ORAL ARGUMENT NOT YET SCHEDULED

Nos. 15-1071 and 16-1042 (consolidated)

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

NEW ENGLAND POWER GENERATORS ASSOCIATION, INC.,

Petitioner in No. 15-1071,

EXELON CORPORATION,

Petitioner in No. 16-1042,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

REPLY BRIEF

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INITIAL BRIEF: September 20, 2016

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Commission or FERC	Respondent Federal Energy Regulatory Commission.
Exelon Order	Order Denying Compl., *Exelon Corp. v. ISO New Eng. Inc.*, 150 FERC ¶ 61,067 (2015), R.88, JA___.
Exelon Reh'g Order	Order Denying Reh'g, *Exelon Corp. v. ISO New Eng. Inc.*, 154 FERC ¶ 61,005 (2016), R.96, JA___.
NEPGA	New England Power Generators Association.
NEPGA Reh'g Order	Order Denying Reh'g & Clarification, *New Eng. Power Generators Ass'n, Inc. v. ISO New Eng. Inc.*, 150 FERC ¶ 61,064 (2015), R.87, JA___.
Petitioners	Exelon Corporation and New England Power Generators Association, Inc.
PJM III	*PJM Interconnection, L.L.C.*, 128 FERC ¶ 61,157 (2009).
Sloped Demand Order	*ISO New Eng. Inc.*, 147 FERC ¶ 61,173 (2014).
Sloped Demand Reh'g Order	*ISO New Eng. Inc.*, 150 FERC ¶ 61,065 (2015).

INTRODUCTION AND SUMMARY OF ARGUMENT

ISO New England seeks to entice new generators to enter New England's forward capacity market by allowing them to lock in their prices for up to seven years — and when they do, it requires them to offer their locked-in power into capacity auctions during the lock-in period at a price of $0. In complaints to the Federal Energy Regulatory Commission, petitioners asked the Commission to modify the zero-price offer requirement. They explained that it unfairly suppresses prices for existing generators in both the entry and post-entry auctions and is therefore unjust, unreasonable, and unduly discriminatory, in violation of the Federal Power Act.

In the orders below, the Commission gave no reasoned response to petitioners' arguments and evidence — including arguments that allowing the zero-price offer requirement was contrary to Commission precedent holding that it would be unlawful even to allow zero-price offers from price-locked resources. The Commission merely stated in conclusory fashion that price suppression due to the zero-price offer requirement was an "acceptable byproduct" of other market rules. Exelon Reh'g Order at P 16, JA___. But it did not explain why failing to mitigate that price suppression was "acceptable" and not unjust, unreasonable, and unduly discriminatory.

The Commission's brief confirms that it made no real effort to grapple with the serious issues raised by petitioners' complaints. The Commission and its supporting intervenors make four basic arguments in support of the orders below. None is availing.

First, the Commission insinuates, but stops short of actually asserting, that petitioners' failure to appeal certain prior orders poses an obstacle to their current challenge. It does not. The orders under review are the first in which the Commission was asked to address the lawfulness of ISO New England's zero-price offer requirement. And petitioners' decision not to challenge other aspects of the New Entry Pricing Rule, such as the availability of the price-lock option, does not prevent them from objecting to ISO New England's failure to mitigate the price suppression that results from the combination of the price-lock option and the zero-price offer requirement.

Second, the Commission and its supporting intervenors claim that failing to mitigate the zero-price offer requirement's price-suppressive effects cannot be unduly discriminatory against existing resources because new and existing resources are not similarly situated. But the differences the Commission identifies between new and existing resources — that the former have higher up-front costs and lower going-forward costs — do not explain why it is appropriate to suppress prices. At most, those differences *might* justify offering special incentives to encourage the construction of new generators. But petitioners are not challenging ISO New England's use of the price-lock option to incentivize new investment; they are seeking to mitigate the price suppression that flows from the zero-price offer requirement. Regardless of whether or not it is lawful for a system operator to attract new generators into the market by offering them special incentives that are not available to existing generators, it is not lawful — or at a minimum, the Commission has not adequately explained *why* it is lawful — for a system operator to refuse to mitigate the harm that existing suppliers suffer as a result of zero-price bidding by those new entrants.

