ORAL ARGUMENT NOT YET SCHEDULED

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

Nos. 16-1234; 16-1235; 16-1236; and 16-1239 (consolidated)

ADVANCED ENERGY MANAGEMENT ALLIANCE, *ET. AL.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

INITIAL FORM BRIEF OF INTERVENORS PJM INTERCONNECTION, L.L.C.; CALPINE CORPORATION; CPV POWER HOLDINGS, LP; EXELON CORPORATION; GENON ENERGY MANAGEMENT, LLC; LS POWER ASSOCIATES, L.P.; INDEPENDENT MARKET MONITOR FOR PJM; NRG POWER MARKETING LLC; PJM POWER PROVIDERS GROUP; PSEG ENERGY RESOURCES & TRADE LLC; PSEG POWER LLC; AND PUBLIC SERVICE ELECTRIC AND GAS COMPANY, IN SUPPORT OF RESPONDENT

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

A. Parties and Amici

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

B. Rulings under Review

1. Order on Proposed Tariff Revisions, *PJM Interconnection, L.L.C.*, 151 FERC ¶ 61,208 (2015) ("Tariff Order"), R. 312 (JA __); and

2. Order on Rehearing and Compliance, *PJM Interconnection, L.L.C.*, 155 FERC ¶ 61,157 (2016) ("Rehearing Order"), R. 413 (JA __).

C. Related Cases

These consolidated petitions for review have not previously been before this Court or any other court. Intervenors in support of Respondent are not aware of any other related cases within the meaning of D.C. Circuit Rule 28(a)(1)(C).

/s/ Matthew E. Price
Matthew E. Price
Counsel for Intervenor in Support of
Respondent Exelon Corporation

CORPORATE DISCLOSURE STATEMENTS

Calpine Corporation states as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: Calpine is a publicly traded Delaware corporation (NYSE: CPN) engaged through subsidiaries in the development, financing, acquisition, ownership, and operation of independent power-production facilities and the wholesale and retail marketing of electricity in the United States and Canada. Calpine has no parent corporation. No publicly held corporation owns 10 percent or more of Calpine's stock.

Respectfully submitted,

/s/ Neil L. Levy
Neil L. Levy
Counsel for Calpine Corporation

CPV Power Holdings, LP ("CPV Power Holdings") states as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: CPV Power Holdings is a non-governmental entity having its principal place of business at 8403 Colesville Road, Suite 915, Silver Spring, Maryland 20910. CPV Power Holdings is a partially or wholly owned subsidiary of the following companies: CPV Power Holdings GP, LLC; GIP II CPV Intermediate Holdings Partnership, L.P.; GIP II CPV Holdings Partnership, L.P.; GIP II CPV Holdings Partnership 3, L.P.; Global Infrastructure Partners II-B Feeder Fund, L.P.; Global Infrastructure Partners II-A, L.P.; Global Infrastructure Partners II-C, L.P.;

GIP IIC Eagle AIV, L.P.; Global Infrastructure Partners II-D1, L.P.; and GIP II Friends & Family Fund, L.P. No publicly held company owns 10% or more of the interests in CPV Power Holdings or its parents.

Respectfully submitted,

/s/ Larry F. Eisenstat
Larry F. Eisenstat
Counsel for CPV Power Holdings LP

Exelon Corporation states as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: Exelon Corporation is a utility and generator of electricity and is a publicly traded company. It has no parent company, and no publicly traded company owns 10 percent or more of its shares.

Respectfully submitted,

/s/ Matthew E. Price
Matthew E. Price
Counsel for Exelon Corporation

GenOn Energy Management, LLC and NRG Power Marketing LLC, (the "NRG Companies") state as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: NRG Power Marketing LLC and GenOn Energy Management are Delaware limited liability companies with their principal offices in Princeton, New Jersey, that engage in electric power marketing by placing market bids and entering into bilateral contracts

on behalf of generating facilities for the supply and purchase of energy throughout the United States. The NRG Companies are subsidiaries of NRG Energy, Inc., a publicly held corporation. At this time, only NRG Energy, Inc. (NYSE: NRG) has issued shares to the public. The NRG Companies have not issued shares to the public. There is no parent or publicly held company that has a 10 percent or greater ownership interest in NRG Energy, Inc.

Respectfully submitted,

/s/ Abraham Silverman
Abraham Silverman
Counsel for NRG Power Marketing LLC
and GenOn Energy Management, LLC

LS Power Associates, L.P. states as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: LS Power Associates is a Delaware limited partnership managed by LS Power Development, LLC, its general partner. Neither LS Power Associates nor LS Power Development is publicly held or publicly traded. No publicly traded company owns 10 percent or more of LS Power Associates or LS Power Development.

Respectfully submitted,

/s/ Neil L. Levy
Neil L. Levy
Counsel for LS Power Associates L.P.

Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM states as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: Monitoring Analytics, LLC has no parent corporation. Because Monitoring Analytics, LLC does not issue stock, no corporation can own ten percent or more of its stock.

Respectfully submitted,

/s/ Jeffrey Whitefield Mayes
Jeffrey Whitefield Mayes
Counsel for Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM

PJM Interconnection, L.L.C. states as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: PJM Interconnection, L.L.C. ("PJM"), states that it is a limited liability company ("L.L.C.") organized and existing under the laws of the State of Delaware. PJM is an independent regional transmission system operator authorized by the Federal Energy Regulatory Commission to administer an open access transmission tariff, operate energy and other markets, and otherwise conduct the day-to-day operations of the bulk power system of a multi-state region. *See Pennsylvania-New Jersey Maryland Interconnection*, 81 FERC ¶ 61,257 (1997), reh'g denied, 92 FERC ¶ 61,282 (2000), *modified sub nom. Atl. City Elec. Co. v. FERC*, 295 F.3d 1 (D.C. Cir.

2002).[1] Under Delaware law, the members of an L.L.C. have an "interest" in the L.L.C. *See* Del. Code Ann. tit. 6, §18-701 (2016). PJM members do not purchase their interests or otherwise provide capital to obtain their interests. Rather, the PJM members' interests are determined pursuant to a formula that considers various attributes of the member, and the interests are used only for the limited purposes of: (i) determining the amount of working capital contribution for which a member may be responsible in the event financing cannot be obtained;[2] and (ii) dividing assets in the event of liquidation. PJM is not operated to produce a profit, has never made any distributions to members, and does not intend to do so (absent dissolution). In addition, "interest" as defined above does not enter into governance of PJM and there are no entities that have a 10% or greater voting interest in the conduct of any PJM affairs.

Respectfully submitted,

/s/ Paul M. Flynn
Paul M. Flynn
Counsel for PJM Interconnection LLC

[1] PJM also is an approved Regional Transmission Organization. *PJM Interconnection, L.L.C.*, 101 FERC ¶ 61,345 (2002).

[2] Under the Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., Rate Schedule FERC No. 24, the amount of capital contributions received from all PJM members combined is capped at $5,200,000. Because PJM has financed its working capital requirements, there have been no member contributions to date, and none are expected.

PJM Power Providers Group ("P3") states as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court: P3 is a non-profit organization dedicated to advancing federal, state, and regional policies that promote properly designed and well-functioning electricity markets in the PJM Interconnection, L.L.C. ("PJM") region. Combined, P3 members own over 84,000 MWs of generation assets, produce enough power to supply over 20 million homes and employ over 40,000 people in the PJM region covering 13 states and the District of Columbia. For more information on P3, visit www.p3powergroup.com. The comments contained in this filing represent the position of P3 as an organization, but not necessarily the views of any particular member with respect to any issue.

Respectfully submitted,

/s/ Jeffrey Lamken
Jeffrey Lamken
Counsel for PJM Power Providers Group

Public Service Electric and Gas Company ("PSE&G"), PSEG Power LLC ("PSEG Power"), and PSEG Energy Resources & Trade LLC ("PSEG ER&T") (collectively, the "PSEG Companies") state as follows under Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Rules of this Court:

1. The PSEG Companies are each wholly owned, direct and indirect subsidiaries of Public Service Enterprise Group Incorporated ("PSEG").

