UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.	)	Docket No. ER05-1410-000 *et al.*
PJM Interconnection, L.L.C.	)	Docket No. EL05-148-000 *et al.*

REQUEST FOR REHEARING OR CLARIFICATION
ON BEHALF OF INDICATED BUYERS

Pursuant to Section 313 of the Federal Power Act ("FPA")[1] and Rule 713 of the Commission's Rules of Practice and Procedure,[2] a number of parties supporting the Reliability Pricing Model ("RPM") settlement as-filed on September 29, 2006 ("Settlement Agreement" or "Settlement"), as well as several parties not opposing that Settlement (collectively "Indicated Buyers"),[3] request rehearing or clarification of the Commission's December 22, 2006 Order Denying Rehearing and Approving Settlement Subject to Conditions (hereinafter "December 22 Order" or "Order") in this proceeding.[4] Indicated Buyers seek rehearing of the conditions imposed by the December 22 Order on the RPM Settlement Agreement filed by PJM Interconnection, L.L.C. ("PJM") in these proceedings.

The vast majority of the parties in these proceedings, buyers and sellers alike, as well as PJM, supported approval of the Settlement Agreement *without modification*. The

[1] 16 U.S.C. § 825*l* (2006).
[2] 18 C.F.R. § 385.713 (2006).
[3] Indicated Buyers include Allegheny Electric Cooperative, Inc.; American Forest & Paper Association; Blue Ridge Power Agency; North Carolina Electric Membership Corporation; Office of the People's Counsel for the District of Columbia; Old Dominion Electric Cooperative; Pennsylvania Department of Environmental Protection; Pennsylvania Office of Consumer Advocate; Pennsylvania Public Utility Commission; Portland Cement Association; Southern Maryland Electric Cooperative, Inc.; and Virginia Municipal Electric Association.
[4] *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006).

conditions the December 22 Order placed on the Settlement unnecessarily and arbitrarily disrupt the careful balance of benefits achieved in that Settlement Agreement, unduly biasing the settlement as agreed upon in favor of certain seller interests. Indicated Buyers request that the Commission grant rehearing of the December 22 Order and restore the balance of interests reflected in the as-filed Settlement Agreement by approving that Settlement without condition or modification.

Specification of Errors and Statement of Issues

1. The December 22 Order erred in failing to approve the as-filed RPM Settlement Agreement without modification. The conditions arbitrarily imposed by the December 22 Order upset the careful balance of seller and buyer interests attained in the as-filed Settlement Agreement, and unduly bias the balance of the benefits in favor of seller interests. These modifications produce an unreasonable result for consumers contrary to the requirements of Section 205 of the FPA, 16 U.S.C. § 824d (2006), and judicial precedent holding that the Commission's primary responsibility is to ensure that consumers have a "complete, permanent, and effective bond of protection from excessive rates and charges." *Atl. Ref. Co. v. Pub. Serv. Comm'n*, 360 U.S. 378, 388 (1959).

2. The December 22 Order erred in arbitrarily modifying the fixed cut-off date for units eligible for the 50-year Mandatory Capital Expenditure adder to mitigated offers, thus ignoring the transitional nature of this provision. This action is contrary to the requirements for reasoned decision-making and represents an inconsistent and unwarranted departure from Commission precedent. *See* December 22 Order at P 85, *citing ANR Pipeline Co.,* 110 FERC ¶ 61,069 at P 49 (2005) (finding that the Commission must accept just and reasonable rates, terms and conditions filed by the

utility regardless of whether other rates, terms and conditions may also be just and reasonable); *see also Williams Gas Processing-Gulf Coast Co., L.P., et al. v. FERC*, 2006 U.S. App. LEXIS 31127 at 18 (D.C. Cir. 2006) (finding that reasoned decision making requires reasoned explanations of departures from prior precedent).

3. The December 22 Order erred in arbitrarily expanding the pool of market participants eligible for certain limited benefits under the Settlement Agreement to include non-signatories to the Settlement, thereby allowing those non-signatory parties to cherry pick the benefits of the Settlement while allowing them to attempt to avoid the burdens through appeal of selective issues. *Cities of Bethany, et al. v. FERC*, 727 F.2d 1131, 1139 (D.C. Circuit), *cert. denied*, 469 U.S. 917 (1984); *Cove Point LNG L.P.*, 98 FERC ¶ 61,270 (2002); *see also Public Utilities Commission of the State of California v. El Paso Natural Gas Co. et al.*, 106 FERC ¶ 61,315 at P 16 (2004) *citing Transcontinental Gas Pipe Line Corp.*, 78 FERC ¶ 61,102 at 61,362 (1997) (finding no reason for rejection or modification of a settlement "as long as the rights of parties that oppose the settlement are protected"). The December 22 Order's failure to even consider the extensive Commission precedent on this matter fails the test for reasoned decision making. *Williams Gas Processing-Gulf Coast, supra* at 18 (finding that reasoned decision making "necessarily requires consideration of relevant precedent.").

4. The December 22 Order erred in finding, without explanation or support, that the as-filed Settlement Agreement's negotiated, objective criteria for mitigating seller offers provide the Market Monitor "excessive discretion," and requiring that PJM unilaterally develop in a compliance filing other criteria to replace the as-filed Settlement provisions. The Order is based on a misunderstanding of the as-filed criteria, and is an

unwarranted departure from the Commission's adoption of similar criteria in the ISO New England settlement of capacity market issues. *Devon Power Co.*, 115 FERC ¶ 61,340 at P 114 (2006); *see also Williams Gas Processing-Gulf Coast, supra* at 18 (vacating Commission orders that are "arbitrary and capricious").