Third, the Commission contends that failing to mitigate the price suppression at issue is not unjust and unreasonable because it reflects a "reasonable balancing" of competing interests. The orders below, however, took no account of the interest of investors, and the longer-term interest of consumers, that existing resources be able to recover prices that fairly reflect New England's capacity shortage. And the Commission's brief does not explain why that interest is unworthy of protection. Instead, it simply proclaims that lower prices for existing generators are justified by consumers' interest in avoiding higher prices. But lower prices are not automatically just and reasonable, and the Commission cannot rationalize price suppression on the tautological ground that it reduces prices. Further, while the Commission tries to suggest that higher prices would be "artificial," it made no finding in its orders below that higher prices would reflect the exercise of market power or be illegitimate in some other way; nor would the record have supported such a finding.

Fourth, the Commission fails to justify departing from its precedential decision in *PJM Interconnection, L.L.C.*, 128 FERC ¶ 61,157 (2009) ("*PJM III*"). It first denies that it has departed at all, insisting that there can be more than one lawful rate. That argument ignores what the PJM precedent actually held: not that banning zero-price bidding by price-locked resources was lawful, but that *allowing* such bidding would be *unlawful*. The Commission identifies no factual differences between the PJM and New England capacity markets that would make zero-price bidding unjust, unreasonable, and unduly discriminatory in one but not the other. And the Commission's alternative claim that its views have "evolved" since *PJM III* remains illogical and inadequately explained.

In sum, the Commission's brief mirrors the superficial approach it took in the orders below. Although the Commission and intervenors pile thousands more words on top of the Commission's unexplained *ipse dixit* that price suppression resulting from the zero-price offer requirement is "acceptable," they are building a house on sand. They cannot overcome the fact that the Commission never meaningfully responded to petitioners' arguments and evidence showing that the zero-price offer requirement violates the Federal Power Act.

ARGUMENT

I. The Commission's Prior Orders Did Not Prevent Petitioners from Challenging the Zero-Price Offer Requirement.

The Commission insinuates, but is not willing to directly assert, that certain prior orders regarding the New Entry Pricing Rule pose an obstacle to petitioners' current challenge to the zero-price offer requirement. *See, e.g.*, FERC Br. 15 (chastising petitioners for not appealing certain "now-final orders"); *id.* at 22–23 (similar). They do not. Before the orders challenged here, the Commission had never addressed whether the zero-price offer requirement could lead to unjust, unreasonable, and unduly discriminatory price suppression. As the orders themselves make clear, that was a question of first impression in these proceedings.

The Commission did not address that question in its 2006 order approving the settlement agreement that created New England's forward capacity market. *See Devon Power LLC*, 115 FERC ¶ 61,340 (2006), *rev'd in part on other grounds*, *Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008), *rev'd in part sub nom. NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n*, 558 U.S. 165 (2010). The Commission's brief is misleading when it asserts that the 2006 order "found the [New

Entry Pricing] Rule just and reasonable, providing 'predictable revenues and facilitat[ing] financing for new capacity.'" FERC Br. 12 (quoting *Devon Power*, 115 FERC ¶ 61,340 at P 16). In truth, that order merely mentioned the lock-in option in passing while describing the settlement and stated that the rule "is *intended* to provide predictable revenues and facilitate financing for new capacity." *Devon Power*, 115 FERC ¶ 61,340 at P 16 (emphasis added). The order did not consider whether the lock-in option would achieve those goals. And it certainly did not address whether the zero-price offer requirement might have unjust, unreasonable, and unduly discriminatory effects on existing suppliers. Petitioners thus had no reason to seek judicial review of the 2006 order. *Cf. Niagara Mohawk Power Corp. v. FERC*, 452 F.3d 822, 827 (D.C. Cir. 2006) (a party "need not seek review if it is satisfied with the practical impact of [an] order," and it does not forfeit its right to challenge subsequent orders that build on the prior order "to cause substantial injury").

Nor did the Commission address the lawfulness of the zero-price offer requirement in its 2014 order approving ISO New England's adoption of a system-wide sloped demand curve. *See ISO New Eng. Inc.*, 147

FERC ¶ 61,173 (2014) ("Sloped Demand Order"), *on reh'g*, 150 FERC ¶ 61,065 (2015) ("Sloped Demand Reh'g Order"). True, in that order the Commission approved an extension of the lock-in period from five to seven years. *See* Sloped Demand Order at PP 55–61; Sloped Demand Reh'g Order at PP 31–34. But the Commission did not consider whether it might be appropriate to mitigate the effects of the extended lock-in option on existing suppliers by changing the zero-price offer requirement. It did not have to address that question in the Sloped Demand Orders because, as the Commission's brief acknowledges, petitioners were already contesting the zero-price offer requirement in parallel proceedings that led to the orders challenged here. *See* FERC Br. 16.

