ORAL ARGUMENT NOT YET SCHEDULED

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

Nos. 15-1453 and 15-1455 (Consolidated)

PJM POWER PROVIDERS GROUP, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for Review of Orders of the
Federal Energy Regulatory Commission

REPLY BRIEF FOR PETITIONERS THE PSEG COMPANIES AND PJM POWER PROVIDERS GROUP

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Reply Brief Dated: September 6, 2016

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

(A) Parties and Amici Curiae

(1) Before the Federal Energy Regulatory Commission

Intervenors and amici appearing before the Federal Regulatory Commission are listed in the Petitioners' Brief.

(2) Before this Court

All parties and intervenors appearing before this Court are listed in the Petitioners' Brief.

(B) Rulings Under Review

The orders on review are listed in the Petitioners' Brief.

(C) Related Cases

The orders on review in this matter have not previously been before this Court or any other court.

Respectfully submitted,

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September 6, 2016

PETITIONERS' CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, Fed. R. App. P. 26.1, and Rule 26.1 of the General Rules of the United States Court of Appeals for the District of Columbia Circuit, the PJM Power Producers Group ("P3"), Public Service Electric and Gas Company ("PSE&G"), PSEG Power LLC ("PSEG Power") and PSEG Energy Resources & Trade LLC ("PSEG ER&T") (collectively "PSEG" or the "PSEG Companies") hereby provide the corporate disclosure statement in connection with the Petition for Review in the above-captioned matter.

1. P3 is a non-profit organization dedicated to advancing federal, state and regional policies that promote properly designed and well-functioning electricity markets in the PJM Interconnection, L.L.C. ("PJM") region.[1] Combined, P3 members own over 84,000 MWs of generation assets, produce enough power to supply over 20 million homes and employ over 40,000 people in the PJM region covering 13 states and the District of Columbia. For purposes of this disclosure statement, P3 respectfully submits that it is a trade association pursuant to Circuit Rule 26.1 (b).

[1] The statements contained in this brief represent the position of P3 as an organization, but not necessarily the views of any particular member with respect to any issue.

2. The PSEG Companies are each wholly owned, direct and indirect subsidiaries of Public Service Enterprise Group Incorporated ("PSEG"). The principal and executive offices of PSEG are located at 80 Park Plaza, Newark, New Jersey 07102. PSEG is a public utility holding company engaged in, among other things, the generation, transmission, and sale of electric energy through its subsidiaries.

3. PSE&G is a public utility company organized under the laws of the State of New Jersey. PSE&G is presently engaged in, among other things, the transmission and distribution of electricity and the distribution of natural gas in New Jersey.

4. PSEG Power is a wholesale energy supply company that integrates its generation asset operations with its wholesale energy, fuel supply, energy trading and marketing, and risk management functions through three principal subsidiaries: (i) PSEG Nuclear LLC, which owns and operates nuclear generating stations; (ii) PSEG Fossil LLC, which develops, owns, and operates domestic fossil-fired and other non-nuclear generating stations; and (iii) PSEG ER&T.

5. PSEG ER&T sells power and certain ancillary services at market-based rates. PSEG ER&T markets the capacity and production of PSEG Nuclear's and PSEG Fossil's generating stations, manages the

commodity price risks and market risks related to generation, and provides gas supply services. PSEG ER&T is engaged in extensive asset-based energy trading operations throughout the Northeast.

6. PSE&G has publicly-held preferred stock and debt securities outstanding. PSEG has publicly-held common stock and debt securities outstanding. PSEG Power LLC, has publicly-held debt securities outstanding.

Respectfully submitted

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GLOSSARY

APA	Administrative Procedure Act
BLS	Bureau of Labor Statistics
Br.	Petitioners Brief for the PSEG Companies & PJM Power Providers filed May 31, 2016
Brattle	The Brattle Group
Brattle CONE Study	"Cost of New Entry Estimates for Combustion Turbine and Combined Cycle Plants in PJM," included as an appendix to the Newell/Ungate affidavit, designated as Attachment D to PJM's September 25, 2014 filing
Brattle Report	"Third Triennial Review of PJM's Variable Resource Requirement Curve," included as an appendix to the Newell/Spees affidavit, designated as Attachment E to PJM's September 25, 2014 filing
Capacity	The ability of a generator to produce a certain quantity of energy, regardless of whether it is actually called upon to operate.
Capital Asset Pricing Model	Capital Asset Pricing Model is a method for pricing securities which assumes that the expected return of a security will equal the rate on a risk-free security plus an additional risk premium associated with the particular security being analyzed**.**
Commission	Federal Energy Regulatory Commission
CONE	The nominal levelized amount intended to represent the "cost of new entry" for a representative peaking plant taking account of capital costs (including a return on investment) and fixed operating and maintenance costs. Net CONE—that is, CONE minus expected revenues

	for energy and ancillary services—is located on the RPM downward sloping demand curve at the point corresponding with the target reserve level plus 1%. The CONE value determines the height of the downward sloping demand curve. CONE is determined administratively through engineering and financial studies. In the past, the tariff required PJM to update CONE every three years. Following the most recent update in 2014, the tariff requires PJM to update CONE every four years.
FPA	Federal Power Act
Gross CONE	The Gross Cost of New Entry reflects the revenues a new generation resource needs to earn to enter the market and recover its capital investment and annual fixed costs and is the value equal to the CONE before subtracting expected revenues for energy and ancillary services.
IMM	The Independent Market Monitor that oversees markets administered by PJM Interconnection, L.L.C.
Int. Br.	Brief of Intervenors PJM Interconnection, L.L.C., American Municipal Power, Inc., The New Jersey Board of Public Utilities, Old Dominion Electric Cooperative and PJM Industrial Customer Coalition filed August 15, 2016
IPP	Independent Power Producer
Initial Order	*PJM Interconnection, L.L.C.*, 149 FERC ¶ 61,183 (2014), JA____-____
IRM	Installed Reserve Margin
Locational Delivery Areas	Zones or sub-zones within PJM that may separate as separate markets under RPM.