The principal and executive offices of PSEG are located at 80 Park Plaza, Newark, New Jersey 07102. PSEG subsidiaries are engaged in, among other things, the generation of electric energy, and the transmission, distribution and sale of electricity and natural gas through its subsidiaries.

2. PSE&G, a wholly owned direct subsidiary of PSEG, is a public utility company organized under the laws of the State of New Jersey, that serves approximately 1.8 million gas customers and 2.2 million electric customers in an area having a population in excess of 5.5 million persons and which extends from the Hudson River opposite New York City, south to the Delaware River at Trenton and west to Camden, New Jersey.

3. PSEG Power, a Delaware limited liability company, is a direct subsidiary of PSEG. PSEG Power is a wholesale energy supply company that integrates its generation asset operations with its wholesale energy, fuel supply, energy trading and marketing, and risk management functions through four principal subsidiaries: (i) PSEG Nuclear LLC ("PSEG Nuclear"), which owns and operates nuclear generating stations; (ii) PSEG Fossil LLC ("PSEG Fossil"), which develops, owns, and operates domestic fossil-fired and other non-nuclear generating stations; (iii) PSEG Power Ventures LLC, which develops utility-scale solar facilities outside

PSE&G's service territory through its subsidiary PSEG Solar Source LLC and operates the Kalaeloa Cogeneration Plant; and (iv) PSEG ER&T.

4. PSEG ER&T, a Delaware limited liability company, is a wholly owned, indirect subsidiary of PSEG. PSEG ER&T sells power and energy and certain ancillary services at market-based rates. PSEG ER&T markets the capacity and production of PSEG Nuclear's and PSEG Fossil's generating stations, manages the commodity price risks and market risks related to generation, and provides gas supply services. PSEG ER&T is engaged in extensive asset-based energy trading operations throughout the Northeast.
5. PSEG has publicly-held common stock outstanding. PSE&G has publicly-held debt securities outstanding. PSEG Power has publicly held debt securities outstanding.

Respectfully submitted,

/s/ Kenneth Richard Carretta
Kenneth Richard Carretta
Counsel for Public Service Electric and Gas Company, PSEG Power LLC, and PSEG Energy Resources & Trade LLC ("PSEG ER&T")

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Reliability Agreement, http://www.pjm.com/media/documents/merged-tariffs/raa.pdf 15

GLOSSARY

AEMA	Advanced Energy Management Alliance, petitioner in Case No. 16-1234
Br.	Brief of Petitioners in Case No. 16-1234
Capacity Performance Filing	Reforms to the Reliability Pricing Market and Related Rules in the PJM Open Access Transmission Tariff and Reliability Assurance Agreement Among Load Serving Entities, FERC Docket No. ER15-623 (Dec. 12, 2014) (JA_)
Energy Market Filing	Proposed Revisions to the PJM Open Access Transmission Tariff and PJM Operating Agreement, FERC Docket No. EL15-29 (Dec. 12, 2014) (JA_)
Exelon Comments	Comments and Partial Protest of Exelon Corporation, FERC Docket No. ER15-623 (Jan. 20, 2015) (JA__)
FERC	Federal Energy Regulatory Commission
JA	Joint Appendix
Operating Agreement	Amended and Restated Operating Agreement of PJM Interconnection L.L.C.
PJM	PJM Interconnection L.L.C., operator of the regional grid in 13 states and the District of Columbia

PJM Response	PJM Response to Deficiency Letter, FERC Docket No. ER15-623 (Apr. 10, 2015) (JA_)
PJM Tariff	PJM Open Access Transmission Tariff
PJM Transmittal	Letter from to Paul M. Flynn to Hon. Kimberly D. Bose accompanying Reforms to the Reliability Pricing Market and Related Rules in the PJM Open Access Transmission Tariff and Reliability Assurance Agreement Among Load Serving Entities, FERC Docket No. ER15-623 (Dec. 12, 2014) (JA_)
Rehearing Order	*PJM Interconnection, L.L.C.*, 155 FERC ¶61,157 (2016), R. 413 (JA__)
Reliability Agreement	Reliability Assurance Agreement Among Load Serving Entities in the PJM Region
Tariff Order	*PJM Interconnection, L.L.C.*, PJM Interconnection, L.L.C., 151 FERC ¶61,208 (2015), R. 312 (JA__)
Schnitzer Testimony	Prepared Direct Testimony of Michael M. Schnitzer on Behalf of Exelon Corporation, FERC Docket Nos. ER15-739; ER15-623 (Jan. 20, 2015) (JA_)

STATUTES AND REGULATIONS

All applicable statutes and regulations are contained in the brief for Respondent Federal Energy Regulatory Commission ("FERC").

SUMMARY OF ARGUMENT

The 2014 Polar Vortex laid bare the urgent need for reforms in the electricity market administered by PJM Interconnection, L.L.C. ("PJM"). Precisely when generation was most needed—to meet record winter demand—more than one-fifth of the generation that had committed to ensuring reliability was unable to perform. PJM identified a flawed market design as the cause of this poor performance, which, if left unaddressed, would worsen over time. Resources that breached their capacity commitments—that is, their commitments to deliver energy when called upon—faced insufficient penalties and thus had insufficient incentives to invest in performance.

After months of stakeholder discussions, PJM proposed various energy and capacity market reforms known as "Capacity Performance." FERC approved those market reforms in large part, finding they would provide generators with the resources to make investments to improve reliability, while also incentivizing performance through bonuses and penalties. *See* Tariff Order, ¶7 (JA__); Rehearing Order ¶11 (JA__) (collectively "Orders"). FERC's Orders were well-reasoned and

reflect policy judgments to which this Court owes the utmost deference. Petitioners' grab-bag of challenges should be rejected.

1. FERC thoroughly examined the reliability problems in PJM and determined PJM's tariff modifications were just and reasonable. In doing so, it considered the costs and found them to be justified to ensure reliability. Although FERC is not required to formally weigh costs and benefits when setting rates, it explained how the costs were justified by significant reliability benefits, cost savings, market efficiencies, and other benefits. Petitioners' arguments to the contrary are mistaken. Br. 57-67.

2. Petitioners err in asserting that FERC acted impermissibly in approving changes to the PJM capacity market under section 205 of the Federal Power Act ("FPA") while approving different changes to the PJM energy market under §206. Br. 52-57. PJM was authorized to file each set of changes separately, and FERC applied the appropriate standard of review in approving each change.

3. Petitioners argue the tariff modifications are discriminatory because intermittent generators (like wind and solar) may have difficulty complying with the concededly "single, uniform" rule requiring generator performance. Br. 67-76. Yet FERC reasonably determined that PJM's need for reliable performance applies regardless of resource type. Given this uniform need, FERC could approve a uniform rule. At the same time, FERC approved structures that allow intermittent

resources to combine their strengths to meet annual performance requirements. FERC's effort to help resources meet performance requirements provides no basis for licensing expansive evasion or dilution of those requirements.

4. Energy users capable of reducing consumption at PJM's direction may commit as capacity resources and receive the same year-round compensation as generators. For a reduction in consumption to actually benefit the system, the customer's baseline usage level must be properly measured. To measure that baseline *outside the summer months*, FERC reasonably approved a baseline tied to a demand resource's normal usage *at the time the reduction was requested*, rather than the much higher usage level only seen at the summer peak. Petitioners' challenge to that sensible judgment, Br. 76-83, should be rejected.

5. To prevent a resource that possesses market power from submitting an excessively high offer to skew auction results, PJM imposes a default offer cap based on PJM's estimates of a generator's costs. FERC increased the offer cap here to take account of the legitimate costs in a capacity offer, including the opportunity costs—specifically, the opportunity to obtain certain increased performance bonuses that is lost when generators take on a capacity commitment. Petitioners' challenges to FERC's well-reasoned approval of that offer cap, Br. 84-92, lack merit.