Petitioners did not seek judicial review of the Sloped Demand Orders because the Commission gave no hint that it thought those orders foreclosed petitioners' then-pending challenge to the zero-price offer requirement. The order denying NEPGA's complaint issued in January 2014, more than five months before the Commission's first Sloped Demand Order. The orders denying Exelon's complaint and NEPGA's rehearing request issued the same day as the Sloped Demand Rehearing Order. Neither of them relied on the Sloped Demand Orders; nor did the order denying Exelon's rehearing request, which issued a year later. In short, there is no support for the Commission's new claim, advanced for the first time on appeal, that the Sloped Demand Orders "altered the Commission's review of [petitioners'] complaints." FERC Br. 16.

Tellingly, the Commission does not go so far as to claim that petitioners' arguments are impermissible collateral attacks on any now-final order (although it does make that contention as to certain arguments raised by intervenor-petitioners, *see* FERC Br. 28 n.4). For good reason: Nothing in any prior order told petitioners that the Commission had conclusively decided that the zero-price offer requirement was consistent with the Federal Power Act. *See Dynegy Midwest Generation, Inc. v. FERC*, 633 F.3d 1122, 1126–27 (D.C. Cir. 2011) (a complaint is not a collateral attack on an earlier order unless that order gave the complainant reasonable notice that the agency had decided the question). Nor did the Commission suggest in the orders under review that it had already decided the question raised by petitioners' complaints.

And even if the Commission had previously decided that the zero-price offer requirement was lawful, it reopened the issue when, in the orders under review, it purported to consider petitioners' challenge on the merits. *See Cent. Hudson Gas & Elec. Corp. v. FERC*, 783 F.3d 92, 105–06 (2d Cir. 2015) ("An agency reopens an issue decided in a previous order—and thus lifts the bar against challenging that decision in a subsequent proceeding—when 'in responding to comments the agency uses language that shows that it did in fact reconsider an issue.'" (quoting *Pub. Citizen v. Nuclear Regulatory Comm'n*, 901 F.2d 147, 150 (D.C. Cir. 1990))); *Am. Gas Ass'n v. FERC*, 912 F.2d 1496, 1514–15 (D.C. Cir. 1990) (Commission reopened an issue when, "far from treating the matter as settled," it "responded in full on the merits").

The Commission is also wrong when it implies — but, again, stops short of directly asserting — that petitioners had to show "changed circumstances" to challenge the zero-price offer requirement. FERC Br. 5; *see, e.g.*, *id.* at 18, 23, 28–29, 35. Nothing in the statute requires such a showing. Indeed, the Commission has recognized that a party need not "demonstrate materially changed conditions in order to challenge" a market rule under § 206 of the Federal Power Act, even if the rule was previously accepted. *ISO New Eng., Inc.*, 135 FERC ¶ 61,029, P 44 (2011). And as the Commission had not previously addressed the zero-price offer requirement, insisting that petitioners show changed circumstances would have made no sense (changed as compared to when?).

The Commission cites *Iberdola Renewables, Inc. v. FERC*, 597 F.3d 1299, 1301 (D.C. Cir. 2010), for the proposition that "petitioner must demonstrate a previously just and reasonable rate *has become* unjust and unreasonable." FERC Br. 29 (emphasis added). But *Iberdola* says no such thing. It simply notes that customers "are not left without redress if they think [a previously approved] rate has become unjust over time," because they can always bring a new challenge to the rate under § 5 of the Natural Gas Act (a provision analogous to § 206 of the Federal Power Act). 597 F.3d at 1301. It does not say that such a challenge requires the petitioner to prove changed circumstances.

In any event, the Commission did not demand proof of changed circumstances in the orders below; it simply considered whether the zero-price offer requirement was unjust and unreasonable. *See, e.g.*, NEPGA Reh'g Order at P 19, JA___ (finding that "NEPGA has failed to show that the existing Tariff's New Entrant Pricing is unjust and unreasonable"); Exelon Order at P 31, JA___ (finding that "the Complainants have not shown ISO-NE's zero-price offer requirement to be unjust and unreasonable"). This Court reviews the Commission's orders, not its counsel's post hoc rationalizations. *See BNP Paribas Energy Trading GP v. FERC*, 743 F.3d 264, 270 (D.C. Cir. 2014) (citing *SEC v. Chenery Corp.*, 318 U.S. 80, 87 (1943)). So even if the Commission could have required petitioners to show changed circumstances, because the orders did not rely on a lack of changed circumstances, this Court cannot uphold them on that basis.