Net CONE	The Net Cost of New Entry is the value equal to the CONE after subtracting expected revenues for energy and ancillary services.
P3	PJM Power Providers Group
PJM	PJM Interconnection, L.L.C.
PJM Filing	*PJM Interconnection, L.L.C.*, Docket No. ER14-2940-000 (filed September 25, 2014)
PSEG	Public Service Electric and Gas Company, PSEG Power LLC and PSEG Energy Resources & Trade LLC
Rehearing Order	*PJM Interconnection, L.L.C.*, 153 FERC ¶ 61,035 (2015), JA____-____
Resp. Br.	Brief of Respondent Federal Energy Regulatory Commission filed on August 1, 2016
ROE	Return on Equity
RPM	Reliability Pricing Model. The rules that govern PJM's procedures for securing sufficient generation capacity to serve anticipated demand. The main provisions of RPM are set forth in Attachment DD of the PJM tariff.
S&L	Sargent & Lundy
Tariff	PJM Open Access Transmission Tariff
VRR Curve	Variable Resource Requirement Curve is the administratively determined demand curve used for RPM auctions. Discrete zones called "locational deliverability areas" may have separate curves for particular auctions to incentive the retention of existing resources or the development of new resources in that area.

Petitioners Public Service Electric and Gas Company, PSEG Power LLC and PSEG Energy Resources & Trade LLC ("PSEG") and PJM Power Providers Group ("Power Providers") hereby reply to the briefs of respondent the Federal Energy Regulatory Commission ("FERC") and intervenors PJM Interconnection, L.L.C., American Municipal Power, Inc., The New Jersey Board of Public Utilities, Old Dominion Electric Cooperative and PJM Industrial Customer Coalition, in support of respondent ("Intervenors"):

I. SUMMARY OF ARGUMENT

FERC is not entitled to the degree of deference claimed by it and by Intervenors. In particular, FERC is not entitled to deference as to findings involving certain legal determinations that lie at the heart of this appeal. In addition, FERC admits that it lacks expertise regarding the risk-profile characteristics of companies that use project financing techniques and should not be accorded deference regarding the Cost of Capital of such companies.

FERC mischaracterizes the labor cost issue raised in this appeal as a simple allegation that Petitioners' witness was more knowledgeable and credible than PJM's witness. The materials cited by FERC and Intervenors fall short of the substantial evidence mark standing alone. Importantly, Petitioners were not afforded a fair opportunity to rebut PJM's presentations due to the lack of explanation in the documents PJM relied upon. Further,

using justifications raised for the first time in its brief, FERC wrongly allowed reliance on materials that it had found in an earlier proceeding were insufficient to support a just and reasonable outcome, without addressing the contradictory evidence raised in that earlier case. FERC's attempt to disparage Petitioners' witness's testimony by ignoring his professional experience and the factual foundation for his testimony misreads the case law and falls flat. Finally, FERC and Intervenors continue to insist that the labor cost values proposed by PJM reflect a stakeholder compromise when, in fact, the stakeholder records maintained by PJM show that the claimed compromise is illusory.

FERC's brief significantly narrows the Cost of Capital issue before the Court. FERC does not contradict the main premises of Petitioners' argument: that 70% of new gas-fired generation in PJM is being built by companies that use project finance techniques; that such companies face higher risks than other types of merchant generators; and that FERC never considered the risk profiles of these types of entities in accepting the Cost of Capital value. FERC's claim that it conducted a detailed analysis of the *other* types of market participants is simply inadequate under the precedent requiring FERC to use a risk-appropriate proxy group. FERC's additional response that it did not consider the available evidence about private equity companies' rates of return

sufficiently granular is also inadequate. If the available evidence was not sufficient, FERC should have issued a deficiency letter or convened a hearing to provide better evidence.

II. ARGUMENT

A. FERC Overstates Its Entitlement to Deference

1. FERC Cannot Claim Deference for Its Reliance on the Stantec or CH2M Hill Reports

FERC claims it should be accorded deference for two categories of findings: "policy decisions" and determinations regarding "technical" matters. Resp. Br. 13-15, 18, 26. However, two of FERC's key assertions are matters of law that cannot be categorized under either of those headings.

First, FERC claims, based solely on its interpretation of judicial precedent, that the Stantec report contained sufficient explanation for Petitioners to fairly challenge the evidentiary foundation for Stantec's conclusions. Resp. Br. 29-30. FERC also opines that PJM could properly rely upon the CH2M Hill report as support for the labor cost estimates, notwithstanding FERC's earlier findings that the recommendations made in the report, and the labor cost values in particular, had not been shown to be just and reasonable. Resp. Br. 28. FERC does not purport to be interpreting the FPA or deciding a matter within its expertise and thus is not entitled to deference with regard to these issues. *See Knott v. FERC*, 386 F.3d 368, 372

(1st Cir. 2004) ("'Pure' legal errors require no deference to agency expertise, and are reviewed de novo.") (citations omitted); *Thomas Hodgson & Sons, Inc. v. FERC,* 49 F.3d 822, 826 (1st Cir. 1995) ("Because FERC did not base its jurisdiction on an interpretation of the statute but looked to case law, we owe its finding of jurisdiction no more deference than we would any lower court's analysis of law.").

2. FERC Overstates The Matters To Which It Is Owed Deference

Notwithstanding FERC's repeated attempts to characterize the issues for review as policy-driven, there are few, if any, "policy determinations" before this Court. FERC and Intervenors make much of the complexities and trade-offs associated with the design of the administratively determined demand curve. *See* Resp. Br. 11, 18; Int. Br. 14. However, the rate design elements of the Reliability Pricing Model ("RPM") are not before the Court and Petitioners do not challenge them here. The questions posed here are purely factual issues affecting how the approved design is implemented. FERC's and Intervenors' attempt to treat these "two narrow discrete parts of [its] orders" as policy matters is misplaced. Resp. Br. 10.