5. The December 22 Order erred in finding that the Minimum Offer Price Rule ("MOPR") is reasonable on the basis that it limits monopsony power. There is no evidence of the exercise of monopsony power in PJM or in the record of this case. *See Kartell v. Blue Shield*, 749 F.2d 922, 931 (1984) (caution should be exercised before intervening in markets where buyer monopsony power is alleged by sellers, but where downstream consumers are seeing the benefits of lower prices); *US v. Syufy*, 903 F.2d 659 (1990) (rejecting monopsony power claims where the government failed to establish the elements of proof for monopsony power cases). The Settlement Agreement does not characterize the MOPR as a mitigation tool for monopsony power, but rather describes the provision as a means of price support for generators during a transitional period.

Argument

A. The Order Erred in Conditioning Approval of the RPM Settlement Agreement and Thereby Disrupting the Carefully Crafted Balance of Interests Reflected Therein.

As noted by the Commission in its Order, PJM's August 31, 2005 filing was preceded by an extensive stakeholder process which attempted to deal constructively with the issues in this case. That process engaged the time and energies of PJM and its stakeholders for well over two years, but produced no consensus. Based on this history, several parties expressed skepticism that resorting to settlement procedures in this docket would be productive. The issues involved were technically complex, financially

contentious and politically difficult. At the time discussions commenced, the parties were divided by what appeared to be insuperable differences of opinion and interest. As the Commission notes in its Order, more than 65 parties spent over 25 days in face-to-face negotiations. In addition, numerous side meetings, phone calls and caucuses were held when Settlement talks were not in formal session.

No party to the Settlement Agreement got everything it wanted. Almost every party felt that at least one major concession had been demanded that it found particularly distasteful and unnecessary and which could only be countenanced in light of the Settlement Agreement as a whole. As PJM has commented "it is remarkable that the contesting parties reached any Settlement, let alone one as broadly supported as the Settlement Agreement."

Each of the Parties to this rehearing request supported or did not oppose the Settlement Agreement as filed. Each felt that, in doing so, it had "given 'til it hurt," but was nonetheless willing to work within the Settlement Agreement framework and move forward. However, the December 22 Order finds that the Settlement Agreement, if modified, will provide for a "just and reasonable capacity market" and produce "just and reasonable rates." December 22 Order at PP 1, 51. Each of the Parties to this rehearing request believes the changes made to the Settlement Agreement by the Commission are directly detrimental to it and will result in greater risk and higher cost to consumers.[5] None of the Commission's conditions redress this balance by providing offsetting benefits for consumers, despite the Commission's primary responsibility under the FPA

[5] The only exception to this is the removal of the requirement that Single Customer Load Serving Entities ("LSEs") be signatories before availing themselves of the self-supply opportunity. Because this option is only available to the first 1,000 MWs of load to be supplied under this self-supply option, the Commission's actions in this respect have not increased the total availability of this option to consumers, but merely removed the preference granted to those who spent the resources to secure it.

to ensure that consumers have a "complete, permanent, and effective bond of protection from excessive rates and charges." *Atl. Ref. Co. v. Pub. Serv. Comm'n*, 360 U.S. at 388. Instead, the conditions in the Order arbitrarily permit a larger class of sellers to raise bids and recover more in the market. As noted further below, none of these adjustments are necessary to produce a just and reasonable result. Each of the as-filed provisions at issue is independently supported by sound rationale and is consistent with past Commission precedent.

Given this, Indicated Buyers are very concerned that the Order does not fully consider the value to the Parties, the region and the eventual implementation process, of preserving the Settlement Agreement as a comprehensive resolution of the issues between the Parties. We are deeply concerned that if rehearing as requested herein is not granted, support for the Settlement Agreement will be unnecessarily undermined, and many Parties who committed themselves to support or not oppose the effort to move forward with RPM will reconsider their positions and make the process of implementation far more costly and litigious, without in the end achieving a better result. The "adjustments" made by the December 22 Order risk losing the baby--the hard won consensus of a majority of the Parties--in the name of throwing out three cups of bathwater. For these reasons, and those outlined more fully below, Indicated Buyers request that the Commission grant rehearing, find that each component of the Settlement Agreement, as filed, is just and reasonable, and approve the as-filed Settlement Agreement as a whole.

B. The Fixed Cut-Off Date For Coal Units To Be Eligible For The Mandatory Capital Expenditure Adder to Mitigated Offers Is Reasonable As A Transition Mechanism And Should Be Maintained.

One of the changes to the Settlement Agreement required by the December 22 Order concerns the Mandatory Capital Expenditure adder to mitigated offers. The Order notes that:

> Three options with alternative Capital Recovery Factors are available for older existing capacity resources that choose an avoidable cost default bid to recover their investment costs, including the Mandatory Capital Expenditure option. This option allows these units, when their bids are mitigated, to adjust their default bids to allow them to recover investment costs required to comply with government-mandated requirements (such as, for example, environmental regulations).

December 22 Order at P 106. The December 22 Order further notes that one of the eligibility criteria for this treatment was to be "a coal-fired unit that has been in operation for 50 years by the effective date of the [Settlement] Agreement." *Id.*

The December 22 Order further stated that "PPL/PSEG contends that it is improper to limit Mandatory Capital Expenditure treatment to coal plants constructed before 1957. PSEG/PPL argues that all coal units that operate for 50 years should be eligible for this benefit once they reach 50 years of operation, or the Commission should establish a reasonable cut-off date for this provision." *Id.* at P 107. The December 22 Order then simply concludes that "a fixed cutoff date (50 years prior to the effective date of the Settlement), is not reasonable as proposed." *Id.* at P 108. The Order's entire explanation of its rationale for this conclusion is as follows:

> We accept PPL/PSEG's argument that this treatment should be extended to additional coal fired plants as they reach 50 years of commercial operation**.** In contrast to the fixed cut-off, other cost recovery provisions, such as the 40 year plus alternative option, use a rolling cut-off date for all similarly situated plants, we will require that a similar rolling cut-off date be applied here. Therefore, we will require the Tariff to be modified to delete the requirement that the plant's commercial operation must have

> begun at least 50 years prior to the effective date of the Settlement, and add a requirement that the eligible unit began commercial operation at least 50 years before the conduct of the relevant Base Residual Auction effective date of the capacity year.

