

125 FERC ¶ 61,231
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

PJM Interconnection, L.L.C.

Docket No. ER09-13-000

ORDER ACCEPTING TARIFF REVISIONS

(Issued November 26, 2008)

1. On October 1, 2008, PJM Interconnection, L.L.C. (PJM), submitted for filing, pursuant to section 205 of the Federal Power Act (FPA),¹ revisions to the PJM Open Access Transmission Tariff (OATT) and PJM Operating Agreement to apply, to the PJM regulation market, a market power screen, i.e., the three-pivotal-supplier test, similar to that currently used by PJM to measure the competitiveness of the PJM energy and capacity markets. For the reasons discussed below, we accept PJM's filing, to become effective December 1, 2008.

Background

2. PJM states that regulation service (an ancillary service provided by PJM under the PJM OATT) provides a supply of energy on short notice, as necessary, to maintain a stable system frequency and control (a reliability need). PJM states that under its existing rules, resource owners submit offers to provide regulation service. PJM then utilizes these offers together with other inputs (i.e., energy offers, resource schedules, and forecasted Locational Marginal Prices) to calculate an hourly regulation market clearing price.

3. PJM states that, currently, regulation offers are subject to a \$100 per MWh offer cap, while offers submitted by two large suppliers (American Electric Power Company (AEP) and Virginia Electric Power Company (Dominion)) are offer-capped at marginal cost plus \$7.50.² PJM states, however, that its Market Monitoring Unit, in its 2007 State of the Market Report, recommended that revised market power mitigation provisions be

¹ 16 U.S.C. § 824d (2006).

² See *PJM Interconnection, L.L.C.*, 111 FERC ¶ 61,134, at P 22 (2005).

adopted.³ The Market Monitoring Unit recommended that: (i) use of the three-pivotal-supplier test be adopted for the regulation market;⁴ (ii) real time, hourly market structure tests be implemented in the regulation market; (iii) market power mitigation be applied only for hours in which the market structure is noncompetitive; (iv) market power mitigation be applied only to the companies failing the market structure tests;⁵ and (v) the overall \$100 per MWh regulation offer cap remain in effect.

4. PJM states that in response to these recommendations a stakeholder process was convened and that, ultimately, a compromise proposal was adopted balancing the need for effective market power mitigation with the need to maintain (or even increase) the amount of regulation offered into the market. PJM states that its stakeholder process considered and attempted to address, in particular, evidence that the regulation capability currently available in the PJM region far exceeds the regulation offered to PJM through the regulation market, while suppliers subject to offer capping offer even less of their capability into the market.

5. PJM states that its filing strikes an appropriate balance on these issues and will increase participation in the regulation market by: (i) mandating use of the three-pivotal-supplier test, as modeled on the test currently employed by PJM in the PJM energy market; (ii) defining available supply for purposes of the market structure screen as all offers submitted at a total price (i.e., offer plus opportunity cost) less than or equal to 150 percent of the cost-based clearing price; (iii) providing for a \$12.00 adder to the calculation of mitigated cost-based offers in place of the current \$7.50 adder;

³ See 2007 State of the Market Report, Volume 2: Detailed Analysis, Market Monitoring Unit, March 11, 2008 (2007 Market Report), *available at* <http://www2.pjm.com/markets/market-monitor/downloads/mmu-reports/2007-sum-volume2.pdf>.

⁴ The three-pivotal-supplier test assumes that in a market with multiple suppliers, three suppliers, operating in collusion, have the ability to raise prices above the competitive level, i.e., to exert market power by withholding capacity, when at least some of the output of one of the three is needed to meet market demand. As applied to the regulation market, a regulation supplier would fail the test if its regulation capacity, in combination with the regulation capacity of the two largest suppliers in the market, exceeds the surplus of total regulation capacity above the regulation requirement. A supplier that fails this test would be deemed to have the ability to withhold capacity and would be subject to mitigation.

⁵ PJM notes that, currently, it mitigates the cost-based offers from the two dominant suppliers, AEP and Dominion, at all times.

(iv) eliminating the current practice of netting regulation market revenues against balancing operating reserve payments; and (v) redefining opportunity costs to measure those against the lesser of the cost-based offer or the market-based offer for the unit, rather than against the market-based offer.

