UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Astoria Generating Company L.P. and TC Ravenswood, LLC	)	
v.	)	**Docket No. EL11-50-000**
New York Independent System Operator, Inc.	)	

REQUEST FOR REHEARING OF
THE NEW YORK POWER AUTHORITY, CITY OF NEW YORK,
METROPOLITAN TRANSPORTATION AUTHORITY,
THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY,
NEW YORK STATE OFFICE OF GENERAL SERVICES,
AND NEW YORK CITY HOUSING AUTHORITY

October 10, 2012

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Pursuant to Section 313 of the Federal Power Act ("FPA"),[1] and Rule 713 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. § 385.713 (2012), the New York Power Authority ("NYPA"), and the City of New York, Metropolitan Transportation Authority, the Port Authority of New York and New Jersey, New York State Office of General Services, and New York City Housing Authority (the "Governmental Customers" and collectively with NYPA and the City, the "New York Parties") respectfully request rehearing of the Commission's September 10, 2012 "Order on Complaint" in this proceeding ("Mitigation Order").[2]

In support thereof, the New York Parties state as follows:

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[1] 16 U.S.C. § 825l (2006).

[2] *New York Independent System Operator, Inc.*, 140 FERC ¶ 61,189 (2012).

I. EXECUTIVE SUMMARY

The New York Parties respectfully submit that the Mitigation Order was both unlawful and unwarranted. The Mitigation Order constitutes arbitrary and capricious decision-making and its effects are unjust and unreasonable.[3]

The Mitigation Order takes the concept of buyer-side mitigation entirely too far. The Commission has held that, in the New York City capacity market, "new capacity should not be penalized after-the-fact for a decision to build that was economically rational at the time the decision was made."[4] But, that is precisely what the Mitigation Order does. The Commission approved the New York Independent System Operator, Inc.'s ("NYISO") market structures so that customers would benefit from meaningful price signals and efficient entry and exit. Indeed, the Commission decided to transform the electric industry into a competitive marketplace primarily to provide better service to customers at lower rates. In doing so, the Commission recognized the importance and value of allowing new entrants to compete against incumbent utilities and attempted to level the playing field so that the new entrants would have equal opportunities to compete for market share. The Mitigation Order is antithetical to the Commission's long-stated policy of fostering stable and competitive markets, and it is inconsistent with the Commission's fundamental purpose of protecting customers. The effect of the Mitigation Order is to prevent new entry into the nation's largest city and single most constrained electricity market. In the short-term, customer bills will increase by hundreds of millions of dollars, and the Governmental Customers will likely incur unnecessary and value-less

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[3] 16 U.S.C. §§ 824d, 824e (2006); 5 U.S.C. § 706(2)(A) (2006).

[4] *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,211 at P 117 (2008).

capacity double charges. In the long-term, customers will be deprived of the benefits of meaningful competition.

The Mitigation Order also makes several legal errors that warrant rehearing. First, by ordering the NYISO to re-test the Astoria Energy II, LLC ("AEII") generating facility for mitigation years after it was exempted, the Mitigation Order improperly changes the rates, terms, and conditions of service under the NYISO's Market Administration and Control Area Services ("Market Services") Tariff. The Commission is empowered to change rates in response to a complaint but may only do so on a prospective basis so that customers and other stakeholders have notice of the change. Interpreting a tariff (*i.e.* filling the gaps) or finding an independent system operator's or regional transmission organization's (collectively, "ISO/RTOs") use of discretion unreasonable does not support retroactive applicability of the outcome of the case. Second, the Commission erred by disregarding the objective determinations of the NYISO and its independent market monitor, just months after it explicitly stated that RTOs and their market monitors need discretion to implement capacity mitigation tests. Third, the Commission failed to consider significant adverse customer impacts, which could be as high as $400-500 million in 2013 alone.[5] This is both legal error and harmful public policy. Fourth, the Mitigation Order amounts to a prudence disallowance but fails to adhere to long-held prudence standards.

In interpreting the Market Services Tariff, the Commission made additional legal and factual errors. First, the Commission erred by holding that the NYISO could not render its mitigation exemption determinations prior to completing the cost allocation process for the 2009

[5] The New York Parties respectfully submit that subjecting New York customers to increases in their energy bills of up to $400-500 million in 2013 alone, while simultaneously preventing a new, state-of-the-art power plant with very low air emissions from competing against existing, less efficient, and higher emitting power plants is not consistent with protecting customers, public policy, or the policies and objectives that formed the basis of the Commission's move to competition in the electric industry.

and 2010 Class Years. A review of the relevant tariff provisions and their history shows this was never the intent, and the Commission's determination constitutes an unexplained departure from its precedent. Second, the Commission erred in mandating an analysis reference date for AEII that is long after the decision was made to proceed with the project. The history of these rules and the Commission's precedent makes clear that the mitigation test was to be applied on an *ex ante* basis. Third, the Commission erred in ordering the NYISO to include sunk costs in calculation of the net cost of new entry for AEII ("Unit net CONE"). Internet definitions are not adequate authority upon which to reverse the determination of independent experts who initially developed and now administer these rules and markets. Finally, the Commission erred in ordering the NYISO to adopt a proxy cost of capital for AEII in light of the Commission's preference for actual costs. In ordering this change, the Commission failed to point to any causal link between the conduct it found objectionable and the terms that AEII was able to obtain from the financial markets. Indeed, as described herein, the Commission's discrimination finding was itself legally and factually incorrect.

For these reasons, the Commission should grant rehearing on the points discussed herein.

II. STATEMENT OF ISSUES AND SPECIFICATIONS OF ERROR

Pursuant to Rule 713(c)(2), 18 C.F.R. § 385.713(c)(2), the New York Parties submit the following statement of issues and specifications of error:

1 The Commission applied its theory of buyer-side market power too broadly in this case, without regard to the legal, policy, and rate implications of its decision, and its effects are unjust and unreasonable.[6]

2. The Commission erred in ordering retroactive relief in this case without finding a tariff violation.[7]

3. The Commission erred by overturning the objective determinations of the NYISO and its independent market monitor, departing from its precedent on this point.[8]

4. The Commission failed to respond to arguments regarding the impact of its order on customers.[9]

5. The Commission erred by making a prudence determination without holding itself

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[6] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 (1989) ("[i]t is not theory, but the impact of the rate order which counts."). *See also* 16 U.S.C. §§ 824d, 824e (2006).

[7] *See City of Anaheim v. FERC*, 558 F.3d 521, 522 (D.C. Cir. 2009) ("When the Federal Energy Regulatory Commission receives a complaint under § 206 of the Federal Power Act and finds that the rate charged by an energy supplier is "unjust" or "unreasonable," the Commission 'shall determine the just and reasonable rate . . . to be thereafter observed and in force, and shall fix the same by order.' That statutory provision prohibits FERC from setting rates retroactively in cases governed by § 206(a)."). *See also PPL EnergyPlus, LLC v. PJM Interconnection, L.L.C.*, 136 FERC ¶ 61,060 at P 19, n.8 (2012) ("If the Commission had found that PJM had not violated its Tariff but had otherwise acted in an unjust and unreasonable or unduly discriminatory manner, PPL Parties would have been eligible for refunds only beginning the date the Complaint was filed.").

[8] *See New York & Atlantic Ry. Co. et al., v. Surface Transp. Bd.*, 635 F.3d 66 (2nd Cir. 2011) ("An agency also acts in an arbitrary and capricious manner if the agency departs from its own precedent without a reasoned explanation.").

[9] *See Motor Vehicle Mfrs. Assn v. State Farm*, 463 U.S. 29, 43 (1983) ("Normally, an agency rule would be arbitrary and capricious if the agency has… entirely failed to consider an important aspect of the problem…."). *See also Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959).

to well-established legal standards for utility prudence.[10]

6. The Commission erred in the Mitigation Order by ruling that the NYISO violated Section 23.4.5.7.2 of its Market Services Tariff with respect to the timing of the mitigation exemption determination for AEII. In the Mitigation Order, the Commission disregarded the plain language, intent, and purpose of the tariff provision, and it misapplied and misinterpreted that provision.[11]

7. The Commission erred in the Mitigation Order by ruling that the analysis reference date for the mitigation exemption test ("MET") for AEII should have been sometime in 2010, thereby departing from its own precedent without adequate explanation.[12]

8. The Commission erred in the Mitigation Order's treatment of AEII's sunk costs. It was arbitrary and capricious for the Commission to rely on internet searches and web-based definitions in interpreting the Market Services Tariff and applying definitions that are not consistent with common practice in the electric industry or sound economic theory.

9. The Commission erred in the Mitigation Order in finding that the request for proposals ("RFP") that led to NYPA entering into a power purchase agreement ("PPA") with AEII was discriminatory, and rejecting the use of AEII's actual capital structure in the application of the MET. The Commission made factual

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[10] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989).

[11] *See* 5 U.S.C. § 706(2)(A) (2006) (An agency decision must not be upheld if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.").

[12] *See New York & Atlantic Ry. Co. et al., v. Surface Transp. Bd.*, 635 F.3d 66, 71 (2nd Cir. 2011) ("An agency also acts in an arbitrary and capricious manner if the agency departs from its own precedent without a reasoned explanation.").

and legal errors and failed to articulate a reasoned basis for its decision because there was no link between the finding and the terms of the PPA and its effect on AEII's ability to obtain attractive financing.[13]

III. REQUEST FOR REHEARING

The Commission should grant rehearing of the Mitigation Order on the points addressed here. As explained below, several aspects of the Mitigation Order constitute reversible error. Section A will discuss why the Mitigation Order represents a misapplication of buyer-side mitigation principles. Section B will discuss discrete legal errors in the Mitigation Order. Section C will discuss why the Commission erred in reaching specific conclusions about the calculation of Unit net CONE for the AEII unit.

