

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

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**Nos. 17-1101, 1106 and 1107 (consolidated)**

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**THE NEW JERSEY BOARD OF PUBLIC UTILITIES, *ET AL.*,**  
*Petitioners,*

v.

**FEDERAL ENERGY REGULATORY COMMISSION,**  
*Respondent.*

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

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**JOINT REPLY BRIEF OF PETITIONERS**

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**TABLE OF CONTENTS**

TABLE OF CONTENTS..... iii

TABLE OF AUTHORITIES .....v

GLOSSARY OF TERMS ..... vii

SUMMARY OF ARGUMENT .....1

ARGUMENT .....2

    I. THE COMMISSION ERRED IN ALLOCATING BALANCING CONGESTION TO LOAD AND EXPORTS, RATHER THAN TO FTR HOLDERS .....2

        A. FERC Has Not Shown that It Should Receive Deference in This Case. ....2

            1. Deference to FERC is Not Limitless.....2

            2. This Case is Not So Complicated.....3

            3. FERC Exceeded Its Authority to Change PJM’s Filing. ....3

            4. FERC Failed to Act Consistent With the FPA.....6

            5. FERC Exceeded Its Authority Under the FPA. ....7

        B. No changed Circumstances Support FERC’s Reversal of Precedent and Over Ten Years of Practice Regarding the Proper Calculation of Congestion.....8

        C. No Rationale Supports Finding that Including Balancing Congestion In the Calculation of Congestion is Unjust and Unreasonable.....11

            1. FERC and Intervenors Err in Asserting that the Day-Ahead Market is the Energy Market, that the Day-Ahead Price is the Energy Price, that Day-Ahead Congestion is Congestion, and that Balancing Congestion Is Not Congestion 11

            2. FERC and Intervenors Err in Arguing that Balancing Congestion Causes Underfunding. ....13

            3. The Assignment of Balancing Congestion to Customers Does Not Correct the Wealth Transfer Problem that FERC Claims to be Correcting. ....16

            4. The Order Does Not Rely on Cost Causation. ....20

II. FERC ERRED IN FAILING TO FIND THAT PJM’S PORTFOLIO NETTING RULE IS UNJUST, UNREASONABLE, UNDULY DISCRIMINATORY AND CONTRAVENES FPA SECTION 217 .....21

III. FERC ERRED IN REJECTING PJM’S PROPOSED ARR AND FTR ALLOCATION METHODOLOGY .....25

    A. Allocating ARRs Based on Current Usage Will Not Restore Value to ARRs and the LSEs that Hold Them.....25

    B. PJM’s Original Proposal was Just and Reasonable.....27

IV. CONCLUSION .....29

## TABLE OF AUTHORITIES

### Cases

<i>Alabama Power Co. v. FCC</i> , 773 F.2d 362, 367 (D.C. Cir. 1985).....	24
<i>ANR Pipeline Co. v. FERC</i> , 71 F.3d 897 (D.C. Cir. 1995) .....	9
<i>Black Oak Energy, LLC v. FERC</i> , 725 F.3d 230 (D.C. Cir. 2013) .....	11
<i>FirstEnergy Solutions Corp. and Allegheny Energy Supply Co., LLC v. PJM Interconnection, L.L.C.</i> , 143 FERC ¶ 61,209 (2013) ( <i>FirstEnergy II</i> ) .....	10
<i>FirstEnergy Solutions Corp. v. PJM</i> , 151 FERC ¶ 61,205 (2015).....	15
<i>La. Pub. Serv. Comm'n v. FERC</i> , 174 F.3d 218 (D.C. Cir. 1999).....	29
<i>La. Pub. Serv. Comm'n v. FERC</i> , 772 F.3d 1297 (D.C. Cir. 2014).....	6, 9
* <i>Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.</i> , 463 U.S. 29 (1983). .....	3, 9
* <i>NRG Power Marketing, LLC v. FERC</i> , 862 F.3d 108 (2017).....	3, 6
<i>Pennsylvania-New Jersey-Maryland Interconnection, et al.</i> , 92 FERC ¶ 61,282 (2000).....	6
<i>Publ. Sys. v. FERC</i> , 606 F.2d 973 (D.C. Cir. 1979) .....	6
<i>Sacramento Mun. Util. Dist. v. FERC</i> , 616 F.3d 520 (D.C. Cir. 2010).....	25
<i>Sierra Club v. FERC</i> , 867 F.3d 1357 (D.C. Cir. 2017) .....	5

\* Authorities upon which Petitioners chiefly rely are marked with asterisks.

**Statutes**

16 U.S.C. § 824d.....3

16 U.S.C. § 824e .....4

16 U.S.C. § 824q.....7, 24

**Regulations**

*Final Order in Response to a Petition From Certain Independent System Operators, et al.*, 78 Fed. Reg. 19,879 (2013) .....7

*Open Access & Priority Rights on Interconnection Customer’s Interconnection Facilities*, Order No. 807-A, 153 FERC ¶ 61,047 (Oct. 15, 2015).....25

## GLOSSARY OF TERMS

Act	Federal Power Act, 16 U.S.C. § 791, <i>et seq.</i>
AMP	American Municipal Power, Inc., a petitioner in Case No. 17-1107.
ARR	Auction Revenue Rights are the rights to Congestion which can be sold as FTRs in return for a fixed payment or claimed as FTRs.
Balancing Market	The Real-Time Energy Market.
Balancing Congestion	Balancing Congestion is a true up to Day-Ahead Energy Market Congestion, based on differences between Day-Ahead and Real-Time Energy Market Binding Constraints and/or the sum of MWh positions charged or credited at Real-Time Energy Market prices.
Binding Constraint	A Binding Constraint is a transmission line loaded to its limit that cannot transfer additional power from low cost generation to load.
CIR	Item number in the Certified Index to the Record (Document #1675764).
CFTC	Commodity Futures Trading Commission
Congestion	Congestion is the difference between what Load pays for energy and what generation is paid for energy, ignoring losses. In a market design with both Day-Ahead and Real-Time Energy Markets, Congestion is the sum of Day-Ahead Congestion and Balancing Congestion.
Congestion Revenue	Congestion Revenue is revenue collected for Congestion as defined by PJM market rules. Congestion Revenue included Day-Ahead Congestion and Balancing Congestion under the Traditional Congestion Allocation Rule and includes Day-Ahead Congestion under the Load Subsidized Congestion Allocation Rule.