Indeed, Intervenors argue that policy trade-offs *not* before the Court are so thorny that, categorically, "any claim that FERC must precisely estimate the only two inputs (construction labor and Cost of Capital) that are challenged

here, is misguided." Int. Br. 14. Yet, PJM's market design witnesses explained that "[a]ccurate Net CONE [Cost of New Entry] values are critical to RPM performance." Third Triennial Review of PJM's Variable Resource Requirement Curve, ("Brattle Report") at iii, PJM Transmittal Letter, Attach. E, Newell/Spees Aff., JA___. Thus, because the CONE level affects capacity auction outcomes, challenges to whether it has been correctly calculated are proper. Further, if Intervenors' sweeping claim were accepted, challenges to PJM's capacity market could never be made except to challenge the design in its entirety.

Also, while it is correct that FERC generally is entitled to deference regarding "technical" matters within its expertise, such deference is not absolute and "expertise cannot be used as a cloak for fiat judgments." *Tennessee Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1211 (D.C. Cir. 1991). Because the Stantec report lacked sufficient detail regarding its source data and methodology to provide Petitioners with a fair opportunity to respond, FERC should not be given deference regarding its conclusions. *See Public Serv. Comm'n of Kentucky v. FERC*, 397 F.3d 1004, 1006 (D.C. Cir. 2005) ("FERC is entitled to deference only if it plays fair."); *SmithKline Corp. v. Food and Drug Admin.*, 587 F.2d 1107, 1118 (D.C. Cir. 1978) ("[I]t is not clear how far that deference [regarding technical matters] should extend when an agency has

deliberately prevented the creation of a record by which its determinations can be probed for their underlying 'basis in fact.'"). Moreover, FERC conceded below that it lacked expertise regarding the risk-profiles of developers that use project financing techniques claiming that the available information was a "poor proxy" for the Cost of Capital associated with power plant development. Rehearing Order P 67, JA___. Accordingly, FERC cannot claim expertise regarding the differences in the characteristics of such companies from other generation developers which Petitioners contend is a key determination affecting the Cost of Capital value. *Cf. Louisiana Pub. Serv. Comm'n v. FERC*, 761 F.3d 540, 554 (5th Cir. 2014) ("[I]f FERC did not rely on any technical or factual expertise [court would] review[] its interpretation 'freely'")

In the end, FERC must engage in reasoned analysis on the basis of substantial evidence, and it must write a decision that reflects a serious look at objections. A plea for "deference" based on claimed policy choices or technical expertise is not a substitute for the essential predicates for lawful agency action. *See Achernar Broadcasting Co. v. FCC*, 62 F.3d 1441, 1447 (D.C. Cir. 1995) ("While agency expertise deserves deference, it deserves deference only when it is exercised; no deference is due when the agency has stopped shy of carefully considering the disputed facts.") (citation omitted).

B. FERC's Attempt to Portray The Dispute Over Labor Costs as a Simple "Battle of Experts" Ignores the Core Issues Raised by Petitioners

FERC attempts to paint Petitioners' objections as simply an assertion that their expert, Mr. Uniszkiewicz, made a more robust showing than PJM's witness, Dr. Sotkiewicz, in estimating the labor costs associated with constructing the reference unit. Resp. Br. 19-26. This is inaccurate. Petitioners' central contentions are that:[2]

(i) PJM's filing lacked reliable evidence regarding one of the main elements of the labor cost calculation—the base labor-hours—and hence FERC's acceptance of PJM's presentations failed to meet the "substantial evidence" standard, Br. 36-38, 40-49;

(ii) FERC relied upon an alleged compromise in the stakeholder process that never occurred, *id.*, 38-40;

(iii) FERC failed to engage in reasoned decision-making by inadequately responding to Petitioners' evidence that the base labor-hour values used for the computations of labor costs were too low, *id*., 49-53; and

[2] Intervenors' claim that Petitioners have waived claims about labor productivity values is of no moment. Int. Br. 16. As Petitioners' brief demonstrates, due to the significantly understated values of the base labor-hours value and the wage rates used by PJM, the overall level of the labor costs used for calculating CONE for the Combustion Turbine reference unit is unreasonably low and will result in RPM auction outcomes that are not just and reasonable.

(iv) FERC never responded to the Petitioners' objections to the use of wage data that did not fairly represent the type of workers who would be expected to construct a power plant, *id.*, 53-56.

1. The Support for the Base Labor-Hours Value Used in PJM's Calculation of Labor Costs Failed to Satisfy the "Substantial Evidence" Standard

FERC claims that it had sufficient evidence to support the base labor-hours value used by Dr. Sotkiewicz in calculating the labor costs for the reference unit. FERC found "that PJM's proposal 'reflects its careful review of the Market Monitor's labor cost estimates, including a comparison against prior labor cost estimates and public data on labor costs,[3] and represents a reasonable alternative estimate for construction labor costs.'" Resp. Br. 16 (citing Initial Order P 107), JA___. That finding is mistaken.

(a) The Stantec Report

i. The Stantec Report Lacks Sufficient Foundation to Be Considered "Substantial Evidence"

PJM could not have made a "careful review" of the labor-hours estimate provided by Pasteris/Stantec because there was nothing substantive to review.

[3] Although included in the section of FERC's brief addressing the base labor-hour values, there is no suggestion in the record of any "public data" supporting the base labor-hours values that PJM used. FERC makes this error a second time in its brief stating that the labor-hours value used by PJM was "confirmed by publicly available data." Resp. Br. 17.

The Pasteris Report included only one vaguely-worded sentence that might, arguably, be read as providing support for the Stantec labor-hours estimate, namely: "The power plant construction estimate was developed based on data from recent construction proposals and input obtained from multiple construction contractors." Br. 41 (quoting Pasteris Report at 2-3).[4] As Petitioners showed, this conveys no meaningful information about the sources Stantec used to acquire the data—certainly not enough information to probe whether the conclusion is reliable. Br. 40-44. Neither PJM nor FERC could have "careful[ly] review[ed]" the underlying data because there wasn't any meaningful data to review.