Id. (footnote citing proposed Tariff section 6.8 omitted).

This conclusion is in error and should be reversed. The December 22 Order's only rationale for eliminating the fixed cut-off date was that other cost recovery provisions are not so limited. *Id.* This simplistic rationale fails to consider the fact that different cost recovery provisions are aimed at different goals. Each such provision must be justified on its own merits based on the goal of the provision. Similarly, the decision of whether to have a fixed cut-off date for eligibility depends on the purpose of the provision. The mere observation that other provisions have rolling eligibility requirements does not constitute reasoned decision making. The December 22 Order fails to explain why it is necessary to allow additional coal plants that will become 50 years old after implementation of the Settlement Agreement to take advantage of this provision, nor does the Order evaluate or even consider the cost implications of the change in cut-off dates for consumers. Indeed, it is inconsistent with the Commission's support for RPM itself as the Commission's order approving RPM anticipates entry by a sufficient amount of economic capacity as to allow retirement by the older, uneconomic units the 50-year adder is intended to retain during the transition period required to accommodate construction lead times for new investment.

The fixed cut-off date in the Settlement Agreement is simply a transition mechanism that is necessary now, but as RPM is allowed to work, this transition mechanism should no longer be needed. The fixed cut-off recognizes, and is justified by, the fact that under current market conditions many of the coal plants that are already 50

years old may be needed to maintain adequate capacity levels. As a result, the as-filed provision allows these units to remain economic until the implementation of RPM has a chance to encourage new, more economic investments and is thus appropriate.[6]

Regardless of whether the adder to mitigated offers for generators that are 50 years of age as of the implementation date of RPM is extended to non-signatories, the 50-year fixed cutoff provision in the Settlement is reasonable because it offers price support during a transitional period to less than 2,000 MWs of capacity that may otherwise retire before new investment that may be encouraged by RPM can become operational. The effect of this transitional element would vanish as the units eventually retire. The December 22 Order's modification of this provision to a rolling 50-year eligibility criterion has significantly expanded the future pool of generators eligible for this limited benefit by allowing the eligible MWs of capacity to grow over time.

The modification is arbitrary and unnecessary to accomplish the Commission's apparent goal of ensuring that all aging generators have access to accelerated recovery of the cost of mandatory capital expenditures. Regardless of the cut-off date for the 50-year sub-category, any coal plant over 15 years meeting the $200/kW threshold could use the alternative accelerated "Mandatory Capital Expenditure" capital recovery factor ("CRF") of 0.45. Moreover, a coal plant over 15 years of age that does not meet the investment threshold referenced above could use the second alternative "16 Plus" CRF of 0.363.

The Settlement Agreement, as filed, set a high bar for eligibility for the highest recovery factor for Mandatory Capital Expenditures, *i.e.*, the 50 year fixed cut-off adder. Moreover, the Settlement Agreement, as filed, sought *only* to offer this adder to a narrow,

[6] This need for capacity is, of course, the very situation that RPM is intended to cure by providing appropriate price signals to encourage new entry. *See, e.g.*, December 22 Order at PP 1, 68, 75, 82.

finite, and bounded transitional set of resources. The remaining Settlement framework has alternative recovery factors in place to address the issue of aging plants that require mandatory capital expenditures in the future. There is no justification for expanding the pool of generators eligible for the 50-year fixed price adder.

Additionally, as the new entry encouraged by RPM occurs, the need for propping up coal units reaching 50 years of age after implementation of the Settlement Agreement will disappear. Thus, the fixed cut-off provision was narrowly tailored to address the problem at hand, while the December 22 Order's mandated rolling 50-year criterion is not. The December 22 Order provides no reason why additional coal units that subsequently turn 50 after implementation of the Settlement and that submit bids otherwise in need of mitigation should be allowed to increase their bids even after RPM has been implemented. The December 22 Order cites nothing in the record to indicate that a rolling cut-off date will be of any use in providing necessary capacity at just and reasonable rates. In fact, the perpetual propping up of 50-year-old, otherwise uneconomical, coal units can only be necessary if it is believed that RPM will not work, an assertion nowhere suggested by the December 22 Order.

The fact that other cut-off dates recommended by parties contesting the settlement may also be supportable is irrelevant. The non-signatories who opposed the Settlement's 50-year cut-off date have conceded that "the Commission could identify a cutoff date supported by a reasonable rationale." PPL/PSEG Initial Comments (Oct. 19, 2006), at 82. Although PPL/PSEG would prefer to apply 1977 as the bright-line cut-off date, on the basis that the Clean Air Act was *amended* in 1977, the fifty-year bright line that was adopted in the as-filed Settlement Agreement is equally supportable. The 1977

amendments were just one step in a progression that dates back much further. The Clean Air Act itself dates to 1963, and has included regulation of power plant emissions from the outset.[7] Federal clean air legislation dates back to 1955, motivated in significant part by the air quality disaster that occurred in Donora, Pennsylvania (located south of Pittsburgh, within PJM's current footprint) in 1948.[8] Clean air legislation by individual states and municipalities in the PJM area likewise predates 1977. Thus, while PPL/PSEG concede that "it would be reasonable to treat facilities constructed after [1977] differently because the builders of those plants could be deemed to be on notice that their facilities would be subject, at least potentially, to heightened environmental compliance measures," exactly the same can be said of facilities constructed after the mid-1950s. Thus, the Commission is faced with several potentially reasonable fixed cut-off dates.