Day-Ahead Congestion	Congestion Revenue collected in the Day-Ahead Energy Market based on day-ahead prices and MWh.
Day-Ahead Energy Market	The PJM energy market that clears financially firm MWh positions in the day prior to the operating day at Day-Ahead Market clearing prices.
DPSC	The Delaware Public Service Commission, a petitioner in Case No. 17-1001.
FERC or “the Commission”	The Federal Energy Regulatory Commission.
Financial Participant	A Financial Participant is a Participant in one or more markets operated by PJM who does not have or does not primarily have obligations or capability to serve Load.
FTR	A Financial Transmission Right entitles the holder to a share of Congestion. FTRs have transmission paths which are directional, with a source, a sink and a MW quantity. An FTR can also be “negative” ( <i>i.e.</i> create a financial obligation for the FTR Holder). Instruments equivalent to PJM’s FTRs are known as Congestion Revenue Rights in other markets.
FTR Holder	The owner of an FTR with rights to receive (or the obligation to pay) Congestion Revenue.
JA	Page number in the Joint Appendix (deferred).
LMP	Locational Marginal Price is the wholesale electricity price at each node in the system, equal to the marginal cost of procuring energy at that node for the specified time. LMP is the result of a security-constrained least-cost dispatch of energy resources to meet forecasted Load in the Day-Ahead Energy Market and actual Load in the Real-Time Energy Market. The Day-Ahead Energy Market solution results in LMPs at every node in every hour. The Real-Time Energy Market results in LMPs at every node in every five-minute interval.



Load	Load is location-specific demand for electricity on the PJM system. Load in the Day-Ahead Energy Market is based on cleared load bids. Load in the Real-Time Energy Market is made up of actual real-time demand for energy by retail customers of LSEs.
Load-Subsidized Congestion Allocation Rule	The Load-Subsidized Congestion Allocation Rule, stated in the Orders, defines Congestion Revenue to include only Day-Ahead Congestion (plus ARR revenues in excess of Target Allocations) and to exclude Balancing Congestion.
LSE	Load-Serving Entity. An LSE buys energy and capacity in wholesale electric markets and sells that energy and capacity to retail customers (Load).
Market Monitor	Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM, a petitioner in Case No. 17-1106.
MW	One megawatt, equal to 1,000 kilowatts, and, equivalently, 1,000,000 watts. The megawatt is a unit used to measure electric capacity.
MWh	One megawatt-hour, equal to one MW of electricity supplied for one hour. The megawatt-hour is a unit used to measure electric energy.
NJBPU	New Jersey Board of Public Utilities, a petitioner in Case No. 17-1101.
OA	PJM Operating Agreement
OATT	PJM's Open Access Transmission Tariff
ODEC	Old Dominion Electric Cooperative, a petitioner in Case No. 17-1107.
Orders	The September 15th Order and the Rehearing Order.
P	Paragraph in a FERC Order.
Participant	A buyer or seller in a PJM Market.

PJM	PJM Interconnection, L.L.C., a FERC-approved Regional Transmission Organization (RTO). PJM operates the bulk power system and the competitive wholesale power markets in the region that includes all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.
PJM Interchange Energy Market	The spot markets for electric energy operated by PJM, including the Day-Ahead Energy Market and the Real-Time Energy Market.
PJM Market	The PJM Market includes a Day-Ahead Energy Market, a Real-Time Energy Market (or Balancing Market), a Capacity Market, Ancillary Services Markets and an FTR Market, as provided for in the Tariff.
Real-Time Energy Market	The PJM energy market that clears on the operating day based on actual Load and actual generation. Also referred to as the Balancing Market because day-ahead positions are balanced based on the Real-Time Energy Market.
Rehearing Order	FERC's decision denying Petitioners' rehearing requests, <i>PJM Interconnection, L.L.C., Order on Rehearing and Compliance</i> , 158 FERC ¶ 61,093 (January 31, 2017) (CIR 132, JA ____).
Revenue Adequacy	A measure of whether Congestion Revenue is sufficient to pay FTRs at levels equal to the Target Allocations.
RTO	Regional Transmission Organization, as defined at 18 C.F.R. § 35.34. RTOs operate the bulk power system and the wholesale power markets in a defined region.
September 15 Order	FERC's order directing implementation of the Load Subsidized Congestion Allocation Rule, <i>PJM Interconnection, L.L.C., Order Addressing Filing and Issues Raised at Technical Conference</i> , 156 FERC ¶ 61,180 (September 15, 2016) (CIR 102, JA ____).

Tariff	The PJM Open Access Transmission Tariff (OATT), including OATT Attachment K–Appendix, which governs the PJM Interchange Energy Market. Attachment K–Appendix contains the same language as Schedule 1 to the PJM Operating Agreement (OA). Citations herein to such rules are to OA Schedule 1, but also apply to OATT Attachment K–Appendix.
Target Allocations	A metric used to determine the allocation of Congestion Revenue among FTR Holders. Target Allocations are based on the difference in the Day-Ahead Congestion prices at the FTR source and FTR sink and the FTR megawatt quantity.
Traditional Congestion Allocation Rule	The Traditional Congestion Allocation Rule, in effect prior to the Orders, defined Congestion Revenue as real-time Congestion and, after the introduction of the Day-Ahead Energy Market, as Day-Ahead Congestion and Balancing Congestion.

## SUMMARY OF ARGUMENT

The Orders are arbitrary and capricious because they are not grounded in accurate facts about what Congestion is and the role of FTRs. Deference to FERC has its limits and rational and reasoned decision-making must have a foundation in reality. Superficial slogans like “hedging” cannot excuse FERC from its requirement that it support its actions with reasoned explanations. FERC fails to articulate a satisfactory explanation of its reversal of correct prior decisions and its rejection of ten years of appropriate policy. FERC claims a change in circumstances, but there are no actual changes. FERC’s reliance on an incorrect, irrelevant and easily reversible administrative change by PJM is particularly misplaced. The Commission failed to meet even the most deferential standards in explaining its actions and its reversal of course. Accordingly, the Orders should be reversed.

## ARGUMENT

### I. THE COMMISSION ERRED IN ALLOCATING BALANCING CONGESTION TO LOAD AND EXPORTS, RATHER THAN TO FTR HOLDERS<sup>1</sup>

#### A. FERC HAS NOT SHOWN THAT IT SHOULD RECEIVE DEFERENCE IN THIS CASE.

##### 1. Deference to FERC Is Not Limitless.

The Commission's brief emphasizes the deference it receives from courts reviewing its actions under the Federal Power Act,<sup>2</sup> but this deference is not in dispute. Rather, Petitioners assert that the Orders fail to provide a rational explanation for reversing over ten years of policy and recent precedent. FERC must "articulate a satisfactory explanation" and provide "a rational connection between the facts found and the choice made."<sup>3</sup> FERC's decisions must have a basis in "substantial evidence."<sup>4</sup> The Orders fall far short of even this deferential standard.

