-affiliated Generators Were Similarly Situated Was Reasonable And Supported By Substantial Evidence

a. Oneta And The AEP-affiliated Generators Were Similarly Situated For Reactive Power Compensation Purposes

AEP further claims that Oneta and the AEP-affiliated generators were not similarly situated. Br. at 37-41. The Commission and ALJ reasonably found otherwise. *E.g.*, First Rehearing Order P 39, JA ___; Order on Initial Decision PP 48, 36, JA ___, ___; Initial Decision P 105, JA ___.

The record established that AEP-affiliated generators were eligible for compensation based on their capability of providing reactive power within their dead band, that Oneta was capable of providing reactive power within its dead band, and that Oneta's capability was comparable to and no less useful than AEP's capability. First Rehearing Order PP 39, 40, 44, 45, JA ___, ___, ___; Order on Initial Decision PP 36, 48, 49, JA ___, ___; Initial Decision P 105, JA ___. Thus, the Commission agreed with the ALJ in finding that Oneta was similarly situated to the AEP-affiliated generators for reactive power compensation purposes. First Rehearing Order PP 39, 40, 44, JA ___; Order on Initial Decision that PP 36, 48, JA ___, ___.

AEP asserts, nonetheless, that Oneta was not similarly situated to the AEP-affiliated generators because, purportedly, only AEP provides a reactive power service. Br. at 37. The Commission and ALJ found, however, that, “AEP’s generators supply no more a reactive power ‘service’ than Oneta’s facility.” First Rehearing Order P 48, JA ___; *see* Initial Decision P 96, JA ___. Thus, the Commission explained, “even if it [had] focus[ed] on service as AEP requests, [it] would still find AEP and Oneta to be similarly situated for reactive power compensation” purposes. First Rehearing Order P 46, JA ___.

This determination was supported by substantial evidence. For example, as discussed above, *supra* pp. 16-18, the evidence showed that: (1) Oneta’s reactive power has helped maintain proper voltage levels and, therefore, service reliability in the AEP control area, First Rehearing Order P 46 and n.96, JA ___; Third Rehearing Order P 17 and n.22, JA ___-___; (2) AEP requires that Oneta be capable of providing a higher ratio of reactive-to-real power than it requires of its own affiliates, Order on Initial Decision PP 40, 47-48, 69, JA ___, ___-___, ___; First Rehearing Order PP 39, 48, JA ___, ___; (3) half of the AEP-affiliated generators are on-line less often than Oneta’s generation, Order on Initial Decision P 48, JA ___; First Rehearing Order PP 23, 25, 49, JA ___, ___, ___; Initial Decision PP 85-86, JA ___; and (4) AEP-mandated voltage schedules for AEP-affiliated generators mirrored AEP-mandated voltage schedules for Oneta, First

Rehearing Order P 48 n. 104, JA ____; Order on Initial Decision P 48, JA ____; Initial Decision P 96, JA ____.

Additionally, the Commission pointed out, AEP-affiliated generators and Oneta are required to operate in accordance with the same Southwest Power Pool Criteria and directives, First Rehearing Order P 46, JA ____ (citing R. 146, Interconnection Agreement § 3.4, JA ____ (“Each Party shall operate in accordance with the [Southwest Power Pool] Criteria and any applicable directive of the [Southwest Power Pool].”)). Furthermore, the evidence established that neither Oneta nor any of the AEP-affiliated generators ever operated outside its established power factor range. First Rehearing Order PP 48-49, JA ____-____; Initial Decision PP 88, 96, JA ____.

The Commission acknowledged AEP’s obligation as control area operator to maintain appropriate voltage levels on the transmission system, and that AEP-affiliated generators may be required to operate to satisfy this obligation. First Rehearing Order PP 46, 63 and nn. 126, 130, JA ____, ____. The Commission found, however, that AEP similarly may exercise control over Oneta’s reactive power output through Southwest Power Pool Criteria §§ 7.8.2.1.a and 7.8.2.1.b and § 3.5 of AEP’s Interconnection Agreement with Oneta, which require Oneta to comply with the voltage/reactive power schedule set by AEP. First Rehearing Order PP 46, 63 and nn.126, 130, JA ____, ____; R. 173, Southwest Power Pool

Criteria, at 2-3, JA ___-___; R. 202, Interconnection Agreement, at 12, JA ___.