The December 22 Order fails to explain the unwarranted departure from Commission precedent ruling that reasonable rates, terms and conditions proffered by a utility must be approved despite the existence of other reasonable rates, terms or conditions recommended by intervenors. December 22 Order at P 85, *citing ANR Pipeline Co.*, 110 FERC ¶ 61,069 at P 49 (2005) (finding that the Commission *must accept* just and reasonable rates, terms and conditions filed by the utility regardless of whether other rates, terms and conditions may be just and reasonable). On rehearing, the Commission should consider that:

- the use of a temporally fixed cutoff was considered acceptable by both PPL/PSEG and the Settlement signatories;
- selection of a cut-off year is a matter of judgment with no single correct answer; and
- formal federal involvement in clean air issues dating back to the mid-1950s justifies the Settlement's 50-year fixed cut-off date.

[7] Pub. L. No. 88-206, 77 Stat. 392 (1963).
[8] Pub. L. No. 84-159, 69 Stat. 322 (1955).

Accordingly, the Commission should accept the 50-year fixed cutoff included in the Settlement Agreement as filed.

C. The December 22 Order Erred in Concluding That A Signatory Versus Non-Signatory Distinction With Respect To Certain Limited Market Mitigation Benefits Is Not Lawful.

The December 22 Order concludes that preferential market power mitigation for Settlement signatories is "unduly preferential and discriminatory." December 22 Order at P 113. The Order fails to substantiate this cursory determination. The Order also fails to distinguish ample precedent that expressly permits different treatment for settlement signatories than for non-signatories. Each of these failures individually warrants rehearing.

First, the judicial requirement for reasoned decision-making requires the Commission to explain and support its conclusions. *Williams Gas Processing-Gulf Coast, supra* at 18. In this context, the Commission is obliged to state "why" it finds that the signatory versus non-signatory distinction with respect to market power mitigation elements is unduly preferential and discriminatory. The December 22 Order provides no rationale and fails to cite any substantial record evidence to support this conclusion. Rather, the December 22 Order simply asserts the conclusion, provides specific instructions to PJM on what to include in its January 22 compliance filing, and then proceeds to discuss briefly the merits of the bid adder. At no point does the Order justify its conclusion that parties opposing the Settlement, like PPL and PSEG, should be entitled to receive the bid adder that was carefully negotiated by Settlement signatories or that they should be entitled to favorable treatment of Mandatory Capital Expenditures.

The Order's cursory and unsubstantiated conclusion does not constitute reasoned decision-making.

Second, the Order fails to acknowledge, much less distinguish, Commission precedent and appellate court precedent that expressly permits distinctions in the treatment of signatories and non-signatories. *Williams Gas Processing-Gulf Coast, supra* at 18 (finding that reasoned decision making "necessarily requires consideration of relevant precedent."). Indeed, the Commission has in many cases approved settlements that prevent non-settling parties from cherry-picking settlement benefits that would not be obtained absent the settlement.

In *Cove Point*, for example, the Commission approved a contested settlement and, in doing so, ruled that a severed contesting party may not "cherry pick those aspects of the [s]ettlement that it deems desirable . . . while rejecting other aspects as undesirable . . . If [WGL] desires to become a party to the [s]ettlement and benefits from the lower [s]ettlement rate it should inform the Commission of its intent to do so . . ." *Cove Point LNG L.P.*, 98 FERC at 62,047.

In *California v. El Paso Natural Gas Company, et al.*, several parties contested a settlement on grounds that the "financial relief" was limited only to the Settling Parties. They argued that neither they, nor Staff, were permitted to participate in the Settlement discussions. They further argued that their interests and those of the settling parties were directly at odds. The Commission denied rehearing, reiterating "that the Settlement in this complaint proceeding is just and reasonable and in the public interest. EOC Shippers have not sustained any undue prejudice as a result of the Commission's acceptance of the Settlement, as modified." *California v. El Paso Natural Gas Co. et al.*, 106 FERC at P

12; *see also* 106 FERC at P 16 ("Where parties have reached such a settlement agreement, there is no reason for the Commission to reject or modify that settlement, as long as the rights of parties that oppose the settlement are protected…") *citing Transcontinental Gas Pipe Line Corp*., 78 FERC ¶ 61,102, at 61,362 (1997) (footnote omitted).

In *Trailblazer Pipeline Co*., the Commission stated that its approval of a contested settlement under Approach No. 2 as just and reasonable "includes a finding that the contesting party would be in no worse position under the terms of the settlement than if the case were litigated." *Trailblazer Pipeline Co.,* 87 FERC ¶ 61,110 at 61,439 (1999), *clarifying* 85 FERC ¶ 61,345 (1998).

Distinguishing between signatories and non-signatories has also found firm ground in the appellate courts. The D.C. Circuit Court of Appeals in *Cities of Bethany* accepted the Commission's arguments that settlement-based distinctions among customers are lawful. The Court stated as follows:

> Like fixed rate contracts, settlements promote market stability and reduce litigation over rate filings under the Federal Power Act. As FERC has noted, settlements would be severely discouraged, if not eliminated, if any resulting price disparities among customers were considered unlawfully discriminatory within the meaning of section 205(b). When a settlement is reached in good faith, by means of proper conduct by the parties, and when the resulting rate disparity is not unduly burdensome to a customer group, a rate difference caused by a private settlement may survive the anti-discrimination mandate of section 205(b).