Agency actions are reversible as arbitrary and capricious when the agency "relies on factors which Congress has not intended it to consider, entirely fails to

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<sup>1</sup> NJBPU, DPSC, the Market Monitor, ODEC and AMP join these arguments.

<sup>2</sup> Respondents' Br. at 21 (citing *FERC v. EPSA*, 136 S. Ct. 760, 782 (2016); *S.C. Publ. Serv. Auth. v. FERC*, 762 F.3d 41, 53-54 (D.C. Cir. 2014); *Wisc. Pub. Power, Inc. v. FERC*, 493 F.3d 239, 260 (D.C. Cir. 2007)).

<sup>3</sup> *Id.*

<sup>4</sup> 5 U.S.C. § 7703(c)(3).

consider an important aspect of the problem, offers an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it cannot be ascribed to a difference in view or the product of agency expertise.”<sup>5</sup> The Orders have each of these defects. Further, the Orders exceed the Commission’s statutory authorization.

## **2. This Case Is Not So Complicated.**

This case is much less complicated than FERC asserts.<sup>6</sup> This case involves the Commission’s failure to provide a rational or convincing basis for its decision that the mechanism included in the PJM tariff for over ten years unlawfully determines the level of Congestion Revenue available to fund FTRs. As a result of this dramatic change in policy, transmission customers pay more for electric service while Financial Participants that own FTRs receive windfalls.

## **3. FERC Exceeded Its Authority to Change PJM’s Filing.**

In *NRG*, the court found that FERC “may not unilaterally impose a new rate scheme” in response to a utility filing.<sup>7</sup> *NRG* involved a filing under FPA section 205.<sup>8</sup> FERC’s response to Petitioners’ argument that *NRG* applies is that “the

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<sup>5</sup> *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

<sup>6</sup> Respondent’s Br. at 2.

<sup>7</sup> *NRG Power Marketing, LLC v. FERC*, 862 F.3d 108, 114 (2017).

<sup>8</sup> 16 U.S.C. § 824d.

Commission reviewed PJM’s proposal entirely under section 206.”<sup>9</sup> In fact, the same limitations on the Commission’s authority should apply with equal force here.

PJM made its filing “pursuant to sections 205 and 206.”<sup>10</sup> PJM may file changes to its OATT pursuant to section 205 without stakeholder approval.<sup>11</sup> PJM is required to obtain supermajority stakeholder approval to file changes to its Operating Agreement under section 205, which includes rules pertaining to ARRs/FTRs, as does the OATT.<sup>12</sup> PJM fell short of the supermajority required to submit its Operating Agreement revisions under section 205.<sup>13</sup> However, the PJM Board authorized PJM to file those Operating Agreement revisions under section 206.<sup>14</sup>

The principal difference between stakeholder-authorized section 205 filings and PJM Board-authorized section 206 filings is that section 206 filings impose on PJM an initial burden to demonstrate that its existing rules are unjust and

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<sup>9</sup> Respondent’s Br. at 47. *See* 16 U.S.C. § 824e.

<sup>10</sup> PJM, Filing, Docket No. EL16-6-000, at 22 (Oct. 19, 2015) (“PJM Oct. 19 Filing”) (CIR 1, JA \_\_\_).

<sup>11</sup> *See* OA § 8.4(c) (JA \_\_\_).

<sup>12</sup> *See* OA § 10.4(xiii) (JA \_\_\_).

<sup>13</sup> *See* PJM Oct. 19 Filing at 12 (CIR 1, JA \_\_\_).

<sup>14</sup> *Id.* at 11.

unreasonable. PJM met that burden based on its own actions that it could easily reverse.<sup>15</sup> Because PJM created its own problem, it did not really meet the burden imposed by section 206 relative to section 205. The filing thus operated like a section 205 filing.

In the September 15 Order, FERC rejected both proposals that PJM put forward. Instead, FERC required that PJM exclude Balancing Congestion from total Congestion despite the fact that PJM did not make this proposal in its filing.<sup>16</sup> But excluding Balancing Congestion from the calculation of Congestion has nothing to do with how conservatively PJM models Stage 1B allocations. There is no record evidence of any unjust or unreasonable market design flaw to which FERC's directive to eliminate Balancing Congestion from the Congestion calculation responds.

The Orders constitute the same type of overreach rejected by the Court in *NRG*. That PJM's filing is not filed purely pursuant to section 205 is a superficial distinction reflecting a feature of PJM's governance arrangements. The Court should ignore form over substance here as it does routinely.<sup>17</sup> Moreover, *NRG's* discussion of section 206 addresses investigations initiated by the Commission,

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<sup>15</sup> See September 15 Order at P 2 (JA \_\_\_).

<sup>16</sup> September 15 Order at PP 2-5.

<sup>17</sup> See, e.g., *Sierra Club v. FERC*, 867 F.3d 1357, 1370 (D.C. Cir. 2017).



rather than section 206 filings initiated by others, and points out the higher burden faced by the Commission.<sup>18</sup> FERC's action in this matter should be reversed and remanded for the same reasons that applied in *NRG*.

#### 4. FERC Failed to Act Consistent with the FPA.

This Court has explained that it “assess[es] the Commission’s remedial decisions in light of the underlying aims of the FPA and will set aside a remedy that “thwart[s] the core purposes . . . of the statute.”<sup>19</sup> The FPA is a consumer protection statute.<sup>20</sup> Congress amended the statute in 2005 to define FTRs as rights to be allocated in connection with service obligations to Load.<sup>21</sup> FTRs return Congestion to Load to ensure that customers who pay for the transmission network receive its benefits in a manner similar to the firm transmission service they received prior to industry restructuring.<sup>22</sup> FERC cites this statutory provision approvingly without appreciating how its actions in this case contravene the

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<sup>18</sup> *NRG*, 862 F.3d at 114, n.2 (citing *City of Winnfield v. FERC*, 744 F.2d 871, 875 (D.C. Cir. 1984)).

<sup>19</sup> *La. PSC v. FERC*, 772 F.3d 1297, 1302 (D.C. Cir. 2014) (citing *Concord v. FERC*, 955 F.2d 67, 75 (1992)).

<sup>20</sup> *See, e.g., Publ. Sys. v. FERC*, 606 F.2d 973, 979 (D.C. Cir. 1979).

<sup>21</sup> *See* 16 U.S.C. § 824q.

<sup>22</sup> *See id.*; *Pennsylvania-New Jersey-Maryland Interconnection, et al.*, 92 FERC ¶ 61,282, 61,956 (2000) (“FTRs entitle the holder to receive a rebate of congestion revenues”); *Pacific Gas and Elec. Co.*, 80 FERC ¶ 61,128, 61,433 (1997); *PJM Interconnection, L.L.C.*, 106 FERC ¶ 61,253, 61,917-61,918 (2004).

statutory directive.<sup>23</sup> The Orders interfere with customers' ability to "secure firm transmission rights (or equivalent tradable or financial rights)."<sup>24</sup> The Orders operate to transform instruments designed to protect the interests of customers into a liability for customers. The Orders thwart a core purpose of the FPA. The Orders should be reversed.