A. The Commission Has Taken Buyer-Side Mitigation Too Far

The Mitigation Order represents an unwarranted and largely undefined expansion of the NYISO's "buyer-side" market power rules. The Commission approved buyer-side market power rules in New York in 2008 to protect against one factual scenario – an intentionally uneconomic investment by a net purchaser of capacity solely to drive down capacity prices.[14] This rule, the theory went, was necessary to ensure that the market would produce accurate and reliable price signals when new generation is needed. The Commission concluded that buyers' attempts to drive down prices could be harmful because they could "inhibit new entry, and thereby raise price and harm reliability, in the long-run."[15] Since that time, a rule originally designed to protect the market from manipulative entry has now been expanded into a general policy that

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13 *See General Chemical Corp. v. U.S.*, 817 F.2d 844, 857 (D.C. Cir. 1987) (finding agency action "arbitrary and capricious" because it was "internally inconsistent and inadequately explained").

14 *New York Independent System Operator, Inc*., 122 FERC ¶ 61,211 at P 101 (2008).

15 *Id.* at P 103.

micro-manages all new entry. While Order Nos. 888[16] and 2000[17] were designed to foster wholesale competition, the Mitigation Order appears to protect incumbents from competition.

The Mitigation Order indicates that new supply will only be permitted to enter when it presents no economic threat to incumbent suppliers. No such rule can be found in the FPA, the Commission's regulations, or the NYISO tariffs, nor is such a rule economically efficient or in the best interest of the market, system reliability, or customers. Moreover, the Mitigation Order disregards objective market rules overseen by independent actors, and instead substitutes subjective regulatory judgment over which assets should be permitted to enter the market and when.

On its face, the Mitigation Order addresses technical mitigation issues such as capital costs and going-forward dates, but the impact of the Mitigation Order is more pervasive, and more troublesome. The Mitigation Order delegitimized (and effectively disallowed) an arms-length PPA with a merchant generator.

Here, a rational market actor went into the marketplace to find for its customers a new source of capacity that was cleaner and more efficient than the last-generation plants that had dominated the highly-concentrated in-City market for so many years. A host of independent suppliers – *including two complainants in this case* – submitted proposals. Pleadings filed by NYPA and the City in this case provided considerable detail regarding the history of the AEII

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16 *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

17 *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089, (1999), *order on reh'g*, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (2000), *pet. for review dismissed sub nom. Pub. Util. Dist. No. 1 of Snohomish Cnty, Wash. v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

project and NYPA's decision to contract for its output.[18] The unit developed by AEII is a state of the art baseload facility built to serve NYPA's Governmental Customers and address what were, at the time the decision was made to proceed with the project, undisputed significant concerns about the future reliability of the electric system.[19] On April 29, 2008, NYPA's Board of Trustees approved the award of a 20-year PPA to AEII.[20] That day, NYPA issued a press release containing the following statements:

> Astoria Energy plans to build a new clean natural gas-fueled generating plant in Queens to supply power under a proposed 20-year contract with NYPA. The plant will help make up for the Power Authority's scheduled retirement in January 2010 of the Charles Poletti Power Project, also in Queens…
>
> "The new supply contract will lead to additional economical generating capacity for New York City schools and hospitals, the subways and commuter trains, public housing and other essential services in the city while curbing pollution and greenhouse gas emissions," Gov. David A. Paterson said. "Responsible, environmentally conscious energy policies are essential for meeting growing electricity demand and stabilizing future costs. Awarding this contract will be in keeping with those policies."
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> "This new state-of-the-art, natural gas-fueled power plant will improve New York City's air quality by displacing electricity production from older, dirtier and less efficient generating capacity," Ashok Gupta, Air and Energy Program Director, Natural Resources Defense Council, said.[21]

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18 *See Astoria Generating Company, L.P. and TC Ravenswood v. New York Independent System Operator, Inc.*, Docket No. EL11-50-000, "Motion to Intervene and Protest of the New York Power Authority, the City of New York, *et al.*," dated August 3, 2011 ("New York Parties Protest").

19 *Id.* at pp. 10-15 (discussing the NYISO's Reliability Needs Assessments for the time period in question in detail).

20 The NYPA Board Resolution approving the award to AEII specifically referenced its contractual obligation to the Governmental Customers, and the need to replace the loss of generation capacity flowing from the anticipated retirement of Poletti. The Board Resolution is reproduced in full at pages 93-95 of Complainants' Motion to Lodge herein. *Astoria Generating Company L.P. and T.C. Ravenswood, LLC v. New York Independent System Operator, Inc.,* Docket No. EL11-50-000, "Motion to Lodge," dated July 29, 2011.

21 *Available at:* http://www.nypa.gov/press/2008/080429d.htm.

On July 11, 2008, NYPA and AEII executed a 20-year PPA. AEII immediately commenced regulatory, pre-construction, and construction activities. The AEII generating facility commenced commercial operations on July 1, 2011.

Over four years after NYPA announced its investment, the Mitigation Order effectively nullifies the benefits that the Governmental Customers were to receive under the AEII PPA. If AEII is deemed mitigated, NYPA's customers must replace that capacity as if AEII is not available to produce energy and support the reliability of the constrained in-City transmission system. NYPA's customers will be required to pay tens of millions of dollars in duplicative capacity payments to the incumbent generators. Both the result of the Mitigation Order and these capacity payments are unjust and unreasonable.

NYPA's RFP was an arms-length, open, and transparent process, consistent with the requirements imposed on governmental agencies under New York law. NYPA properly selected AEII as the winning bidder, and it then entered into a long-term contract with AEII for the output of its new, efficient, low emitting combined-cycle facility. Four years ago, that investment was cheered by a wide spectrum of parties with a stake in New York's energy future, and was certified by the state siting board as in the public interest.[22] Now, at the request of those who have the most to fear from competition, the Commission has reversed the objective determination of two independent actors, and ordered the NYISO to re-calculate the MET for AEII. In so doing, the Mitigation Order cherry-picks a series of artificial assumptions that

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[22] Case No. 99-F-1191, *Application of Astoria Energy LLC, for a Certificate of Environmental Compatibility and Public Need to Construct and Operate an Approximately 1000 Megawatt Generating Facility in the Astoria section of Queens County*, Opinion And Order Granting Certificate Of Environmental Compatibility And Public Need (Nov. 21, 2001), Erratum Notice (Nov. 29, 2001), Order Dismissing Petition For Reh'g (Jan. 25, 2002), Order Granting Amendment of Certificate (Jan. 27, 2005).

misrepresent the nature of the investment and will likely lead to the unit being held out of the capacity market.

A hugely capital intensive investment in a state-of-the-art combined cycle facility that will contribute to system reliability and improved environmental conditions in New York City for decades – truly an energy success story – should not be deemed *uneconomic* or *unneeded* by attributing to the investor perfect foresight of the prices that would result in a six-month strip auction for residual capacity a few years into the future, which is what the Mitigation Order does. While the dysfunction in the capacity market rules is not at issue in this proceeding, the Commission's interpretation of those rules in this case will result in significant over-mitigation both for AEII and others. There is no law, rule, or regulation that requires a purchaser in Commission-jurisdictional markets to fully subsidize owners of incumbent generators before it is permitted to invest in a long-term power supply contract with a new supplier. Such a result is anti-competitive and inefficient.

By interpreting buyer-side rules in this manner, the Mitigation Order represents a step backwards from the Commission's policy of promoting competition and fairness in the wholesale electric markets. It puts the interests of a select few market participants ahead of both competition, generally, and the interests of customers by effectively closing off new entry into the nation's most constrained market and largest city.

B. The Mitigation Order Made Several Legal Errors

1. The Mitigation Order Erred by Ordering a Re-Test for AEII Without Finding a Tariff Violation

The Commission erred by ordering the NYISO to re-test AEII for mitigation.[23] Because the tariff was silent on the matters upon which the Commission ruled, under the FPA and Commission precedent the substantive findings of the Mitigation Order should have applied only to mitigation analyses performed *after* a properly established refund effective date.[24] Providing the complainants retroactive refund relief in the form of a mitigation re-test for AEII would have only been legally supported by a finding by the Commission that the NYISO *violated* its tariff.[25] It made no such finding on the key mitigation test elements. Critically, the Commission ruled on this very question in a recent PJM case. In rejecting a complaint by PPL, the Commission found that the PJM tariff permitted PJM to exercise discretion in its simultaneous feasibility

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[23] The Mitigation Order is completely silent on the standard of review the Commission is applying or upon what authority it bases its order to re-do the mitigation test for AEII. This silence is error in and of itself. *See General Chemical Corp. v. U.S.*, 817 F.2d 844, 857 (D.C. Cir. 1987) (finding agency action "arbitrary and capricious" because it was "internally inconsistent and inadequately explained").

[24] *See City of Anaheim v. FERC*, 558 F.3d 521 (D.C. Cir. 2009) ("When the Federal Energy Regulatory Commission receives a complaint under § 206 of the Federal Power Act and finds that the rate charged by an energy supplier is "unjust" or "unreasonable," the Commission 'shall determine the just and reasonable rate . . . to be thereafter observed and in force, and shall fix the same by order.' That statutory provision prohibits FERC from setting rates retroactively in cases governed by § 206(a)."). *See also Grand Valley Rural Power Lines, Inc., et al. v. Pub. Serv. Co. of Co.,* 141 FERC ¶ 61,019 at P 14 (2012) (explaining in cases where an investigation is initiated under a complaint pursuant to section 206 of the Federal Power Act, the statute "requires that the Commission establish a refund effective date that is no earlier than the date a complaint was filed, but no later than five months after the filing date."); *see also Seminole Elec. Coop., Inc. v. Fla. Power & Light Co.,* 65 FERC ¶ 61,413 at p. 61,139 (1993).