FERC's reliance upon *Sacramento Municipal Utility District v. FERC*, 616 F.3d 520 (D.C. Cir. 2010), and similar cases is misplaced. *See* Resp. Br, 12, 13, 14, 17, 18, 20, 26, 36. Those cases do not support FERC's "substantial evidence" claim with respect to the Stantec report for two reasons. First, unlike the fact pattern in *Sacramento*, where FERC had grounds to conclude that the sworn testimony of the experts was reliable, here FERC blindly accepted PJM's reliance on the Stantec report despite the fact that FERC had no means to evaluate it. Second, the evidentiary foundation for the Stantec

[4] Pasteris Report, Brattle CONE Combustion Turbine Revenues Requirement Review http://www.pjm.com/~/media/committees-groups/task-forces/cstf/20140725/20140725-brattle-vs-ma-som-cone-ct-revenue-requirements-comparison-final-report.ashx.

report is insufficient on its face even without recourse to contradictory evidence. FERC should have found PJM's supporting documents deficient even before it considered the competing evidence. *Sacramento* and other cases cited by FERC involving contradictory evidence between experts in which FERC weighs the relative merits of that evidence thus are not on point.

Florida Gas Transmission Co. v. FERC, 604 F.3d 636 (D.C. Cir. 2010), which FERC also relies upon, provides a more useful framework for evaluating FERC's "substantial evidence" claim. The issue in *Florida Gas* was determining a reasonable compliance standard for the interchangeability of natural gas from divergent sources. *Id*. at 643-644. Certain generators receiving service from the pipeline argued that the standard adopted by FERC was too lax. *Id*. at 644. FERC's findings in that case rested on two "public documents": materials prepared by generator manufacturers that set forth the technical capabilities of their machines. *Id*. at 644, 645. The facts in *Florida Gas* thus are analogous to those here in that the supporting presentations upon which FERC based its decision consisted of materials that were not sponsored by the utility's witnesses. But the similarities end there.

In *Florida Gas*, FERC included a detailed explanation about why these "public documents" were considered "particularly reliable" which took account of the reasons why they were prepared and why the manufacturing companies

would have set forth the specifications at reasonably achievable levels. *Id.* For example, the Court noted that the manufacturers had financial incentives to prepare accurate reports consistent with their warranties because "customers rely upon [the specifications] for ordering, operating their equipment and warranties." *Id*. at 644-45.

In contrast, nothing similar can be said about FERC's knowledge or analysis of the Stantec Report's base labor-hours estimate. At best, all that FERC knew was that Stantec prepared some "proposals" for some unknown purposes and obtained some "input" from unknown construction contractors. Unlike *Florida Gas*, FERC had no knowledge regarding the source of underlying data, e.g., whether it pertained to construction of the reference unit or the identity of the contractors providing input. Thus, FERC had no basis for assessing the reliability of the opinion.[5] The Stantec Report does not come close to providing the level of "substantial evidence" found in *Florida Gas* for a "public document," given its almost complete lack of foundation.

Further, FERC's brief proposes a double standard for "substantial evidence." Specifically, in criticizing Petitioners' witness, Mr. Uniszkiewicz,

[5] *Cf. BP Pipelines (Alaska) Inc. et al.*, 146 FERC ¶ 63,019, 66,345, fn.663 (2014) ("The Carriers have abandoned their claims that the cost estimate it commissioned from Stantec Consulting should be used .... As the State points out ..., the Stantec estimate is a wholly unreliable, rough order of magnitude estimate based on 'budgetary pricing.'")

FERC claimed that the data he relied upon rendered his testimony "conclusory assertions unsupported by record evidence." Resp. Br. 2. Yet, Mr. Uniszkiewicz did identify the source of his conclusions regarding a reasonable base labor-hour value for the reference unit, i.e., specific combustion turbine plants constructed by PSEG including the location, size, date constructed and labor-hours for each plant and the methodology used for his calculation. P3 Protest, Uniszkiewicz Aff. P 12, JA___. And, in response to Dr. Sotkiewicz's claim that he did not consider "economies of scale," he disagreed based on his experience in constructing "plants larger than the reference unit." P3 Reply, Uniszkiewicz Resp. Aff. P 6, JA____. The sources identified for what FERC characterizes as Mr. Uniszkiewicz's "conclusory assertions" thus were significantly more detailed than the single sentence in the Pasteris Report describing the basis for Stantec's labor-hour estimate. The Stantec Report fails the very standard for "substantial evidence" endorsed by FERC.

FERC similarly disparages Petitioners' evidence regarding the cost of equity of private equity firms on the grounds that Petitioners' refer to "a publication not in the record." Resp. Br. 40. If that is the standard, then FERC has no basis for relying upon the Stantec report which is also "not in the record" and is not even sponsored by a witness who claims to have seen it.

ii. To Accept FERC's Derivative Reliance on Non-Record Documents Like the Stantec Report as "Substantial Evidence" Deprives Litigants Of Reasonable Due Process in FERC Proceedings

The lack of specificity regarding the source of the Stantec data severely hampered Petitioners' ability to challenge the base labor-hour value in a meaningful way. Br. 40-44. Because Petitioners lacked critical information about the specific data sources Stantec used or the methodology employed in analyzing that data, they were prevented from directly challenging the foundational elements of Stantec's conclusion.

FERC's response is that Petitioners have no cause to complain because a due process issue is presented only for "failures by FERC to provide *any* detail behind a particular conclusion, a very different factual scenario than here." Resp. Br. 29 (emphasis in original.) This sweeping claim is insupportable. Moreover, the cases cited by FERC demonstrate its falsity.

For example, FERC cites *Sithe/Independent Power Partners, L.P. v. FERC*, 165 F.3d 944, 951 (D.C. Cir. 1999), as support for its "any detail" standard. Resp. Br. 29. In that case, Niagara Mohawk, "attempted to demonstrate that the total rate it charges Sithe is lower than the total rate it could charge Sithe … and that Sithe had bargained for this benefit." *Id.* at 947. FERC undertook an "independent analysis" to "confirm" Niagara Mohawk's

presentations in its rate filing. *Id.* at 948. The Court found FERC's analysis lacking because FERC "offered no indication of what exactly its 'independent analysis' entailed or what issues it considered." *Id.* at 951. As the Court further explained:

> Because the Commission in this case failed to disclose its calculations, we do not know whether it simply adopted Niagara's figures and, if so, why. We also have no basis to confirm FERC's assumptions—for instance, we are left to wonder if it considered whether Niagara's variable costs, such as transmission line losses, would remain constant and, therefore, whether the alleged discount would actually exist over the long term.