### **5. FERC Exceeded Its Authority Under the FPA.**

FERC arbitrarily changed the fundamental nature of FTRs and undermined its own jurisdiction by redefining FTRs as hedges against day-ahead Congestion for FTR Holders. FERC argues that nothing has changed since FTRs received exemption from CFTC jurisdiction.<sup>25</sup> Intervenors claim that "[r]emoving balancing congestion from the definition of FTRs does not alter" FERC's jurisdiction.<sup>26</sup> These conclusory statements do not address the legal issues underlying the Orders.

The Orders changed FTRs in ways material to whether a CFTC exemption continues to be warranted. Under the Traditional Congestion Allocation Rule, which existed when the CFTC granted its exemption,<sup>27</sup> FTRs returned Congestion

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<sup>23</sup> Respondents' Br. at 39-40.

<sup>24</sup> See 16 U.S.C. § 824q(b)(4).

<sup>25</sup> Respondent's Br. at 41 (citing Rehearing Order at 82 (JA \_\_\_)).

<sup>26</sup> Intervenors' Br. at 26 (citing Rehearing Order at 82).

<sup>27</sup> *Final Order in Response to a Petition from Certain Independent System Operators, et al.*, 78 Fed. Reg. 19,879, 19,880 (Apr. 2, 2013).

to FTR Holders based on the price of energy purchased in the Day-Ahead Energy Market and in the Real-Time Energy Market. The application of the Traditional Congestion Allocation Rule created an inextricable link to physical deliveries in the Real-Time Energy Market. By redefining Congestion to be only day-ahead, FTRs are no longer tied to physical delivery.

FERC and Intervenors avoid responding to this argument on the merits. FERC claims that “the CFTC recently exempted a financial product intended to hedge congestion based solely on day-ahead energy prices.”<sup>28</sup> Neither FERC’s brief nor the Rehearing Order explain the CFTC’s decision and whether the CFTC considered the implications of severing FTRs from physical delivery, which has been a critical element in exempting FTRs from CFTC jurisdiction. The CFTC’s order includes no analysis or reference to financial hedges of Transmission Congestion Rights supporting FERC’s position.

**B. NO CHANGED CIRCUMSTANCES SUPPORT FERC’S REVERSAL OF PRECEDENT AND OVER TEN YEARS OF PRACTICE REGARDING THE PROPER CALCULATION OF CONGESTION.**

No one disputes that FERC can change its mind for good reason. This Court has held: “[t]he Commission can depart from a prior policy or line of precedent,

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<sup>28</sup> Respondent’s Br. at 41-42 (citing *Final Order Regarding Sw. Power Pool, Inc. Application to Exempt Specified Transaction*, 81 Fed. Reg. 73,065 (Oct. 24, 2016); see also Rehearing Order at 82 (JA \_\_\_).

but it must acknowledge that it is doing so and provide a reasoned explanation.”<sup>29</sup>

This Court has affirmed a change from a prior regulatory approach where the Commission “explained how changed circumstances justified a new policy”<sup>30</sup> and FERC has attempted to justify its reversal in this matter on that basis. In *ANR Pipeline Co.*, the Commission cited changes in the “structure of the natural gas industry as well as the Commission’s regulatory approach.”<sup>31</sup> These included “technological changes.”<sup>32</sup> The Commission identified no change of comparable significance here.

While it is less than clear, FERC appears to allege three changed circumstances: a change in FTR funding levels; the failure of the stakeholder process to address the asserted underfunding issue; and PJM’s implementation of conservative Stage 1B ARR allocations.<sup>33</sup> These purported changes do not explain or justify reversal of FERC’s longstanding and recently upheld policy on calculating Congestion. The referenced change in funding levels was an increase in

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<sup>29</sup> *La. PSC v. FERC*, 772 F.3d 1297, 1303 (D.C. Cir. 2014) (citing *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009); *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57 (1983)).

<sup>30</sup> *ANR Pipeline Co. v. FERC*, 205 F.3d 403, 407 (D.C. Cir. 2000).

<sup>31</sup> *Id.* (quoting *ANR Pipeline Co.*, 85 FERC ¶ 61,056, 61,176 (1998)).

<sup>32</sup> *Id.*

<sup>33</sup> Respondent’s Br. at 22-28.

FTR funding identified by PJM in the second *FirstEnergy* case.<sup>34</sup> FERC does not explain how that is a change in circumstance since the second *FirstEnergy* case or how it contributes to a need for their proposed changes. A rational stakeholder decision refusing to approve rule changes that would damage stakeholders' legitimate interests is not a failure or change in circumstances. An easily reversible change in the allocation of Stage 1B ARR by PJM is not a change in circumstances. The Commission fails to identify any real change in circumstances.

In addition to these referenced changes, FERC references PJM's position that Balancing Congestion contributes to underfunding. FERC implies, but does not assert, that PJM staff's statement of its policy preferences is a change in circumstances. FERC primarily relies on the argument that PJM's unilateral decision to implement more conservative Stage 1B allocations constitutes a material change in circumstances. PJM's decision to shift revenues from ARRs to FTRs was a choice. PJM's decision could simply have been reversed by the Commission.

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<sup>34</sup> *Id.* at 23. See *FirstEnergy Solutions Corp. v. PJM Interconnection, L.L.C.*, 143 FERC ¶ 61,209, at P 43.

**C. NO RATIONALE SUPPORTS FINDING THAT INCLUDING BALANCING CONGESTION IN THE CALCULATION OF CONGESTION IS UNJUST AND UNREASONABLE.**

The core of FERC's and Intervenors' responses are a repetition of industry slogans concerning "hedging" and "underfunding."

**1. FERC and Intervenors Err in Asserting that the Day-Ahead Market is the Energy Market, that the Day-Ahead Price is the Energy Price, that Day-Ahead Congestion is Congestion, and that Balancing Congestion Is Not Congestion.**

Intervenors state: "[t]he cost of electricity is set through a day-ahead market, in which generators of electricity enter offers to sell electricity through what is referred to as a 'single clearing price' auction."<sup>35</sup> Intervenors would have the Court believe that the Day-Ahead Energy Market is *the* energy market, the day-ahead price is *the* energy price, and that Day-Ahead Congestion is *total* Congestion. These statements are not correct. FERC's conclusions based on these statements are likewise not correct.