II. The Commission Has Not Explained Why the Price Suppression Caused by the Zero-Price Offer Requirement Is Not Unduly Discriminatory.

The Commission argues that suppressing prices for existing resources through the zero-price offer requirement cannot be unduly discriminatory because new and existing resources are "not similarly situated." FERC Br. 29–35; *see also* Int.-Resp. Br. 22–24. But it does not address the Commission precedent holding that new and existing capacity "provide the same service" and "should receive the same price." Pet. Br. 26 (quoting, respectively, *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, P 91 (2006); *PJM III*, 128 FERC ¶ 61,157 at P 102).

To defeat the charge of undue discrimination, it is not enough for the Commission to say that new and existing resources differ in some respects. It must explain why those differences are material; that is, it must reasonably explain why the differences justify refusing to mitigate price suppression for existing generators. *Cf. BP Energy Co. v. FERC*, No. 15-1205, 2016 WL 3853870, at *7 (D.C. Cir. July 15, 2016) (vacating finding of no undue discrimination where Commission identified differences between two natural-gas companies but failed to "adequately explain[] why they provide a 'rational basis' for" the challenged difference in treatment); *Dynegy*, 633 F.3d at 1127 ("The Commission has revealed no basis for its contention that generators in different zones are not 'similarly situated' for purposes of receiving reactive power compensation.").

The Commission has provided no such explanation. In the orders under review, the Commission did not even claim that new and existing generators were differently situated, much less explain how they were different in any way that would justify suppressing prices for existing generators. While the Commission now points to "two salient factual differences between new and existing generators," FERC Br. 31, that is another impermissible post hoc rationalization. *See BNP Paribas*, 743 F.3d at 270. In any event, those differences at most suggest why the

Commission has allowed ISO New England to offer special incentives (such as the price-lock option) to attract new generation. They have no apparent connection to the Commission's refusal to order ISO New England to mitigate price suppression for existing resources.

First, the Commission points out that "a new generator faces high up-front costs [of] entry because it must construct a power plant — something an existing generator need not do." FERC Br. 31. But new generators' high up-front costs do not justify refusing to mitigate price suppression for existing generators. At most, and if accompanied by an adequate explanation, those costs might perhaps justify giving new generators special incentives, not available to existing generators, to overcome a "risk of lack of investment when new capacity is needed." *Id.* at 32 (quoting Sloped Demand Order at P 58). But petitioners are not challenging ISO New England's use of incentives, like the price-lock option, to incentivize new generators to enter the market. The Commission even concedes that petitioners are not trying to reduce the incentives available to new entrants, admitting that they are seeking only to "mitigate the . . . impact [on existing suppliers] with an approach consistent with that taken in the PJM (Mid-Atlantic) Region." FERC

Br. 17; *see also id.* at 34 (acknowledging that petitioners are not challenging the availability of the price-lock option).

Yet despite acknowledging that ISO New England's use of incentives to attract new entry is not at issue here, the Commission spends much of its brief defending those incentives. It even starts its brief with a deeply flawed analogy, likening petitioners to "existing customers" who "complain when a business gives a special, introductory deal to new customers." *Id.* at 21. It says that petitioners, like those customers, "object to the particular mix of incentives offered to attract new entrants in New England." *Id.* at 22. That is wrong. As their opening brief made clear, petitioners are "not challenging the availability of the price-lock option for new entrants," but are "only asking the Commission to mitigate the harm caused to existing suppliers" as a result of the zero-price offer requirement. Pet. Br. 15; *see also id.* at 46. To be sure, petitioners' arguments may cast doubt on the principles underlying the original decision to give only new resources a preferential price-lock option. But petitioners are entitled to accept that original decision and still contest the orders below, which build on those underlying principles to inflict harm on existing resources. *See Niagara Mohawk*, 452 F.3d at 827.