Id.

Here, the assertions made by PJM in reliance on the Stantec report had even less support than representations made by Niagara Mohawk in its filing. Niagara Mohawk's calculation concerned service it actually provided and was thus based upon the utility's knowledge of its own contracts and rates. Here, PJM "simply adopted [Stantec's] figure[]" from a report it did not sponsor and which contained one vague sentence of explanation as to its source data and methodology. Second, FERC undertook an "independent analysis" in *Sithe* without disclosing its "calculations." This "independent analysis" was less transparent than FERC's derivative reliance on the allegedly "careful analysis" undertaken by PJM. FERC did not explain in either case how it verified the utility's evidence.

FERC's criticisms of Mr. Uniszkiewicz's testimony, moreover, illustrate the disingenuousness of FERC's position that "any detail" is sufficient. Thus, PJM was able to criticize the methodology used by Mr. Uniszkiewicz to calculate the base labor-hours for the reference unit (a criticism ultimately accepted by FERC) because PJM had access to the unit-specific source data that Mr. Uniszkiewicz relied upon. *See* Rehearing Order P 77, JA___. But the data sources identified in the Stantec report are so undefined, Petitioners had no way to determine whether Stantec's methodology was susceptible to similar criticisms. This amounts to a double standard (again) in which FERC gets to stack the deck against disfavored litigants.

(b) The CH2M Hill Report Also Lacks Probative Value

FERC claims it considered the CH2M Hill report from the 2011 CONE filing to "confirm" the Stantec report values for base labor-hours. Resp. Br. 28. Yet, FERC could not reasonably rely upon this data because it had previously found that PJM's 2011 filing, including labor costs, had not been shown to be just and reasonable. *See* Br. 44-46. FERC now argues that it could still rely upon the CH2M Hill report because "there was no ultimate finding as the accuracy of CH2M Hill's estimate." Resp. Br. 27.

First, this is the first time FERC directly addresses PSEG's objection on rehearing that FERC could not reasonably rely upon the CH2M Hill study. *See*

PSEG Rehearing at 9, 10, JA___, ___. Its argument is thus a *post hoc* rationalization of counsel and should not be countenanced by this Court. *See FPC v. Texaco. Inc.*, 417 U.S. 380, 397 (1974) ("[A]n agency's order must be upheld, if at all, 'on the same basis articulated in the order by the agency itself'") (quoting *Burlington Truck Lines v. U.S.*, 371 U.S. 156, 168-69 (1962)).

In any event, FERC's attempted hair-splitting does not withstand analysis. The *only* finding made in the earlier proceeding was that PJM had not demonstrated that certain elements of its CONE estimates, specifically including the labor cost values, were just and reasonable. Whether FERC might have eventually sustained those values if it had adjudicated the case is pure speculation. FERC cannot exercise its powers "based on speculation, conjecture, divination, or anything short of factual findings based on substantial evidence." *Fla. Gas Transmission Co. v. FERC*, 604 F.3d 636, 641 (D.C. Cir. 2010).

Further, there was significant evidence presented in the 2011 CONE case challenging CH2M Hill's estimates of labor-hours values. Mr. Uniszkiewicz, Petitioners' witness here, presented evidence based on plants constructed by PSEG prior to the time that the CH2M Hill report was prepared that the labor-

hour values were understated by 46%.[6] As with the Stantec Report at issue here, PSEG also criticized the CH2M Hill report because the lack of data source information "undermine[s] the credibility of the study [and] stymies the ability of affected parties to fully evaluate the results." (footnote omitted) PSEG Protest in Docket No. ER12-513-000 at 18. At a minimum, if FERC was going to rely upon CH2M Hill values for the base-hours from the 2011 CONE filing, it needed also to take account of the contrary evidence from that case.

2. FERC Failed to Adequately Address the Lack of "Negotiation" Over the Labor Costs Values In the Stakeholder Process

In its Rehearing Order, FERC claimed that "[PJM] adopted the Pasteris Report's labor estimate as credible, as part of a good faith negotiation during the stakeholder process." Rehearing Order P 76, JA___. Yet, Petitioners showed that the Pasteris labor cost values did not become part of PJM's proposal until adopted by the PJM Board of Managers in a closed-door session *after* the stakeholder process was concluded. Br. 38-40. Petitioners also showed, from the voting record of the PJM stakeholder process, that PJM staff

[6] *See* Motion to Intervene, Protest and Request for Evidentiary Hearing of the PSEG Companies, Docket No. ER12-513-000 ("PSEG Protest in ER12-513"), Attach. B, Uniszkiewicz Aff. PP 17, 18. http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=12848105 (Labor-hours analysis based on Bethlehem Energy Center combined cycle plant (763 MWs), Lawrenceburg combined cycle plant (1096 MWs) and Linden combined cycle (1,220 MWs).)

supported the Sargent & Lundy values for labor costs and that the Market Monitor's CONE calculation received no more than 32% of the stakeholder vote. *Id.* 38-39.

FERC's attempts to discredit Petitioners' evidence fail. First, FERC tries to recast Petitioners' argument as a challenge of the stakeholder process generally, claiming that Petitioners assert the "stakeholder process was somehow tainted or not a good faith negotiation." Resp. Br. 31. Petitioners made no such allegation. Petitioners' unanswered contention is that the labor cost reductions were *not* "adopted … during the stakeholder process," and not whether such stakeholder process was generally well-conducted or otherwise.

FERC also cites to PJM's Answer in the proceedings below claiming that "as a result of ... consultations, [PJM and the Market Monitor] came to agreement on the construction labor component of the estimate." Resp. Br. 32. And Intervenors made a similar claim citing to PJM's initial filing. Int. Br. 7 (citing PJM Filing at 28), JA___. Yet the characterizations made in PJM's pleadings cannot be reconciled with the actual record of the stakeholder meetings.