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<sup>35</sup> Intervenors' Br. at 23. Intervenors cite *Black Oak Energy, LLC v. FERC*, 725 F.3d 230, 233-34 (D.C. Cir. 2013), in support of this facially correct, but incomplete assertion. The Court accounted for role of the real-time markets in pricing delivered electricity: "Not all electricity is purchased in advance, however. Various risk factors upset sellers' and buyers' projections of supply and demand as manifested in the Day-Ahead schedule. In PJM's Real-Time Market, participants correct for these changes by trading electricity at prices quoted for sale and delivery within five-minute intervals. PJM calculates these prices based on grid operating conditions and submitted bids. PJM then coordinates the supply and distribution chain 'to meet the instantaneous demand for electricity.'" *Id.* at 233 (internal citations omitted).

The cost of electricity is set in both the Day-Ahead<sup>36</sup> and Real-Time<sup>37</sup> Energy Markets. Customers pay for electricity based on the day-ahead price times day-ahead megawatt-hour volume plus the real-time price times balancing megawatt-hours (the difference between the Participant's real-time megawatt-hour and day-ahead megawatt-hour purchases).<sup>38</sup>

Congestion is the difference—due to transmission constraints—between what Load pays for energy and what generation is paid.<sup>39</sup> Day-ahead Congestion is

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<sup>36</sup> OATT §§ 1 (Definitions C–D), 2.6. (JA \_\_).

<sup>37</sup> OATT §§ 1 (Definitions R–S). 2.5 (JA \_\_).

<sup>38</sup> OA Schedule 1 § 3.2.1 (JA \_\_).

<sup>39</sup> *See* OA Schedule 1 § 5.1 (eff. prior to Feb. 1, 2017) (JA \_\_). In the explanatory statement in the filing that established the PJM market, members of the PJM power pool explained: “The prices paid for energy bought and sold in the Mid-Atlantic Market will reflect the hourly locational marginal price at each load and generation bus, determined by the ISO. Transmission congestion charges, which will be determined by the differences in locational marginal prices in each hour between load and generation busses caused by transmission constraints, will be collected from all transactions causing or contributing to congestion.” *See* Members of the Pennsylvania-New Jersey-Maryland Interconnection, Filing, Docket No. ER96-2516-000, *et al.*, at 14 (Jul. 24, 1996). The members of the PJM power pool also explained: “All firm point-to-point customers will pay transmission costs based on differences in locational prices. Firm point-to-point customers will be eligible for rebates of those congestion charges.” *Id.* at 7. *See also*, Compliance filing of the Pennsylvania-New Jersey-Maryland Interconnection with Order No. 888, FERC Docket No. OA97-261-000 *et al.* (Dec. 31, 1996), Brief of the Supporting Companies, Attachment (William W. Hogan, Report on PJM Market Structure and Pricing Rules at 50 (Dec. 31, 1996) (“Each unit of energy transferred to the constrained region would cause the SO [system operator] to collect, in the form of congestion

the difference between what Load pays for day-ahead energy and what generators are paid for day-ahead energy. Balancing Congestion is the difference between what Load pays for balancing energy and what generators are paid for balancing energy. Total Congestion is the sum of Day-Ahead Congestion and Balancing Congestion. It makes no more sense to assert that total Congestion does not include Balancing Congestion than to assert that total Congestion does not include Day-Ahead Congestion.

## **2. FERC and Intervenors Err in Arguing that Balancing Congestion Causes Underfunding.**

The concept of underfunding illustrates the flaws in FERC's reasoning. It is not possible that the obligation to pay out Congestion could exceed the total amount of Congestion. Yet that is what FERC asserts as the core of its argument. But there is no such thing as underfunding. The purpose of FTRs is to return Congestion to customers who paid Congestion through LMP market prices and paid for the transmission system, nothing else.

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payments, the difference between the locational marginal price at the location where the energy is consumed and that location where the energy is injected.... FTRs provide a mechanism for distributing (or assigning ownership to) the congestion credits collected by the SO.... The SO would be simply a conduit for the distribution of congestion credits.... [N]othing ... would preclude the FTRs from being freely tradable in a secondary market as purely financial instruments.”).



The concept of underfunding is based on the mistaken assertion that FTR Holders have a right to Congestion Target Allocations. Target Allocations are only an allocation mechanism for Congestion.<sup>40</sup> Target Allocations are not Congestion. Target Allocations have been used as an allocation mechanism for total Congestion, including Day-Ahead and Balancing Congestion, for seventeen years.<sup>41</sup>

Target Allocations are based solely on the day-ahead market prices and FTR megawatt values, not Day-Ahead Congestion and not total Congestion. Target allocations are equal to FTR megawatts times the difference in the day-ahead prices between the FTR end points.<sup>42</sup> FTRs do not entail energy flows between their source and sink points in either the Day-Ahead or Real-Time Energy Markets. The FTR does not, therefore, accrue any Congestion or energy costs in the Day-Ahead or Real-Time Energy Market. FTRs do not pay Congestion.

FERC's logic is that Target Allocations define the correct payments to FTR Holders and Target Allocations are based solely on the day-ahead market and it follows that Balancing Congestion should not affect payments to FTR Holders.

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<sup>40</sup> See OA Schedule 1 § 5.2.3 (CIR 116, JA \_\_\_).

<sup>41</sup> *Id.*

<sup>42</sup> OA Schedule 1 § 5.2.2 (CIR 116, JA \_\_\_).

FERC and Intervenors argue that FTR underfunding is caused by the inclusion of real-time Balancing Congestion.<sup>43</sup>

Intervenors argue, based on the same mistaken premise, that “[i]f PJM is unable to pay FTR holders the full value of the congestion charges collected, then the hedge fails because the holder of the FTR ends up paying congestion charges (and, moreover, being exposed to uncertain prices) that the FTR does not recompense.”<sup>44</sup> Intervenors assert that FTR Holders should be guaranteed the payment of Target Allocations even when Target Allocations exceed total Congestion.<sup>45</sup> This equates to asserting that Load must subsidize FTR Holders when Target Allocations exceed actual total Congestion.

As FTR Target Allocations are not Congestion, it is not surprising that FTR total Target Allocations frequently differ from total Congestion, based on whether FTR megawatts are greater than or less than actual system transmission capability and actual flows of energy.<sup>46</sup> It is a logical impossibility that FTR Holders are

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<sup>43</sup> Respondents’ Br. at 27, Intervenors Br. at 6.

<sup>44</sup> Intervenors’ Br. at 6.