6. PJM states that the compromise proposal reflected in its filing (including its proposed use of the three-pivotal-supplier test) is not intended to commit market participants regarding the continued efficacy of this market power screen, either in the regulation market or in PJM's other markets. PJM notes, in this regard, that the Commission is currently investigating this issue as it relates to PJM's energy and capacity markets in Docket Nos. EL08-34-000 and EL08-47-000.⁶

Notice of Filing and Responsive Pleadings

7. Notice of PJM's filing was published in the *Federal Register*, 73 Fed. Reg. 41,924 (2008), with protests and interventions due on or before October 22, 2008. Motions to intervene and notices of intervention were timely filed by the Illinois Commerce Commission (Illinois Commission); the PJM Independent Market Monitor (Market Monitor); Allegheny Energy Companies; PPL Parties; Duke Energy Corporation; Dominion Resources Services, Inc.; Old Dominion Electric Cooperative; American Municipal Power – Ohio, Inc.; Exelon Corporation (Exelon); Dayton Power and Light Company (Dayton); the Public Service Commission of Maryland (Maryland Commission); Constellation Energy Commodities Group, Inc. and its affiliates⁷ (collectively, Constellation); Mirant Parties; and NRG Companies. Comments were timely filed by the Market Monitor, Constellation, the Maryland Commission, Dayton, and Exelon. In addition, on November 3, 2008, the Illinois Commission submitted a motion to file comments out-of-time.

8. Comments generally supportive of PJM's filing were submitted by Exelon and Constellation. Dayton too supports PJM's filing but requests that PJM's use of the three-pivotal-supplier test be accepted on an interim basis, subject to the outcome of the Maryland Commission's complaint proceeding, in Docket Nos. EL08-34-000 and EL08-47-000.

9. The Market Monitor asserts that while PJM's filing appropriately promotes the use of the three-pivotal-supplier test in the regulation market (and was the product of a stakeholder compromise), certain features of the compromise proposal may result in non-

⁶ See *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,169 (2008) (*Market Power Screen Order*).

⁷ Constellation NewEnergy, Inc. and Constellation Power Source Generation, Inc.

competitive outcomes.⁸ In particular, the Market Monitor is concerned with the proposals to: (i) raise the adder applicable to cost-based offers from \$7.50 to \$12.00; (ii) calculate estimated unit-specific opportunity costs on the basis of the lower of cost-based or price-based energy offers (as opposed to the use of the actual dispatch schedule of the resource, whether cost-based or price-based); and (iii) eliminate the netting of revenues from the regulation market against balancing operating reserve payments (contrary to the existing practice allowing suppliers to receive make-whole balancing operating reserve payments only when the revenue from all PJM markets, including the regulation market, is insufficient to cover the generator's scheduled offer). The Market Monitor asserts that it intends to monitor these issues and requests a directive from the Commission requiring it to submit a report on the effects of PJM's proposed rule changes.

10. The Illinois Commission objects to PJM's proposed incentives. The Illinois Commission characterizes these incentives as largely arbitrary increases that have not been supported by any formal analysis of the relevant market conditions. The Illinois Commission further argues that while these changes may, in fact, increase generator participation, they are unlikely to produce lower prices, i.e., the benefits of competition. The Illinois Commission asserts that the statistics relied on in the stakeholder process (suggesting that the supply of regulation service is scarce and requires additional financial incentives to boost participation) are also misinterpreted. The Illinois Commission asserts that, on average, nearly twice as much regulation service has been offered than has actually been needed.

11. On November 4, 2008, as supplemented on November 18, 2008, PJM filed an answer. In response to the Market Monitor's request that a Market Monitor report be required to be filed addressing the effectiveness of PJM's proposed changes, herein, PJM asserts that no such report is required. PJM argues that the Market Monitor already has the authority to conduct such an evaluation and prepare such a report without any further Commission order.

12. PJM also responds to intervenors' concerns regarding PJM's proposed cost incentives. PJM argues that its proposal, taken as a whole, strikes a balance by deterring the exercise of market power, on the one hand, and ensuring adequate cost recovery (and thus promoting participation) on the other hand.