The letter issued by the PJM Board of Managers states unequivocally that it "directed staff to file a *modified version of the PJM staff proposal* for the triennial review parameters [including] modifications ... [that] utilize the

IMM's proposed labor cost estimates in the CONE calculation instead of Brattle's recommended labor cost estimates." PJM Board Letter at 1 (emphasis added). Also, the voting records show unequivocally that PJM staff supported a proposal that used the (higher) Sargent & Lundy labor cost value and that proposals utilizing the Sargent & Lundy labor costs (or a higher value) garnered the most support. *See* Br. 38-39 (citing PJM voting records). FERC's and Intervenors' attempt to rewrite history is unavailing. The records of the stakeholder process maintained by PJM on its website speak for themselves.

Finally, even if PJM and Intervenors were correct that PJM and the Market Monitor reached some accommodation, there would still not be a basis to ascribe weight to such an agreement. FERC cites *Public Service Commission of Wisconsin v. FERC*, 545 F.3d 1058 (D.C. Cir. 2008) for the proposition that "FERC [could] accord[] weight to a non-consensus stakeholder process." Resp. Br. 31. That case, however, involved a "cost-allocation policy the majority approved at the conclusion of the lengthy deliberative process." *Id.* at 1063. In contrast, here, the majority position shown by the voting record actually supported the *higher* labor cost value as determined by Sargent & Lundy. An agreement between PJM and the Market Monitor outside the stakeholder process does not confer "majority" status.

3. FERC Failed to Adequately Respond to the Criticisms Presented by Petitioners' Witness, Mr. Uniszkiewicz.

FERC claims in its brief that it adequately addressed the criticisms made by Mr. Uniszkiewicz of Dr. Sotkiewicz's labor cost estimates. Resp. Br. 19-26. Mr. Uniszkiewicz's affidavit focused on his determination that: (i) the base labor-hours were understated; and (ii) the wage rates were understated. FERC's response is lacking on both fronts.

(a) Mr. Uniszkiewicz's Criticisms of the Base Labor-Hour Values

First, Mr. Uniszkiewicz demonstrated that Mr. Ungate of Sargent & Lundy—PJM's expert witness for all elements of the Gross CONE estimate except the labor cost estimates—supported a base labor-hour value considerably higher than that supported by PJM. *See* Br. 46-49. FERC summarily rejected Mr. Uniszkiewicz's demonstrations, finding in the rehearing order and reiterating on brief that Mr. Uniszkiewicz was "mistaken" based on hearsay statements of PJM witnesses Pfeifenberger and Zhou that Mr. Ungate used a value close to that used by PJM. Resp. Br. 21 (citations omitted). No explanation was provided as to why Mr. Ungate could not speak for himself nor is any source support for the attributed statement provided.

FERC's claim that it could reasonably rely upon the Pfeifenberger/Zhou hearsay evidence without any further explanation is simply unsustainable.

Although mischaracterized by FERC as "hypothetical alternatives," Resp. Br. 12, 20, 23, Mr. Uniszkiewicz showed through simple arithmetic calculations based on PJM's own data that Mr. Ungate must have used a much higher value for base labor-hours than the value used by Dr. Sotkiewicz. Br. 46-49. Apparently realizing that Mr. Uniszkiewicz's calculations cannot be ignored, Intervenors attempt to deflect the importance of these calculations for the base labor-hours by suggesting that the wage rates "were potentially much higher." Int. Br. 26. However, this attempted concession cannot save PJM or FERC. PJM's witness, Dr. Sotkiewicz, also relied on the Sargent & Lundy values for "fringe" labor costs such as taxes, benefits, and workers' compensation which he claimed was about half of the overall wage rate. Sotkiewicz Aff. P 42, JA__. Thus if FERC accepts Intervenors' version that the wage rates "were potentially much higher," it undermines PJM's wage rate calculations that were also challenged by Petitioners.

Even more fundamentally, FERC acknowledges that PJM "departed from Brattle's recommendation on ... the estimate of labor costs," Resp. Br. 7, but then states that it "accepted Brattle's representation as to the work performed by Sargent [&] Lundy [regarding the level of the base labor-hours]." Resp. Br. 21. Intervenors compound this confusion with their acknowledgment that "the record does not reflect either the specific wage rate used by

Brattle/Sargent & Lundy or all of the details of their construction labor cost estimate ….” Int. Br. 26. At a minimum, FERC needed to justify how it could both simultaneously reject and rely upon the accuracy of elements of Mr. Ungate’s labor cost calculations that Intervenors contend “the record does not reflect.” *Id.*

Second, Mr. Uniszkiewicz showed, based on data from five recently completed combustion turbine generating plants built by PSEG affiliates in New Jersey and Connecticut that the 360,000 labor-hours value used by Stantec was unreasonably low. Uniszkiewicz Aff. P 12, JA___. By averaging the labor-hours for these plants on a per MW basis, he calculated a labor-hours estimate that was about 135% higher than the Stantec value for base labor-hours of 360,000 MWs. *Id.*

The only criticism of Mr. Uniszkiewicz’s calculation made by Dr. Sotkiewicz–who is not an expert on labor costs–was that Mr. Uniszkiewicz failed to consider “economies of scale” associated with the larger CT reference unit. *See* Rehearing Order P 77, JA___. FERC dismissed Mr. Uniszkiewicz’s assertion that significant economies would not be present. *Id.* FERC now attempts to justify this rebuff by claiming that Mr. Uniszkiewicz’s response merely reflected his “personal experience” and are not entitled to evidentiary weight. Resp. Br. 22-23.

FERC's criticisms are misguided. First, FERC's selective editing of Mr. Uniszkiewicz's affidavit in its brief does not fairly represent his statement. FERC quotes him as saying: "Based on my extensive experience ... I do not believe that there would be significant economies of scale." *Id.* at 22. But what he actually said was "based on my extensive experience *with providing cost estimates for power plant projects which has included plants larger than the CT reference unit*, I do not believe that there would be significant economies of scale realized (if any) ...." Uniszkiewicz Resp. Aff. P 7, JA___ (emphasis added). FERC's substituting of an ellipsis for the italicized phrase ignores the reference to the data source he relied upon and the work he performed in his *professional* capacity, i.e. his involvement in projects for construction of larger power plants. *See also*, *supra,* n.6 (noting Uniszkiewicz experience in building larger power plants from 2011 CONE filing).