<sup>45</sup> *Id.* at 21-22. FERC rightly determined no such guarantee exists, including prior to the *FirstEnergy* cases. See *FirstEnergy Solutions Corp. v. PJM*, 151 FERC ¶ 61,205 at P 23 (2015) (citing *PJM Interconnection, L.L.C.*, 143 FERC ¶ 61,209, at P 41 (2013) (citing *PPL EnergyPlus, L.L.C. v. PJM Interconnection, L.L.C.*, 134 FERC ¶ 61,263, at P 46 (2011))).

<sup>46</sup> PJM Oct. 19 Filing at 7 (CIR 1, JA \_\_\_).

owed more Congestion than the total Congestion paid by all customers on the system. Put a different way, it is not logically possible that FTRs can be underfunded relative to Congestion collected. The fact that Target Allocations may exceed total Congestion illustrates the fact that Target Allocations are an allocation mechanism and do not define an obligation to pay FTR Holders.

**3. The Assignment of Balancing Congestion to Customers Does Not Correct the Wealth Transfer Problem that FERC Claims to be Correcting.**

PJM claimed that the ARR/FTR construct was not, as of the 2014/2015 planning year, providing just and reasonable results.<sup>47</sup> PJM noted that its own unilateral decision to undersell transmission system capability in order to guarantee a revenue surplus for FTRs caused a wealth transfer from ARR holders to FTR Holders.<sup>48</sup> PJM stated:

While FTR underfunding has been resolved for now, the consequence is that customers have experienced reduced ARR allocations during Stage 1B. PJM's solution has therefore shifted revenues from ARR holders, through a reduction of the quantity of ARRs, to FTR holders, in the form of increased FTR funding. PJM believes this inequitable cost shift is unjust and unreasonable, and this cost shift can be significantly reduced with the proposed reforms to the ARR and FTR process.<sup>49</sup>

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<sup>47</sup> *Id.* at 2, 10, 13-14.

<sup>48</sup> *Id.* at 13-14.

<sup>49</sup> *Id.* at 14.

Relying on the misconception that Target Allocations are Congestion and that FTR Holders should be guaranteed payment of Target Allocations, PJM was willing to engage in actions that produced unjust and unreasonable results. PJM explicitly recognized that its unilateral action caused a wealth transfer from ARR holders to FTR Holders in order to pay Target Allocations to FTR Holders.<sup>50</sup>

FERC agreed that PJM's unilateral decision to undersell system capability caused an unjust and unreasonable market outcome and a wealth transfer between holders of ARRs and FTRs.<sup>51</sup> But FERC did not order PJM to reverse its decision in order to relieve the unjust and unreasonable outcome. Instead, FERC determined that the issue of surplus allocation was outside the scope of its proceeding and delegated the issue to a PJM stakeholder process.<sup>52</sup>

FERC incorrectly determined that the real issue underlying PJM's decision to undersell system capability was that negative Balancing Congestion reduced the Congestion Revenue available to fund FTR Target Allocations.<sup>53</sup> On that basis, FERC determined that negative Balancing Congestion should be assigned to Load

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<sup>50</sup> *Id.*; see also September 15 Order at PP 10, 93 (JA \_\_); Respondent's Br. at 26; PJM, Comments, at 1-2 (filed Mar. 15, 2016) (CIR \_\_, JA \_\_).

<sup>51</sup> PJM Oct. 19 Filing at 10-11 (CIR 1, JA \_\_); September 15 Order at PP 2, 40; Respondents' Br. at 14, 24.

<sup>52</sup> Rehearing Order at PP 137-138.

<sup>53</sup> September 15 Order at PP 5, 96.

(ARR holders) rather than FTR Holders. This, FERC argued, would allow more system capability to be sold and still allow full FTR funding.<sup>54</sup>

But FERC's action does not resolve the wealth transfer issue created by PJM's conservative modeling. PJM indicated that, even with Balancing Congestion removed from the funding of FTRs, PJM would continue to undersell the system in order to guarantee full funding of FTRs.<sup>55</sup> PJM stated "that the Simultaneous Feasibility Test requirement *ex ante* is designed to ensure, under normal circumstances, that there could be only under-allocation and no over-allocation of ARRAs ... PJM argues that this is an appropriately conservative approach to ensure revenue adequacy and prevents allocating more ARRAs than what it knows the system can handle as of that point in time."<sup>56</sup> PJM will employ conservative modeling assumptions to undersell expected system capability in the day-ahead market and guarantee surplus Day-Ahead Congestion relative to FTR Target Allocations.

PJM explained to FERC that simply removing Balancing Congestion from Congestion accounting would not fix the wealth transfer problem created by

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<sup>54</sup> *Id.*

<sup>55</sup> *See* Rehearing Order at P 133 (JA \_\_\_).

<sup>56</sup> *Id.*

PJM.<sup>57</sup> PJM argued that the surplus or unallocated Congestion that results from underselling system capability is “by definition the congestion collected for which no risk hedge was allocated and therefore to which the congestion could be distributed.”<sup>58</sup> PJM argued that, to address the wealth transfer problem, it is therefore “appropriate to provide that value back to ARR holders since it was caused by not having allocated the ARRs in the first instance.”<sup>59</sup>

PJM informed the Commission that the required change to the definition of Congestion “puts load at risk for the allocation of additional costs attributable to the real-time energy market.”<sup>60</sup> This is because negative Balancing Congestion adds costs to ARR holders, reducing the value of ARRs as an offset against Congestion. Assigning negative Balancing Congestion to ARR holders forces them to subsidize FTR Holders by paying more than total Congestion to FTR Holders and requiring ARR holders to make up the difference. Assigning Balancing Congestion to Load and exports results in FTRs receiving more revenue than total Congestion. This is overfunding and FERC’s arbitrary and capricious Orders

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<sup>57</sup> PJM Compliance Filing, FERC Docket No. EL16-6-003 (Nov. 14, 2016) at 10-11 (CIR 116, JA \_\_).

<sup>58</sup> PJM, Answer, FERC Docket No. EL16-6-003, at 4 (Dec. 12, 2016) (JA \_\_).

<sup>59</sup> *Id.*

<sup>60</sup> PJM, Compliance Filing, Docket No. EL16-6-001, at 11 (Nov. 14, 2016) (CIR 116, JA \_\_).

subsidize FTR Holders relative to actual Congestion Revenue at the expense of Load and exports. FERC's Order creates a new wealth transfer by assigning Balancing Congestion to Load, purportedly to address a wealth transfer unilaterally created by PJM.