[25] *IDACORP Energy L.P. v. FERC*, 433 F.3d 879, 883 (D.C. Cir. 2006) ("The ban on retroactive ratemaking, however, imposes no obstacle to amending invoices; in fact, the prohibition on retroactive ratemaking may well require an amended invoice if the original invoice deviated from the tariff.") (emphasis added); *Exelon Corp. v. PPL Elec. Utils. Corp*., 114 FERC ¶ 61,298 at P 14 (2006) ("Correcting improperly billed invoices does not violate the ban on retroactive ratemaking...because it does not result in a change to a prior rate, but rather is enforcing the filed rate.").

determinations and therefore PJM did not violate its Tariff and did not act in an unjust, unreasonable, or unduly discriminatory manner.[26] The Commission found:

> In order to receive refunds or other remedies with respect to the Meadowbrook Outage, PPL had to establish that PJM violated its Tariff…. **If the Commission had found that PJM had not violated its Tariff but had otherwise acted in an unjust and unreasonable or unduly discriminatory manner, PPL Parties would have been eligible for refunds only beginning the date the Complaint was filed**.[27]

The same rule must apply in this case. This case is about mitigation exemption details not addressed in the tariff. In the Mitigation Order, the Commission provides entirely new guidance on key inputs to the Unit net CONE analysis including: (1) how the NYISO should interpret the term "embedded costs" (a term not defined in the tariff or Commission regulations); (2) when purchase decisions require the use of proxy capital costs in place of actual capital costs (a question not addressed in the tariff or any prior order related to the NYISO's market power mitigation rules); (3) what reference date to use in mitigation analyses (something the Commission called a "very significant omission" from the tariff, but which had been extensively addressed by the Commission in prior orders).[28] With regard to embedded costs, the Commission only found that it was "improper" for NYISO to exclude the costs associated with the shared facilities from the calculation of AEII's Unit net CONE) based not on the tariff, but on the "common meaning" of the term "embedded costs."[29] With regard to capital costs, the Commission found that the NYISO should use proxy capital costs because NYPA's RFP was

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[26] *PPL EnergyPlus, LLC v. PJM Interconnection, L.L.C.*, 136 FERC ¶ 61,060 (2012).

[27] *Id.* at P 19 and n.8 (emphasis added).

[28] Mitigation Order at P 81

[29] *Id.* at P 121.

discriminatory, a matter of new policy, not a test found in the tariff.[30] With regard to the going-forward date, the Commission noted that the tariff was silent on the issue, but nevertheless found the NYISO's approach unreasonable.[31] The Commission even noted, "[i]f this was intended to be in the tariff, it was a very significant omission, as such date can be crucial to whether a developer passes or fails the mitigation test."[32]

Therefore, the Mitigation Order does not find that the NYISO violated its tariff. Rather it interprets discretion-based tariff provisions, just like in *PPL*. Indeed, the Commission has expressly said details of mitigation exemptions "will obviously involve the exercise of judgment and discretion"[33] on the part of the RTO. In light of that grant of discretion and tariff silence, the Commission could not reasonably have concluded (indeed, it did not conclude) that the NYISO violated the filed rate. Moreover, the Commission's decision in *PPL* makes abundantly clear that, even if the NYISO "acted in an unjust and unreasonable or unduly discriminatory manner" the Commission is still barred from invoking retroactive remedial measures that pre-date a refund effective date.

The Commission's *PPL* decision was consistent with the long-understood operation of Section 206. In response to a complaint, the Commission's ability under FPA Section to "fix" a rate is prospective only.[34] As the D.C. Circuit described:

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30 *Id.* at P 135.

31 *Id.* at P 81.

32 *Id.*

33 *PJM Interconnection*, 137 FERC ¶ 61,145 (2011).

34 *Concord v. FERC*, 955 F.2d 67 (D.C. Cir 1992) ("Whatever the justification, it is generally agreed that with respect to the Federal Power Act, the filed rate doctrine rests on two provisions: section 205(c), which requires utilities to file rate schedules with the Commission, and section 206(a), which allows the Commission to fix rates and charges, but only prospectively. Together, these provisions prohibit "a regulated seller of [power] from collecting a rate other than the one filed with the Commission and prevent[] the Commission itself from imposing a rate increase for [power] already sold.", *citing Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. at 578.").

> Once approved, there is only one way for FERC to revisit its determination that a rate is reasonable. Section 206(a) of the FPA requires FERC, upon its own motion or the filing of a complaint, to determine whether "any rate, charge, or classification . . . observed [or] charged . . . by any public utility for any transmission or sale . . . is unjust, unreasonable, unduly discriminatory or preferential." Id. § 824e(a). FERC must remedy such a rate by "determin[ing] the just and reasonable rate, charge, [or] classification . . . to be thereafter observed and in force, and shall fix the same by order." FERC may not retroactively alter a filed rate to compensate for prior over- or underpayments.[35]

While the Commission may "take retroactive refund action to address circumstances where a seller did not charge the filed rate or violated statutory or regulatory requirements or rules in applicable rate tariffs . . . .,"[36] its retroactive remedial authority is not plenary.[37] Rather, it is an exception to the well-established prohibition against retroactive ratemaking for cases where the public utility has failed to adhere to the filed rate.[38] This foundational principle applies with equal force to RTOs, who (under the FPA) are simply public utilities charging rates.

Correcting past errors upon finding a tariff violation, which the Commission has routinely done retroactively, is a very different action than providing interpretative guidance on questions the tariff did not address at all, which is precisely what it did in this case. Indeed, the Commission has previously found, as it did in *PPL*, that a utility interpreting gaps in the filed

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35 *Exxon Mobil Corp. v. FERC*, 571 F.3d 1208 (D.C. Cir. 2009). *See also Duke Energy Hinds, LLC v. Entergy Services, Inc.*, 117 FERC ¶ 61,210 (2006) ("In other words, credits are only to be applied for transmission service taken on or after the refund effective date; to do otherwise would create a refund effective date earlier than that provided for by the FPA, as well as violate the filed rate doctrine and rule against retroactive ratemaking.").

36 *Golden Spread Elec. Coop., Inc.*, 123 FERC ¶ 61,047 at P 53 (2008).

37 *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981) ("Not only do the courts lack authority to impose a different rate than the one approved by the Commission, but the Commission itself has no power to alter a rate retroactively. When the Commission finds a rate unreasonable, it "shall determine the just and reasonable rate . . . to be *thereafter* observed and in force.") (emphasis in original).

38 *Exelon Corp. v. PPL Elec. Utils. Corp.*, 114 FERC ¶ 61,298 at P 14 (2006) ("Correcting improperly billed invoices does not violate the ban on retroactive ratemaking.").

rate is not legally equivalent to violating that filed rate and is thus not a sufficient basis for the Commission to order retroactive remedies.[39]

The reason why the Commission's tariff interpretation is not sufficient grounds for retroactive relief is that it would violate the foundational premise of the filed rate doctrine by depriving affected parties of prior notice.[40] After all, "[p]roviding the necessary predictability is the whole purpose of the well established 'filed rate' doctrine…."[41] This is why, when acting pursuant to Section 206, the Commission's refund authority is prescribed by law and limited to prospective changes only.[42] Neither the public utility at issue (here, the NYISO) nor its stakeholders had notice of a rate change or a rate re-interpretation before the complaint was filed, especially in light of the Commission's prior holding that "<u>a mitigation exemption determination once granted cannot be revoked</u>."[43] Clearly, at the time the mitigation analyses were conducted for AEII and BEC, neither the NYISO, the independent market monitor, nor any stakeholder had notice of the Commission's intention to establish new rules in the Mitigation Order. If, upon complaint, the Commission concludes (as it did here) that the tariff contains

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[39] *Golden Spread Elec. Coop., Inc*., 123 FERC ¶ 61,047 at P 53 (2008) ("The Commission may take retroactive refund action to address circumstances where a seller did not charge the filed rate or violated statutory or regulatory requirements or rules in applicable rate tariffs…. Accordingly, SPS is directed to make refunds starting with the refund effective date, January 1, 2005, and to apply the FCAC as directed herein on a prospective basis."). *See also Seminole Elec. Coop., Inc. v. Fla. Power & Light Co*., 139 FERC ¶ 61,254 at P 34 (2012) ("On the other hand, Order No. 890 is silent with respect to apportionment; the language of Schedules 4 and 9 is similarly silent and provides no guidance regarding what the Commission intended regarding apportionment. Consequently, we conclude that FPL's reading of Schedule 4 is not unreasonable. Therefore, we find that FPL did not violate Schedule 4 of its OATT by levying imbalance charges on a single imbalance in the highest applicable tier.").

[40] As the District of Columbia Circuit has held, "[n]otice to affected parties, we have explained, 'changes what would be purely retroactive ratemaking into a functionally prospective process by placing the relevant audience on notice at the outset that the rates being promulgated are provisional only and subject to later revision.'" *NSTAR Elec. & Gas Corp. v. FERC*, 481 F.3d 794, 801 (D.C. Cir. 2007) (*citing Consolidated Edison Co. of N.Y. v. FERC*, 347 F.3d 964, 969 (D.C. Cir. 2003)).

[41] *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 493 (D.C. Cir. 1985).

[42] *See* 16 U.S.C. § 824e(a) (2006).

[43] *New York Independent System Operator, Inc.* 136 FERC ¶ 61,077 at P 20 (2011) (emphasis added).

insufficient detail on key points, its recourse was to find the existing rate unjust and unreasonable, and order the NYISO to modify its tariff, to be effective as of a properly-established refund effective date.

In sum, the Commission should not have ordered the NYISO to re-do the MET for AEII because it long pre-dated the date of the complaint.

2. The Commission Erred in Disregarding the Objective Determinations of the NYISO and Its Independent Market Monitor

ISO/RTO institutions exist precisely for the reasons illustrated by this case – to independently manage wholesale markets and transmission systems so that incumbent suppliers and transmission owners cannot use their institutional positions (and the threat of burdensome litigation) to exclude competitors and forestall new entry. Instead of relying on these institutions, the Commission erred by substituting its judgment for that of the NYISO and its independent market monitor on issues that fell appropriately within the range of an ISO/RTO's discretion.

Indeed, the Commission's action in this matter is contrary to its prior statements regarding the role and function of the ISO/RTOs. In the context of this very question in PJM – how to conduct capacity mitigation determinations – the Commission recently emphasized the need for ISO/RTOs to exercise reasonable discretion:

> Protesters argue that the proposed tariff changes grant PJM and/or the IMM too much discretion in assessing whether "competitive cost advantages" are legitimate and determining whether there are "irregular or anomalous" cost advantages or sources of revenue that "do not reflect arm's-length transactions, or that are not in ordinary course of [business]." **Decisions based on these considerations will obviously involve the exercise of judgment and discretion on the part of the IMM and PJM**.[44]

[44] 137 FERC ¶ 61,145 (2011) ("*PJM*").