Cities of Bethany, et al. v. FERC, 727 F.2d at 1139. Because the Federal Power Act exists primarily to protect customers, one could reasonably conclude that these concerns over potential undue discrimination are even less applicable when the distinction is among sellers, as is the case here. In any event, the December 22 Order makes none of the findings that *Cities of Bethany* identifies as relevant. The December 22 Order does

not find that the Settlement was the product of bad faith. The December 22 Order does not find that the Settlement is unduly burdensome to a customer group.

By finding that Settlement benefits relative to market mitigation must be extended to parties opposing the Settlement, the Order eviscerates a key benefit of entering into the Settlement Agreement, viz., the ability to obtain an outcome that is better than would be available absent the Settlement. The Order encourages parties to cherry pick one or more settlement benefits, then withdraw from the negotiation process in order to avoid the burdens of the settlement through appeal of selective issues. As a matter of law, the Order's actions in this regard are not well-founded, and discourage, or make more difficult, the fashioning of future settlements in difficult cases where many parties must compromise on a large number of significant issues to reach closure. If the Commission does not reconsider its upset of this Settlement's temporary, narrowly drafted and factually limited market mitigation rate cap provisions that limit certain benefits to Settlement signatories, it may well be sending a signal to future litigants that parties may freely pick and choose the benefits of a settlement, while retaining rights to litigate the burdens of the settlement they feel can be improved through appellate litigation. As a matter of policy, these actions are not consistent with the Commission's well-established policy of encouraging and promoting amicable resolution to contentious issues.

D. The December 22 Order Erred in Directing PJM to Replace the Negotiated, Objective Settlement Agreement Criteria for Review of Offers by the Market Monitor with Criteria To Be Developed Solely by PJM.

The December 22 Order expresses concern over the discretion afforded the Market Monitoring Unit ("MMU") under the Settlement Agreement with respect to three provisions of the OATT: the MOPR, Market Power Mitigation Rules for Planned Generation Capacity Resources, and provisions regarding Data Submission related to sell

offers. December 22 Order at P 115. On that basis, the December 22 Order directed PJM to file, within nine months of the December 22 Order, "objective factual criteria to be used by the MMU in reviewing bids under these three sections of the Tariff." The Order further directed that such criteria to be developed by PJM "would replace the criteria included in the Settlement . . ." *Id.*

At the outset of our discussion on this issue, Indicated Buyers urge the Commission to grant rehearing, find that the Settlement Agreement, as originally filed by PJM, is just and reasonable on the merits, and approve it without modification. The Settlement Agreement represents an integrated package that was only acceptable to Indicated Buyers as such. The MMU modifications are but one example of modifications to the Settlement Agreement where the Order has unreasonably upset the balance of benefits and burdens reached by the Settling Parties, resulting in withdrawal from the Settlement Agreement of a number of Indicated Buyers. In order to restore the balance reached in the Settlement Agreement, and retain a just and reasonable capacity market model, Indicated Buyers urge the Commission, on rehearing, to approve for implementation the RPM Settlement Agreement and related documents as filed by PJM on September 29, 2006.

Further, the December 22 Order errs in its finding that the criteria and processes outlined in the Settlement Agreement and OATT provisions regarding the monitoring of the PJM capacity market may be "excessive" and, therefore, should be replaced in their entirety by criteria to be developed solely by PJM. *Id.* To the contrary, as explained below, the provisions referenced by the Order place considerable limits on any exercise of discretion by the MMU in reviewing offers for capacity under RPM. Moreover, given

the Order's failure to engage in reasoned decision making on this point, including its failure to explain its departure from recent precedent on a similar issue, the December 22 Order contains an error that must be corrected on rehearing. Therefore, Indicated Buyers request that the Commission grant rehearing of the December 22 Order and determine that the objective criteria and processes in the as-filed Settlement Agreement shall be retained and that no replacement or supplemental criteria are necessary at this time. Alternatively, Indicated Buyers request that the Commission grant rehearing and/or clarification to direct that any criteria to be developed by PJM must supplement the existing criteria and must be developed as part of an open and inclusive stakeholder process.

1. The Settlement Agreement Provides Objective Criteria and Processes That Prevent the Exercise of Excessive Discretion by the Market Monitor and Must Be Preserved.

The referenced provisions of the Settlement Agreement do not provide the MMU with excessive discretion. As the Commission itself recognizes in the December 22 Order, "under the Settlement, there are objective criteria that determine when bids are potentially subject to mitigation." December 22 Order at P 114. Thus, the Market Monitor's initial mitigation decision is not subject to discretion at all, but instead is based solely on objective criteria defined in the Settlement Agreement and Tariff. The Order is apparently based upon a mistaken belief that the provisions permitting the MMU to allow bids that fail the criteria in the Settlement Agreement to go forward, and the provisions regarding default bids, afford the MMU excessive discretion. *Id.* The Order is wrong.

First, under the MOPR, Section 5.14(h) of Attachment DD to the PJM OATT, the MMU must follow a specific process and criteria for determining whether an offer is subject to mitigation and whether the Sell Offer shall be based on the net Cost of New

Entry ("CONE"). The MOPR provisions require the MMU to apply specific criteria, outlined in Section 5.1(h)(2), to determine whether an offer is subject to mitigation. Next, the "satisfactory justification" referenced in the December 22 Order (note 81) is not subject to excessive discretion. The MMU is limited to a determination of whether the cost and operational parameters to be provided by the Capacity Market Seller, together with revenues that would be earned in PJM-administered markets as determined by PJM, support the offer. Thus, the MMU is not allowed to exercise unlimited or unfettered discretion, but instead must only determine whether the information provided adds up to a Sell Offer that has failed the objective and clearly-defined criteria in Section 5.14(h)(2).

