

125 FERC ¶ 61,340
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.

Maryland Public Service Commission

Docket No. EL08-34-002

v.

PJM Interconnection, L.L.C.

PJM Interconnection, L.L.C.

Docket No. EL08-47-000

ORDER ON REHEARING

(Issued December 19, 2008)

1. In this Order, the Commission denies the requests for rehearing of the order granting the complaint of the Maryland Public Service Commission (Maryland PSC) which eliminated the PJM Interconnection, L.L.C. (PJM) market rule provisions that exempted certain generation facilities from energy offer mitigation.¹

I. Background

2. Under PJM's existing market power mitigation rules, a generator is subject to energy offer mitigation whenever a transmission constraint arises that creates two conditions. The first condition is that the generators within a transmission constraint fail a market power screen.² The second condition is that PJM is required to commit the unit

¹ *Maryland Public Service Commission v. PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,169 (2008) (May 16, 2008 Order).

² Under PJM's current market power screen, the three-pivotal-supplier test, PJM imposes bid capping when, for any hour, there are three or fewer generation suppliers available for redispatch that are jointly pivotal with respect to a transmission limit. If there are three or fewer such pivotal suppliers, only the generation units whose owner, when combined with the two largest other generation suppliers, is jointly pivotal are subject to mitigation.

out of merit order to relieve the constrained interface. In addition, PJM's tariff provides that in constrained areas no mitigation will be applied to any generator that passes its market power test and no mitigation is applied during defined scarcity conditions.

3. Over the years PJM, and the Commission, have struggled with the need for exemptions from the mitigation rules for newly constructed generation and transactions occurring across large interconnections. As of the date of the complaint, the exemptions applied to generation resources whose construction began between April 1, 1999 and September 30, 2003 (construction exemption), and to East, West, and Central in the Mid-Atlantic Area Council (MAAC) control zone and the AP South interface (between the former Allegheny Power System and PJM) (interface exemptions).

4. At the outset of market-based pricing in PJM, all newly constructed generation was exempt from mitigation in order to encourage new entry. In 2003, however, PJM and the Commission reconsidered whether such an exemption should be continued, and the Commission determined that changes were necessary to ensure protection against the exercise of market power. The Commission, therefore, eliminated the exemption for units constructed after 2003. The Commission retained the exemption for those units built when the exemption was in effect, finding that investors may have relied on the exemption in committing funds to such projects and that this reliance interest should be taken into account. But even in continuing the exemption, the Commission recognized that the exemption would be subject to removal once an appropriate test for market power was developed.³

5. The interface exemptions initially were approved for East, West, and Central interfaces in 1999 based on a market power study using data from 1994 and 1995 to show that with the then-existing configuration of PJM, mitigation need not be applied when constraints occurred across the identified interfaces.⁴ Through a settlement in November 2005, the interface exemptions were expanded to include the AP South interface, along with the integration of AEP, ComEd, and VEPCO to the PJM configuration.⁵

6. On January 15, 2008, Maryland PSC filed, pursuant to sections 206, 306 and 309 of the Federal Power Act (FPA),⁶ and Rule 206 of the Commission's Rules of Practice

³ *PJM Interconnection, LLC*, 112 FERC ¶ 61,031, at P 45 (2005) (July 5, 2005 Order).

⁴ *PJM Interconnection, LLC*, 86 FERC ¶ 61,248 (1999).

⁵ *PJM Interconnection, LLC*, 114 FERC ¶ 61,076 (2006) (January 27, 2006 Order).

⁶ 16 U.S.C. §§ 824e, 825e, 825h (2006).

and Procedure,⁷ a complaint against PJM. Maryland PSC requested that the Commission remove the interface and construction exemptions from energy offer mitigation, and apply mitigation to these resources. On May 16, 2008, the Commission granted Maryland PSC's complaint and eliminated the interface and construction exemptions.⁸

7. In the May 16, 2008 Order, the Commission re-examined the balance it had previously struck between the need to protect against the exercise of market power and the effects on new entry and reliance of removing the exemptions. In light of changes to the PJM system, including the integration of new transmission owners, the implementation of a market power test, and the implementation of new mechanisms, such as the Reliability Pricing Model (RPM), for recovery of costs, the Commission found that the balance had again shifted so that it had become unjust and unreasonable to continue the construction and interface exemptions. The Commission determined that these changes justified the application of the existing just and reasonable market power test and mitigation provision to all generators in PJM without discriminating based on date of construction or on whether the transaction crossed particular interfaces.

8. With respect to the construction exemption, the Commission found that the July 5, 2005 Order that continued the exemption from mitigation for grandfathered generating units put these customers on notice that "once the Commission determines the appropriate test for market power within load pockets, that test also would be appropriate to determine when the grandfathered units have sufficient market power to warrant mitigation."⁹ Further, the Commission found that the existing provision under which PJM can make a filing to mitigate "significant" market power had become unjust and unreasonable.¹⁰ Finally, the Commission recognized that the market has changed to such a degree, including the implementation of the RPM,¹¹ that the Commission's original

⁷ 18 C.F.R. § 385.206 (2008).