Cases such as *Apple Inc. v. Samsung*, 816 F.3d 788 (Fed. Cir. 2016) cited by FERC, in which the court rejected the sufficiency of testimony based on the witness's personal "frustrations" in using a cell phone, purporting to demonstrate "an industry-wide long-felt need," thus are inapposite. *Id.* at 804, 805. In contrast to the situation in *Apple Inc.*, Mr. Uniszkiewicz's statements were based on extensive industry experience and he explained the source of his statements. *See Allstate Ins. Co. v. Plambeck*, 802 F.3d 665 (5th Cir. 2015)

(noting that "expert witness's testimony (and its reliability) may be based on his personal and professional experience and his own observation" (citing *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 151–53 (1999)). Mr. Uniszkiewicz's explanation, moreover, was more descriptive of his source data than the absent Stantec report, which FERC somehow deemed to be "well-supported." Resp. Br. 17.

(b) FERC Never Responded to Mr. Uniszkiewicz's Objection That The Data Used by Dr. Sotkiewicz To Calculate the Wage Rate Were Not Representative of Workers Who Construct Generating Plants

Mr. Uniszkiewicz took issue with Dr. Sotkiewicz's wage rate calculation because his data set did not represent workers who actually construct power plants, contending that they should be 8% to 10% higher due to the failure to include adequate overtime. Uniszkiewicz Aff. P 10, JA___. The category of Bureau of Labor Statistics data relied upon Dr. Sotkiewicz used included workers in utilities other than the power business and included full time utility workers who work regular jobs *in* power plants, not the workers who *build* power plants. Uniszkiewicz Resp. Aff. P 4, JA___.

FERC never responds directly to this argument. Rather, FERC attempts to discredit Mr. Uniszkiewicz's objection by contending (again) that he was voicing an unsupported "personal" opinion. Resp. Br. 25. This specious

argument, which ignores Mr. Uniszkiewicz's extensive *professional* experience, was addressed *supra*. *Apple Inc.* and the other similar cases cited by FERC in support of its claim are inapposite.

FERC also suggests it was excused from responding to Mr. Uniszkiewicz's criticism made in his Reply Affidavit because he refined his original criticisms regarding wage rates made in his Initial Affidavit. Resp. Br. 25. Intervenors make similar claims. Int. Br. 18-19. Yet, Mr. Uniszkiewicz's Reply Affidavit is part of the record and his conclusions include supporting data and explanations. *See Tesoro Ala. Petroleum Co. v. FERC*, 234 F.3d 1286, 1294 (D.C.Cir.2000) ("Unless an agency answers objections that on their face appear legitimate, its decision can hardly be said to be reasoned."). FERC was obligated to provide a meaningful response and is not excused simply because Mr. Uniszkiewicz refined his views over the course of the proceeding. *See Louisiana Public Service Comm'n v. Entergy Corp.*, 155 FERC ¶ 61,065, P 86 (2016) (Where respondent provided revised damages calculation, Commission addressed "figures, it ultimately presented ....")

C. FERC Has Still Not Justified the Cost of Capital Used for the CONE Calculations

1. FERC Never Reconciles Its Failure To Include Developers That Use Project Financing Techniques in The Proxy Group For Determining the Cost of Capital With Its Acceptance of the Fact that Most Developers In PJM Use Project Financing Techniques

Petitioners showed in their initial brief, based on the record below, that:

(i) 70% of new gas-fired generating plants in PJM were being constructed by developers that used project financing techniques many of which were private equity funds or single-project developer shops, Br. 17, 34, 59;

(ii) companies that use project financing techniques typically seek higher than average returns as compared with companies which manage their assets on a portfolio basis, *id.*, 58, 60-62; and

(iii) FERC did not consider the unique risks of project-finance developers in its proxy group for determining the Cost of Capital used in connection with the CONE calculation, *id.*, 58-61.

FERC does not dispute these facts.

FERC contends that it did not need to consider developers that face project financing risks because it included a "detailed explanation" of its methodology, Resp. Br. 33, and took account of "the relatively higher risks faced by generic merchant projects within PJM [that] were partially mitigated

by their ability to arrange medium-term financial hedges." *Id.* 34. But given FERC's lack of disagreement with Petitioners' assertions, this response is patently inadequate. As Petitioners showed, the proxy group used to determine the return of equity for a regulated entity must be "risk-appropriate." Br. 62, 63. *See Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 699 (D.C. Cir. 2007) (holding that the proxy group for a regulated firm whose rate is being determined must be "risk-appropriate"). As this Court noted recently in rejecting FERC's selection of data for a return on equity study, "FERC cannot rely in conclusory fashion on its knowledge and expertise without adequate support in the record." *United Airlines, Inc. v. FERC*, 2016 WL 3568136, at *10 (D.C Cir. July 1, 2016) FERC must explain though reasoned decision-making why it failed to include companies subject to project-finance risk.

FERC's contention that it reasonably responded to Petitioners' contentions regarding project finance risk cannot be sustained. FERC argues that because it set the Cost of Capital level higher than the levels sought by "groups representing consumers [that]... advocated for a *lower* cost of capital" somehow absolves it of having to consider other data. Resp. Br. 35. This response is a *non sequitur*. Since FERC never considered the risk profiles of companies that use project financing, it cannot say what the impact would have been had it done so. Further, given the uncontested record evidence that 70%

of the developers constructing new gas-fired generation experience such risk, it is clear that the impact could be substantial. Moreover, as noted *supra*, because FERC claims not to be familiar with the equity returns associated with entities that use project finance techniques, this matter is not within its technical expertise and FERC is not entitled to deference regarding its refusal to include these types of entities.