6. Although the Orders should be affirmed in all respects, if the Court disagrees it should remand without vacatur. There is no claim that FERC acted *ultra*

vires, only (at most) that it failed to make or support the required statutory showings. Br. 110-112. Vacatur would be highly disruptive and return PJM to a framework that failed to ensure reliability for consumers.

ARGUMENT

I. FERC PROVIDED A WELL-REASONED EXPLANATION FOR WHY THE CAPACITY PERFORMANCE REFORMS ARE "JUST AND REASONABLE."

A. FERC Identified Specific Threats to Reliability and Explained How Capacity Performance Would Address Them.

Petitioners claim FERC "cursorily relied on the 'talismanic invocation of reliability' as justification for the [Capacity Performance] proposal." Br. 39. In fact, FERC provided a thorough explanation of serious and worsening reliability problems resulting from PJM's market design and the ways in which Capacity Performance would address them. Under § 205 of the FPA, 16 U.S.C. §824d(e), FERC must accept electricity rates proposed by a public utility (such as PJM) so long as the proposed rates are "just and reasonable," *see, e.g.*, *Atlantic City Electric Co. v. FERC*, 295 F.3d 1, 9 (D.C. Cir. 2002), and this Court gives "great deference" to FERC's rate determinations, *Blumenthal v. FERC*, 552 F.3d 875, 881 (D.C. Cir. 2009). FERC's approval of Capacity Performance merits that deference.

FERC first pointed to evidence that forced outage rates—the portion of generators out of service when they are expected to perform—have "steadily increased" over the last decade, Tariff Order ¶27 (JA__); Rehearing Order ¶¶24, 42

(JA__, __), from "approximately 6 percent to almost 10 percent," Rehearing Order ¶24 (JA__). This diminished performance was starkly highlighted during the 2014 Polar Vortex, when "PJM's forced outage rate (22 percent) far exceeded its 7 percent historical average." Tariff Order ¶27 (JA__). The fleet's inadequate performance was worrisome not only because so many resources that had committed to ensure reliability were unavailable at a critical time, but also "for the scope and breadth of reasons resources were unable to deliver energy." *Id.*, ¶42 (JA__). As FERC observed, existing market rules were clearly insufficient: "[W]hile ... capacity resources ... had a tariff obligation to perform, it is ... clear … that capacity resources failed to deliver on their commitments during periods of system stress, notwithstanding that obligation." Rehearing Order ¶35 (JA__).

What is more, "ongoing changes in the resource mix in the PJM region" would threaten further deterioration in resource performance in coming years. *Id.* ¶25 (JA__). The replacement of coal- and oil-fired resources by natural gas-fired resources, which would place additional demand on an already taxed natural gas pipeline system, presented the PJM region with "unique challenges." Tariff Order ¶43 (JA__). In sum, generators had "fail[ed] to make necessary investments" to prevent a deterioration in performance. *Id.*, ¶24 (JA__); Tariff Order ¶42 (JA__). And the danger was urgent. *See* Tariff Order ¶38 (JA__) ("PJM could experience a

loss-of-load event as early as delivery year 2015-16, if conditions similar to the events of January 2014 occur.").

FERC next identified "three primary reasons for this failure to perform," each rooted in the then-existing capacity market design: (1) lack of an adequate penalty structure; (2) limited ability to recover costs of necessary investments; and (3) incentives to trim capital improvement plans and operating budgets. *Id.* ¶44 (JA__). Regarding "the lack of an adequate penalty structure … even poorly performing resources can expect to pay only minimal penalties, placing most of the risk of under-performance on load." *Id.* ¶45 (JA__). Indeed, PJM's penalty structure actually provided "a perverse incentive," because a "poorly-performing resource can avoid penalties by improving its performance only slightly over its five-year average." *Id.* As a result, "there is little incentive for a seller to make capital improvements, or increase its operating maintenance for the purpose of enhancing the availability of its unit during emergency conditions." *Id.*

Further, the market design also "limit[ed] the seller's opportunity to recover … costs it must incur to improve the performance capability of its resource," *id.*, ¶46 (JA__), while competitive pressures encouraged generators to trim maintenance budgets, *id.*, ¶47 (JA__). Thus, the market design "not only inadequately incent[ivized] resource performance, but may perversely select less reliable resources over more reliable resources because a capacity seller's decision to forego

investments that would improve resource performance allows it to offer … at a lower price and be paid." *Id.*, ¶48 (JA__).

In short, these flaws not only undermined the incentives to perform, they even encouraged poor performance. FERC found Capacity Performance addressed these impediments to the capacity market's fundamental reliability objectives: Capacity Performance made penalties far stricter; greatly reduced excuses for non-performance; created affirmative incentives to invest in improved performance; and allowed resources the opportunity to recover the costs of such investments. *See generally* Tariff Order ¶¶158-159 (JA__); Rehearing Order ¶¶32-33 (JA__-__).

B. FERC Reasonably Determined the Costs of the Capacity Performance Reforms Were Justified.

Petitioners claim FERC failed to provide even "a 'rudimentary' analysis 'indicating whether the benefits [of Capacity Performance] are at least roughly commensurate with the costs." Br. 66. The text of the Orders refutes that contention. To be clear, this Court has never required FERC to "engage in painstaking cost-benefit analysis" when setting rates, *Process Gas Consumers Group v. FERC*, 866 F.2d 470, 477 (D.C. Cir. 1989), and Petitioners do not contend otherwise, *see* Br. 66. When evaluating the justness and reasonableness of a rate, FERC must only conduct a "candid, common-sense assessment," *Process Gas*, 866 F.2d at 477, which can include the "consider[ation of] non-cost factors." *Pub. Utils. Comm'n of Cal. v. FERC*, 367 F.3d 925, 929 (D.C. Cir. 2004) (citing *Permian Basin Area Rate Cases*,

390 U.S. 747, 791 (1968)). These include the critically important benefit of reliable power. *See, e.g.*, *NAACP v. FPC*, 425 U.S. 662, 670 (1976) (FERC must "promote the orderly production of plentiful supplies of electric energy … at just and reasonable rates").

FERC provided just such a common-sense assessment, explaining why the "reliability benefits" of correcting the demonstrated shortcomings of PJM's pre-existing rules "are significant." Rehearing Order ¶31 (JA__). FERC explained:

> Customers will receive greater assurance that the resources needed to keep their lights on will deliver when needed because the Capacity Performance reforms will incentivize better performance and penalize poor performance, thereby allowing PJM to meet its reliability objective at a reasonable cost over time… [A]bsent PJM's proposed changes, resource performance and anticipated resource fleet changes could cause reliability issues in the future that impose on consumers greater realized costs in the form of extreme price spikes and loss of load or other reliability events. While these costs might be difficult to quantify in advance, they are very real, and we believe that PJM's reforms will reduce the likelihood of such occurrences.

Id., ¶¶31, 33 (JA__, __); *see also id.* ¶35 (JA_) (describing the likelihood of "potentially significant cost spikes" during peak periods, which results from a need to ration a limited supply of energy). FERC also explained why Capacity Performance would address these problems. It found that Capacity Performance was "based on sound economic principles" because it would "strengthen the relationship between a market seller's capacity revenues and its resource's real-time performance" thus "improv[ing] resource performance and reliability by enhancing capacity resources' incentive to perform." *Id.* ¶28 (JA__).

FERC has thus made a technical judgment, grounded in record evidence, regarding existing reliability dangers that will worsen over time. It concluded that for PJM to "meet its reliability objective, which currently is a loss of load expectation of 1-day-in-10-years," a "new penalty and incentive structure" was needed that penalized non-performance and rewarded performance. *Id.* ¶32 (JA__). That predictive judgment merits substantial deference. *See Elec. Consumers Res. Council v. FERC*, 407 F.3d 1232, 1239 (D.C. Cir. 2005) (deferring to FERC's "predictive judgments and policy choices"); *Nat'l Comm. for the New River, Inc. v. FERC*, 373 F.3d 1323, 1327 (D.C. Cir. 2004).