The Commission has also explicitly stated that "each RTO and ISO is responsible for administrating and otherwise overseeing its markets, and as such, we expect each RTO and ISO to exercise its reasonable discretion" in interpreting and applying its tariff provisions.[45] This sentiment has been reiterated by the Commission on several occasions.[46]

The Commission has held that the discretion granted to ISO/RTOs is particularly applicable where there is an absence of prescriptive tariff detail.[47] In this case, the Commission departed from this policy and substituted its own interpretation of the Market Services Tariff for the reasonable, fair and unbiased interpretation that was applied by the NYISO and its independent market monitor.

In light of the Commission's precedent and its reliance on ISO/RTOs to ensure that rates remain just and reasonable, the Mitigation Order's lack of deference to the independence of the NYISO and its independent market monitor is troubling and introduces considerable uncertainty into future such determinations. The Commission should grant rehearing and respect the

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[45] *New York Independent System Operator, Inc.*, 136 FERC ¶ 61,193 at P 54 (2011); *reh'g denied, PJM Interconnection, L.L.C., et al.*, 138 FERC ¶ 61,182 (2012).

[46] *See, e.g., ISO New Eng. Inc.*, 140 FERC ¶ 61,088 at P 30 (2012) ("The Commission agrees with ISO-NE that the proposed Tariff Revisions <u>provide a reasonable level of discretion</u> regarding which one-year de-list bids are included in the Needs Assessments, while providing for appropriate release and evaluation of information."); *PJM Interconnection, L.L.C.*, 139 FERC ¶ 61,183 ("While the Commission in Order No. 2000 delineates some of the general responsibilities of an RTO, <u>it leaves "to the discretion of the region to decide on the combination of direct and functional control that works best for its circumstances."</u>"); *Jeffers South, LLC*, 139 FERC ¶ 63,002 ("<u>Midwest ISO's Tariff affords it a measure of discretion</u> under its tariff when determining facilities needed to interconnect a generator. The choice does not have to be "least cost" alternative, but does have to be reasonable.") (emphasis added).

[47] *See, e.g., New York Independent System Operator, Inc.*, 136 FERC ¶ 61,193 at P 54 (2011); *reh'g denied, PJM Interconnection, L.L.C., et al.*, 138 FERC ¶ 61,182 (2012) ("In this regard, each RTO and ISO is responsible for administrating and otherwise overseeing its markets, and as such, we expect each RTO and ISO to exercise its reasonable discretion in deciding in what circumstances to seek additional collateral, and when it need not do so. The Commission declines to limit an RTO's or ISO's exercise of such discretion and so we will not require each RTO and ISO to modify its proposed tariff revisions to expressly require that it must consider the totality of the circumstances in determining whether a material adverse change has occurred.").

reasonable interpretation and implementation of the NYISO on the very question this Commission said the NYISO should be vested with such discretion.[48]

3. The Mitigation Order Failed to Address Significant Customer Impacts

Perhaps the paramount legal flaw of the Mitigation Order is its failure to consider the impact on the Commission's primary constituency – customers. Under the FPA, the "Commission must ensure that rates are just and reasonable. The courts have long held that establishing just and reasonable rates involves a balancing of consumer and investor interests."[49] The Commission must acknowledge customer interests and balance them against competing interests. The Mitigation Order does neither.

The record in this case put the Commission on notice that the effect of unwarranted mitigation of AEII would be to cause NYPA's Governmental Customers to purchase that same amount of capacity in the NYISO's spot capacity market, even though they already bought capacity from AEII.[50] This would result in an unnecessary double-charge, estimated by the New York Parties at the time to be approximately $60 million annually.[51] The Mitigation Order makes no reference, analysis, or any attempt to address the customer impact concerns raised by the New York Parties in their protest to the complaint. In fact, the word "customer" occurs only twice in the Mitigation Order, once when quoting the Pre-Amendment Rules mitigation exemption test, and once when listing the Governmental Customers on the list of case

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48 The New York Parties extensively briefed this issue. *See* New York Parties Protest at pp. 8-10. The Commission's failure to address the New York Parties' arguments also constitutes reversible error.

49 *New York Independent System Operator, Inc*., 122 FERC ¶ 61,211 at P 103 (2008). *See also Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989).

50 *See* New York Parties Protest at pp. 31-32; *see also Astoria Generating Company L.P. and TC Ravenswood, LLC v. New York Independent System Operator, Inc.,* Docket No. EL11-50-000, "Motion for Leave to Answer and Answer of NYPA and the City of New York" at p. 28, dated October 11, 2011 ("October 11 Answer").

51 *Id.*

participants.[52] In order for the Mitigation Order to be a justified exercise of this Commission's authority, it must articulate and defend a decision that it is just and reasonable to force the Governmental Customers to pay twice for capacity.

Putting aside the policy implications of failing to consider customer impacts, it is well established that the Commission must address all significant issues presented to it. First, the Administrative Procedure Act ("APA"), "which governs the proceedings of administrative agencies and related judicial review, establishes a scheme of 'reasoned decision-making'"[53] requires "[t]he Commission [to] … respond *meaningfully* to the arguments raised before it."[54] As such, the Commission may not ignore important arguments, or otherwise fail to offer an adequate explanation for a particular decision.[55] Instead, the Commission must provide a meaningful response to the issues raised by a party; failure to do so renders its decision arbitrary and capricious.[56] Second, and more fundamentally, the Mitigation Order is inconsistent with the Commission's core statutory responsibility to protect customers. Specifically, a cornerstone of the FPA is that the Commission ensures that rates are just and reasonable and that the

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52 Mitigation Order at PP 3, 20 (2012).

53 *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, at 374 (1998) (citation omitted); *see also Motor Vehicle Mfrs. Assn. v. State Farm Mutual Auto Ins. Co.*, 463 U.S. 29, 43 (1983); *Panhandle Eastern Pipe Line Co. v. FERC*, 890 F.2d 435, 440 (D.C. Cir. 1989).

54 *Pub. Serv. Comm'n of Kentucky*, 397 F.3d 1004, 1008 (D.C. Cir. 2005) (emphasis added); *see also, e.g., Laclede Gas Co. v. FERC*, 997 F.2d 936, 948 (D.C. Cir. 1993) (requiring FERC to provide adequate explanation). In reviewing the Commission's orders, a court must "consider whether the decision was based on a consideration of the relevant factors." *Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285 (1974).

55 *See, e.g., Laclede Gas*, 997 F.2d at 945-48; *North Carolina Util. Comm'n v. FERC*, 42 F.3d 659, 666 (D.C. Cir. 1994) (finding that an agency's failure to engage the arguments raised before it warrants review).

56 *Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001). An agency decision which is not reasoned persuades no more than it controls; reasoned decision-making considers "relevant factors" and explains the "'facts and policy concerns.'" *American Horse Protection Ass'n v. Lyng*, 812 F.2d 1, 5 (D.C. Cir. 1987).

Commission protects customers.[57] In fact, Supreme Court precedent has held for over fifty years that one of the Commission's primary responsibilities is to "afford consumers a complete, permanent, and effective bond of protection from excessive rates and charges."[58] Indeed, customers are the Commission's "prime constituency."[59] As such, the Commission is required "to examine the cost-shifting effect of its orders."[60] The Mitigation Order lacks an adequate legal foundation if it "fail[s] to make findings as to the impact the [order] would actually have on ultimate consumers."[61]

Here, the Mitigation Order does not address customer impacts or respond to those issues raised by the New York Parties. As such, the Mitigation Order fails to constitute reasoned decision-making,[62] which requires that the Commission grant rehearing. Beyond the immediate cost impacts of the order, the Mitigation Order does not adequately consider the future impacts on customers. The costs of erecting a significant barrier to entry in the nation's largest load pocket will be felt by customers for years to come and was not taken into account in the Mitigation Order.

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[57] *See Pa. Water & Power Co. v. Fed. Power Comm'n*, 343 U.S. 414, 418 (1952) ("A major purpose of the whole [Federal Power] Act is to protect power consumers against excessive prices."); *California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1017 (9th Cir. 2004) (describing "protecting consumers" as the FPA's "primary purpose").

[58] *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959).

[59] *Maryland People's Counsel v. FERC*, 761 F.2d 780, 781 (D.C. Cir. 1985).

[60] *Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305, 1315 (D.C. Cir. 1991).

[61] *Id*. (second alteration in original).

[62] *See Tarpon Transmission Co. v. FERC*, 860 F.2d 439, 445 (D.C. Cir 1988); *City of Charlottesville v. FERC*, 661 F.2d 945, 950 (D.C. Cir. 1981); *Moraine Pipeline Co. v. FERC*, 906 F.2d 5, 9 (D.C. Cir. 1990).

4. The Mitigation Order Amounts to Unlawful and Unsupported Prudence Determination

The Commission erred in the Mitigation Order by making a prudence-based disallowance without holding itself to long-held prudence review standards for utility regulators. To support its decision, the Commission questions, and finds imprudent, AEII's decision to go-forward with the project and suggests it should have cancelled the project after signing the PPA: "We would expect that a prudent developer contemplating the expenditure of over a billion dollars to build a plant would periodically re-evaluate the economics of its potential investment."[63] This statement ignores the realities of developing long-life assets, and is contradicted by the Commission's own bedrock principles of the prudence standard it invokes.

The U.S. Supreme Court has held that under the prudent investment rule, "a utility is compensated for all prudent investments at their actual cost when made… irrespective of whether individual investments are deemed necessary or beneficial in hindsight."[64] The Commission has further stated that management decisions are "not considered on the basis of 20/20 hindsight" and that prudence of the utility's actions and resulting costs are "reviewed in light of all circumstances existing at the time the challenged costs were actually incurred or at the time the utility became committed to incur those expenses."[65] The Commission's standard for reviewing prudency is "based on the 'reasonable person' test and is well established:

> [M]anagers of a utility have broad discretion in conducting their business affairs and in incurring costs necessary to provide services to their customers. In performing our duty to determine the prudence of specific costs, the appropriate test to be used is

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63 Mitigation Order at n.87.

64 *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989).

65 *Yankee Atomic Electric Co.*, 65 FERC ¶ 63,001 at p. 65,003 (1993), *aff'd in pertinent part* 67 FERC ¶ 61,318 (1994), *citing New England Power Co.*, 31 FERC ¶ 61,047 at p. 61,084 (1985), *aff'd sub nom. Violet v. FERC*, 800 F.2d 280 (1st Cir. 1986).

> whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that, while in hindsight it may be clear that a management decision was wrong, our task is to review the prudence of the utility's actions and costs resulting there from based on the particular circumstances existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses.[66]

The Commission has explained further that "risks are inherent in business and imprudence is based not on the mere presence of risks but on the failure to carefully evaluate the risks and weigh them against the potential benefits."[67] Generally, utility management is presumed to have acted prudently.[68]

In this case however, the Commission ignores this presumption and the prudence standard generally and substitutes information that is available only now, or at least at a time long after the key investment decisions were made. It orders the NYISO to assume 2010 market price data for a project for which: (i) a binding PPA was executed in 2008; (ii) financing was secured in 2009; (iii) equipment purchase orders were made in 2008 and 2009; (iv) construction contracts were let and executed in 2008 and 2009; and (v) construction started in 2009. In essence, the Commission has engaged in exactly the type of 20/20 hindsight regulation that the Supreme Court has long found unlawful.

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66 *Columbia Gas Transmission, LLC*, 138 FERC ¶ 61,044 (2012), citing *New England Power Co*., Opinion No. 231, 31 FERC ¶ 61,047, at p. 61,084 (1985).

67 *Kentucky Utilities Co*., 62 FERC ¶ 61,097 at p. 61,698 (1993).

68 *Entergy Services, Inc*., Initial Decision, 124 FERC ¶ 63,026 (2008), *aff'd in relevant part*, 130 FERC ¶ 61,023 (2010), *citing, inter alia, West Ohio Gas Co. v. Public Utilities v. Commission of Ohio*, 294 U.S. 63, 73, 55 S. Ct. 316 (1935); *Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Commission*, 262 U.S. 276 (1923); *Yankee Atomic Electric Co.*, 65 FERC ¶ 63,001 at p. 65,003 (1993), *aff'd in pertinent part* 67 FERC ¶ 61,318 (1994).

C. The Commission Erred In Its Mitigation Determination For Astoria Energy II

1. The Commission Erred In Holding That The NYISO Could Not Render Its Mitigation Exemption Determinations Prior To Completing The Cost Allocation Process For The 2009 And 2010 Class Years

In 2010, the NYISO rendered mitigation exemption determinations for AEII and the Bayonne Energy Center ("BEC") pursuant to Attachment H of its Market Services Tariff as it existed prior to being revised as of November 27, 2010. Section 23.4.5.7.2 of the Attachment H provided that:

> The ISO shall inform the requesting entity whether the exemption specified in (b) above is applicable ***as soon as practicable after completion of the relevant Project Cost Allocation or Revised Project Cost Allocation***, in accordance with methods and procedures specified in ISO Procedures. [emphasis added].

In the Mitigation Order, the Commission held that under this tariff provision, the NYISO could have made its mitigation exemption determinations for AEII and BEC only after the conclusion of the cost allocation process for class year 2009 and 2010 projects, which occurred in November 2011.[69] This determination was incorrect because it was based on a misreading and misinterpretation of Section 23.4.5.7.2. To demonstrate this point, a review of the genesis of the tariff provision, and the Commission's consideration of it, follows.

On October 4, 2007, the NYISO submitted a conceptual structure to the Commission for a new entrant mitigation test. It described the MET as follows:

> The units will be exempted from mitigation if the NYISO determines that ***at the time for which the investor is committing to the investment*** (*e.g.,* three years in advance) that near-term capacity price levels, post-entry, are forecasted to be greater than

[69] Mitigation Order at P 63.

> 75% of net CONE in the area where the new unit is proposed. [emphasis added][70]

In support of this proposal, the NYISO submitted an affidavit of Dr. David Patton, its then-Independent Market Advisor. Dr. Patton explained:

> It is important to recognize that an investor might expect a new unit to be economical at the time the investor commits resources three years in advance of entering the market. Therefore, I propose that units be exempted from mitigation if the NYISO determines that ***at the time for which the investor is committing to the investment*** that near-term spot market-clearing prices, post-entry, are forecasted to be greater than 75 percent of CONE in the area where the new unit is proposed. The evaluation of whether or not the new entrant would be economic should be conducted ***before the developer commits to go forward with the project and accepts its cost allocation*** from the facilities study and makes a security deposit in the interconnection process. [emphasis added][71]

The NYISO generally referred to this proposal as an "*ex ante*," or "before the fact," test.[72] Whether viewed individually or collectively, these pleadings clearly demonstrate that the *ex ante* test was to occur as of the time the developer decided to proceed with its project, not at some later date. Moreover, Dr. Patton's statement is clear that the *ex ante* test was to be completed <u>before</u> the cost allocation process was completed so that the developer would be in a best position to decide whether to proceed and make the financial commitments required at the end of the interconnection process.

In approving this proposal, the Commission stated:

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[70] *New York Independent System Operator, Inc.*, Docket No. EL07-39-000, "Compliance Filing of the New York Independent System Operator, Inc. Regarding the New York City ICAP Market Structure," dated October 4, 2007, p. 30.

[71] *Id.*, Attachment 1 – Affidavit of Dr. David B. Patton, sworn to on October 4, 2007, ¶ 70.

[72] *New York Independent System Operator, Inc.*, 131 FERC ¶ 61,170 at P 2 (2010) ("NYISO proposed an ex ante offer cap and a must-offer provision to implement mitigation for withholding by large, Pivotal ICAP Suppliers, and an ex ante offer floor for uneconomic new entry to implement in-City buyer mitigation.").

> To ensure the mitigation rules do not deter economic entry, the Commission agrees that units should be exempted when their decision to enter was based on price signals the market sent indicating that entry was needed…. **Such new capacity should not be penalized after-the-fact for a decision to build that was economically rational at the time the decision was made.** If the actual capacity price in a year is below seventy-five percent of net CONE and differs from the forecast of higher capacity prices for that year made **at the time the decision to build the new capacity was made, the owner of the new capacity should not be penalized** because it (and NYISO) did not correctly estimate that demand…. To do otherwise would be a penalty that could deter economic entry. [emphasis added][73]

In short, the Commission fully endorsed the concept of a test performed as of the time the developer decided to proceed, rather than as of some later date.

In compliance with that order, the NYISO filed tariff amendments to implement the new entrant mitigation rules and the *ex ante* mitigation exemption test. The NYISO explained the *ex ante* test, found in Section 4.5(g)(ii) of Attachment H (later renumbered as Section 23.4.5.7.2) as follows:

> Section 4.5(g)(ii) obligates the NYISO to make the necessary projections and other determinations, if the developer fulfills its obligation to provide the necessary information to the NYISO, in time for the developer to be able to take into account the mitigation status of its project before committing to go forward with it. As indicated in the proposed language, for new units **this decision would be made in an Initial Decision Period or Subsequent Decision Period in the OATT interconnection process**. This is the point in the interconnection process at which a project would be beyond the mere planning stage, and beyond which a developer would have to make a significant financial commitment to continue with a project. [emphasis added][74]

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[73] *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,211 at P 117 (2008) (emphasis added).

[74] *New York Independent System Operator, Inc.*, Docket No. ER08-695-003, "Second tariff Compliance Filing of and Request for Waiver of the New York Independent System Operator, Inc. Implementing New York City ICAP Market Mitigation Measures," dated May 6, 2008, pp. 8-9 (emphasis added).

There can be no doubt that the tariff provision referenced above, which is the exact same tariff provision discussed in Section IV.B.1 of the Mitigation Order, provided for the *ex ante* mitigation exemption determination to be made during, not at the end of, the interconnection cost allocation process. In fact, no party challenged the timing of this determination, and the Commission accepted it as proposed.[75]

Finally, it is important to focus on the tariff's use of defined terms because the words used have very specific meanings. The provision provides that the *ex ante* mitigation exemption determination would be made upon completion of the "Project Cost Allocation or Revised Project Cost Allocation;" significantly, it does <u>not</u> provide that the determination would be made at the end of the Interconnection Facilities Study described in OATT Attachment X, which incorporates the cost allocation rules in OATT Attachment S. Indeed, Section 25.1.2 of OATT Attachment S defines the two terms as follows:

> **Project Cost Allocation:** The dollar figure estimate for a Developer's share of the cost of the System Upgrade Facilities required for the reliable interconnection of its project to the transmission system and/or the share of the cost of the System Deliverability Upgrades required for the Developer's project to meet the NYISO Deliverability Interconnection Standard.
>
> **Revised Project Cost Allocation:** The revised dollar figure cost **estimate** and related information provided by the NYISO to a Developer following receipt by the NYISO of a Non-Acceptance Notice, or upon the occurrence of a Security Posting Default by another member of the respective Class Year. [emphasis added]

According to both Section 23.4.5.7.2 of Market Services Tariff Attachment H and Section 25.8 of OATT Attachment S, Project Cost Allocations and Revised Project Cost Allocations are

75 *New York Independent System Operator, Inc.*, 124 FERC ¶ 61,301 at P 1 and Ordering Clause (C) (2008), (the condition on the Commission's approval of the NYISO's tariff filing pertained to exports, not this issue).

prepared (*i.e.*, completed) and provided to class year members during the cost allocation process, not at the end of the process (in fact, long before the end of the process).

The foregoing documents, and the plain language of Section 4.5(g)(ii)/23.4.5.7.2 highlighted above, demonstrate that the Commission's new interpretation of this tariff section in the Mitigation Order is incorrect. First, the Commission conflated the completion of the Project Cost Allocation with the completion of Interconnection Facilities Study and its cost allocation process.[76] They are two very different points in the interconnection process. In the Mitigation Order, the Commission stated:

> Attachment S in effect at the time of the NYISO exemption determinations at issue here provided that the "completion" of the interconnection cost allocation ***process*** occurs either when none of the remaining projects gives notice of non-acceptance of their cost allocation or all developers have dropped out. [emphasis added][77]

However, Section 23.4.5.7.2 does not provide for the determination to be made at the completion of the "process." it provides for the determination to be made after completion of the Project Cost Allocation (or Revised Project Cost Allocation, as appropriate).