Second, the provisions regarding mitigation for offers from new capacity resources appropriately limit the MMU to application of specific criteria in determining whether a bid is competitive. The Settlement Agreement and Section 6.5(a)(ii) of Attachment DD to the PJM OATT provide that all bids from Planned Generation Capacity Resources are presumed competitive in the first-year capacity auction and can only be found to be uncompetitive if they fail the specific criteria in Section 6.5(a)(ii)(B).[9] Only if the bid fails such specific criteria does the MMU then investigate in order to determine whether the bid is indeed uncompetitive. In making such determination, the MMU is limited to a comparison of the Sell Offer to other Sell Offers and the CONE in the relevant LDA, plus a review of potential barriers to entry. Further,

[9] PJM OATT Attachment DD, Section 6.5(a)(ii)(B) provides as follows: "Sell Offers based on Planned Generation Capacity Resources submitted for the first year in which such resources qualify as Planned Generation Capacity Resources shall be deemed competitive and not be subject to mitigation if: (1) collectively all such Sell Offers provide Unforced Capacity in an amount equal to or greater than two times the incremental quantity of new entry required to meet the LDA Reliability Requirement; and (2) at least two unaffiliated suppliers have submitted Sell Offers for Planned Generation Capacity Resources in such LDA . . ."

even if the MMU's analysis based on these specific criteria results in a determination that the offer is uncompetitive, the MMU must provide the seller an opportunity to submit a revised bid and use that bid in the auction. These provisions place significant limitations on the ability of the MMU to exercise any discretion, and most certainly do not provide an opportunity for any excessive discretion on the part of the MMU.

Third, Section 6.7(c) does not afford excessive discretion to the MMU. This provision addresses information to be submitted by auction participants. Subsection (c) provides an exception to the data requirements for those Generation Capacity Resources that either are in the resource class determined by the MMU as not likely to include the marginal price-setting resources in such auction or for which the participant commits not to submit an offer in excess of the price identified by the MMU for the resource class. The MMU is then tasked with determining the resource classes and corresponding prices *following stakeholder consultation*. As the Commission itself notes in the December 22 Order, PJM is already working with stakeholders on such consultations. Although the resource classes and prices are to be ultimately determined by the MMU, the stakeholder process should be expected to provide input into the criteria for such determinations and will at least provide stakeholders with insight into the factors to be used by the MMU in making such determinations. Here again, the MMU does not have the sort of excessive discretion that the Order suggests in an attempt to justify ordering a full-scale replacement of the Settlement Agreement and OATT provisions with provisions to be developed in a vacuum by PJM.

For the reasons discussed above, the Settlement Agreement does not afford the MMU excessive discretion. Rather, as demonstrated above, the provisions of the

Settlement Agreement and OATT insure against such excessive discretion by the MMU. Therefore, in addition to maintaining the integrity of a very complex and integrated settlement package, Indicated Buyers urge the Commission to find that the as-filed Settlement Agreement provisions contain the requisite level of objective criteria and process to render them just and reasonable, without further modification.

2. The Order Failed to Engage in Reasoned Decision-Making In Its Findings Regarding the Mitigation Provisions of the Settlement Agreement.

The December 22 Order errs in failing to provide any explanation for its finding that the discretion afforded the MMU under the Settlement Agreement may be excessive. Further, the Order errs by failing to provide any reasoning for its determination that the criteria agreed upon by the Settling Parties must be replaced in their entirety by criteria to be developed by PJM, apparently unilaterally. Therefore, the Commission should grant rehearing of these findings and instead determine that the mitigation provisions in the as-filed Settlement Agreement are just and reasonable on the merits.

The December 22 Order simply summarizes the Settlement provisions relating to mitigation of bids, and expresses concern that the MMU may have excessive discretion under those provisions. December 22 Order at PP 114-115. Based solely on this concern, the Order directs PJM to file within nine months objective factual criteria to be used by the MMU in reviewing bids under the referenced tariff provisions, and states that "such objective criteria would replace the criteria included in the Settlement . . ." December Order at P 115. The Order provides no discussion to explain and support its determination that the criteria would allow the exercise of excessive discretion by the MMU and must be replaced altogether.

Moreover, the Order's determination that the Market Monitor may have excessive discretion under this Settlement Agreement, despite the clear objective criteria and processes to protect against just that concern, is a departure from the Commission's own reasoning that *supported* exercise of discretion by the market monitoring unit for resetting capacity bids under the ISO New England ("ISO-NE") locational capacity market ("LICAP") mechanism. There, the Commission specifically found that:

> . . . it is reasonable for the Market Monitor to review offers from new capacity that appear to be unreasonably low. And if the Market Monitor determines that a low offer is not economically justified, it is reasonable to reset the clearing price to a level that would be expected in a competitive market that requires new capacity.