FERC was not required to advance a painstaking quantification of the "very real" costs of future reliability events that "might be difficult to quantify in advance," Rehearing Order, ¶33 (JA__). Nevertheless, FERC cited "evidence in the record demonstrat[ing]" that "the reliability benefits … are significant and justify the costs." *Id.*, ¶34 (JA__). Specifically, FERC pointed to a formal cost-benefit analysis by Exelon's witness Michael Schnitzer, which estimated the value of customers *not losing electric service* and of avoiding sudden price spikes as ranging from "$3.8 billion to over $7 billion" *annually*. *Id.*, ¶34 & n.42 (JA__) (citing Comments and Partial Protest of Exelon Corporation ("Exelon Comments") at 40 & Ex. A to Exelon Comments ("Schnitzer Testimony") at 8-9 (JA__)). The cited testimony showed that without the Capacity Performance reforms, the probability of customers losing

service would exceed industry-standard reliability requirements, and periods of "scarcity pricing"—price spikes from high demand and low supply—would increase more than twenty-fold. Exelon Comments at 39 (JA__) (showing 0.3 hours of scarcity pricing annually with Capacity Performance versus 7.5 hours without). Notably, Mr. Schnitzer showed that the $3.8 to $7 billion annual reliability benefits, alone, were larger than Capacity Performance's projected $2.5 to $5 billion cost to customers. *Id.* at Schnitzer Testimony 8-9 (JA__-__). By contrast, "parties objecting to PJM's proposal" made no effort even to quantify the benefits of reliability. Rehearing Order ¶34 (JA__).

In addition to reliability, FERC also identified other consumer benefits. *First*, Capacity Performance was expressly designed to shift the costs and risks of non-performance away from customers and onto the resources that agree to meet capacity needs. Under the old rules, "customers would pay for resources that did not reliably perform;" *id.*, ¶32 (JA__), whereas under the new rules, a failure by a committed capacity resource "to perform during periods of system stress" will "result[ ] in the loss of their capacity revenues," *id.*, ¶33 (JA__), with customers' payments automatically redirected to the resources that *do* perform. *Second*, "because of the expected improvement in resource performance, PJM should need to procure less capacity to meet its reliability objective under Capacity Performance than under pre-existing market rules." *Id.* *Third*, better performing units will lead to "reductions in

energy production costs, reductions in distortionary out-of-market energy market payments, more efficient energy market dispatch, reduced energy and natural gas market volatility, and improved price signals for natural gas infrastructure." *Id.*, ¶34 (JA__). These lower energy costs were estimated to save customers an additional $2.2 billion annually. Exelon Comments at 40 (JA__); *see* Tariff Order ¶37 (JA__).

C. Petitioners' Arguments Regarding the Inadequacy of FERC's Explanation Are Meritless.

First, Petitioners claim "the record contain[s] undisputed evidence that Capacity Performance would impose significant costs on consumers." Br. 59, 61. But that ignores the threshold question of whether those costs are just and reasonable, and by ignoring benefits addresses only half the story. *See supra* at 8-11. Notably, Petitioners do not dispute the substantial evidence supporting FERC's diagnosis of significant reliability problems, or FERC's conclusion that consumers would benefit from the Capacity Performance reforms' alleviation of those problems. They also fail to mention that Mr. Schnitzer estimated Capacity Performance's reliability benefits to be in the range of $3.8 billion to over $7 billion annually, on top of the $2.2 billion in energy market cost reductions estimated by PJM.

Second, Petitioners wrongly assert PJM estimated Capacity Performance would have no net benefits in a typical year. Br. 60. The cited PJM analysis

accounted *only* for energy-market cost reductions.[1] It did not attempt to quantify reliability benefits or the avoidance of scarcity pricing, even though those benefits are plainly substantial and obtaining them was the main purpose of Capacity Performance. In any event, Petitioners' argument is also conceptually flawed: Improved resource performance ensures reliability at times of peak system stress. Peak stress might occur only in years with unusually harsh weather. But to ensure performance in bad years, it is necessary to incentivize performance every year.

Third, Petitioners incorrectly seize (Br. 61-63) on an asserted "major caveat" in Mr. Schnitzer's reliability cost analysis—that the penalty rate should be based on an expectation of fewer than 30 "performance assessment hours" per year. *See* Exelon Comments at 40-48 (JA__-__); Schnitzer Testimony at 50-51 (JA__-__). Petitioners confuse two separate issues: 1) whether the penalty rate is sufficient to allow Capacity Performance to achieve its objectives of avoiding adverse reliability events; and 2) the monetary benefits when such reliability events are avoided. FERC

[1] In its cost-benefit analysis (cited by Petitioners, *see* Br. 36) PJM estimated the net incremental costs—without accounting for the reliability benefits of Capacity Performance—to be: $0.2 to $0.6B in 2015/16; $0.3 to $1.4B in 2016/17; and $0.9 to $2B in 2017/18. *See* PJM Interconnection and Monitoring Analytics, Capacity Performance Initiative at 4 (Oct. 2014)) (JA__). PJM further estimated—again without accounting for the value of reliability benefits—that in delivery years thereafter the net incremental cost of Capacity Performance would be $300 to $700M in years with average weather and could result in net savings during years with extreme weather. *Id.* Even assuming years of average weather, the reliability benefits of Capacity Performance (estimated by Mr. Schnitzer at $1.2 to $4.8B annually), *see* Exelon Comments at 33 (JA__), dwarf any incremental costs.

was not required to accept Mr. Schnitzer's opinion on the appropriate penalty rate in order to rely on Mr. Schnitzer's estimate of the benefits to customers of not losing electric service or not having to pay very high "scarcity" prices if reliability events arise. FERC concluded the penalty rate, including its invitation to PJM to revisit that rate if experience showed it to be insufficient, would advance Capacity Performance's reliability objectives. Tariff Order ¶163 (JA__). Having made that decision, FERC was entitled to rely on Mr. Schnitzer's estimate that "the value of avoiding load curtailment and scarcity energy pricing ranges from $3.8 billion to over $7 billion," Rehearing Order ¶34 (JA__), as an indication of the "significant" costs of adverse reliability events—especially in contrast to Petitioners who made no effort to quantify the "very real" reliability benefits of the Capacity Performance proposal that was expressly motivated by reliability concerns, *id.*, ¶33 (JA__).

Finally, Petitioners rely, wrongly, on *TransCanada Power Marketing. Ltd. v. FERC*, 811 F.3d 1 (D.C. Cir. 2015). Br. 64-65. In *TransCanada*, FERC approved a pay-as-bid program (paying each generator what it offered rather than a single market-clearing price) that would compensate certain generators for maintaining supplies of oil and providing energy at times of system stress. 811 F.3d. at 2. This Court remanded for further consideration of the extent to which the program's costs were attributable to profit and risk mark-up, as opposed to costs generators actually incurred. *Id.* at 11.

Unlike *TransCanada*, Capacity Performance is an auction with a single clearing price, in which resources may offer at a price no higher than their marginal cost (including opportunity costs) of committing as capacity. *See infra* 30-33. By adopting a price cap that limits Capacity Performance offers to legitimate costs, FERC *did* take steps to "determine participants' market power," *TransCanada*, 811 F.3d at 13, and prevent its exercise. Under Capacity Performance, sellers profit from efficiency, not market power, by offering resources with lower marginal costs than the resource that sets the market price, yielding lower costs for consumers over time. *See PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, P.141 (2006).[2]

II. PETITIONERS PROVIDE NO BASIS FOR THEIR ASSERTION THAT FERC CANNOT PROCESS PJM'S §205 CHANGES UNDER §205.[3]

Certain Petitioners assert that because FERC "link[ed]" PJM's related filings under §205 and §206, the FPA required FERC to act "under §206 alone," without first accepting "a portion" of the proposed market rule changes under §205. Br. 54-

[2] *Michigan v. EPA*, 135 S. Ct. 2699 (2015) (cited by Petitioners Br. 66), is also inapposite. The error in that case was EPA's treatment of cost as categorically "*irrelevant* to the initial decision to regulate power plants," *id.* at 2711 (emphasis added), despite a statute that required regulation to be "appropriate." The Court underscored that, on remand, EPA could satisfy that statutory mandate simply by "ensur[ing] that the costs are not disproportionate to the benefits." *Id.* at 2710. Here, FERC did not treat costs as irrelevant, but instead considered the costs and concluded they were outweighed by the benefits.