#### **4. The Order Does Not Rely on Cost Causation.**

FERC claims that it allocated Balancing Congestion to Load and exports rather than to FTRs based on cost causation.<sup>61</sup> Intervenors agree, noting that “the Commission recognized, the guiding principle when allocating costs amongst entities is cost causation, and it found based on the evidence before it that ‘FTR holders do not cause . . . balancing congestion.’”<sup>62</sup> The FERC and Intervenors argue that “PJM market participants, the PJM market operator, outside systems, and other external influences can introduce deviations to effectively increase or decrease balancing congestion.”<sup>63</sup> FERC and Intervenors argue that “cost causation principles required PJM to allocate the costs of balancing congestion ‘on a pro-rata basis to real-time load and exports.’”<sup>64</sup>

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<sup>61</sup> September 15 Order at PP 94-95 (JA \_\_).

<sup>62</sup> Intervenors' Br. at 18 (citing September 15 Order at P 95).

<sup>63</sup> September 15 Order at P 98; Intervenors Br. at 13.

<sup>64</sup> Intervenors Br. at 13 (citing September 15 Order at P 99).

But FERC's logic proves too much. Based on the logic of FERC and Intervenors, FTRs should not be paid Target Allocations. PJM market Participants, the PJM market operator, outside systems (modeled) and other factors external to FTRs contribute to and cause Target Allocations to change in the Day-Ahead Energy Market. FTRs do not cause Target Allocations. Load causes total Congestion and total Congestion should be paid to Load.

**II. FERC ERRED IN FAILING TO FIND THAT PJM'S PORTFOLIO NETTING RULE IS UNJUST, UNREASONABLE, UNDULY DISCRIMINATORY AND CONTRAVENES FPA SECTION 217<sup>65</sup>**

Intervenors' brief includes a newly-crafted example<sup>66</sup> in an effort to prop up their position that PJM's portfolio netting rule "ensures equal treatment for both prevailing and counteflow [sic] FTRs . . . ." <sup>67</sup> Intervenors erroneously conclude that, where "the purchase prices of the FTRs net to zero (a \$3.50 payment for the FTR from A to B plus a -\$3.50 payment for the FTR from B to A) . . . ," <sup>68</sup> the resulting prevailing and counterflow FTRs should obviate any Congestion payments or obligations. Intervenors conclude that netting the portfolio before applying payout adjustments results in equitable treatment of FTRs. This

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<sup>65</sup> NJBPU, DPSC, the Market Monitor, ODEC, and AMP join these arguments.

<sup>66</sup> Intervenors' do not cite the administrative record for this example and it appears to be wholly new hypothetical material.

<sup>67</sup> Intervenors' Br. at 27.

<sup>68</sup> Intervenors' Br. at 31.



conclusion is incorrect. PJM's portfolio netting rules result in the Intervenors receiving inappropriate and substantial benefits for their portfolio structures at the expense of LSEs and Intervenors do not want to surrender these benefits.

This undeserved benefit flows from the fact that the netting rules offset two different things (prevailing and counterflow FTRs). "When FTRs are revenue inadequate, the prevailing flow FTR holders receive a reduced amount of Transmission Congestion Credits."<sup>69</sup> However, revenue inadequacy does not affect the value of counterflow FTRs, because counterflow FTRs do not receive revenue from Congestion. Instead, holders of counterflow FTRs pay into the total revenues used to fund prevailing flow FTRs.

As a result, PJM's netting rules artificially treat prevailing FTRs differently based on whether or not they are held within a portfolio. Outside of a portfolio with prevailing flow FTRs, the revenue due from counterflow FTRs is used to fund all prevailing flow FTRs. Placed in a portfolio, the revenue due from counterflow FTRs is first used to fund any prevailing flow FTRs within that portfolio rather than prevailing flow FTRs as a whole. Thus, the portfolio retains 100% of the payments from any counterflow FTR that would otherwise help fund all prevailing flow FTRs. Prevailing flow FTR's in a portfolio containing counterflow FTRs thereby receive a higher proportion of available funds than prevailing flow FTRs

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<sup>69</sup> September 15 Order at P 2, n.3 (JA \_\_\_).

outside of such a portfolio. This is the source of the windfall received by Intervenors under PJM's netting rules.

FERC and Intervenors muddle these basic facts by declaring that the Petitioners have adopted the wrong "payout ratio,"<sup>70</sup> or would apply it incorrectly.<sup>71</sup> FERC states that, "there was no improper subsidy under FERC's definition of payout ratio, *i.e.*, 'available congestion credits as a percentage of the *net* target allocations' instead of *positive* target allocations."<sup>72</sup> FERC effectively argues that defining "payout ratio" to disregard devaluation of prevailing flow FTRs caused by revenue inadequacy solves the problem. In contrast, Petitioners rely on the disparate obligations associated with prevailing flow and counterflow FTRs and the resulting undue benefit netting provides to Intervenors to demonstrate that PJM's netting rules are unjust, unreasonable and unduly discriminatory.<sup>73</sup> Petitioners do not base their case on any particular definition of "payout ratio." Assuming away the problem, as FERC has, is neither rational nor reasonable.

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<sup>70</sup> Respondent Br. at 49.

<sup>71</sup> Intervenors Br. at 29.

<sup>72</sup> Respondent Br. at 49.

<sup>73</sup> PJM's own filing identified the misallocation of revenues as the basis for eliminating netting. PJM Oct. 19 Filing at 19-20 (CIR 1, JA \_\_\_).

The Commission's factual determination is erroneous.<sup>74</sup> Further, the Commission's discretion is constrained by FPA section 217(b), which provides that "[a]ny load serving entity ... is entitled to use the firm transmission rights, or, equivalent tradable or financial transmission rights, in order to deliver the output or purchased energy, or the output of other generating facilities...."<sup>75</sup> FPA section 217(d) allows that "[t]he Commission may exercise authority under this chapter to make transmission rights not used to meet an obligation covered by subsection (b) available to other entities in a manner determined by the Commission to be just, reasonable, and not unduly discriminatory or preferential."<sup>76</sup> This section creates a preference for LSEs with respect to use of transmission rights, such as FTRs in PJM, and requires that the Commission ensure these rights are made available to others only on terms and conditions that are just, reasonable, and not unduly discriminatory or preferential.

PJM's netting rules require LSEs to subsidize transmission service obtained by the Intervenors. This subsidization is ongoing and was properly brought to FERC's attention in the proceedings below, but the Commission disregarded it.

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<sup>74</sup> *E.g., Alabama Power Co. v. FCC*, 773 F.2d 362, 367 (D.C. Cir. 1985).

<sup>75</sup> 16 U.S.C. § 824q(b)(2).

<sup>76</sup> 16 U.S.C. § 824q(d).