“In other words, AEP could use affiliated and unaffiliated generation to fulfill its duties as control area operator to maintain the proper voltage levels contemplated in Schedule 2 of [Southwest Power Pool]’s [Open Access Transmission Tariff].”

First Rehearing Order P 63, JA ___.

Moreover, the Commission pointed out, although a Transmission Provider may not be able to demand that an Interconnection Customer operate its generating facility solely to provide reactive power, it may require the Interconnection Customer to provide reactive power when its generation is in operation. First Rehearing Order P 46 and n.95, JA ___ (citing Order No. 2003-C at P 43). As the Commission found, “AEP requires Oneta to remain ready to provide reactive power service to AEP (and thus to [Southwest Power Pool]) as a condition of interconnection.” First Rehearing Order P 46, JA ___. And, in fact, the record showed that Oneta “does contribute to the provision of a reliability service in the control area,” as “when the Oneta Facility was operating it produced 155.1 [megavolt amperes reactive] out of the total produced 344.1 [megavolt amperes reactive] of reactive power produced in the Tulsa area” First Rehearing Order n.96, JA ___.

Additionally, the Commission pointed out, as the ALJ had explained, “there is no justification for the position that certain of AEP’s generators are required to

be available for supplying reactive power, while Oneta's units are not," because "[i]f those AEP units were taken off line, there would be other units, perhaps even Oneta's, on-line taking their places to supply real power for sale to customers. And, as the evidence indicates, they have similar reactive power capability as the displaced AEP units." Initial Decision P 89, JA ____, *cited in* First Rehearing Order P 46 n.95, JA ____.

Finally, the Commission noted that § 13.16 of the Interconnection Agreement states that "Company [AEP] shall not require Customer [Oneta] to comply with standards and procedures in excess of those applied to Company's own interconnected generating facilities that are *similarly situated*." First Rehearing Order P 50 (emphasis added by Commission), JA _____. "Thus, contrary to AEP's assertions that AEP and Oneta are not similarly situated, the parties to the Interconnection Agreement (including AEP) recognized that AEP has generation that is similarly situated to the Oneta facility." *Id.*

b. AEP's Challenges To The Commission's Similarly Situated Finding Fail

Ignoring most of the facts cited in support of the Commission's finding, AEP challenges only a few of them. Br. at 38-40. Specifically, AEP claims that neither the fact that Oneta has a broader power factor range (*i.e.*, must be capable of providing a higher ratio of reactive-to-real power) than half of the AEP-

affiliated generators, nor the fact that no generator in the AEP control area ever operated outside its power factor range, indicates that Oneta provides a reactive power service. Br. at 38-39.

The question before the Commission regarding undue discrimination was whether Oneta and AEP-affiliated generators are similarly situated for reactive power compensation purposes. As the Commission found, the challenged facts supported the conclusion that AEP-affiliated generators supply no more of a reactive power service than Oneta does and, therefore, that Oneta and AEP-affiliated generators are similarly situated for reactive power compensation purposes. Order on Initial Decision PP 40, 47-48, 69, JA ____, ____-____, ____; First Rehearing Order PP 39, 48-49, JA ____, ____; Initial Decision PP 88, 96, JA ____, ____.

AEP challenges the Commission's citation to the fact that half of AEP's affiliated generators (for which AEP is compensated on a capability basis) are on-line less often than Oneta's generation. Br. at 39-40. In AEP's view, this ignores that these infrequently run generators are peakers (*i.e.*, are intended to run only when there is high demand) that AEP located where they can provide beneficial reactive power. Br. at 40.