[3] The Market Monitor does not join in this Section II of the Argument.

55. They cite no precedent for this theory. Its adoption would require the Court to ignore the plain terms and longstanding judicial understanding of the FPA, as well as the agreements affirming PJM's §205 filing rights.

PJM's Open Access Transmission Tariff ("PJM Tariff") contains all PJM capacity market rules. PJM is a "public utility" within the meaning of the FPA. As such, PJM is permitted to make changes to its FERC-filed rates and terms of service under §205 upon showing that the changes are just and reasonable. *See* 16 U.S.C. §824d; PJM Tariff, §9.2(a), http://www.pjm.com/media/documents/merged-tariffs/oatt.pdf. PJM also can file changes under §205 to reliability rules in the Reliability Assurance Agreement among Load Serving Entities in the PJM Region ("Reliability Agreement"), which underlies the capacity market. *See* Reliability Agreement §16.4, http://www.pjm.com/media/documents/merged-tariffs/raa.pdf. PJM exercised these rights to file the proposed changes to the capacity market under §205 ("Capacity Performance Filing").

PJM concurrently filed related changes to certain energy market rules under §206 ("Energy Market Filing"), which requires a showing that the existing rules are unjust and unreasonable. *See* 16 U.S.C. §824e. The energy market rules are appended to the 1997 agreement that established PJM as an independent limited liability company. *See* Amended and Restated Operating Agreement of PJM Interconnection L.L.C., Schedule 1 ("Operating Agreement"),

https://www.pjm.com/media/documents/merged-tariffs/oa.pdf. Pursuant to the Operating Agreement, the energy market rules may be amended only by a supermajority vote of a stakeholder committee comprised of members of the LLC. However, if the members do not agree, PJM is expressly authorized to seek Operating Agreement changes under §206. *Id.*, §7.7(vi). Lacking supermajority approval, PJM submitted the Energy Market Filing under §206.

In the Orders, FERC: 1) conditionally accepted PJM's Capacity Performance Filing under §205, subject to further ordered changes; and 2) found that PJM's Energy Market Filing demonstrated under §206 that the existing provisions were unjust and unreasonable in three areas, and largely accepted PJM's proposed replacement provisions. Tariff Order ¶2 (JA__).

Petitioners contend that FERC was forbidden from approving PJM's Capacity Performance Filing under §205 because those changes to the capacity market "provided the sole basis" for FERC's §206 finding that certain energy market rules were unjust and unreasonable. Br. 54. That is wrong. Petitioners ignore FERC's specific findings that certain existing energy market rules were unjust and unreasonable in light of basic capacity market objectives that undergird both the former rules and the modifications adopted under §205.

For example, FERC explained that the prior operating parameter rules permitted energy market offers that did not reflect actual resource capabilities, which

was "inconsistent with [a resource's] obligation to make its capacity available to the PJM region, including during the most critical hours of the year." Tariff Order ¶433 (JA__). Similarly, FERC found that existing generator outage provisions "impede PJM's ability to ensure reliability" because they do not give PJM the authority to rescind approval for a planned outage when there is an emergency. *Id.*, ¶¶493-494 (JA__). Finally, FERC found "an expansive definition of force majeure … incompatible with reasonable expectations of performance" in the context of PJM's "markets," *id.*, ¶462 (JA__), and then explained why this was the case for *both* PJM's capacity market, *id.*, ¶463 (JA__), *and* its energy market, *id.*, ¶462 (JA__). Those rationales are independent of the §205 changes to capacity market rules.

Petitioners' argument rests almost entirely on FERC's summary statement that "given the changes we are accepting to its capacity market provisions, its existing energy market rules with respect to operating parameters, force majeure, and generator outages are unjust and unreasonable and must be revised." Tariff Order ¶400 (JA__); *see* Br. 52. But FERC's specific findings on these issues did not depend upon its acceptance under §205 of PJM's Capacity Performance Filing. Instead, FERC reasonably explained why these specific aspects of the existing construct were unjust and unreasonable, and those findings should control over the high-level summary cited by Petitioners.

Moreover, even assuming FERC's decision to change the energy market rules under §206 rests in part on changes accepted under §205, that would not "contravene[]" the FPA. Br. 52. PJM had the right to file the Capacity Performance and energy market changes as it did, and FERC properly addressed the related filings, "appl[ying] the appropriate burdens under each provision of the statute, reviewing the capacity market proposal under section 205 and the proposed energy market provisions under section 206." Rehearing Order ¶15 (JA__). FERC's action under the two sections "need not be exercised in separate proceedings." *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 184 (D.C. Cir. 1986). As the Court explained for equivalent Natural Gas Act provisions, "where a §4 proceeding is under way, [FERC] may discover facts that persuade it that … changes are appropriate that require the exercise of its §5 powers … [FERC] is free to act on those discoveries, so long as it shoulders the §5 burdens." *Pub. Serv. Comm'n of N.Y. v. FERC*, 866 F.2d 487, 491 (D.C. Cir. 1989).

Petitioners' proposal to bar FERC from approving PJM's capacity-market rules under §205 if that "render[s]" PJM's Operating Agreement unjust and unreasonable for purposes of §206, Br. 53-54, also makes no sense. If FERC had approved the capacity-market changes under §205 now, but did not discover that those changes rendered the Operating Agreement unreasonable until six months later, no one could argue that the §205 changes were retroactively invalidated, or

that FERC was barred from making the needed changes under §206. To the contrary, it is not unusual for FERC to base its §206 tariff changes on a recognition that other market rules have evolved, including rules added via §205. *See, e.g.*, *PJM Interconnection, L.L.C.*, 149 FERC ¶61,091, P.30 (2014) (finding pre-existing energy market price adders "have been rendered unjust and unreasonable due to evolving market mechanisms, including PJM's implementation of its capacity market auctions"). Nothing bars FERC from making such changes on a contemporaneous rather than delayed basis.

To the extent Petitioners claim an impact on other tariff provisions could, in and of itself, preclude FERC from making a §205 "just and reasonable" finding, their argument is alien to long-standing judicial recognition of the breadth of that standard, which "is obviously incapable of precise judicial definition." *Morgan Stanley Capital Grp. Inc. v. Pub Util. Dist. No. 1*, 554 U.S. 527, 532 (2008). Far from assigning preclusive effect to a single consideration (such as impact on other tariff provisions), a reviewing court must balance "the investor and the consumer interests," and "[i]f the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry … is at an end." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602-03 (1944).

FERC extensively supported its conclusion that emerging reliability concerns had revealed severe flaws in PJM's pre-existing capacity market rules, and that

PJM's §205 changes directly addressed those shortcomings. *See supra* 4-13. Yet under Petitioners' view of the statute, all of those findings and conclusions would be nullified if FERC also found those necessary capacity market reforms highlighted a loophole in provisions of *another* agreement that could be closed only under §206. FERC's §205 authority is not so constrained.

Finally, it is noteworthy that Petitioners did not oppose *any* of the §206 energy market changes on the merits. Nor did they argue FERC lacked substantial evidence to find the §205 Tariff changes just and reasonable *specifically because* the Operating Agreement previously allowed broad force majeure excuses, or did not allow PJM to rescind generator outage approvals, or afforded too much flexibility to condition energy offers with operating parameters. FERC therefore was entirely correct to reject Petitioners' "interpretation of the FPA [that] would deny PJM the right it has reserved unilaterally to file changes to its [Tariff] under section 205 merely because some related provisions of the Operating Agreement may be implicated by the filing." Rehearing Order ¶16 (JA__).

