14-1786 (L)

14-1830 (Con), 14-2130 (Con), 14-2248 (Con)

United States Court of Appeals
for the
Second Circuit

CENTRAL HUDSON GAS & ELECTRIC CORP., PEOPLE OF THE STATE OF NEW YORK and PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, NEW YORK POWER AUTHORITY, NEW YORK STATE ELECTRIC & GAS CORP., ROCHESTER GAS AND ELECTRIC CORP.,

Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent,

ENTERGY NUCLEAR POWER MARKETING, LLC, NRG POWER MARKETING LLC GENON ENERGY MANAGEMENT LLC, ARTHUR KILL POWER LLC, ASTORIA GAS TURBINE POWER LLC, DUNKIRK POWER LLC, NRG BOWLINE LLC, HUNTLEY POWER LLC, OSWEGO HARBOR POWER LLC, INDEPENDENT POWER PRODUCERS OF NEW YORK, INC. (IPPNY),

Intervenors.

REPLY BRIEF OF PETITIONERS
PEOPLE OF THE STATE OF NEW YORK AND PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

Of Counsel

Jonathan D. Feinberg
Solicitor
John C. Graham
Assistant Counsel
Nelli Doroshkin
Assistant Counsel
(518) 474-7687

Kimberly A. Harriman
General Counsel
Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, New York 12223-1350

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PRELIMINARY STATEMENT

In their responses to the Initial Brief of Petitioners People of the State of New York and Public Service Commission of the State of New York (together, NYPSC), Respondent Federal Energy Regulatory Commission (FERC) and Intervenors Entergy Nuclear Power Marketing, LLC and Independent Power Producers of New York, Inc. (together, Entergy) have failed to rebut the NYPSC's demonstrations that FERC did not properly balance the needs of customers and generators in creating incentives for new generation in the lower Hudson Valley. FERC relies on an alleged long-term reliability need, but 1) it rejected a reliability test as part of its imposition of incentives and 2) any long-term incentive could be phased-in to meet that long-term need. The irrationality of FERC's decisions is compounded by its misunderstanding on rehearing of extra-record evidence that it incorrectly found showed a short-term reliability need. Finally, FERC failed to recognize that the incentives it seeks to impose will ultimately be virtually eliminated by state efforts to provide new transmission.

ARGUMENT

POINT I.

FERC HAS FAILED TO ENSURE JUST AND REASONABLE ELECTRIC RATES

FERC argues that it "weighed the competing goals in this case" of reliability and cost. Brief of Respondent Federal Energy Regulatory Commission (FERC Brief) at 19. FERC failed to balance those "goals," however, inasmuch as it has significantly increased electric costs, through a flash-cut to its new rate zone, based on its misapprehension of reliability needs.

A. FERC irrationally invoked reliability as a basis for immediate price increases for the lower Hudson Valley.

FERC defines reliability as "a capacity deficiency due to both the lack of resources within the constrained area and the inability to import resources into the constrained area." FERC Brief at 21; *cf. New York Indep. Sys. Operator, Inc.*, 147 FERC ¶ 61,152, Order on Rehearing (May 27, 2014) (Zone Rehearing Order) at P 14 (JA 2994-95). It arbitrarily invokes this construct of "reliability" as a basis for immediate price increases in the lower Hudson Valley when it previously rejected reliability as a criterion for a new capacity zone.

In its September 8, 2011 order, FERC expressly rejected the New York Independent System Operator's (NYISO) reliability test, which looked to whether the loss of a large generator, plus losses of transmission into a zone, would "create a resource deficiency condition (i.e., imports and generation equal less than peak load)." *New York Indep. Sys. Operator, Inc.*, Order on Compliance Filing, 136 FERC ¶ 61,165 (Sept. 8, 2011), at P 59. FERC rejected that test on the ground that even when reliability needs are met on both sides of a transmission constraint, the relative market value of capacity on either side of the constraint might not be recognized. *Id.* at P 60.