As the ALJ found, and the Commission affirmed, however, the infrequently run AEP-affiliated generators are no more beneficial to the transmission system

than Oneta. Order on Initial Decision P 48, JA ___ First Rehearing Order PP 23, 25, 49 and n.105, JA ___, ___, ___; Initial Decision PP 85-86, JA ___. Reactive power is needed instantly, but infrequently-run AEP-affiliated generators take from 20 minutes to 24 hours to come on-line. Initial Decision PP 85-86, JA ___. Additionally, while AEP claims Oneta is not a viable substitute for AEP's must-run generators, Br. at 40, the record established that no AEP-affiliated generator provides any more of a reactive service than Oneta does. First Rehearing Order P 48, JA ___.

Moreover, contrary to AEP's claim, Br. at 40, reactive power considerations play no part in determining where to locate a new generating plant. Initial Decision PP 90-93, JA ___. "The entire consideration focuses on the need for, and the opportunity to sell, real, not reactive power." *Id.* P 90, JA ___; *see also id.* ("There has not been one iota of evidence adduced that would suggest that a decision to build or locate a plant has ever been based on the need for, or potential to sell, reactive power."). Thus, "on the evidence adduced, there [was] no basis for arguing that AEP's generators are entitled to more favorable treatment than Oneta's because, unlike Oneta's, they were built in locations based upon reactive power considerations. That is simply an unsupported rationalization for denying Oneta comparable treatment." *Id.* P 93, JA ___.

Next, AEP contends that, if the Commission were concerned about AEP including costs of the infrequently run AEP-affiliated generators in its reactive power revenue requirement, the only proper course was to initiate an FPA § 206, 16 U.S.C. § 824e, investigation into the matter. Br. at 40. As the Commission recognized, however, changes in rate design can be applied only prospectively and, therefore, the Commission could not remedy the incomparable treatment and undue discrimination Oneta experienced during the historical, locked-in period at issue here by instituting an FPA § 206 proceeding. First Rehearing Order n.49, JA ___; Second Rehearing Order P 16 and n.23, JA ___; Third Rehearing Order P 5 and n.7, JA ___; *see, e.g., City of Anaheim v. FERC*, 558 F.3d 521, 522 (D.C. Cir. 2009) (FPA § 206(a) prohibits FERC from setting rates retroactively).

AEP also argues for the first time that the challenged orders conflict with *Southern Company Services, Inc.*, 116 FERC ¶ 61,247 at P 22 (2006), *order on reh'g*, 119 FERC 61,023 at PP 20-22 (2007), and *Florida Power & Light Company*, 113 FERC ¶ 61,263 (2005), *order on reh'g*, 116 FERC ¶ 61,013 (2006). Br. at 40-41. AEP is incorrect.

As the Commission has explained, “[t]he circumstances in [the instant case] were, put simply, different than the circumstances [in *Southern*].” *Southern*, 119 FERC at P 22. In the instant case the issue was whether Oneta should be compensated for its reactive power capability when transmission owner-affiliated

generators were compensated for their reactive power capability. *Southern* involved a completely different issue – whether the costs associated with a radial transmission line should be rolled-in with the costs of Southern Company’s transmission network or directly assigned to its owner. *Id.* Unlike the issue here, Southern’s treatment of other facilities had no bearing on the issue in that case. *Id.*

The instant case is not inconsistent with *Florida Power & Light* either. The Commission acted to ensure consistency between a utility’s treatment of its own and other facilities in both cases, but the means available to the Commission to remedy the inequitable treatment it found were different. *See Florida Power & Light*, 113 FERC at P 24.

In *Florida Power & Light*, the Commission had before it an FPA § 205 rate filing proposing the procedure the Commission found would improperly favor the proponent’s own facilities. The Commission was able, in that circumstance, to remedy the undue discrimination it found by approving a revised procedure that would apply during the entire period at issue. By contrast, the Commission could provide a real remedy for the undue discrimination it found during the historical, locked-in period at issue here only by approving Oneta’s filing. That filing requested that, like AEP, Oneta be compensated for its reactive power capability within the dead band. Initiating a forward-looking FPA § 206 proceeding would not have allowed the Commission to reach back to require retroactive

implementation of a revised procedure under which AEP affiliates would not be compensated for their reactive power capability. *See supra* p. 32.