Devon Power, L.L.C., 115 FERC at P 114. The ISO-NE LICAP Settlement provides no more objective criteria than those contained in the referenced provisions of the instant Settlement Agreement, and allows for the resetting of clearing prices based on the Market Monitor's discretion to determine whether bids below a specified level are consistent with costs identified in the Settlement Agreement. [10]

The Order's failure to explain its rationale, both in finding that the MMU may exercise excessive discretion under the Settlement Agreement and in directing a complete replacement of the objective criteria contained therein, is an error that must be corrected on rehearing. As the courts have consistently held, the requirement that the Commission engage in reasoned decision making is not satisfied by a passing reference without

[10] The ISO-NE LICAP settlement provides as follows, on this point: "[i]f the Market Monitor finds that the New Capacity Bid below 0.75 times CONE is consistent with the long run average costs of that Resource (absent contractual considerations), or for New Import Bids below 0.75 times CONE, the opportunity cost or another reasonable economic measure, then the bid can set the Capacity Clearing Price. Otherwise, the New Capacity Bid or the New Import Bid (considered an "Out of Market Bid") shall be entered into the FCA pursuant to the Alternative Price Rule of Part IlL/below." Settlement filed March 6, 2006 in Docket Nos. ER03-563-000, *et al.*, at Section III.H.

explanation for departure from prior precedent.[11] The December 22 Order's discussion regarding the MMU provisions of the Settlement Agreement is woefully lacking in any justification for the determinations therein. Therefore, Indicated Buyers urge the Commission to correct the December 22 Order on rehearing and determine that the mitigation provisions in the Settlement Agreement, as filed, are just and reasonable.

3. If the Commission Does Not Approve the Settlement Agreement Provisions As Filed, then it Must Grant Rehearing (or Clarification) and Direct PJM To Engage in A Stakeholder Process To Develop Supplemental Criteria.

As members of Indicated Buyers explained in their Reply Comments to the Settlement Agreement, the Settlement Agreement represents a carefully crafted balance among the competing interests of a diverse group of PJM market participants. Therefore, for the reasons discussed above, the Commission should maintain the Settlement Agreement mitigation provisions as filed by PJM, without modification.

Alternatively, if the Commission rejects the request for rehearing on this point and instead determines that additional objective criteria are necessary, Indicated Buyers request rehearing (or clarification) and a Commission directive that any criteria to be developed by PJM must supplement, not replace, the criteria in the Settlement Agreement and accompanying OATT, and that any such criteria must be developed in consultation with stakeholders. The Commission must be clear that mere after-the-fact discussions

[11] *See Williams Gas Processing-Gulf Coast, supra* at 18-19 ("[w]e must vacate FERC's 2005 orders if they are arbitrary and capricious. We therefore look to whether FERC 'articulated a rational explanation for its action.' Reasoned decisionmaking necessarily requires consideration of relevant precedent. *See Brusco Tug & Barge Co. v. NLRB*, 247 F.3d 273, 278 (D.C. Cir. 2001) ("[I]t is 'axiomatic that [agency action] must either be consistent with prior [action] or offer a reasoned basis for its departure from precedent . . .'") (citations omitted); *See also*, *Missouri PSC v. FERC*, 234 F.3d 36, 41 (D.C. Cir. 2000) ("A passing reference . . . is not sufficient to satisfy the Commission's obligation to carry out reasoned and principled decisionmaking**.** We have repeatedly required the Commission to fully articulate the basis for its decision.") (internal quotation marks omitted).

with stakeholders are not satisfactory, but that stakeholders must be allowed to be intimately involved in the formulation of any new, supplemental criteria.

The Commission has acknowledged that there are objective criteria in the Settlement Agreement for mitigation of bids. December 22 Order at P 114. To the extent further criteria may be necessary (and Indicated Buyers submit that they are not), such criteria should be supplemental to the objective and agreed-upon criteria in the Settlement Agreement, to fill in any perceived gaps in criteria to be applied by the MMU. The Commission should not give PJM license to develop full-scale criteria to replace those that have already been agreed upon by the vast majority of the parties and stakeholders in these proceedings. Further, in order to maintain the balance achieved in the Settlement Agreement and hopefully retain the buy-in of the Settling Parties on the MMU criteria, the Commission should direct on rehearing that PJM develop any supplemental criteria together with stakeholders, not in a vacuum through unilateral action. Otherwise, the Commission's apparent attempt to provide market participants with clarity in the mitigation provisions for RPM will only result in even greater uncertainty and concern on the part of the Settling Parties. Absent a directive to involve stakeholders in the process of developing any supplemental criteria, the critical issue of the criteria to be applied by the MMU in determining whether bids for capacity should be mitigated will drag on well beyond the implementation of RPM.

E. The December 22 Order Erred in Describing the Minimum Offer Price Rule as A Reasonable Method to Forestall "Monopsony Power."

The December 22 Order unnecessarily and incorrectly characterized the MOPR as forestalling "monopsony power."[12] *Order* at P 104. This passing statement, included without any discussion or reasoned decision making, is unfortunate and contrary to the actual terms of the Settlement Agreement. The precise terms of the Settlement *do not* characterize the MOPR as directed at monopsony power. This omission is not accidental. MOPR is an administrative price support, not a barrier against monopsony power.

The Parties to the Settlement Agreement did not agree on a definition of monopsony power and did not agree that the analyses typically employed in antitrust litigation under the laws of the United States have any applicability to a federally tariffed capacity charge that is itself essentially administrative in nature and not the product of a fully functioning competitive market.[13] The MOPR was drafted in exactly the same manner as many other provisions of the Settlement – a compromise between opposing positions as part of a total Settlement package. Some portion of those Parties that signed the Settlement Agreement or that did not oppose it may have rejected the Settlement had it contained "monopsony" language.

Thus, it is clear error to characterize the MOPR as intended to forestall "monopsony power" without any real analysis of the RPM "market" to determine whether the fundamental elements of monopsony might exist. Indicated Buyers strongly

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[12] "The Commission finds the Minimum Offer Price Rule a reasonable method of assuring that net buyers do not exercise monopsony power by seeking to lower prices through self supply."