FERC's belated invocation of reliability, then, is merely an attempt to backfill a consumer benefit into a rationale for price increases founded on market theory. As it recognized in its 2011 compliance order, system reliability means that the electric power grid can withstand a large generator loss followed, after system adjustments, by loss of another generator or transmission element (known as an "N-1-1 loss"). *Id.* at PP 6, 59.[1] FERC, however, did not require such a showing of reliability need in order to create a new capacity zone by, for instance, requiring an engineering analysis of such a need. Thus, as the NYPSC demonstrated in its initial brief, at 27-33, FERC's finding of reliability need lacks record support.

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[1] This is an engineering test based on NYISO's Comprehensive Reliability Planning Process Manual and North American Electric Reliability Corporation (NERC) system engineering standards. *Id.* at P 6 n.11.

Having built no engineering record on reliability, FERC instead attempts to create a potential reliability need based upon the performance of the capacity market. Notably, its so-called "long-term reliability" concerns rely on claims about the need for proper economic signals, FERC Brief at 20-21; *New York Indep. Sys. Operator, Inc.*, Order Accepting Proposed Tariff Revisions, 144 FERC ¶ 61,126 (August 13, 2013) (Zone Order) at P 31 (JA 980); Zone Rehearing Order at PP 14-16 (JA 2994-95), or upon market "deliverability" constraints, Zone Order P 31 & n.31 (JA 980).

Entergy goes one step further, claiming that there is an immediate reliability need. It argues that delaying price increases through imposition of the New Capacity Zone for another three years would "risk blackouts for three more summers and winters." Joint Intervenor Brief of Entergy and IPPNY in Support of Respondent Federal Energy Regulatory Commission (Entergy Brief) at 18. There is, however, no factual support for a risk of blackouts in the new zone within the next three years even under extreme weather conditions. As discussed in the NYPSC brief at 28-30, the 121 MW extreme weather need the NYISO identifies for Southeast New York in its 2014 Summer Capacity Assessment includes Long Island, which is not part of the new zone. Entergy asserts that it "strains credulity" to assume that the entire extreme weather need would be due to Long Island, which it claims has excess generation capacity. It fails to observe, however, that Long

Island has only 249 MW in excess generation capacity,[2] even under normal weather conditions. In extreme weather, Long Island's demand for electricity would be 451 MW higher than normal.[3] Moreover, Entergy refers to the locational capacity requirement of 107% but fails to acknowledge that the statewide requirement is 117%,[4] so even under the current conditions of a small excess, Long Island needs to procure some capacity from upstate. Thus, Entergy's attempt to explain away Long Island's contribution to extreme weather electric needs in Southeast New York fails.

Given the absence of an immediate reliability need, FERC's alleged balancing of cost and reliability considerations is unpersuasive. The 2012 State of the Market Report cited by FERC vaguely refers only to long-term reliability needs. FERC Brief at 40 (quoting the 2012 State of the Market Report: "the Reliability Needs Assessment has identified resources … are necessary for resource adequacy over the next ten years"). There is, however, no likelihood of a resource adequacy need in the lower Hudson Valley or the New Capacity Zone

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[2] Entergy brief, Addendum G, page A-115.

[3] New York Independent System Operator 2014 Load & Capacity Data 'Gold Book,' at 12 (showing baseline load data for Zone K) and 16 (showing 90/10, or extreme weather load data for Zone K), *available at* http://www.nyiso.com/public/webdocs/markets_operations/services/planning/Documents_and_Resources/Planning_Data_and_Reference_Docs/Data_and_Reference_Docs/2014_GoldBook_Final.pdf.