Alleviating the unfair price-suppressing effects of the zero-price offer requirement "would *not* require eliminating the price-lock option for new entrants." Pet. Br. 46 (emphasis added). Nor would it diminish the incentives for new entry one iota. If anything, it would enhance those incentives: not only would potential new entrants be able to enjoy seven price-locked years, but they could also look forward to receiving just and reasonable prices after the end of the lock-in period. As petitioners' expert explained, "institutionalized price suppression and price discrimination" is "self-perpetuating; as potential investors in new resources factor in the probability that the clearing prices paid to incumbents in New England will never be allowed to reflect the true cost of entry, they are likely to require recovery of a disproportionate amount of revenues during the [lock-in] period." Direct Testimony of Michael M. Schnitzer 4, Docket No. EL15-23-000, R.63 Attachment A, JA___.

Second, the Commission says that a new generator often faces "lower 'going-forward costs' than existing plants," making it economically rational for a new generator to submit zero-price offers "once [it] clears its first auction." FERC Br. 31–32. But as petitioners have explained, even if zero-price offers might be viewed as economically rational, that is not an adequate explanation for refusing to mitigate price suppression that results when such offers are submitted by resources that would not be participating in the auction *at all* if they had not been enticed by the price-lock. *See* Pet. Br. 36–37.

Put differently, ISO New England had two options for inducing new generators to enter the market: it could allow market prices to rise to reflect New England's capacity shortage, which would have benefited all market participants, both new and existing; or it could offer an out-of-market price-lock incentive to new generators alone (provided it took steps to mitigate any price-distorting effects that incentive might have). *See, e.g.*, Sloped Demand Order at P 55 (if the lock-in period had not been extended, "a higher price cap would [have been] needed to achieve the same degree of reliability"). ISO New England chose to incentivize new generators instead of letting prices rise for everyone, and the Commission accepted ISO New England's proposal. For purposes of these proceedings, petitioners have accepted that decision; they have sought only to mitigate the price suppression for existing resources that results from requiring new generators to bid their power into the market at a $0 price. The fact that new generators have low going-forward costs *after* they are enticed into the market by a preferential incentive does not explain why they should be permitted to suppress prices for existing generators.

The Commission's reasoning appears to consist of three steps: (1) New England's capacity shortage made it reasonable to encourage market entry by offering new generators preferential incentives; (2) once new generators are enticed to enter the market, it may be rational for them to submit zero-price bids; therefore (3) there is no need to mitigate the harmful effects of the incentivized new generators' zero-price bidding on existing suppliers. *See* FERC Br. 31–32. That is a fallacy. When A acts in a way that injures B and C, who are innocent third parties, the fact that A's action might have been voluntary or rational does not mean that reasonable steps should not be taken to mitigate the harm to B and C. The Commission's contrary reasoning — that because incentivizing new entry is warranted, there is no need to mitigate the harmful effects of incentivized new entrants' zero-price bidding on existing suppliers — is inconsistent with its statutory obligation to ensure just and reasonable rates and to act reasonably with respect to all market participants. *See* 16 U.S.C. §§ 824d(a)–(b), 824e(a).

In the end, the Commission's argument is just an expanded version of its unexplained claim that the price suppression challenged by petitioners is "an acceptable byproduct of a just and reasonable market rule." Exelon Reh'g Order at P 16, JA___. That argument continues to be arbitrary and circular. Even assuming the price-lock option to incentivize new entry is just and reasonable, that does not mean the harm to existing suppliers from incentivized new entrants' zero-price bidding is "acceptable" and need not be mitigated. *See* Pet. Br. 45. Especially because the harm to existing resources can be mitigated without diminishing the incentives for new entry, "it is not a sufficient answer for the Commission to declare, without further explanation," that the harm to existing resources is "acceptable." *Id.* at 46. The Commission has no meaningful response.

III. The Commission Has Not Explained Why the Price Suppression Caused by the Zero-Price Offer Requirement Is Not Unjust and Unreasonable.

The Commission argues that the zero-price offer requirement is just and reasonable based on the "balance" supposedly struck by the orders below. *See* FERC Br. 35–41. But any balancing in those orders was a one-sided affair. The orders said only that "the lock-in option strikes a reasonable balance between incenting new entry . . . and protecting consumers from very high prices." Exelon Reh'g Order at P 16, JA___. The Commission did not even pay lip service to the interest of investors, and the longer-term interest of consumers, in ensuring that existing generating facilities receive prices that fairly reflect New England's capacity shortage. *See* Pet. Br. 47–48 (explaining that the Commission "appears only to have balanced two factors on the consumer side of the scale").