III. THE CAPACITY PERFORMANCE RULES ARE NOT UNDULY DISCRIMINATORY.

A. There Is No Undue Discrimination

PJM is treating all annual Capacity Resources identically for purposes of the Capacity Performance requirements: "All annual Capacity Resources are eligible to offer in as Capacity Performance Resources[.]" PJM Transmittal at 22 (JA__). The

same requirement of "sustained, predictable operation . . . to provide energy and reserves" applies across the board. *Id.* And identical consequences are imposed on any resource that undertakes capacity obligations but fails to fulfill them. *Id.* at 39-40 (JA__). FERC appropriately found "PJM is treating all resources identically." Rehearing Order ¶59 (JA__).

1. Certain Petitioners ("Public-Interest Petitioners") argue that PJM's "single, uniform" rule is "discriminatory [because] it imposes disparate burdens." Br. 73; *see* Intervenors-Pet'rs Br. 7-8. But FERC's decision to impose a uniform reliability obligation reflects PJM's uniform need to ensure that promised capacity actually materializes in emergencies. Neither that need, nor the consequences of non-performance, varies by the type of resource committing to provide capacity. Tariff Order ¶99 (JA__). FERC cannot exempt some capacity providers from performance obligations, or selectively excuse non-performance, without threatening the purpose of capacity markets—ensuring power is available when needed. Where the need for reliable fulfillment of capacity obligations is uniform, the obligation to perform can be uniform too.

That distinguishes *Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 27-28 (D.C. Cir. 1982) and *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511, 1515-16 (D.C. Cir. 1984). Br. 67-73; Intervenors-Pet'rs Br. 8. Those cases hold that where rate-of-return regulations require rates to reflect cost of

service, charging a uniform rate can be discriminatory where service costs vary. *See Complex Consol. Edison Co. of N.Y. v. FERC*, 165 F.3d 992, 1014 (D.C. Cir. 1999) (analyzing *Alabama Electric Cooperative*). But that is an "unusual" context where *regulations require* prices to differ based on differences between generators. *Id*. at 1013-14. Those cases do not prevent FERC from imposing uniform performance requirements where performance is uniformly critical. Nor do they suggest FERC must create special exceptions to uniform performance requirements, at the cost of reliability, for those who cannot meet the uniform standards.

Moreover, even if Public-Interest Petitioners were correct that a uniform rule could be discriminatory if it affected different resources differently without justification, Br. 70, an ample justification for the uniform rule would still exist here. As Petitioners concede, Br. 68, and as FERC found, "non-year-round resources do not provide equivalent service as year-round resources" and their inability to commit year-round "could result in a loss of reliability during the fall, winter and spring." Rehearing Order ¶59 (JA_); *see* FERC Br. 60. For that reason, allowing them (or any other resource) to make capacity commitments but tolerating non-performance for much of the year would threaten reliability.

2. Public-Interest Petitioners argue (Br. 69) that PJM should not require all resources to "act as a twelve-month resource" because some (like wind and solar) have seasonal variability. But that argument is beyond the scope of this proceeding,

waived, and without merit. Wind, solar, and other non-conventional generators have *always* been subject to the requirement that they provide an annual capacity commitment. The prior rule—which Petitioners support, Br. 71—likewise classified solar and wind as "Annual Resources." *PJM Interconnection, L.L.C.*, 146 FERC ¶61,052, P.2 (2014). And a proposal for "seasonal pricing and operational reliability requirements" was rejected when the PJM capacity market was created. *PJM Interconnection, L.L.C.*, 117 FERC ¶61,331, P.29 (2006). Nothing has changed. A utility need not "prove the continued reasonableness of . . . unchanged attributes of its rate structure" in a §205 proceeding, nor can Petitioners attack a longstanding rule by objecting to a tariff filing that leaves the rule unchanged. *City of Winnfield v. FERC*, 744 F.2d 871, 877 (D.C. Cir. 1984).

Petitioners also waived their demand that PJM move to semi-annual or seasonal auctions, Br. 74-75, by failing to raise it on rehearing. FERC Br. 56-57. Even now, Petitioners do not address the burden of moving to more frequent auctions, or the possibility that seasonal auctions could impede the development of new capacity by causing prices to fluctuate unpredictably every few months. Nor do they address the consequences for transactions with neighboring regions that do not use a seasonal market design.

The only *change* in the Capacity Performance Filing relating to treatment of any particular resource concerns demand response (resources paid to reduce energy

consumption). In phasing out Base Capacity Resources, Capacity Performance gradually eliminates seasonal demand response in favor of annual demand response. Tariff Order ¶99 (JA__). But any objection to that change is waived because Public-Interest Petitioners did not raise this argument in their *own* petition for rehearing. *See ASARCO, Inc. v. FERC*, 777 F.2d 764, 773 (D.C. Cir. 1985); *see also* FERC Br. 60.

In any event, FERC explained that participation of seasonal demand response would impair reliability. Rehearing Order ¶59 (JA__). That conclusion was supported in the record. *See* PJM Transmittal at 68-69 (JA__-__). Under PJM's prior rule, seasonal demand response "provide[d] a lesser quality of service for the same price." Rehearing Order ¶59 (JA__). Indeed, PJM had to relax its reliability goal by 10% to facilitate participation of seasonal demand response. PJM Transmittal at 67 (JA__). FERC fully justified the elimination of such preferential treatment, and its expert judgment in this technical area merits deference.

B. FERC Acted Well Within Its Authority By Establishing A Regime That Facilitates Intermittent and Seasonal Resources' Ability to Meet Performance Obligations.

Far from discriminating against intermittent and seasonal resources, FERC and PJM created a regime that helps these resources meet reliability requirements and limit their non-performance risks, thereby enabling them to participate in the capacity market consistent with PJM's reliability needs. For example, FERC

permitted wind, solar, and demand response resources to make an aggregated, collective offer into the market, reducing their non-performance risk. Rehearing Order ¶51 (JA__). No other entities are afforded that option. And while Public-Interest Petitioners decry associated "burdensome contracting and transaction costs," Br. 69, they cite no record support for these concerns.

In addition, conventional resources must offer *all* their installed capacity into the market, potentially incurring significant obligations and the risk of penalties for non-performance. PJM Transmittal at 59, 62 (JA__, __). Intermittent resources and demand response, by contrast, can choose to offer less than their full capacity—or none of it. *Id.* at 60-61 (JA__-__). That allows these resources to avoid or reduce capacity obligations that could result in non-performance penalties, while collecting "bonus" payments if they "over-perform" when other resources cannot perform. Tariff Order ¶73 (JA__); PJM Transmittal at 61 (JA__). The rules thus afford intermittent resources ample opportunity to participate in markets. The FPA does not require FERC to go further and adopt changes that might impede reliability, much less require FERC to allow resources to sell capacity without meeting performance requirements at all.

Petitioner AMP, meanwhile, argues that FERC discriminated *against conventional resources* by failing to let *them* aggregate bids. Br. 99-104. FERC was not required to do so. Capacity offers generally are tied to specific resources,

see PJM Tariff, Attachment DD, § 5.6.1(a), to ensure the resulting commitments are "backed by resources that can be verified." *Midwest Indep. Transmission Sys. Operator, Inc.*, 125 FERC ¶61,061, P.19 (2008). Aggregated bids undermine that principle: When an aggregated resource fails to perform, it is difficult to hold a specific unit accountable. FERC reasonably provided a limited exception to its general prohibition on aggregated bids for seasonal and intermittent resources. But it declined to eliminate the aggregate-bidding prohibition for resources that—because they do not depend on wind, sun, or other variables—would not need it. Balancing competing interests—such as PJM's need for year-round reliability against enabling the participation of diverse resource types—is a matter for which this Court "afford[s] great deference to the Commission." *FERC v. EPSA*, 136 S. Ct. 760, 782 (2016) (quotation marks omitted). FERC had an amply "rational basis" for limiting aggregation. *Complex Consol. Edison Co. of N.Y.*, 165 F.3d at 1013.