[4] *See* Requirement Percentages, *available at* http://icap.nyiso.com/ucap/public/ldf_view_icap_calc_selection.do.

under the appropriate Loss of Load Expectation metric. New York State has "a reliability requirement for minimum capacity meeting a one day in ten year (0.1 day per year) Loss of Load Expectation." Zone Order at P 2 (JA 969-70). The NYISO's current Loss of Load Expectation data show reliable performance in the Zones making up the New Capacity Zone through 2018.[5] No document cited by FERC or Entergy evidences a resource adequacy need in the lower Hudson Valley, or even refers to a reliability need before 2019.[6]

In objecting, moreover, to FERC's irrational approach to reliability needs, the NYPSC is not collaterally attacking FERC's criteria for creating a capacity zone, as Entergy charges. Entergy Brief at 23-26. To the contrary, the NYPSC objects to FERC's inconsistent, post-hoc reliance upon unsubstantiated reliability needs on rehearing. Reliability was not among the criteria employed in establishing the zone, inasmuch as FERC expressly rejected it, but FERC nonetheless sought to invoke an immediate reliability need on rehearing. As FERC has reopened the handling of reliability by adding previously unasserted bases for creating the zone, the NYPSC's challenge is not barred. *Sacramento Mun. Utility*

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[5] New York Independent System Operator 2014 Reliability Needs Assessment Draft Report at 32, *available at*: http://www.nyiso.com/public/committees/documents.jsp?com=bic_espwg&directo%20ry=2014-06-30.

[6] The Affidavit of Mark D. Younger (JA598-613), cited by FERC (Brief at 40), alleges a potential "reliability" need that is founded upon market value, rather than system engineering.

Dist. v. FERC, 428 F.3d 294, 299 (D.C. Cir. 2005).[7] Further, Entergy (at 26-29) wrongly accuses the NYPSC of failing to preserve its objection to FERC's incorrect reliance on extra-record materials to show an immediate reliability need; FERC did not invoke that alleged immediate reliability need until rehearing.[8]

B. FERC failed to examine cost impacts of the new zone.

FERC has failed to offer any explanation that it examined how capacity price increases will affect residential, commercial and industrial customers. Instead, it offers the proposition that "the ultimate impact will be determined by supply and demand conditions." FERC Brief at 23. In so arguing, FERC incorrectly treats the demand curve "as a model of the relationship between prices and consumer preferences in a free market," which it is not. *Maine Pub. Util. Comm'n v. FERC*, 520 F.3d 464, 468 n.3 (D.C. Cir. 2008), *rev'd on other grounds*, 558 U.S. 165 (2010). Rather, as the D.C. Circuit recognized, "the 'demand curve'

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[7] Likewise, Entergy wrongly claims (Entergy Brief at 2, 16, 17, 23, 26 and 29) that the NYPSC's claims are jurisdictionally barred, but because the harm to ratepayers was not definitive at the criteria creation stage, the NYPSC's claims would have been premature. *Pub. Serv. Co. of New Mexico v. FPC*, 557 F.2d 227, 233 (10th Cir. 1977). Moreover, the NYPSC objection is not to FERC's refusal to adopt reliability as a criteria, but to its attempt to reintroduce that criteria without a proper record.

[8] Similarly, the NYPSC preserved its objection to FERC reliance on potential reliability needs by seeking rehearing of FERC's failure to recognize that New York State's transmission initiatives would resolve the transmission constraint ahead of NYISO's projected 2019 reliability need.

proposed by the ISO is an entirely artificial construct that specifies the prices that must be paid for various quantities of capacity." *Id*.

FERC argues that price changes within the new zone "promote efficient decisions" (FERC Brief at 25), and cites as an example of that efficient decision-making NYPSC's actions in removing obstacles to the return of the 540 MW Danskammer generating facility to service in response to the creation of the new zone. FERC seems to believe that because Danskammer's return to service increases capacity within the zone, in conformance with its intent, that intent must be just and reasonable. Instead, the circumstances attending the resumption of operations at Danskammer demonstrate the opposite–that FERC has failed to show its actions are either just or reasonable.

In 2013, NYPSC decided, based on analyses and findings submitted by the NYISO and the local distribution utility, that retirement of the Danskammer facility would not adversely affect reliability within the lower Hudson Valley region. NYPSC Case 13-E-0012, *Dynegy Danskammer LLC*, Order Approving Transfer and Authorizing a Retirement Prior to Expiration of the Notice Period (April 22, 2013). As FERC admits in citing the NYPSC order on the return of Danskammer to service, the only reason Danskammer was not retired in conformance with NYPSC's expectations was the creation of the new zone. NYPSC Case 14-E-0117, *Helios Power Capital, LLC*, Order Approving Transfer and Making Other Findings, p. 23 (June 27, 2014).[9] Indeed, the NYPSC authorized the facility's return to service because it could serve as an immediate market-based response that would constrain the FERC-imposed rate increases.