The Commission now says that "[r]ead in context," its orders should be construed as having held "that incentivizing new entry and seeking to maintain consumer prices outweigh potentially higher returns for existing generators." FERC Br. 38–39. That is not what the orders said. And even the Commission's revisionist formulation does not explain *why* it struck the "balance" it did. For one thing, incentivizing new entry does not belong in the equation at all given that petitioners did not challenge the incentives for new entry. So in rejecting petitioners' request to mitigate price suppression, the Commission could only have "balanced" consumers' short-term interest in suppressed prices, on one hand, against existing generators' interest (and consumers' longer-term interest) in reasonable, market-based prices, on the other. Even assuming the Commission *sub silentio* weighed those interests, it gave no reasoned explanation for the choice it made. *See New Eng. Power Generators Ass'n, Inc. v. FERC*, 757 F.3d 283, 293 (D.C. Cir. 2014) (the Commission must "'reflect[] on the competing interests at stake to explain why it struck the balance it did'" (quoting *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 541–42 (D.C. Cir. 2010)).

The Commission's unexplained claim to have "found that lower clearing prices . . . would achieve the desired reliability for New England," FERC Br. 37, does not show that lower prices are just and reasonable. If reliability were the only standard, then a system operator could suppress prices to as low a level as it wanted so long as there was still enough supply to meet demand. Under that standard, the Commission would never have to balance investor and consumer interests; it would only have to consider consumers' short-term interest in paying the lowest prices consistent with a reliable power system. But it is black-letter law that "setting a just and reasonable rate necessarily 'involves a balancing of the investor *and* the consumer interests.'" *Wisc. Pub. Power, Inc. v. FERC*, 493 F.3d 239, 262 (D.C. Cir. 2007) (quoting *FPC v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944)) (emphasis added).

Nor can the Commission justify its supposed "balancing" by declaring that changing the zero-price offer requirement "could significantly raise consumer prices." FERC Br. 36. When Congress enacted the Federal Power Act, it "was not only expressing its conviction that the public interest requires the protection of consumers from excessive prices," but "was also manifesting its concern for the legitimate interests of . . . companies in whose financial stability the . . . consuming public has a vital stake." *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 113 (1958).

Put simply, the Commission cannot refuse to remedy unjust and unreasonable price suppression simply because doing so would result in higher prices. While the Commission argues that "lower consumer prices can be the desired outcome," FERC Br. 36, lower prices are not self-justifying. The Commission must explain *why* the suppression of market prices is just and reasonable with reference to market conditions, generally by pointing to evidence that prices were artificially high due to the exercise of market power.

This is not the first time the Commission has made this mistake. For example, in *Edison Mission Energy, Inc. v. FERC*, this Court vacated a Commission order that allowed unreasonable price suppression. *See* 394 F.3d 964, 968–69 (D.C. Cir. 2005). It held that the Commission had not adequately explained why price-lowering measures were justified where high prices were "due not to market power but to temporary scarcity." *Id.* at 968. The Court recognized that "curtailing [higher prices] attributable to genuine scarcity" and not to "the exercise of market power" would "wreak substantial harm." *Id.* at 969; *see also Grand Council of Crees (of Quebec) v. FERC*, 198 F.3d 950, 956 (D.C. Cir. 2000) (noting that "the grant of ratemaking authority [to the Commission] stems from congressional concern over market power").

The Commission did not explain in the orders under review why the New Entry Pricing Rule's lowering of the prices received by existing resources is not unjust and unreasonable price suppression. Nor does it do so here. It certainly does not contend that lowering prices through the zero-price offer requirement is necessary to counteract the exercise of market power, or that higher prices would reflect market power as opposed to genuine scarcity. On the contrary, the Commission has acknowledged that New England faced a capacity shortage, *see, e.g.*, Sloped Demand Order at P 57, and such scarcity would normally cause market prices to rise for new and existing suppliers alike without any exercise of market power. Indeed, the Commission recently recognized that higher energy prices in times of shortage are necessary to "reflect adequately the value that a resource provides to the system" and to "provide an incentive for the performance of existing resources and help to maintain reliability." *Settlement Intervals & Shortage Pricing in Markets Operated by Reg'l Transmission Orgs. & Indep. Sys. Operators*, 155 FERC ¶ 61,276, P 105 (2016); *see id.* at PP 162–63 (requiring system operators to let prices rise in times of shortage to "help ensure just and reasonable rates").