Procedural Matters

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), the timely, unopposed motions to intervene and notices of

⁸ See also Maryland Commission comments at 5.

intervention serve to make the entities that filed them parties to this proceeding. We also grant, for good cause shown, the Illinois Commission's unopposed motion to submit comments out-of-time.

14. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2008), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept PJM's answer because it has provided information that assisted us in our decision-making process.

Discussion

15. We accept PJM's proposed tariff revisions to become effective December 1, 2008, subject to the outcome of the proceeding in Docket No. EL08-47-000. First, we accept PJM's proposal to apply a three-pivotal-supplier test to PJM's regulation market. The three-pivotal-supplier test is PJM's currently-effective just and reasonable market power screen. While the Commission currently is reviewing this test in Docket No. EL08-47-000, as it applies to PJM's energy and capacity markets (specifically including the assertion that this test may conclude too frequently that market power exists), we find that PJM has adequately justified the use of this test in the regulation market, at this time, to determine whether a supplier's offer may be pivotal in the regulation service market and should be offer-capped at its cost plus a \$12.00 adder, or if not pivotal, then bid-capped (at a \$100 rate). As noted above, the PJM Market Monitor supports this change as do a significant majority of PJM's stakeholders. Our acceptance of this proposal, however, is subject to possible revision based on the outcome of the proceedings in Docket No. EL08-47-000.⁹

16. We also accept, as appropriate, PJM's proposed package of price incentives. Specifically, we agree with PJM that, on balance, these incentives, when used in conjunction with the three-pivotal-supplier test, strike a balance reasonably calculated to both deter market power and ensure sufficient generator participation in the market. PJM has also explained that its current tariff deters participation because all regulation market revenues are netted against balancing operating reserve payments. We also find the \$12 adder to be just and reasonable. The current \$7.50 adder applies only to the Mid-Atlantic Area and to the two companies subject to mitigation. Under the revised tariff provisions, mitigation will now potentially apply to all suppliers in PJM that fail the three-pivotal-supplier test. As PJM has explained, the \$12 adder is designed to create an incentive for more firms to participate in the regulation market, because, although PJM is receiving

⁹ See *Market Power Screen Order*, 123 FERC ¶ 61,169 at P 59 (establishing hearing procedures to consider the continued justness and reasonableness of the three-pivotal-supplier test).

sufficient bids for regulation service, it is not receiving the range of participation that it would expect in a competitive market. PJM estimates that in 2007 parties controlling regulation supply offered only 30-40 percent of that capability into the market, while offer-capped sellers offered only 15-30 percent of their capability.¹⁰ PJM stakeholders found that this package of changes was needed to create an appropriate balance between ensuring a sufficient supply of regulation service, competitive pricing, cost recovery during mitigation, and protection against market power.¹¹ PJM believes that the balance of incentives and mitigation will induce more regulation supply offers going forward, thus increasing competition in the provision of a service critical to the operation of the electric system. We agree. Accordingly, we reject the Illinois Commission's argument that this package of incentives will not produce a just and reasonable result.

17. While we agree with PJM that an insufficient cost recovery in offer-capped areas could reduce the availability of regulation service, we encourage the parties to monitor the impact of PJM's incentives, once implemented. We also encourage the parties to work with PJM regarding the development of any additional revisions, as may be required.

18. The Market Monitor requests a Commission directive, in this regard, requiring it to submit a report to the Commission addressing PJM's proposed revisions, as implemented. A report will help to evaluate the impact of the changes discussed herein to the regulation market, and therefore, we direct the Market Monitor to submit a report within one year of the date of this order that analyzes changes in regulation market clearing prices, the passage rate of the three pivotal supplier test and the amount of regulation supply offers.

The Commission orders:

PJM's proposed tariff revisions are hereby accepted, to become effective December 1, 2008, as requested.

¹⁰ See PJM filing at 14.

¹¹ See *Wisconsin Pub. Power, Inc. v. FERC*, 493 F.3d 239, 260-61 (D.C. Cir. 2007) (affirming approval of a fixed cost adder was necessary to provide an efficient incentive to invest and ensure that electricity suppliers continue to invest in offer-capped areas where needed).

The Market Monitor is hereby directed to submit an informational report within one year of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.