Intervenors, recognizing the hole in FERC's analysis, fail to fill it. Thus Intervenors cite testimony by Drs. Pfeifenberger and Zhou that purports to demonstrate that companies which experience project finance risk "can easily diversify the diversifiable risks themselves as long as there is a well-functioning capital market." Int. Br. 36 (citing Pfeifenberger/Zhou Aff. at 14), JA___. Intervenors claim that FERC "agreed with that conclusion." Int. Br. at 36 (citing Rehearing Order P 58), JA__. And they quote FERC as finding, "despite the likely difference in risk, merchant projects are able to mitigate risk by arranging medium-term financial hedging tools." *Id.* Intervenors, however, are clearly wrong in asserting that FERC was addressing project-financing entities.

The quoted sentence refers to "merchant projects" which is the nomenclature used for the divested merchant portfolio companies analyzed in the Brattle Cone Study. *See* Cost of New Entry Estimates for Combustion

Turbine and Combined Cycle Plants in PJM ("Brattle CONE Study") at 38, Tab. 25, PJM Transmittal Letter, Attach. D, JA___. And "medium-term financial hedging tools" are the financial instruments that Brattle claimed were available to these types of entities as compared with publicly traded companies. *Id.* at 34. Further, lest there be any doubt, the quoted sentence in the Rehearing Order cites the "Brattle CONE Report at 34" which only discusses merchant generation companies with portfolios of assets. The comments made in the Pfeifenberger/Zhou Affidavit about companies with project-finance risk were not addressed in this passage. In short, FERC never made the findings claimed by Intervenors or otherwise discussed the theory put forth on this issue in the Pfeifenberger/Zhou Affidavit.

This Court's recent decision in *Petro Star Inc. v. FERC*, No. 15-1009 slip op. (D.C. Cir Aug. 30, 2016), involving the value apportionment of commingled crude oil on the Trans Alaska pipeline is instructive. FERC rejected the petitioner's claim that the positive capital recovery assumption made by FERC for a "hypothetical refinery" was unrealistic in light of the fact that refinery asset sales were actually occurring at "depressed prices." *Id.* at 7, 19. The Court found that FERC erred because the data it relied upon purporting to show positive returns on refining operations excluded capital costs. *Id.* The Court found FERC's "failure to acknowledge or address the

apparent limitations of the data leaves its conclusions largely unsubstantiated. In conjunction with its failure to address directly the most concrete evidence put forth by [petitioner] (the depressed asset prices), its explanation here is, at best, incomplete." *Id.* at 19-20. Similarly, Petitioners' claims here are also based on facts about real-world conditions that FERC chose to ignore based on inadequate data.

2. FERC's Argument That It Need Not Consider Evidence Regarding the Cost of Equity Required by Private Equity Capital Because Public Information About Such Entities Is Not Readily Available Fails To Establish That FERC Acted Reasonably

FERC argues that it need not consider evidence put forward by Petitioners' witnesses regarding the return on equity values typically required by private equity investors—the largest segment of developers in PJM of gas-fired generation. Resp. Br. 37. FERC contends that this was proper because PJM used "verifiable" information about other kinds of market participants, *Id.*, and because the cost of data for private equity funds provided by Petitioners was purported to be a "poor proxy" for energy investments because those entities are also engaged in non-energy investments. *Id*. 38.

FERC, however, still fails to address Petitioners' objections. As this Court has previously held, "[a] petitioning utility's bare assertions that its methods and forecasts are 'reasonable' or the 'best available' are not sufficient

to shift the burden of persuasion onto those objecting to the new tariff." *Villages of Chatham & Riverton, Ill. v. FERC*, 662 F.2d 23, 33 (D.C. Cir. 1981). Having conceded that it did not consider private equity funds in determining the appropriate Cost of Capital and that private equity funds require higher returns that other types of developers, FERC's response that it used the best available public data falls short of the mark. FERC does not disagree with Petitioners' contention regarding the type of entities that typically build gas-fired generating plants in PJM. Therefore, it is not enough for FERC only to consider information from a small subset of lower-risk companies regardless of how available that information may be.

FERC also dismisses *Cities of Anaheim v. FERC*, 669 F.2d 799 (D.C. Cir. 1981), as supporting the assertion that FERC should not have rejected the information about private equity funds out of hand merely because those funds may also engage in other industries. FERC contends that *Cities of Anaheim* did not require FERC "the Commission, in all instances, to consider the risk profiles of unrelated industries...." Yet, Petitioners did not contend that FERC should do so "in all instances" but only in cases, such as here, in which industry specific data was not available.

Finally, FERC claims that a hearing was not needed because the matter could be "resolve[d] on the written record." Resp. Br. 41. Yet, that claim begs

the point. The case could only be "resolve[d] on the written record" if FERC did not need to consider the cost of equity for private equity funds. If that information needs to be considered—as Petitioners contend—and the record does not contain it—as FERC apparently contends—then a hearing is needed or FERC should have directed PJM to submit a deficiency letter.

III. CONCLUSION

For the reasons set forth hereinabove, FERC's orders should be remanded for further proceedings.

By: /s/ *Kenneth R. Carretta*

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September 6, 2016

CERTIFICATE OF COMPLIANCE CIRCUIT RULE 32

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, Circuit Rule 32(a)(2), I hereby certify that the foregoing document contains no more than 7,000 words (6,900) words using the word-count feature in Microsoft Word), excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii). This brief complies with the typeface and type style requirements of Fed. R. App. P. 32(a)(5)-(6) because has been prepared in a proportionally spaced typeface using Microsoft Office Word 2010 in 14 point Times New Roman font.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Pursuant to Rule 25(d) of the Federal Rules of Appellate Procedure and Rule 25(c) of the Circuit Rules of this Court, I hereby certify that on September 6, 2016, I electronically filed the foregoing document with the Clerk of the Court for the United States Court of Appeals for the District of Columbia Circuit by using the CM/ECF system. I certify that for all participants in the case who are registered CM/ECF users, that service will be accomplished by the CM/ECF system. For any party who has not consented to electronic service, a service copy has been sent by electronic mail or via such other means as may have been specified by such party in accordance with the Court's rules.

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