That the return of Danskammer mitigates those increases in conformance with FERC's market design does not demonstrate they were reasonable in the first instance. Moreover, that the creation of the new zone had the effect FERC intended, by increasing capacity in the new zone above what it otherwise would have been, does not demonstrate that the increases, as intended, were cost-effective.

Consequently, the outcome of FERC's decision is that a specific finding that the Danskammer facility was not needed for reliability purposes, as made by NYPSC and supported by NYISO, was in effect overturned by the creation of the new zone without any inquiry as to whether the return of the facility to operation would cause consumers to unreasonably bear costs that are not required to persevere reliability. The creation of the new zone therefore has caused the return of Danskammer to operation at a significant cost (as compared to what the cost would have been absent the new zone) to consumers without any showing that it is, in fact, needed for reliability purposes.

[9] In its citation, FERC references the wrong NYPSC case number; the correct number is Case 14-E-0117, not Case 13-E-0012, which is the earlier proceeding where NYPSC found the Danskammer facility was not needed for reliability purposes.

NRG Power Marketing LLC, et al. (NRG), responding to the NYPSC's refutation of FERC's reliance upon the potential restoration of NRG Bowline LLC Unit 2, attempts to explain away its March 17, 2014 letter to the NYPSC, NYPSC Reply Brief in Support of Emergency Motion for Stay, 2d Cir. Docket No. 14-1482, Attachment A; cited by FERC in the Zone Rehearing Order (JA 3039), indicating its hesitancy to consummate that project if Danskammer were to resume operation. Its response, however, concedes that a "competing resource" could enter the market "in lieu of Bowline," NRG Brief at 7, and that "entry of a new resource certainly affects price projections," *id.* at 8. These statements show that any market entry could discourage further market entry, and thereby undermine FERC's basis for assuming that the price increase will be mitigated.

Entergy wrongly maintains that the NYPSC failed to preserve arguments regarding the FPA's requirement that FERC consider consumer impacts of tariff revisions. The first heading in the discussion section of the NYPSC's Petition for Rehearing of the August Order, however, reads: "The Commission . . . Failed to Provide Meaningful Consideration of Arguments That the New Capacity Zone Would Result in Unjust and Unreasonable Impacts." (JA 1075). In any event, FERC does not appear to concur with Entergy's preservation claims.

C. FERC has not rebutted the demonstration that its rejection of the phase-in was unreasonable.

FERC now argues that the New Capacity Zone addresses only a long-term reliability need, FERC Brief at 1, but it nonetheless refused to implement a phase-in that would have mitigated consumer impacts without impeding long-term investments in generation capacity. *See New York Indep. Sys. Operator, Inc.*, Order Accepting Tariff Filing Subject to Condition and Denying Waiver, 146 FERC ¶ 61,043 (Jan. 28, 2014) (Demand Curve Order) at P141 (JA 2827-28) (noting the NYISO's statement that a phase-in would not interfere with long-term investment decisions, due to the longer-term revenue forecast horizon used by generation developers). Even had FERC developed a record supporting a long-term reliability need, as it claims it had done, FERC Brief at 26-27, its rejection of the phase-in was irrational. Any FERC balancing of "the need for accurate price signals, price impacts to consumers, and the significant process leading up to these orders," would favor phase-in of the cost increases in the Hudson Valley resulting from the New Capacity Zone, so as to match the timing of impacts to the realization of any theoretical benefits.[10]

[10] FERC claims at 22 that it could rely on projected demand curves and entry costs, citing *Maine Pub. Util. Comm'n v FERC*, 520 F.3d at 472. Courts looking at demand curves have required, however, a reasoned explanation of why "more good than harm" will come from their implementation. *Electricity Consumers Resource Council v. FERC*, 407 F.3d 1232, 1238 (D.C. Cir. 2005).