[13] While the discussion of why RPM does not create a fully functioning competitive market in capacity could fill many pages, the fundamental nature of RPM, as a product that *must* be purchased by buyers and cannot be omitted or substituted by another product conclusively establishes that capacity markets are essentially administrative, not competitive markets.

urge deletion of the reference to "monopsony power" from the Order. As drafted, the MOPR is an administrative price support that does not require a rigorous monopsony market analysis typical of those conducted in litigation and regulation under Section 2 of the Sherman Act[14] and other federal and state laws governing competitive markets.

1. Application of the MOPR Does Not Require Proof of the Elements of Monopsony Power Under the Laws of the United States.

The December 22 Order recognizes that the MOPR provision allows the Market Monitor to establish an alternative higher bid during a transition period where certain supply offers fall below specified parameters. December 22 Order at P 103. As with the 50-year fixed cut-off for mandatory capital expenditure adders, this provision is a transitional mechanism intended to provide price support for generators until the lead time required for new investment envisioned in RPM passes. Nevertheless, the Order erroneously characterizes this provision as addressing "the concern that net buyers might have an incentive to depress market clearing prices" and approves the provision as a "reasonable method of assuring that net buyers do not exercise monopsony power . . . ." *Id.* at 103-104. The December 22 Order's unwarranted leap to the conclusion that this provision is targeted at mitigating monopsony market power presumes without support that monopsony power is a concern that must be addressed in PJM. However, the evidence in this case does not support such a finding, and does not satisfy the requisite proof of the elements of monopsony power mandated by the courts.

In *US v. Syufy*, the 9th Circuit illustrated some of the complex elements of a monopsony power complaint, dismissing a case brought by the U.S. Department of

[14] 15 U.S.C. § 2 (2006).

Justice against a theater chain owner that was allegedly "paying too much" for first run films:

> Thus, the government argues that Syufy had market power, but that it exercised this power only against its suppliers (film distributors), not against its consumers (moviegoers). This is consistent with the record, which demonstrates that Syufy always treated moviegoers fairly: The movie tickets, popcorn, nuts and the Seven-Ups cost about the same in Las Vegas as in other, comparable markets. While it is theoretically possible to have a middleman who is a monopolist upstream but not downstream, this is a somewhat counterintuitive scenario. Why, if he truly had significant market power, would Raymond Syufy have chosen to take advantage of the big movie distributors while giving a fair shake to ordinary people? And why do the distributors, the alleged victims of the monopolization scheme, think that Raymond Syufy is the best thing that ever happened to the Las Vegas movie market?

Syufy, 903 F. 2d at 663.

In essence, a successful monopsony complaint must establish:

- A relevant product;
- A relevant market;
- A pattern of upstream purchases and downstream sales below cost;
- A lack of potential for market entry that could forestall an exercise of market power;
- An ability by the buyer to dictate sellers prices over the long term;
- An ability by the buyer to thus reduce output to increase downstream prices and thus maximize revenue;[15] and
- A dangerous probability of success.

Not surprisingly, monopsony cases typically involve a relevant market which contains a single buyer or small buyer oligopoly pitted against multiple sellers.[16] Monopsony power cases are rare, simply because the purpose of federal and state competition laws are to protect consumers from high prices, not to be used as a weapon against consumers seeking to negotiate lower prices. Caution should be exercised in

[15] *Kamine/Besicorp Allegany L.P. v. Rochester Gas & Elec. Corp.*, 908 F.Supp. 1194, 1203 (W.D.N.Y. 1995); *Kartell v. Blue Shield*, 749 F.2d at 931.
[16] *Mandeville Island Farms v. American Crystal Sugar Co*, 334 U.S. 219 (1948), R. Lipsey, P. Steiner & D. Purvis, *Economics* 976 (7th ed. 1984), *cited* in *Syufy*, 903 F.2d at 663.

intervening in markets where buyer monopsony power is alleged by sellers, but where downstream consumers are seeing the benefits of lower prices. *Kartell v. Blue Shield*, 749 F.2d at 931.

2. As a Tariffed Rate Approved By An Administrative Agency, RPM Does Not Establish a Competitive Market in which a Monopsony Power Analysis Can Be Conducted.

The essential nature of RPM as a tariffed, administratively based charge cannot be denied. No real competitive market would require all buyers and sellers to conform to the set of voluminous, highly detailed and mandatory rules and obligations dictated by the RPM tariffs. All load serving entities in PJM are *required* to purchase capacity rights and may do so only in the manner dictated by the RPM tariff. Buyers do not have an economic choice whether to buy or not buy (even if sellers do have such a choice). In addition, the many administrative rules and requirements, not the least of which being the administratively determined demand curve that establishes the cost of new entry and auction clearing price, are completely uncharacteristic of a competitive market in which buyers and sellers act from their own information and requirements.

Indeed, the Settlement's RPM structure is not the result of bilateral free market negotiations, but the result of a negotiated deal to avoid a fully litigated proceeding before an expert regulatory agency. That fact alone would provide an antitrust defendant with a Noerr-Pennington defense[17] (that RPM is not a market, but the result of a petition by private parties and active supervision by a federal agency pursuing public policy objectives), establishing that monopsony law derived from Sherman antitrust cases may be inapplicable and perhaps counterproductive to the public policy objectives (primarily

[17] *Eastern Railroad Presidents Conference. v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

reliability) sought by the Commission. For the foregoing reasons, the Commission should grant clarification and delete all references to monopsony power or pricing from the Order.

Conclusion and Prayer for Relief

Indicated Buyers respectfully request that the Commission grant Indicated Buyers' requested rehearing or clarification of the December 22 Order in this proceeding, and restore the balance of interests reflected in the as-filed Settlement Agreement by approving the Settlement Agreement without modification.

Respectfully submitted,

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