PJM's netting rule is unjust, unreasonable, and unduly discriminatory and preferential, and therefore contravenes FPA section 217.<sup>77</sup>

### **III. FERC ERRED IN REJECTING PJM'S PROPOSED ARR AND FTR ALLOCATION METHODOLOGY<sup>78</sup>**

#### **A. Allocating ARRs Based on Current Usage Will Not Restore Value to ARRs and the LSEs that Hold Them**

FERC erred in directing PJM to develop a methodology for Stage 1A ARR allocation based on actual system usage because allocating ARRs based on current usage will not restore value to ARRs and the LSEs that hold them. The root cause of the decline in ARRs made available to LSEs by PJM has been PJM's overly conservative outage modeling included in its simultaneous feasibility tests. As ODEC explained in its comments:

PJM's conservative modeling of outages, which assumes a greater number and impact of outages than previously, has had an adverse impact on ARR holders in Stage 1B and Stage 2. The conservative outage modeling causes an inequitable cost shift to load . . . . PJM's

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<sup>77</sup> See *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 542 (D.C. Cir. 2010) (“if, in the future, the allocation process results in an unjust outcome, San Diego may petition the Commission to order appropriate changes at that time under section 206 . . . .”); *Open Access & Priority Rights on Interconnection Customer's Interconnection Facilities*, Order No. 807-A, 153 FERC ¶ 61,047, at P 14 (Oct. 15, 2015) (“[t]his section would . . . be violated if the Commission exercised its authority in a manner that was at odds with the needs of load-serving entities.”) (quoting *South Carolina Pub. Serv. Comm'n v. FERC*, 762 F.3d 41, 90 (D.C. Cir. 2014)).

<sup>78</sup> ODEC and AMP join these arguments.

October 19 filing proposes to remedy the unjust and unreasonable cost shift that results from its conservative outage modeling . . . .<sup>79</sup>

In fact, PJM's increasingly conservative outage modeling had nearly eliminated Stage 1B and Stage 2 ARR allocations.<sup>80</sup> According to PJM, conservative outage modeling reduced the ARRs allocated in Stage 1B from 27,850 MW in PJM's 2010/2011 planning period, to only 2,390 MW in the 2014/2015 planning period.<sup>81</sup> This is the foundation of Indicated LSEs' arguments in their rehearing request that "[d]espite the Commission's representation that the use of 'only actively used paths' in Stage 1 ARR modeling will 'rectify the underlying root cause,' there is no such evidence in the record,"<sup>82</sup> and "[t]he result will likely be fewer feasible Stage 1A ARRs."<sup>83</sup>

However, the Commission never addressed these very real concerns that were first identified by PJM itself in its original filing. Instead, the Commission engaged in what its own brief characterizes as a "predictive and inherently

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<sup>79</sup> ODEC & AEP, Comments, at 2-3 (filed Mar. 15, 2016) (CIR 78, JA\_\_\_).

<sup>80</sup> *Id.* at 3.

<sup>81</sup> PJM, Filing, at 8 (filed Oct. 19, 2015) (CIR 1, JA\_\_\_).

<sup>82</sup> Indicated LSEs, Rehearing Request, at 7 (filed Oct. 17, 2016) (CIR 110, JA\_\_\_).

<sup>83</sup> *Id.*

speculative' judgment."<sup>84</sup> It was unreasonable for the Commission to ignore the concrete evidence of the root cause of declining ARR availability presented by PJM and to resort to speculation instead.

### **B. PJM's Original Proposal was Just and Reasonable**

The Commission's rejection of PJM's proposed 1.5% load growth adder for the Stage 1A ARR simultaneous feasibility analysis was arbitrary and capricious because PJM demonstrated that its original proposal was just and reasonable. PJM had assured the Commission that its proposal "will not necessarily result in additional transmission being built."<sup>85</sup> However, the Commission continued its speculation by concluding that PJM's proposed 1.5% growth adder will result in construction of unnecessary transmission facilities.

The record reflects that only one transmission project has ever been developed specifically to address ARR infeasibility. In the Rehearing Order, the Commission dismissed this "single example," concluding that "[t]his is insufficient evidence to find that utilizing PJM's actual load forecast without escalation for the assumed load reflected in the simultaneous feasibility analysis is unjust and

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<sup>84</sup> Respondents Br. at 44 (quoting *E. Niagara Pub. Power All. & Pub. Power Coal. v. FERC*, 558 F.3d 564, 567 (D.C. Cir. 2009)).

<sup>85</sup> PJM Comments, at 3 (filed Mar. 15, 2016) (CIR 77, JA\_\_\_).

unreasonable.”<sup>86</sup> However, the fact that only one such project exists after many years of conservative modeling by PJM undercuts, rather than supports, the Commission’s argument that a modest upward adjustment to PJM’s growth forecast would “result in unwarranted transmission enhancements.”<sup>87</sup>

As discussed in the preceding section regarding netting, FPA section 217 creates a preference for LSEs with respect to use of transmission rights. This preference extends to ARRs in PJM, as well as FTRs. The Commission argues that Petitioners wrongly allege that the Commission’s alternative to PJM’s proposal is inconsistent with FPA section 217.<sup>88</sup> However, the Commission bases this conclusion on an argument that the Petitioners have not made; namely, that PJM is obligated to allocate ARRs using “historical paths . . . no longer in service in its Stage 1A [auction right] allocation.”<sup>89</sup> Instead, Petitioners argue that the Commission’s actions in ignoring the root cause of PJM’s reduced ARR allocations and the resulting continued impairment of LSEs’ ability to obtain “a

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<sup>86</sup> Rehearing Order at P 23 (JA\_\_\_).

<sup>87</sup> *Id.*

<sup>88</sup> Respondent’s Br. at 46; Rehearing Order at P 25.

<sup>89</sup> Respondent’s Br. at 46 (citing Petitioners’ Initial Br. at 80).

more reliable long-term tradable financial transmission right”<sup>90</sup> is inconsistent with the directives of FPA section 217 and therefore is an abuse of discretion.<sup>91</sup>

#### IV. CONCLUSION

For the foregoing reasons, Petitioners respectfully request that the Court find that FERC failed to engage in reasoned decision-making and that the Orders should be vacated and remanded with direction to FERC to ensure all Congestion is returned to Load in a manner that is just and reasonable and not unduly discriminatory and that FERC’s treatment of Balancing Congestion in the calculation of Congestion not result in an unjust and unreasonable or unduly discriminatory rate to Load.

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<sup>90</sup> Petitioners’ Initial Br. at 80.

<sup>91</sup> *E.g., La. Pub. Serv. Comm’n v. FERC*, 174 F.3d 218, 225 (D.C. Cir. 1999).



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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 May 31, 2017, I certify that the Joint Reply Brief of Petitioners has been prepared in a proportionally spaced typeface (using Microsoft Word 2010, in 14-point Times New Roman) and contains 6,225 Limit words, not including the tables of contents and authorities, the glossary, and the certificates of counsel.

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October 25, 2017

**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 25th day of October 2017, 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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