The Commission's brief asserts without explanation that the New Entry Pricing Rule "ensures that new entrants can bid at their actual cost of entry — and not *artificially* high — because of the current risks associated with the New England market." FERC Br. 41 (emphasis added). By slipping in the word "artificially," the Commission seems to imply that the higher prices that are suppressed by new entrants' zero-price offers would be in some way illegitimate. But that idea, which the Commission's brief barely develops, is totally absent from the orders below. The Commission has never found that the higher prices that existing generators would receive in the absence of the price-lock option and zero-price offer requirement would reflect the exercise of market power or that they would be "artificial" in some other way.

Intervenor-respondents' claim that the Commission "found that lower prices . . . reflect competitive market pricing and serve to protect against the exercise of market power," Int.-Resp. Br. 7–8, is pure fiction. Tellingly, the Commission and intervenors both try to support their claim of "artificial" price inflation by citing, not the Commission's own findings, but vague assertions that *ISO New England* made in the proceedings below — assertions that the Commission never endorsed in the orders on review. *See* FERC Br. 41; Int.-Resp. Br. 13, 16–17. (Although the Commission cites a paragraph in the background section of one of its orders, that paragraph merely summarizes ISO New England's arguments without adopting or endorsing them. *See* Exelon Order at P 18, JA___.) The Court cannot entertain such post hoc rationalizations for the Commission's orders. *See BNP Paribas*, 743 F.3d at 270.

Further, the notion that capacity prices would be "artificially" high without special incentives for, and zero-price bidding by, new generators is illogical and unsupported. While the Commission's brief does not make clear in what sense higher prices would be "artificial," that notion appears to rest on an unexplained distrust of market-based price signals that runs counter to the ordinary presumption that market prices not affected by the exercise of market power are just and reasonable. *See, e.g.*, *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) (citing *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990)). If the Commission meant to adopt a theory under which market-based prices are deemed "artificial," it needed to articulate that theory much more clearly, and defend it much more thoroughly, than it has done here.[1]

[1] The Commission's mention of the Minimum Offer Rule, *see* FERC Br. 40–41, is a red herring. It did not rely on that rule below, and its brief says only that the rule might "mitigate" the price-suppressive effect of

IV. The Commission Cannot Reconcile the Orders Below with Its Precedent Concerning the PJM Market.

The Commission concluded in 2009 that a proposal to *allow* zero-price bidding by price-locked resources in the PJM market would unfairly suppress market prices and would therefore be unjust, unreasonable, and unduly discriminatory. *See* Pet. Br. 13, 27–28 (discussing *PJM III*, 128 FERC ¶ 61,157 at P 112). The orders below do not "provide a reasoned explanation for departing from [that] precedent" and upholding a rule that *requires* zero-price bidding by price-locked resources in the New England market. *West Deptford Energy, LLC v. FERC*, 766 F.3d 10, 20 (D.C. Cir. 2014) (quoting *ANR Pipeline Co. v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995)).

The Commission's main argument — that its "findings here did not represent a departure from" *PJM III*, FERC Br. 42 — cannot withstand scrutiny. Its insistence that "regional market rules need not be identical" and "[t]here can be more than one just and reasonable rate,"

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the zero-price offer requirement, not that it will eliminate that effect. It could not say more, as it has repeatedly acknowledged that the zero-price offer requirement lowers prices for existing generators. *See, e.g.*, Sloped Demand Order at P 56; Exelon Order at P 31, JA___; Exelon Reh'g Order at P 16, JA___; *see also* Pet. Br. 10–11 (petitioners offered expert testimony explaining how the zero-price offer requirement suppresses prices).

id. at 42–43, misses the point. Petitioners are not arguing that because particular rules have been found *lawful* in the PJM market, no other rules can be lawful in the New England market. Rather, petitioners contend that market rules that have been found *unlawful* in PJM cannot be deemed *lawful* in New England — at least not without a reasoned explanation why specific, concrete regional differences make the same rule unacceptable in Pennsylvania but acceptable in Connecticut. *See* Pet. Br. 32 ("At a minimum, the Commission must explain in concrete terms what the relevant differences between the regions might be and why under the statute those differences justify a different approach."); *Consol. Edison Co. of N.Y., Inc. v. N.Y. Indep. Sys. Operator, Inc.*, 150 FERC ¶ 61,139, P 47 (2015) (rejecting idea that "principles underlying market design in one region are not applicable to another").