C. The Commission Reasonably Interpreted The Interconnection Agreement

AEP also erroneously challenges the Commission’s interpretation of § 13.16 of the FERC-jurisdictional Interconnection Agreement. Br. at 33-35. The Commission found that, while § 3.5 of the Interconnection Agreement required Oneta to follow the reactive power and voltage restrictions set by AEP, it neither explicitly included rates to compensate Oneta for its reactive power capability nor precluded compensation to Oneta for that capability. Order on Initial Decision P 69, JA ____; First Rehearing Order P 66, JA ____.

Moreover, the Commission noted, while an Interconnection Agreement can: (1) commit a generator to being able to provide reactive power without compensation; (2) commit the transmission owner to compensate the interconnecting generator for being able to provide reactive power; or (3) not address the issue at all, only in the first instance would it be clear that the generator would not be entitled to compensation. Order on Initial Decision n.82, JA ____ (citing *Calpine Construction Finance Co., L.P.*, 111 FERC ¶ 61,403 at P 9 (2005)).

Looking to the rest of the Interconnection Agreement, the Commission determined that § 13.16 (which states that “Company shall not require Customer to

comply with standards and procedures in excess of those applied to Company's own interconnected generating facilities that are similarly situated") contemplates comparable treatment in the standards and procedures applied to similarly situated Oneta and AEP-affiliated generators. Order on Initial Decision P 69, JA ____; First Rehearing Order P 66, JA ____.

The Commission reasonably "interpret[ed] this section of the Interconnection Agreement to mean that if AEP receives compensation from [Southwest Power Pool] for reactive power service then AEP must ensure that Oneta receives similar compensation for the reactive power service provided by the Oneta Facility." Order on Initial Decision P 69, JA ____.

"By treating the Oneta Facility in a manner similar to AEP's similarly situated generation, for the purpose of receiving reactive power compensation under Schedule 2 of the [Southwest Power Pool] [Open Access Transmission Tariff], AEP will be holding Oneta to procedures that are not in excess of the procedures to which it holds itself and would allow AEP to comply with section 13.16 of the Interconnection Agreement." *Id.*

AEP claims that § 13.16 "is about operating standards and not about payment," and "can only be read to mean that AEP will not hold Oneta to more restrictive operating standards than it holds its own generators." Br. at 33; *see also* Br. at 34. This claim ignores that § 13.16 is also about "procedures," and that the Commission found that it would violate § 13.16 if AEP compensated only its

affiliated generators for their reactive power capability, as AEP would be holding Oneta to procedures in excess of the procedures to which it held itself. Order on Initial Decision P 69, JA _____. The Commission's reasonable interpretation of this FERC-jurisdictional agreement, and not AEP's alternative interpretation, should be upheld. *Old Dominion*, 518 F.3d at 48-49.

AEP also asserts, as an aside, that "the Interconnection Agreement was executed even before FERC issued the cases that allegedly began the general reactive power comparability policy." Br. at 34. AEP did not raise this assertion to the Commission in either of its petitions for rehearing. R. 104, JA ____; R. 129, JA _____. As a result, AEP is precluded from raising this assertion on appeal.

FPA § 313(b), 16 U.S.C. § 825l(b), provides that "[n]o 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 to do so." Courts strictly construe this jurisdictional requirement, as the express statutory limit it imposes on a court's jurisdiction cannot be relaxed. *See, e.g., California Department of Water Resources v. FERC*, 306 F.3d 1121, 1125 (D.C. Cir. 2002); *ASARCO, Inc. v. FERC*, 777 F.2d 764, 775 (D.C. Cir. 1985).

In addition to being a jurisdictional prerequisite, rehearing at the Commission level regarding all objections to be raised on court review serves an

important purpose. It “enables the Commission to correct its own errors, which might obviate judicial review, or to explain in its expert judgment why the party’s objection is not well taken, which facilitates judicial review.” *Save Our Sebasticook v. FERC*, 431 F.3d 379, 381 (D.C. Cir. 2005).

In any event, AEP’s new assertion has no merit. As explained above, utilities have been required to “provide access to their transmission lines to anyone *purchasing or selling* electricity in the interstate market *on the same terms and conditions as they use their own lines*” since Order No. 888, *Transmission Access*, 225 F.3d at 681 (emphases added), long before the Interconnection Agreement was executed.