Second the Commission tried to backstop its reading of the tariff provision by asserting that its interpretation was reasonable because the net Cost of New Entry for a unit ("Unit net CONE") cannot be fully calculated until the interconnection costs for the unit are known.[78] While the Commission is correct that the final amounts will not be known until the end of the Interconnection Facilities Study and its cost allocation process, the tariff does not call for the exemption determination to be made based on the final amounts. As shown above, by definition,

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76 *Id.* at PP 61, 63.

77 *Id.* at P 61.

78 *Id.* at P 62.

Project Cost Allocations and Revised Project Cost Allocations are "<u>estimates,</u>" and the tariff requires only that the determination be made once those estimates are completed.

Third, from October 2007 to November 27, 2010, it was crystal clear to everyone – market participants, market observers, developers, the public, the NYISO, and even the Commission – that the new entrant mitigation exemption test would be performed *ex ante* – before the Interconnection Facilities Study and cost allocation process was completed – so that developers would know whether they would be able to participate in the NYISO's capacity markets prior to making a security deposit or otherwise committing to their allocated shares of system upgrade facility and system deliverability upgrade costs. The Commission's new and different interpretation of this five-year old provision is inconsistent with the very premise underlying the timing of the determination and with its prior treatment of this tariff provision.[79]

Fourth, in the Mitigation Order, the Commission asserts that "granting a waiver of the exemption determination timeline in this instance is consistent with our ruling in the August 2, 2011 Order" in Docket No. ER10-3043, where it stated that "the initial exemption determination or redetermination <u>occurs prior to when the project accepts its cost allocation and enters the capacity market</u>."[80] The language the Commission cited, <u>and emphasized</u>, from the August 2, 2011 Order further demonstrates that the Commission's new interpretation of Section 23.4.5.7.2 is erroneous. The cited language carries forward the exact same concept as existed under the prior tariff provision – that the exemption determination should be made before the end of the cost allocation process. Indeed, the cited language was discussing statements in Dr. Patton's

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[79] It is well-settled that when the Commission deviates from its precedent, such as it has done here, it must state that it is changing its policy and it must provide a reasoned explanation for the change. The failure to do so renders the deviation arbitrary and capricious. *See, e.g., Algonquin Gas Trans. Co. v. FERC*, 948 F.2d 1305, 1315-1316 (D.C. Cir. 1991).

[80] *New York Independent System Operator, Inc.*, 136 FERC ¶ 61,077 at P 65 (2011) (emphasis in order).

Affidavit from 2007, in which he was describing the concept of the new entrant mitigation exemption determination (which, as discussed above, led to the adoption of Section 4.5(g)(ii)/23.4.5.7.2). Accordingly, under the cited language, the NYISO's and its independent market monitor's original interpretation of Section 23.4.5.7.2 was correct; there was no tariff violation, and thus, no need for a tariff waiver.

2. The Commission Erred in Mandating an Analysis Reference Date for AEII that is Long After the Decision Was Made to Proceed with the Project

In their Protest to the underlying complaint, the New York Parties provided extensive information regarding the need and rationale for entering into a PPA with AEII and moving forward with that project.[81] The New York Parties also provided uncontroverted evidence that, at the time the RFP was issued and AEII was selected, the future looked very different than it does today, and there was an identified and credible need for new capacity in New York City in the then-near future (*i.e.*, 2011-2012).[82] However, in the Mitigation Order, the Commission ignored all of this undisputed information.

The Commission's finding on this point also reverses its own precedent. When it first adopted new entrant market power mitigation rules in 2008, the Commission readily acknowledged that market conditions change over time, and a developer "should not be penalized after-the-fact for a decision to build that was economically rational at the time the decision was made."[83] When it reconsidered the new entrant market power mitigation rules in 2010, the Commission affirmed this perspective, stating:

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[81] New York Parties Protest at pp. 7-15.

[82] The evidence cited included the NYISO's 2005 and 2007 Comprehensive Reliability Plans and its 2008 Reliability Needs Assessment.

[83] *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,211 at P 117 (2008).

> It is reasonable for NYISO to provide an exemption test before a supplier begins construction of a new resource, as NYISO's tariff currently provides, and to apply such a test to all new entrants. An entity whose resource is forecast to be economic at the time its construction begins is not attempting to artificially depress market prices through uneconomic entry. Thus, **it would not be reasonable to impose an offer floor on such a resource that prevented it from clearing in the capacity auction if market conditions unexpectedly worsened by the time that construction is completed**.[84]

In the Mitigation Order, however, the Commission entirely disregarded this precedent.[85] Instead, the Commission held that the determination should have been made "based on the most up-to-date data information available during the period when NYISO was evaluating the request to exempt Astoria II … from offer floor mitigation, i.e., during 2010."[86] The Commission also held that there was no tariff basis for the NYISO's decision to base the mitigation exemption determination for AEII on the project's going forward date.[87]

Here, the Commission's findings are at odds with its prior decisions on the very same issue, and the Commission failed to explain why its prior decisions were no longer valid or why it was changing its interpretation of the same tariff provisions. Indeed, the Commission's prior holding that the mitigation decision should be made prior to the time a developer commences construction cannot reasonably be reconciled with the Mitigation Order's holding that the

84 *New York Independent System Operator, Inc.*, 133 FERC ¶ 61,178 at P 71 (2010) (emphasis added).

85 When an administrative agency decides to deviate from its precedent, it must provide a "reasoned analysis indicating the prior policies and standards are being deliberately changed, not casually ignored." *Greater Boston Television Corp. v. Fed. Comm. Comm'n.*, 44 F.2d 841, 852 (D..C. Cir. 1970); *see also Atchison, Topeka & Santa Fe Ry. Co. v. Wichita Bd. Of Trade*, 412 U.S. 800, 808 (1973) ("Whatever the ground for the departure from prior norms, however, it must be clearly set forth …"); *Entergy Services, Inc. v. Fed,. Energy Reg. Comm'n.*, 319 F.3d 536, 541 (D.C. Cir. 2003); *Michigan Consol. Gas Co. v. Fed,. Energy Reg. Comm'n.*, 883 F.2d 117, 122 (D.C. Cir. 1989), *cert. denied*, 494 U.S. 1079 (1989).

86 Mitigation Order at P 78.

87 *Id.* at P 81.

mitigation decision should be made when the request for mitigation analysis is made to the NYISO, irrespective of when constructed commenced.

Moreover, the Commission was incorrect when it claimed that no party provided a tariff-based basis for rendering the mitigation exemption determination based on AEII's going forward date. The basis for the NYISO's going-forward date determination is Attachment H to the Market Services Tariff, which the New York Parties referenced in their August 3, 2011 Protest in this proceeding (pages 35-38 and Appendix C). Attachment H generally was the exact same basis upon which the Commission itself held in 2008 that "[t]o ensure the mitigation rules do not deter economic entry, the Commission agrees that units should be exempted when their decision to enter was based on price signals the market sent indicating that entry was needed…. If the actual capacity price in a year … differs from the forecast of higher capacity prices for that year *made at the time the decision to build the new capacity was made*, the owner of the new capacity should not be penalized because it (and NYISO) did not correctly estimate that demand."[88]

In 2010, when the NYISO proposed revisions to Attachment H, certain market participants, including the Complainants in this proceeding, protested the filing. In rejecting the position of the Complainants and others there, the Commission stated: "It is reasonable for NYISO to provide an exemption test before a supplier begins construction of a new resource, ***as NYISO's tariff currently provides***…."[89] Thus, the Commission's assertion in the Mitigation Order that the "NYISO's approach is not consistent with the Pre-Amendment NYISO tariff"[90] is contrary to the Commission's own interpretation of the version of Attachment H at issue in this

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88 *New York Independent System Operator, Inc.*, 122 FERC ¶ 61,211 at P 117 (2008) (emphasis added).

89 *New York Independent System Operator, Inc.*, 133 FERC ¶ 61,178 at P 71 (2010) (emphasis added).

90 Mitigation Order at P 81.

matter. Moreover, the Commission's holding, as well as the submissions to the Commission in that proceeding – as described by the Commission in its order – demonstrate that all parties with an interest in this topic interpreted and understood Attachment H as providing for the mitigation exemption determination to be made as of the date the developer decided to proceed with its project.

The Commission also erred in finding that "[i]t is entirely feasible that a developer would construct a generating unit primarily for the purposes of providing energy … rather than capacity."[91] There is simply nothing in the record to support this finding. Indeed, AEII was developed and financed around a long-term PPA with NYPA. To suggest that AEII, a baseload facility, could have intended to act solely as an energy resource or that NYPA might not have intended to seek capacity treatment for a long-term resource in its portfolio has no basis in the record of this case.

3. The Commission Erred in Including Sunk Costs in Unit Net CONE

The Commission erred by finding that NYISO improperly excluded the costs associated with shared facilities from calculation of AEII's Unit net CONE.[92] The Mitigation Order found that, regardless of whether the costs of AEII's shared facilities are appropriately considered sunk costs, they should be included in the Unit net CONE analysis as "localized embedded costs" under Section 23.4.5.7.2 of Attachment H. The Mitigation Order errs on this point by adopting arbitrary and out of context internet-based definitions of tariff terms as sufficient controlling authority to negate the independent expert analysis of the NYISO, its independent market monitor, and its consultants (NERA Economic Consulting and Sargent & Lundy ("S&L")).

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[91] *Id.* at P 81.

[92] *Id.* at P 121.

In conducting the mitigation analysis for AEII, the NYISO excluded from AEII's Unit net CONE the costs of certain facilities it shared with Astoria Energy I, LLC ("AEI") because "the costs incurred by Astoria I to construct the shared facilities were sunk when Astoria II's investors decided to go forward with the project."[93] The NYISO's decision to treat costs associated with shared facilities between AEII and AEI as "sunk costs" was appropriate and consistent with the advice of its outside consultants and experts, including the independent market monitor. In their October 11, 2011 Answer,[94] and accompanying testimony by Dr. Mathew J. Morey, the New York Parties argued that shared facilities[95] between AEII and AEI were properly excluded from Unit net CONE for AEII.[96] The New York Parties pointed to testimony by Dr. Patton, who recommended to the NYISO that sunk costs be excluded from the mitigation exemption determination, as they are "not germane to an investor's decision to move forward with a project" and therefore "should not be part of a determination of whether a project would be expected to be economic."[97] Dr. Patton indicated that the application of the MET could improperly result in mitigation of an economic project if it included sunk costs.[98] In this case, AEI had already invested in shared facilities prior to 2008 while anticipating construction of the second power block on the site.[99]

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93 *Id.* at P 112.