AMP also challenges (Br. 104-07) FERC's refusal to allow resources in different Delivery Areas to aggregate bids arguing that FERC's refusal to do so imposed upon PJM "a burden far more stringent than section 205 requires." *Id.* at 106. But §205 is irrelevant, because PJM never filed a tariff proposal for allowing cross-Delivery Area aggregation. Tariff Order ¶53 (JA__). PJM merely noted, in one paragraph of its answer, that such aggregation was potentially feasible, *id.*, ¶74 (JA__), and FERC reasonably rejected the idea as "not fully developed." Rehearing

Order ¶52 (JA__). PJM has since filed a proposal in a separate docket where this issue will be properly addressed. *See* FERC Docket ER17-367-000, PJM Transmittal at 6 (Nov. 16, 2016).

IV. FERC REASONABLY ACCEPTED PJM'S PROPOSED USE OF CURRENT LOAD, RATHER THAN SUMMER PEAK LOAD, TO MEASURE DEMAND RESOURCE PERFORMANCE OUTSIDE THE SUMMER.

Demand resources are permitted to participate in Capacity Performance by committing to reduce their electricity usage upon PJM's request during times of peak system stress. Tariff Order ¶36 (JA__). Petitioner AEMA challenges the baseline level from which a demand resource's reduced use of electricity should be calculated. There is no dispute that in the summer the demand resource's share of the annual summer peak, known as Peak Load Contribution ("Summer Peak"), defines the level from which reductions are measured. But demand resources, like all other capacity resources under the Capacity Performance rules, are annual products and thus their performance must be measured *any* time the PJM system has an urgent need for capacity, *i.e.*, during "Performance Hours." Measuring performance in the winter as an increment of reduction from the Summer Peak poses a problem, because an end-use customer's normal energy use in winter may already be well below its Summer Peak. In the winter, a demand resource could claim to have reduced its usage by a specified amount below its Summer Peak, when in reality it did not reduce at all below its normal winter usage–thus doing nothing to alleviate

the present emergency and requiring PJM to dispatch other resources to provide the needed capacity.

For Capacity Performance, therefore, PJM chose a methodology, Customer Baseline Load ("Current Load"), already used in the energy market to estimate what a demand resource's load would have been *at the time of the load reduction if it had not reduced*. Tariff Order ¶54 (JA__). FERC accepted PJM's proposal to use Current Load to measure demand resource performance in the non-summer months. FERC noted Capacity Performance's "stated aim … to tie capacity revenue to resource's performance in the energy markets during [Performance H]ours" necessitating "a reasonable measure for assessing performance and penalties during non-summer [Performance H]ours." *Id.*, ¶180 (JA__). FERC found Current Load "an appropriate measure of such performance." *Id.* Moreover, measuring demand resource performance against Current Load in the non-summer months "help[s] guarantee that Demand Resources are available to be dispatched to help supply meet demand in the winter period." Rehearing Order ¶120 (JA__). And because Capacity Performance overall "has stronger performance incentives than the preexisting capacity product, with an emphasis on improved resource performance in winter periods," *id.*, ¶124 (JA__), FERC found it "reasonable that PJM is choosing to tighten up its performance measurement to provide an incentive for year-round dispatchability," *id.*, ¶121 (JA__).

AEMA's principal argument is that FERC inadequately distinguished its action in a 2011 proceeding affirming reliance on Summer Peak to measure performance. Br. 78-82, *citing* FERC Docket No. ER11-3322. But the 2011 proceeding only concerned *summer* performance. The annual demand resource product, expected to perform year-round, *did not exist* until June 2014. *See PJM Interconnection, L.L.C.*, 134 FERC ¶61,066, P.27 (2011). In the 2011 proceeding, FERC expressly recognized the Summer Peak approach may not be appropriate for non-summer measurement and urged PJM "to give consideration to how to appropriately measure performance of capacity for resources that are procured specifically to perform outside of PJM's June through September summer period." *See PJM Interconnection, L.L.C.*, 137 FERC ¶61,108, P.85 (2011).

FERC thus reasonably distinguished the 2011 proceeding in the Rehearing Order, explaining that Capacity Performance "has stronger performance incentives than the preexisting capacity product, with an emphasis on improved resource performance in winter periods," which "provides PJM adequate justification to move to a stronger measurement standard than was approved through Docket No. ER11-3322." Rehearing Order ¶124 (JA__). FERC therefore met its obligation to "supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored." *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (1970).

V. FERC'S ACCEPTANCE OF THE COST-BASED INCREASE IN THE CAPACITY PRICE OFFER CAP WAS WELL JUSTIFIED AND CONSISTENT WITH PRECEDENT.

Certain Petitioners (Br. 84) contend FERC's approval of a higher offer cap for Capacity Performance is arbitrary and capricious and produces rates that are unjust and unreasonable. To the contrary, the Orders allow this Court to readily "discern the Commission's path from its goal ... to the rule it imposed." *Transcontinental Gas Pipe Line Corp. v. FERC*, 518 F.3d 916, 922 (D.C. Cir. 2008).

As the Supreme Court has explained, "[n]o matter what rate [sellers] listed in their original bids [in PJM's capacity auction], all accepted capacity sellers receive the highest accepted rate, which is called the 'clearing price.'" *Hughes v. Talen Energy Mktg., L.L.C.*, 136 S. Ct. 1288, 1293 (2016). That single-price auction "simulates the rates produced in a competitive market in which the same price is paid to all suppliers based on the marginal cost of the least efficient supplier necessary to serve that market." *Md. Pub. Serv. Comm'n v. PJM Interconnection, L.L.C.*, 127 FERC ¶61,274, P.15 (2009). However, if a generator has market power, it can skew the results of the single-price auction by submitting a higher offer than it would in a competitive market, resulting in a higher clearing price than would otherwise occur.

Thus, when approving PJM's single-price auction, this Court approved a method for mitigating any exercise of market power, by "substitut[ing] a proxy bid,

determined by a formula…, in the place of the supplier's actual offer[, which] pushes high bids down to more competitive levels." *Md. Pub. Serv. Comm'n v. FERC*, 632 F.3d 1283, 1284 (D.C. Cir. 2011). That proxy bid—the default offer cap—allows the market to continue functioning while preventing higher prices that could result from the exercise of market power.

FERC found it "reasonable to allow capacity sellers to factor into their offers the costs and risks associated with assuming the redefined capacity obligation." Tariff Order ¶344 (JA__). FERC therefore changed the formula for determining the "proxy bid" to reflect the additional costs, including the opportunity costs, that a capacity resource now faces due to Capacity Performance. *Id.*, ¶¶335-336 (JA__-__). After all, a seller offering a product in a competitive market would reflect in its offer price the costs and risks associated with providing that product.

Capacity Performance has two ways of incenting resources to perform at times of urgent need, each of which affects the costs and risks associated with providing the product. *First*, resources that clear the capacity auction earn the right to be paid the clearing price multiplied by their committed quantity of capacity. If a resource does not perform when needed, it faces a steep penalty, and if it performs better than it committed to, it receives a bonus payment for that extra performance. *Second*, resources *that do not clear the capacity auction*, and thus have made no commitment to deliver energy, can receive a bonus payment (funded by penalty revenues) if they

nevertheless perform at critical times. *Id.*, ¶336 (JA__). The possibility that a resource may earn bonus payments for performing without a capacity commitment creates an opportunity cost for resources that offer to commit capacity through the capacity auction: they will not earn a bonus on any capacity they commit to provide, because bonuses are for *over*-performance only. In a competitive market, a seller would factor that opportunity cost into its capacity offer. For example, if a seller believed it could earn $100 per megawatt in bonus payments without any capacity commitment, it would offer to sell its capacity for no less than $100 per megawatt.