D. The Commission Ensured That Oneta’s Reactive Power Compensation Was Just And Reasonable

Based on its contention that Oneta’s reactive power is neither needed by nor useful to the transmission system, AEP further asserts that the challenged orders allowed Oneta to receive an excessive rate. Br. at 45-46. To the contrary, the Commission ensured that the reactive power compensation rate it approved was just and reasonable. Order on Initial Decision PP 1, 16, JA ____, ____; First Rehearing Order PP 1, 22-26, JA ____, ____-____.

As previously noted, because Oneta was similarly situated with the AEP-affiliated generators for reactive power compensation purposes, it would be unduly

discriminatory and contrary to the Commission’s long-standing policy of reactive power comparability to deny Oneta compensation. *E.g.*, Order on Initial Decision PP 27, 68, 73, 74, JA ____, ____, ____, ____; First Rehearing Order PP 4, 10, 22, 24, 29, 44-50, JA ____, ____-____, ____, ____, ____, ____; Second Rehearing Order P 15, JA _____. The requested compensation was not excessive, as it was calculated using the AEP methodology, which is the established, just and reasonable methodology to calculate reactive power revenue requirements, and is the same methodology AEP used to calculate its reactive power revenue requirement. First Rehearing Order P 24 and n.44, P 55, JA ____, ____; Third Rehearing Order P n.6, JA _____. As the Commission found, “comparable reactive power capability should be comparably compensated.” Third Rehearing Order P 10, JA _____.

E. The Commission Reasonably Determined That Comparability Required Oneta To Recover Its Full Reactive Power Revenue Requirement

AEP claims that comparability does not require that Oneta be allowed to recover its full reactive power revenue requirement because, due to AEP-affiliate and third-party self-supply of reactive power, AEP does not recover its full revenue requirement. Br. at 47-51; *see also* Br. at 31-32. The Commission disagreed. First Rehearing Order P 68, JA ____; Second Rehearing Order PP 15-17, JA ____-____; Third Rehearing Order PP 5, 10-18, JA ____, ____-____. *See also Niagara*

Mohawk Power Corp. v. FERC, 452 F.3d 822, 825-26 (D.C. Cir. 2006) (explaining generator self-supply options).

In this case, “reactive power capability was compensated within the deadband under Schedule 2 during the historical locked-in period of time. Accordingly, consistent with [the Commission’s] comparability policy, both AEP and Oneta had the opportunity to recover their reactive power revenue requirements based on their capability to produce reactive power.” Third Rehearing Order P 13, JA _____. “By self-supplying its reactive power requirements,” the Commission found, “AEP essentially chose not to exercise its opportunity to recover that portion of its revenue requirement under Schedule 2.” *Id.*; *see also id.* P 14, JA ____ (if AEP had not chosen to self-supply, it would have fully recovered its revenue requirement as well; “The nature of AEP’s recovery is the result of its chosen rate design and its decision to self-supply”).

The Commission determined that “AEP’s decision to self-supply should have no bearing on Oneta’s comparable opportunity to recover its own revenue requirement for providing reactive power capability.” Third Rehearing Order P 13, JA ____; *see also id.* P 14, JA ____ (“it would be unfair to limit Oneta’s recovery of its revenue requirement because of AEP’s actions or inactions”; if AEP’s view prevailed, “Oneta would recover less than one-quarter of its revenue requirement simply because Oneta chose to self-supply”). “Unlike AEP, Oneta chose to

exercise its opportunity and filed a rate schedule to recover its revenue requirement,” and, “[a]ccordingly, Oneta should get paid its full reactive power requirement.” *Id.* P 13, JA _____. *See also* First Rehearing Order P 68 (“AEP’s underrecovery was the result of its own choice to self-supply reactive power, and this choice cannot be used as a basis to deny Oneta its reactive power revenue requirement for comparable reactive power capability.”); Second Rehearing Order P 18 (same); Third Rehearing Order P 11, JA _____.