94 October 11 Answer at pp. 19-22

95 AEII paid AEI for purchase of certain shared facilities. AEII will be sharing facilities such as land, electrical interconnect, NYISO system upgrade, gas pipeline interconnect, preconstruction development/permitting, demolition, and other costs. These costs were incurred before July 2008. October 11 Answer at p. 21, n. 45.

96 *Id.* at p. 18.

97 *Id., citing Astoria Generating Company L.P. and TC Ravenswood, LLC v. New York Independent System Operator, Inc.,* Docket No. EL11-50-000, Confidential Supplemental Answer of the New York Independent System Operator, Inc., ("NYISO Supp. Answer"), Confidential Affidavit of Dr. David B. Patton, dated Sept. 8, 2011 at ¶ 26 ("Patton Aff.").

98 *Id.*

99 October 11 Answer at p. 21.

The Commission reversed the NYISO's determination and found that the costs of shared facilities should have been included in, and thus increased, AEII's Unit net CONE, making mitigation more likely. In its Mitigation Order, the Commission interpreted the term "embedded costs" to include "all costs that have been incurred in the past, whether or not the associated assets have any opportunity costs of market value."[100] The Commission concluded that because the developers of AEII paid for the use of the shared facilities, the amount paid should be included in AEII's Unit net CONE.[101]

The Mitigation Order erred on this point because it reverses the independent judgment of the NYISO and its independent market monitor and instead relies upon broad, web-site definitions of economic terms. The term "embedded costs" is not defined in the NYISO's tariffs. The independent experts at the NYISO and its independent market monitor who interpreted Section 23.4.5.7.2 in the context of performing the MET reasonably concluded that embedded costs should exclude sunk costs. Dr. Patton explained that when an investor "commits to move forward with an investment project, costs incurred prior to the decision cannot be recouped (these costs are generally referred to as "sunk costs"). A rational investor excludes such costs from its assessment of whether an investment is profitable."[102] This testimony is consistent with that of Dr. Morey, who argued that AEI secured facility and operating permits "long before" AEII was created and the AEII Project launched.[103] Further, he argued the common equity ownership and joint occupancy of the facilities would not have accommodated an independent

100 Mitigation Order at P 121.

101 *Id.*

102 *Id.* at p. 18, *citing* Patton Aff. at ¶ 26.

103 October 11 Answer, First Supplemental Affidavit of Dr. Mathew J. Morey on Behalf of the New York Power Authority and the City of New York, at p. 3 ("Morey Supp. Aff.").

generation developer and made it "virtually impossible" for rights to those joint facilities and permits to be recovered through a sale to a third party.[104]

The Commission did not dispute that the shared facilities costs were in fact sunk costs, and that sunk costs as a matter of economics are generally excluded from suppliers' going-forward decision making. Rather, the Commission determined that the only relevant question was whether these costs were appropriately considered "embedded" costs such that they be included in Unit net CONE. The Commission reversed the NYISO's decision to exclude the sunk costs associated with the shared facilities solely on its interpretation of the "common meaning" of embedded costs as "those that have been incurred in the past, whether or not the associated assets have any opportunity costs or market value."[105]

The basis of the Commission's "common meaning," as set forth in the Mitigation Order was apparently an internet search of the term.[106] However, the Commission did not explain how the internet search results are more appropriate than the determinations of the NYISO and its independent market monitor. Further, there is no support for the Commission's conclusion that generic internet definitions constitute controlling authority for either a "common meaning" of the term embedded costs or its meaning as used in the electric industry and in this particular application.

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104 *Id.*

105 *Id.* at P 121.

106 *Id.* at P 121, n. 153. The Commission did not support the notion that "EnergyVortex.com" or "UtilityRegulation.com" are commonly used in the electric industry (the New York Parties suggest they are not) or otherwise amount to persuasive authority for the "common meaning" of embedded costs. Indeed, the Utilityregulation.com definition was offered in the context of an essay concerning telecommunications issues, not mitigation determinations for electric generating facilities, making the application of that definition in this context highly questionable.

In sum, including sunk costs in the Unit net CONE calculation is inappropriate because no reasonable investor would have considered them when making a going-forward decision. The inclusion of these costs is not pertinent to the purpose of the buyer-side mitigation rules – to protect against uneconomic entry. The Commission's decision, which lacks any stated basis in economics, market theory, Commission precedent, or tariff history is therefore arbitrary and capricious.

4. The Commission Erred in Ordering the NYISO to Adopt a Proxy Cost of Capital, and Departed From Precedent in Doing So

In the Mitigation Order, the Commission found that the NYISO should have used a proxy capital cost profile for AEII in its calculation of the Unit net CONE for the MET. The Commission's decision to impose proxy capital costs was based on legally and factually incorrect conclusions about NYPA's RFP, which conclusions were, in any case, irrelevant to AEII's financing terms. Moreover, the Commission drastically departed from the very precedent it cites as support for its decision.

The unit-specific exemption test aspect of the mitigation exemption determination "examines whether a generator's expected capacity revenues would exceed ***its net costs*** during the generator's first three years of operation."[107] In other words, the test relies on inputs that are specific to the generator, as compared to generalized assumptions underlying the Mitigation net CONE and the development of the costs of the proxy peaking unit in the demand curve process – assumptions that could be far different from the actual facts and figures. Inasmuch as the purpose of the new entrant mitigation rules was solely and specifically to check for uneconomic entry on a unit-specific basis, the Commission's decision to ignore AEII's actual economics

[107] Mitigation Order at n. 30 (emphasis added).

defeats this purpose and converts the new entrant mitigation rules into nothing more than a barrier to entry. Here, in accordance with the Section 23.4.5.7.2, the NYISO used AEII's actual cost of capital to derive its expected net CONE, a decision endorsed by the independent market monitor. The Commission reversed the NYISO and its independent market monitor and found that a *proxy* cost of capital should have been used. Each reason the Commission provides for this decision fails.

The Commission cites to *PJM Power Providers Group v. PJM Interconnection, L.L.C*[108] as its primary support for the use of proxy capital costs for AEII, but that decision undermines the findings it made in this case. In *PJM*, the Commission held:

> Protesters argue that the proposed tariff changes grant PJM and/or the IMM too much discretion in assessing whether "competitive cost advantages" are legitimate and determining whether there are "irregular or anomalous" cost advantages or sources of revenue that "do not reflect arm's-length transactions, or that are not in ordinary course of [business]." Decisions based on these considerations will obviously involve the exercise of judgment and discretion on the part of the IMM and PJM. We find, however, that while such discretion should be minimized to the extent possible, some amount of discretion is unavoidable and perhaps even necessary when making the types of determinations proposed by PJM in its compliance filing. We agree with PJM that the guidance it provides on this process, including its plan to evaluate whether a subsidy, grant, or revenue is of the type customarily enjoyed by the type of seller at issue and whether the cost or revenue item pre-existed RPM, provides a more objective standard than evaluating whether a cost or revenue is simply "competitive."
>
> The Commission rejects Hess' proposal to require PJM to adopt a reference unit financing structure as part of its unit-specific review process. Such a requirement would not allow PJM to recognize the lower financing costs of sellers that are especially creditworthy or that have negotiated contracts that have enabled them to secure favorable credit terms.[109]

108 137 FERC ¶ 61,145 (2011) (*PJM*).

109 *Id.* at PP 245, 249.

In other words, the Commission's policy, as articulated in *that* case, is that: (i) the RTOs and their independent market monitors must have discretion in evaluating transactions associated with new entrants; (ii) it is reasonable and appropriate to allow the RTOs and their independent market monitors to exercise such discretion; (iii) a new entrant's actual financing structure should be used in recognition that different entities have different financial profiles (*e.g.*, creditworthiness), and the unit-specific review should capture the advantages or disadvantages each new entrant may have; and (iv) it is appropriate, if not essential, to recognize that a developer with a PPA may be able to secure more favorable financing than other developers.

While citing to that policy, the Commission almost completely departed from it in ordering the NYISO to use a proxy capital structure for AEII. Indeed, the Commission makes its finding in a single conclusory sentence:

> Because the contracting process was discriminatory, the lower financing costs associated with the power purchase agreement fall into the category of "irregular or anomalous" cost advantages that are "not in the ordinary course of business;" so, consistent with *PJM*, we find that NYISO should use the proxy cost of capital.[110]

The flaws with this reasoning are numerous.

First, as a factual matter, NYPA's RFP was not discriminatory. The Mitigation Order erred by declaring as a factual matter that the NYPA RFP that led to the PPA with AEII was "discriminatory." It was not. A critical fact undermines the Commission's finding of discrimination. <u>Under the tariff rules in place at the time the NYPA RFP was issued, the Divested Generation Owners ("DGOs") in the in-City market were prohibited from entering into bilateral transactions for capacity. It was not until the following year that the Commission</u>

[110] Mitigation Order at P 135.

approved lifting that ban.[111] This fact not only undermines the Commission's finding of discrimination, it is indicative of the larger problem with the Mitigation Order. It attempts to take current theories, current constructs, current facts, and current market data, and superimpose them on decisions that were made years ago based on a different factors and circumstances.

The record in this case demonstrates that the RFP was issued pursuant to an open, transparent and competitive procurement process. Before deciding to buy capacity from AEII, an independent merchant generator, NYPA received nine proposals from prospective suppliers. NYPA's RFP was fuel neutral and resource neutral. The RFP did not discriminate among fuel sources and was even open to Demand Response. In fact, NYPA received proposals from two of the Complainants in this case. That highlights a critical point. NYPA did not exclude any single market participant from the RFP, it only limited the ability of certain resources to bid because they could not solve the problem. Discrimination against resources (*i.e.* the plant itself) cannot be undue discrimination when the owners of those resources are included in the solicitation.