Recognizing this opportunity cost, the Independent Market Monitor for the PJM region, who is charged with "objectively monitor[ing] the competitiveness of PJM markets," PJM Tariff, Attachment M, section IV(A), told FERC that the default offer cap should be based on the "competitive, profit-maximizing offer" of "units that could profitably [earn bonus payments] even without a capacity payment." Answer of the Independent Market Monitor for PJM, at 3 (Feb. 25, 2015) (JA__) ("Market Monitor Answer"). The Market Monitor performed a "detailed review of the mathematics of the Capacity Performance design," which resulted in a default offer cap equal to the product of the key determinants of both the penalty and the bonus payment: "net CONE," which is the per-megawatt penalty paid by a non-performing generator, and the balancing ratio "B," which is the estimated ratio between all capacity committed for a peak hour and all capacity needed for that hour.

See Tariff Order ¶310 (JA__). PJM agreed. (PJM Response to Deficiency Letter, Response to Request No. 1 (Apr. 10, 2015) (JA__) ("PJM Response").

FERC accepted that formula for the default offer cap, finding any offer "below [that] default offer cap can properly be deemed competitive." Tariff Order ¶340 (JA__). FERC recognized that a seller forgoes bonus payment opportunities when it commits its resource in the capacity auction, and the default offer cap should account for these opportunity costs. FERC explained that a resource "whose avoidable costs are less than its … expected … Bonus Payments … will be willing to take on a capacity obligation as long as the amount it can earn" from the capacity auction "exceeds the amount it could earn in … Bonus Payments" if it did not clear the auction. *Id.*, ¶336 (JA__). Accounting for opportunity costs in this fashion, moreover, is similar to the approach FERC previously approved for the New England market. Rehearing Order ¶¶187 n.218, 189 (JA__, __); *ISO-New England Inc.*, 153 FERC ¶61,223, P.102 (2015) (*"ISO-NE"*); *Transcontinental Gas Pipe Line Corp.*, 518 F.3d at 922 (upholding rule where FERC had "imposed precisely this rule in [a] recent case[] presenting the same issue").

Petitioners make almost no mention of FERC's above-described rationale, PJM's and the Market Monitor's supporting analyses, or the *ISO-NE* precedent. Their sole argument is that the availability of bonus payments cannot be considered

because the PJM Tariff's "must-offer" obligation means a seller cannot "opt to sit out of the capacity auction." Br. 91.

That response misses the mark. The question is not whether a resource may decline to submit an offer in the capacity market, but instead the maximum price a resource can submit *when* it offers. For example, if a seller anticipates it could earn $100 per megawatt in bonus payments without a capacity commitment, it would submit an offer of $100 per megawatt into the capacity auction. If the auction clearing price is $90 per megawatt, the seller does not clear and will receive no capacity revenues; the seller will then test its theory that it can earn more by relying solely on bonus payments. In this situation the seller has complied with the "must-offer" requirement by offering into the market, but it has priced its offer based on the opportunity costs it faces by committing capacity.

FERC reasonably concluded, based on substantial evidence, that in a competitive market, a resource would account for opportunity costs in formulating its offer price in this manner. As FERC explained, "[t]he opportunity cost facing a resource that would be profitable even absent capacity auction revenues ... is significant because it reflects the economic trade-off a rational market seller considers *when formulating its capacity market offer*." Rehearing Order ¶185 (JA__) (emphasis added). Indeed, PJM has long allowed resources to account for opportunity costs in formulating competitive bids. Thus, pre-existing rules capacity

market rules allowed a seller "to increase its offer cap should it be able to document the price it may receive as a generation resource in a market external to PJM." *Id.*, ¶188 (JA__), *citing* PJM Tariff Attachment DD, §6.7(d). A seller with a documented opportunity to sell capacity into a different market at $100 per megawatt would offer its capacity into the PJM capacity auction at $100 per megawatt and, if it fails to clear, would be free to make its sale in the external market. The default offer cap approved by FERC for Capacity Performance applies the same concept to the potential for receiving Bonus Payments.

Petitioners assert the increase in the default offer cap "essentially eliminates market power mitigation," and permits "resources [to] exercise market power in formulating bids." Br. 84. That assertion is unsupported and contrary to the very purpose of the default offer cap, which *prevents* the exercise of market power by determining what a resource would offer in a competitive market. To be sure, the Capacity Performance default offer cap might be higher than in the pre-existing market construct, but as FERC correctly explained, market power mitigation does not "protect consumers from actual capacity cost increases." Rehearing Order ¶183 (JA__). The Capacity Performance default offer cap is higher because it accounts for additional costs, including the costs of investments needed to improve reliability as well as opportunity costs that capacity sellers face under Capacity Performance. *Id.*, ¶184 (JA__). Petitioners never explain why these costs—which are real costs

borne by capacity sellers—should not be reflected in "a reasonable approximation of a competitive offer in PJM's capacity market under the new Capacity Performance market rules." *Id.*, ¶187 (JA__); *see also Wisconsin Pub. Power, Inc. v. FERC*, 493 F.3d 239, 260 (D.C. Cir. 2007) (finding FERC's judgment about the reasonable costs to include in a mitigated offer price within an "agency's predictive judgments" warranting "particularly deferential review" (quotation marks omitted)).

Petitioners similarly argue that the higher default offer cap "strips away" the "ability to determine whether a seller's offer [below the default offer cap] includes actual or legitimate costs." Br. 87-88. Again, that argument simply ignores FERC's finding—with which the Independent Market Monitor agreed—that the new offer cap *is based on* actual and legitimate costs, which include opportunity costs. Petitioners present no basis to undercut FERC's finding that the identified costs are "actual and legitimate."

VI. IF THE COURT REMANDS, IT SHOULD NOT VACATE THE ORDERS

For the foregoing reasons, the Orders should be affirmed and thus no remand is necessary. If the Court disagrees, however, it should remand without vacatur. "The decision to vacate depends on two factors: the likelihood that 'deficiencies' in an order can be redressed on remand, even if the agency reaches the same result, and the 'disruptive consequences' of vacatur." *Black Oak Energy, LLC v. FERC*, 725 F.3d 230, 244 (D.C. Cir. 2013). Both factors weigh against vacatur here.

Petitioners do not argue FERC lacks authority to approve the tariff changes. They fault FERC's reasoning and whether it has sufficiently made the required statutory findings. But that is precisely the circumstance where this Court remands without vacating. *See, e.g.*, *Black Oak Energy, LLC*, 725 F.3d at 244; *Allied-Signal, Inc. v. U.S. NRC*, 988 F.2d 146, 151 (D.C. Cir. 1993).

Vacatur would also be highly disruptive. PJM has already held auctions for capacity to be delivered through May 2020 under the new rule. While petitioners assert that they do not seek to undo those auctions, Br. 111, vacatur could undermine confidence in those results or lead other parties to question their validity. The impact on reliability could be severe if that uncertainty deters successful bidders from investing in resources necessary to meet their commitments. Forward capacity markets were created to ensure infrastructure investments needed to meet future demand are "put into place before reliability is sacrificed." *See Devon Power LLC*, 137 FERC ¶61,073, PP.32-33 (2011). Instability in market rules can undermine the investment incentives required to ensure there is sufficient capacity to "keep the lights on."

Vacatur, moreover, would re-impose the prior rule until FERC issues a replacement. That would be unlikely to happen for some time. But FERC determined the prior rule lacked sufficient teeth to ensure performance, creating undue threats to reliability. Rehearing Order ¶26 (JA__). Even if the Court finds

the current rule falls short of perfection, the Court should not impose vacatur where that would re-instate a regime inadequate to ensure reliability for the millions of consumers in PJM. *Rodway v. USDA*, 514 F.2d 809, 817 (D.C. Cir. 1975) (no vacatur because of the "critical importance" of the regulations).

CONCLUSION

For the foregoing reasons, and the additional reasons stated in Respondent's brief, the petitions should be denied and the 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) and this Court's Order dated September 9, 2016, I certify that the Brief for Respondent has been prepared in a proportionally spaced typeface (using Microsoft Word 2010, in 14-point Times New Roman) and contains 8,736 words, not including the tables of contents and authorities, the glossary, and the certificates of counsel.

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CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d) and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 9th day of December 2016, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system or by U.S. Mail, as indicated below.

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