Moreover, the Commission “explained that by allowing control area operators, like AEP, to self-supply their reactive power requirements, those operators could claim a capacity to self-supply as a means for reducing funds available to unaffiliated generators like Oneta. Unaffiliated generation capability would be called only to the extent that reactive power was not provided to a transmission customer from the operator’s own resources (*i.e.*, a ‘needs test’).” Third Rehearing Order n.16, JA _____; *see also* Second Rehearing Order P 17, JA _____ (same). Such a practice, the Commission found, would violate its policy of comparability. Third Rehearing Order n.16, JA _____. The only way to ensure comparability between independent power producers in the AEP zone, like Oneta, and the control area operator, AEP, which self-supplies its reactive power requirements, is to allow independent power producers to collect their full reactive power revenue requirement. Third Rehearing Order P 11, JA _____. *See also*

Niagara Mohawk, 452 F.3d at 829 (upholding as reasonable FERC’s decision “to put wholesale generators in roughly the competitive position integrated utilities enjoy”).

AEP claims the Commission disregarded that self-supply by third-party transmission customers reduced AEP’s Schedule 2 revenues. Br. at 49. To the contrary, the Commission found that, “[t]o the extent any of AEP’s underrecovery of Schedule 2 revenues is attributable to third-party self-supply arrangements, AEP should have changed, or requested [Southwest Power Pool] to change, the billing determinants under Schedule 2 to reflect a partial self-supply of reactive power by third-party transmission customers (*i.e.*, NTEC and Oklahoma Municipal Power Authority).” Second Rehearing Order n.27, JA _____. In other words, AEP should have had the self-supplied loads of third-party customers removed from the Schedule 2 billing determinant denominator (which consists of the load within the AEP control area) since the cost of reactive power capability used to self-supply that load is excluded from the billing determinant numerator (which consists of the cost of the reactive power capability within the AEP control area). Third Rehearing Order P 15 and n.18, JA _____.

While AEP contends this would make self-supply arrangements meaningless, Br. at 50, the Commission reasonably found otherwise. Second Rehearing Order P 19, JA _____. Reactive power charges would be assessed only to

the portion of a transmission customer's load that did not self-supply reactive power. *Id.*

AEP next complains that the Commission would not allow it to “recover the cost of serving retail customers from wholesale customers.” Br. at 50. The Commission reasonably found, however, that doing so would constitute improper subsidization of one group of customers by another. Third Rehearing Order P 17, JA ____.

There also is no merit to AEP's claim that the Commission's ruling is arbitrary because, if AEP collects any Schedule 2 revenues, Oneta can collect its entire revenue requirement, but if AEP agreed not to collect any Schedule 2 revenues, Oneta would not be entitled to any. Br. at 48. This result is wholly consistent with the Commission's general reactive power compensation policy. It is only because AEP-affiliated generators were compensated for their reactive power capability that Oneta must be compensated for its reactive power capability. *See Michigan Electric*, 97 FERC at 61,853.

Finally, the Commission's determination here is not inconsistent with *Southwest Power Pool*, 121 FERC ¶ 61,196 at P 18, as AEP contends, Br. at 49-50. Third Rehearing Order P 12, JA ____ (“AEP's reliance on *Southwest Power Pool* is misplaced.”). In the instant case, the Commission found comparability satisfied when, under Schedule 2, “both AEP and Oneta had the opportunity to recover their

reactive power revenue requirements based on their capability to produce reactive power.” Third Rehearing Order P 13, JA _____. In *Southwest Power Pool*, the Commission approved the transmission provider’s proposal to no longer compensate any generators for their reactive power capability within the dead band. Second Rehearing Order P 16 and n.23, JA ____; Third Rehearing Order P 5 and n.7, P 12, JA ____, _____. The Commission similarly found comparability satisfied there because both transmission owners and independent power producers would have the opportunity to recover their costs through means other than Schedule 2, such as power sales rates. Third Rehearing Order P 12, JA ____; *Southwest Power Pool*, 121 FERC ¶ 61,196 at P 18.

CONCLUSION

For the reasons stated, the Commission's orders should be affirmed in all respects.

Respectfully submitted,

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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 9,653 words, not including the tables of contents and authorities, the certificates of counsel, or the addendum.

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May 1, 2009