Again, the circumstances surrounding the Danskammer facility are instructive. A phase-in might have supported the return of the Danskammer facility to service without imposing on New York ratepayers the full burden of the costs of the new zone as FERC has implemented it. But, since FERC declined to conduct any inquiry as to whether a phase-in would have been adequate for its purposes, the answer to the question of whether Danskammer would have returned in response to a phase-in is unknown. That FERC failed to even conduct the requisite inquiry, however, demonstrates it did not engage in reasoned decision-making.

FERC also attempts to rely on alleged advance notice to stakeholders of price increases. FERC, however, never considered the magnitude of the price increases, so customers were given no time to plan for the immediate price increases due to the New Capacity Zone. Moreover, while consumers here incurred millions of dollars in costs well in advance of the prospect of any potential price relief, incumbent generators were given the price incentives immediately, well in advance of providing any benefits. The contrast clearly identifies the parties whose interests FERC favors.

POINT II.

TRANSMISSION PROJECTS RENDER THE NEW CAPACITY ZONE UNNECESSARY AND INEFFECTUAL

The NYISO proposed the New Capacity Zone on the basis of a deliverability study that identified a transmission constraint. Zone Order at P 6 (JA 971). As the NYPSC noted before FERC, the State's ongoing competitive procurement processes for transmission projects "would address the same deliverability constraint identified by the NYISO," NYPSC Rehearing Request at 2 (JA 1071), rendering the New Capacity Zone unnecessary. Moreover, in light of the transmission projects, price signals that are intended to encourage long-term generation investments become meaningless. Any overall long-term need for the lower Hudson Valley will be met by New York's transmission initiatives, which, in the meantime, will diminish any incentives provided to generation projects. FERC has thus not promoted the orderly development of plentiful supplies of electricity. See *Consol. Edison Co. of New York v. FERC*, 510 F.3d 333, 342 (D.C. Cir. 2007), cited in FERC Brief at 19.

Though FERC recognizes that the transmission constraint would be alleviated by the New York transmission projects, it dismissed the NYPSC's arguments because the projects were not put in place immediately after the constraint was observed. FERC Brief at 35. FERC also argues that it lacks assurances that the projects will be completed during the 2016-2018 timeframe. *Id.* at 36. Two of the Transmission Owner Transmission Solutions projects identified by the NYPSC, however, have an in-service date of summer 2016. NYPSC Case 12-E-0503, *Generation Retirement Contingency Plans*, Order Upon Review of Plan to Issue Request for Proposals at 3 (issued March 15, 2013). As FERC understands, making decisions on assets with 40-plus years of service life requires careful deliberation.

Finally, FERC cannot simply rubber-stamp the NYISO's proposed tariff revisions without regard to the requirement that rates be just and reasonable, contrary to its claims (FERC Brief at 46-48). 16 U.S.C. §824d. The NYISO's tariff requires only that the NYISO *propose* a new capacity zone for review by FERC as to whether the implementation of the proposal is just and reasonable. New York Independent System Operator Markets and Services Tariff at 5.16.4 ("If the NCZ Study identifies a constrained Highway Interface, the ISO shall file for Commission review proposed tariff revisions necessary to establish and recognize the New Capacity Zone or Zones.") (JA 217). That the NYISO followed its procedures for proposing a new capacity zone does not relieve FERC of its statutory obligation to ensure the reasonableness of rates resulting from market changes.

CONCLUSION

For the foregoing reasons, this Court should vacate Respondent FERC's orders challenged herein, to the extent necessary to eliminate the New Capacity Zone and to restore the New York capacity market to the status quo ante. The Court should further direct FERC to issue refunds of capacity charges assessed back to May 2014 to the extent this Court finds those charges to have been excessive, and grant such other and further relief as it deems just and reasonable.

Respectfully submitted,

Kimberly A. Harriman
General Counsel

/s/ John C. Graham
John C. Graham
Nelli Doroshkin
Assistant Counsel
Jonathan D. Feinberg, Solicitor
Of Counsel
Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, New York 12223-1350
(518) 474-7687

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