

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

July 26, 2007

In Reply Refer To:
PJM Interconnection, L.L.C.
Docket Nos. EL03-236-009
and EL04-121-004

Wright & Talisman, P.C.
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1200 G Street, N.W., Suite 600
Washington, D.C. 20005-3802

Dear Ms. Bumgarner:

1. On April 27, 2007, you filed, on behalf of PJM Interconnection, L.L.C. (PJM), the PJM Market Monitor's 2006 State of the Market Report (Market Report). You state that the Market Report is being filed in compliance with PJM's obligations under article VI of the settlement agreement approved in this proceeding on January 27, 2006 (Settlement).¹ We accept the Market Report for filing.

2. Article VI provides that, no later than 15 months following approval of the Settlement, PJM's Market Monitoring Unit will file a report with the Commission evaluating the effect of the Settlement as it relates to certain market power mitigation issues. Specifically, article VI requires PJM to evaluate: "(i) the price and total impact of the [settlement's] scarcity pricing and mitigation terms; (ii) whether the mitigation terms result in mitigation during competitive conditions; (iii) the effect of any market design changes occurring or anticipated to occur since the Commission's acceptance of the [S]ettlement (including changes, if any, that could enable PJM to take account of demand response in the Real Time Energy Market); (iv) whether PJM's overall market design, including the mitigation rules, provides for a robust and competitive market that encourages, among other things, demand response and, over the long term, produces prices that are just and reasonable and sufficient to induce entry and/or provide incentives

¹ *PJM Interconnection, L.L.C.*, 114 FERC ¶ 61,076 (2006).

to maintain generation when necessary; (v) whether other approaches to mitigation would be more appropriate; and (vi) whether any changes to the PJM [open access transmission tariff] and [PJM] Operating Agreement or its rules should be implemented.”

3. You state that the Market Report addresses each of these issues and, with respect to certain matters, recommends market modifications. For example, the Market Report concludes that market modifications are required to provide better investment incentives, including Reliability Pricing Model (RPM) market design changes and revisions to the scarcity pricing mechanism included in the Settlement.² The Market Report also recommends the implementation of targeted, flexible real-time market power mitigation in the regulation market. In addition, the Market Report recommends that all constraints in the PJM region be subject to dynamic three pivotal supplier testing, without an allowance for exemptions.

4. You state that the views reflected in the Market Report are those of the PJM Market Monitor, as required by article VI, and thus do not necessarily reflect the views of PJM. However, you also state that PJM intends to undertake a comprehensive review of its market power mitigation rules over the course of the coming year and discuss these issues with its members, states utility commissions, the PJM Market Monitor, and other interested parties.

5. Notice of PJM’s filing was published in the *Federal Register*, 72 Fed. Reg. 27,552 (2007), with interventions, protests and comments due on or before May 18, 2007. Notices of intervention and motions to intervene were timely filed by the Illinois Commerce Commission; the Public Service Commission of Maryland; Williams Power Company, Inc.; the PJM Power Providers Group;³ Reliant Energy Inc.; Pepco Holdings, Inc.; the Dayton Power and Light Company and Consolidated Edison Energy, Inc. (Dayton/CEE); and the PJM Consumer Representatives.⁴ On June 12, 2007, a motion to

² With respect to scarcity pricing, the Market Report concludes that the definition of the term “scarcity” should encompass distinct steps, or states, of scarcity, each with an associated price, based on system conditions. The Market Report further recommends that the single scarcity price signal that is currently in effect be replaced by locational signals.

³ The PJM Power Providers Group consists of: Constellation Energy Group, Inc.; Edison Mission Energy; FirstEnergy Service Company; NRG Energy; PSEG Services Corporation; Exelon Corporation; Mirant Corporation; and PPL Services Corporation.

intervene out-of-time and protest were filed by American Electric Power Service Corporation (AEP).

6. Protestors generally underscore the recommendations made by the Market Report, *i.e.*, they allege that PJM's mitigation and scarcity pricing rules are not optimal in their current form and should be further revised. The PJM Power Providers Group, for example, argues that the three-pivotal supplier test results in mitigation that errs on the side of suppressing prices at the expense of sending appropriate signals to incent investment. Reliant and Dayton/CEE add that, to date, there has not been a single instance of scarcity pricing in the PJM region. Mirant urges the Commission to require PJM to submit revised scarcity pricing rules by a date certain. Reliant requests that the Commission convene a technical conference. PJM Consumer Representatives argue that, under article VI, the Market Monitoring Unit is required to confirm that it is fully satisfied that the Market Report addresses the issues it was required to address under the Settlement. The PJM Consumer's Representatives assert that PJM's filing fails to satisfy this obligation.

7. On June 6, 2007, an answer to protests was filed by PJM. In its answer, PJM commits that it will file a report with the Commission following the conclusion of its stakeholder process. PJM also notes that, to aid this process, it has commissioned certain economic studies. On June 25, 2007, answers to PJM's answer were filed by Mirant and Dayton/CEE. Mirant reiterates its request for timeframes and deadlines applicable to PJM's stakeholder process. Dayton/CEE requests that PJM be required to file a report with the Commission addressing whether the application of the three pivotal supplier test could lead to over-mitigation.

8. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We also grant the unopposed late-filed intervention submitted by AEP, given its interests in this proceeding and the absence of undue prejudice or delay.

9. Rule 213(a)(2) of the Commissions Rules of Practice and Procedure, 18 C.F.R. § 385.213(a) (2007), prohibits an answer to a protest or an answer to an answer unless

⁴ The PJM Consumer Representatives consists of: the PJM Industrial Customer Coalition; the D.C. Office of the People's Counsel; Old Dominion Electric Cooperative; Southern Maryland Electric Cooperative, Inc.; the Office of the Ohio Consumers' Counsel; the Borough of Chambersburg; the North Carolina Electric Membership Corporation; and the Maryland Office of People's Counsel.

otherwise permitted by the decisional authority. We are not persuaded to accept the answers submitted by Mirant and Dayton/CEE and therefore reject them. However, we will accept PJM's answer because it has provided information that assisted us in our decision-making process.

10. We accept the Market Report for filing. The Market Report addresses each of the issues it was required to address under article VI. The protests request that additional procedures be established at this time under section 206 of the Federal Power Act in advance of (or in lieu of) the comprehensive review and broad-based stakeholder process currently underway within PJM. PJM, however, commits, in its answer, to: (i) supplement the currently-available record with new economic analyses of its markets and (ii) submit a report to the Commission at the conclusion of its stakeholder process reporting on these and related issues. We find that under these circumstances, we should not preempt the PJM processes through the establishment of a section 206 proceeding to examine these issues. We also reject the PJM Consumer Representatives' argument that PJM's filing is deficient and should be rejected because it fails to include an express confirmation from the PJM Market Monitor that the Market Report addresses the issues it was required to address under article VI. The State of the Market Report was prepared by the Market Monitor, not PJM, and, as discussed above, addresses each of the issues required by article VI. We, therefore, find no need for any further attestation by the Market Monitor or a further report by the Market Monitor.

By direction of the Commission.

Kimberly D. Bose,
Secretary.