Moreover, contrary to the Commission's finding at paragraph 135 of the Mitigation Order, the NYPA RFP was not limited to new resources. Existing resources outside the City could bid if they could secure delivery to Zone J. The only limitation in the RFP was that the winning bidder must be new to Zone J. Indeed, that was the express intention of the RFP. The only types of resources that could not qualify were existing in-City capacity resources. Even those resources would have qualified if they were repowered. This limitation was not

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111 *New York Independent System Operator, Inc*., 122 FERC ¶ 61,211at P 60 (2008) ("With the removal of the revenue cap for mitigated suppliers, it is no longer necessary to prevent DGOs from selling capacity bilaterally.")

discriminatory – it was a deliberate and justified attempt to bring new capacity into the City. As NYPA and the City explained in this case, the NYISO determined in 2005, 2007, and again in 2008, that there was a need for new generation resources in New York City by 2011-2012.[112] The actions of NYPA (and the Governmental Customers) were motivated by a clearly-identified need for additional generation in New York City.

Second, the Commission employed the wrong legal standard. Even if NYPA's RFP was discriminatory, it was not *unduly* discriminatory. The only legal framework relevant to this discussion that justifies remedial action by the Commission is *undue* discrimination. It is firmly established that for discrimination to be *undue* – and thus unlawful under the FPA – a regulated entity must engage in disparate treatment of similarly-situated entities.[113] On the contrary, when the utility can "justify the disparate effect," its actions are not unduly discriminatory.[114] Here, resources that were already providing Zone J capacity could not, by definition, replace the capacity of a soon-to-be retired 875 MW generation plant, and thereby alleviate constraints in New York City and satisfy expected future shortfalls. Existing in-City resources were clearly and obviously distinguished from eligible bidders in that they lacked the ability to solve the problem.[115] Such a meaningful distinction between the existing in-City suppliers and the

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112 New York Parties Protest at p. 37.

113 *City of Vernon v. FERC*, 845 F.2d 1042, 1045-46, (D.C. Cir. 1988).

114 *Ark. Elec. Energy Consumers v. FERC*, 290 F.3d 362, 367 (D.C. Cir. 2002) ("[A] rate is not 'unduly' preferential or 'unreasonably'" discriminatory in violation of the FPA if disparate effect of transmission or sale of electric energy by the jurisdictional utility can justify the disparate effect").

115 In other words, NYPA made a resource planning decision, which the Commission has now undermined, not withstanding that it would not intervene in state level resource planning decisions. *See Promoting Wholesale Competition through Open Access Non discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 FR 21,540 at n.547 (1996), FERC Stats. & Regs. 31,036 ("[S]tates retain authority over state integrated resource planning, utility resource portfolios, and utility buy side and demand side decisions.").

universe of eligible respondents to the RFP means that any discrimination was surely not *undue* discrimination.

Even if NYPA engaged in a selective bilateral procurement, there is no basis in federal law for the Commission to disallow or otherwise limit the participation of that capacity in the market based on the scope of NYPA's RFP. Putting aside the fact that NYPA is not a public utility, there is no federal law or regulation that requires NYPA to open its bilateral procurement to existing resources, or one that vests in this Commission the ability to pass judgment on NYPA's procurement or dictate market outcomes that flow from that judgment.[116] Yet, that is exactly what the Mitigation Order did. Based on its discrimination finding, the Commission ordered the NYISO to conduct AEII's mitigation analysis again, this time using *proxy* capital costs for AEII's Unit net CONE – i.e. costs that were higher than AEII actually incurred – based solely on the notion that AEII's *buyer* engaged in discrimination when selecting a supplier.

Third, the Commission fails to establish any causal link between the NYPA RFP and AEII's financing costs. The scope of NYPA's RFP had no impact at all on AEII's cost of capital. As the Commission itself recognized in *PJM*, long-term PPAs lower capital costs, and the unit-specific evaluations should include these benefits. Here, it finds that NYPA's *RFP* was discriminatory – that is, the manner in which NYPA sought to engage in supply procurement was

[116] As a general matter, the Commission's authority under the FPA does not extend to purchases. Section 201 of the FPA states that "*selling* electric energy for ultimate distribution to the public is affected with the public interest"16 USC § 824(a) (emphasis added). It is well established, and the Commission itself has recognized, "the FPA regulates *sales* public utilities make, not their *purchases*."*Prior Notice and Filing Requirements under Part II of the Federal Power Act*, 65 FERC ¶ 61,081 at p. 61,507 (1993) (emphasis added) (". . . we clarify that the FPA regulates sales public utilities make, not their purchases. Therefore, public utilities may buy from any seller without the need for FPA review at the time of the purchase. That also applies to changes in the amounts contracted for by the purchasing jurisdictional utility."); *see also NorthWestern Corp.*, 125 FERC ¶ 61,066 at P 5 (2008) ("The FPA does not require a public utility as purchaser to file a power purchase agreement. . . . We therefore direct NorthWestern to remove the provision included in Schedules 2, 3, 4, and 9 which requires NorthWestern to file under FPA section 205 any agreement for the purchase of products to provide ancillary services under these schedules and to reflect this change in a compliance filing within 30 days of the date of this order.").

discriminatory (according to the Commission). Even if that were true, the Commission never articulates a link between NYPA's RFP and AEII's capital costs. Exactly *how* the scope of NYPA's RFP translated to an anomalous or non-arm's-length transaction with AEII is not discussed. Indeed, there is no basis in this record to support the Commission's significant leap – that a PPA from a *discriminatory* RFP leads to even lower capital costs than a PPA from non-discriminatory RFPs – and the Commission offered no explanation for this holding. Moreover, there was no record or extra-record basis, or other foundation, for the Commission's conclusion that the NYPA RFP enabled AEII "to attract debt and equity capital investors on more favorable terms inconsistent with a competitive offer."[117] The Commission did not explain what it means in this context by a "competitive offer," making it difficult to properly address this finding.

Fourth, the Commission fails to explain how it concluded that NYPA's RFP, conducted in an open and transparent process was somehow "irregular or anomalous" or "not in the ordinary course of business" or did "not reflect arm's-length transactions."[118] Although it labeled NYPA's RFP for <u>new capacity in New York City</u> as discriminatory solely because it was not open to the existing generating facilities,[119] the Commission did not cite to any anomalies or irregularities in the actual transaction between NYPA and AEII. The finding that the cost advantages secured by AEII were not in the ordinary course of business lacks any factual foundation, either in the record or otherwise, and it is wholly at odds with the Commission's

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[117] Mitigation Order at P 135.

[118] In *PJM*, the Commission itself acknowledged that the new entry of some generation developers would be tied to PPAs with loads. The Commission did not disparage such arrangements or suggest that they represented a departure from the ordinary course of business in the electric industry. Rather, the Commission implicitly endorsed such arrangements when it held that the unit-specific evaluations for the holders of PPAs should reflect the financial benefits accruing from them.

[119] While the existing facilities were not permitted to participate in the RFP because they could not be considered "new" capacity, the owners of such facilities were fully able to (and some did) participate in the RFP process. Thus, it would be factually incorrect to state that NYPA discriminated against any generation owner or developer.

findings in *PJM*. In fact, the Commission failed to identify any cost advantages of AEII that were different from any other developer that is a party to a PPA.

Fifth, the Commission undermined its own long-held support for bilateral contracting.[120] Bilateral contracting for capacity has been an integral component of the NYISO capacity market since its inception.[121] If the Commission means to suggest that any payment outside NYISO's capacity auctions is "inconsistent with a competitive offer," that is a remarkable reversal of Commission policy and sound public policy. The Commission cannot mean to suggest that all capacity must be procured in the auction. If the Commission considers the PPA to be non-competitive because it results in extra-market payments or superior financing for AEII, the Commission is ignoring an elementary truth of financing power projects, as well as its own decision in *PJM*.

Finally, the Commission is legally obligated to balance the interests of all segments of the marketplace in making its determinations.[122] Here, the Commission made findings and issued directives to the NYISO that will likely have rate impacts that could be as high as a $400-500

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120 *See, e.g., Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697-A, 123 FERC ¶ 61,055 (2008) (discussing application of FERC's market-based rate policies to long-term bilateral contracts and concluding that markets for those contracts are "inherently competitive."). *See also* 16 U.S.C. 824(q)(b)(4) (2006) ("The Commission shall exercise the authority of the Commission under this Act in a manner that… enables load-serving entities to secure firm transmission rights… on a long-term basis for long-term power supply arrangements….") (emphasis added); s*ee also Wholesale Competition in Regions with Organized Electric Markets*, 119 FERC ¶ 61,306 (2007) ("Competitive wholesale markets need a strong infrastructure—both adequate electricity supply and a robust interstate transmission grid. Long-term contracts are an important tool to achieve and maintain a strong power infrastructure, particularly for new entrants into the generation sector and especially for many renewable energy developers.") (emphasis added).

121 *New York Independent System Operator, Inc*., 108 FERC ¶ 61,280 (2004) ("Three parties (AES Eastern Energy, IPPNY, and NRG Companies) filed comments in support and recommend that the Implementation Report be accepted. They commend the NYISO on the quality of the analysis, and are pleased that the ICAP Demand Curve has performed in practice as was intended and expected. While they acknowledge that there has been insufficient time and experience with the ICAP Demand Curve to gauge whether there have been increased commitments to bilateral transactions, they argue that over time the ICAP Demand Curve should encourage long-term contracting.").

122 *Cf. Federal Power Comm'n. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("The rate-making process under the Act, *i.e.*, the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests").

million annual increase in electric rates and bills for New York State customers in 2013 alone. While customers will experience this massive bill increase, they will not see any improvement in system reliability, resource adequacy, environmental emissions, safety, or any other aspect of the provision of electric service.

For all of the foregoing reasons, the Commission should grant rehearing, reconsider, and reverse its findings that the NYPA RFP was discriminatory and that AEII's actual capital structure should be disregarded. Instead, the Commission should uphold the NYISO's and its independent market monitor's determinations as a proper and reasonable exercise of their discretion.

IV. CONCLUSION

The Mitigation Order erred for the reasons discussed herein and, accordingly, the Commission should grant rehearing on the points raised here by the New York Parties. Rehearing would be in the best interest of the New York market and competition in general. Accordingly, the under-signed entities respectfully request that the Commission grant rehearing as discussed above.

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Dated: October 10, 2012
Washington, D.C.

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of October, 2012, I have caused a copy of the foregoing document to be served electronically on each person listed on the Secretary's official service list for the above-referenced proceeding.

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