The Commission's brief confirms that no such explanation exists. Unlike its supporting intervenors, the Commission does not try to argue (much less did it find in the orders below) that ISO New England's zero-price offer requirement and PJM's bidding floor for price-locked resources somehow work the same way in practice. *See* Int.-Resp. Br. 19–20. Instead, the Commission relies on two supposed differences between New England and the PJM region to justify the difference in rules. First, it points to "a lack of regional investment in capacity" in New England. FERC Br. 43. But the need to encourage more investment could *at most* justify providing greater incentives for new entry in New England, not refusing to mitigate the resulting price suppression for existing generators. Second, the Commission refers vaguely to "the [New Entry Pricing R]ule's link to the System Operator's sloped demand curve." *Id.* What exactly that means is anyone's guess, but it is surely not a reasoned explanation for concluding that price suppression from zero-price bidding is unjust and unreasonable in PJM but just and reasonable in New England.

In the alternative, the Commission claims that "even if" it did depart from *PJM III*, it "adequately acknowledged and explained" the departure. *Id.* at 45. That claim is paradoxical on its face: an agency cannot "acknowledge" a departure from precedent while denying that any such departure exists. In any event, the Commission's alternative argument fails as well.

The Commission suggests that its departure from *PJM III* was justified "based on changes in how capacity markets have functioned since its 2009 PJM Order." FERC Br. 46; *see also id.* ("The Commission may change its position based on changed factual circumstances . . . namely industry or market changes."). But it does not claim that capacity markets worked any differently in 2009 than they do today; nor did it make such a claim in the orders below. Rather, it said only that its views had "evolved" and that it now recognized that zero-price bidding by price-locked resources could be economically rational.

That is not an adequate explanation either, in part because it has long been understood that rational price-locked resources will have incentives to submit zero-price offers. *See* Pet. Br. 36–37. The Commission did not decide *PJM III* the way it did because it somehow failed to grasp that basic economic fact. Instead, the Commission recognized in *PJM III* that even rational zero-price bidding can unfairly suppress prices for existing resources. The Commission cannot justify departing from precedent by pointing to a fact that everyone has always known and that had no bearing on the decision in *PJM III*. Moreover, the fact that zero-price bidding is economically rational is not a sufficient answer to petitioners' complaints because, as explained above, it ignores that the new generators would not be in the market *at all* but for the preferential price-lock incentive.

The Commission's last resort is to fall back on its claim that "following its 2009 PJM Order . . . could result in significantly higher prices for New England consumers." FERC Br. 47. But as explained above, that is not an answer. Everything that results in short-term lower electricity prices for consumers is not automatically just and reasonable, and avoiding higher prices in times of scarcity is not a legitimate basis for disregarding precedent and ignoring the interests of investors in existing generation.

* * *

The fundamental requirement of the Federal Power Act — that rates must be just and reasonable and not unduly discriminatory — is designed to promote the longer-term interests of both consumers and market participants by having the Commission ensure that market rules are fair, prices are neither unreasonably low nor unreasonably high, and investors are able to compete on an even playing field.

Although the Commission's rate decisions are entitled to deference, deference is appropriate only when the Commission has adequately explained its decision and responded meaningfully to arguments and evidence that proposed rates are unjust, unreasonable, and unduly discriminatory. That basic duty of explanation is required not only to make sure that the Commission complies with the Federal Power Act, but also to promote transparency and accountability in agency decisionmaking and to avoid the impression that the Commission's decisions are being driven by impermissible considerations that may produce lower prices in the short term but serve no one's interests over the longer term.

Here, the Commission did not satisfy those basic statutory obligations. Its unexplained failure to respond to arguments and evidence showing that the zero-price offer requirement results in unlawful price suppression means that its orders cannot be sustained. Its attempts to support those orders with post hoc rationalizations should be rejected. And its failure to address its 180-degree change in position from *PJM III* confirms that the Commission's orders are neither reasoned nor reasonable.

CONCLUSION

The Court should reverse the Commission's decision and order it to grant appropriate relief. In the alternative and at a minimum, the Court should require the Commission to meaningfully address petitioners' arguments and its own precedent and issue a reasoned decision.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7) and D.C. Circuit Rule 32(a)(2), I certify that this brief complies with the length limitations set forth in that rule because it contains 6,327 words, as counted by Microsoft Word, excluding the items that may be excluded.

/s/ Ashley C. Parrish
Ashley C. Parrish

CERTIFICATE OF SERVICE

Pursuant to Fed. R. App. P. 25, I certify that on September 20, 2016, I caused a copy of the foregoing document to be served electronically on all registered counsel through the Court's CM/ECF system.

/s/ Ashley C. Parrish
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