⁸ In addition, the Commission opened a section 206 proceeding to determine the continued just and reasonableness of the three-pivotal-supplier test, Docket No. EL08-47-000.

⁹ May 16, 2008 Order, 123 FERC ¶ 61,169 at P 42 (*citing PJM Interconnection, LLC*, 112 FERC ¶ 61,031, at P 45 (2005) (July 5, 2005 Order)).

¹⁰ May 16, 2008 Order, 123 FERC ¶ 61,169 at P 43.

¹¹ The implementation of the RPM capacity pricing mechanism provided all generators, including the previously construction-exempt generators with a new, additional source of revenue that was not available at the time the exemption was first permitted.

concern with the lowered revenues and valuation resulting from removal of the mitigation exemptions had been addressed.

9. With respect to the interface exemptions, the Commission concluded that because PJM can apply a market power screen on an hourly basis, it is no longer just and reasonable for PJM to maintain a blanket exemption that provides for only periodic review of the appropriateness of the interface exemptions.¹² The Commission stated that the Market Monitor's recommendations, in addition to the additional revenues provided by the RPM mechanism, supported the conclusion that the existing interface exemptions are unjust and unreasonable.

II. Requests for Rehearing

10. The PPL Companies,¹³ NRG Companies,¹⁴ and PJM Power Providers Group (PJM Power Providers) filed requests for rehearing of the May 16, 2008 Order. Maryland PSC filed a motion to answer and answer to the rehearing requests, and PJM Power Providers filed an answer in opposition to Maryland PSC's motion to file an answer.

11. PJM Power Providers argue that the May 16, 2008 Order erred in four ways. First, PJM Power Providers argue that the Commission failed to conform to the statutory requirements of FPA section 206. PJM Power Providers explain that the Commission is required to find that the existing rate is not just and reasonable, and a finding that the new rate is just and reasonable. PJM Power Providers contend that the Commission found that the existing rate was not just and reasonable, but failed to make a clear finding that the three-pivotal-supplier test is just and reasonable. PJM Power Providers contend that the Commission conceded that it lacked the statutory authority under FPA section 206 to impose the three-pivotal-supplier test on previously exempt generators and interfaces when it established the FPA section 206 proceeding to examine the justness and reasonableness of the three-pivotal-supplier test.¹⁵ Further, PJM Power Providers

¹² May 16, 2008 Order, 123 FERC ¶ 61,169 at P 47.

¹³ PPL Electric Utilities Corporation, PPL EnergyPlus, LLC, PPL Brunner Island, LLC, PPL Holtwood, LLC, PPL Martins Creek, LLC, PPL Montour, LLC, PPL Susquehanna, LLC, PPL University Park, LLC, Lower Mount Bethel Energy, LLC.

¹⁴ NRG Power Marketing LLC, Conemaugh Power LLC, Indian River Power LLC, Keystone Power LLC, NRG Energy Center Dover LLC, NRG Energy Center Paxton LLC, NRG Rockford LLC, NRG Rockford II LLC, Vienna Power LLC.

¹⁵ PJM Power Providers Request for Rehearing at 2.

contend that by extending the three-pivotal-supplier test to previously exempt generators, the Commission established a new rate.

12. Second, PJM Power Providers argue that the May 16, 2008 Order does not adequately address the economic expert evidence in support of its position that the mitigation exemptions are just and reasonable,¹⁶ and that, by doing so, the Commission did not engage in reasoned decision-making. Third, PJM Power Providers contend that the decision to eliminate the mitigation exemptions compromises regulatory certainty and thus harms the public interest. Finally, PJM Power Providers state that the May 16, 2008 Order fails to meet the standards for imposition of a market power mitigation scheme consistent with *Edison Mission*.¹⁷ PJM Power Providers contend that imposition of a market power mitigation scheme requires an underlying finding that the participants have market power, and that the Commission must take care to avoid confusing the existence of market power with the price signals sent by scarcity.

13. PPL Companies contend that the May 16, 2008 Order relied on several factual assumptions that do not support the conclusion that the interface exemptions are unjust and unreasonable. Specifically, PPL Companies contend that (1) because the market analysis initially used to justify the interface exemptions relied on 1994-1995 data does not mean that the analysis is no longer reliable; (2) the expanded PJM market provides for an increase in competition, and that there was no need to institute offer caps on the interfaces; (3) the market analysis used to grant or renew market-based rate authority is superior to the three-pivotal-supplier test; (4) the conclusion that RPM provides generators a reasonable opportunity to offset lost revenues is not supported by the record; and (5) even where the interfaces are sometimes constrained does not mean that market power may be exercised.¹⁸

14. PPL Companies also contend that the May 16, 2008 Order is inconsistent with the Commission's standards for evaluating market power.¹⁹ PPL Companies argue that the

¹⁶ PJM Power Providers point to the Affidavit of A. Joseph Cavivvhi and Joseph P. Kalt, Ph.D., submitted as Exhibit A with PJM Power Providers' Answer.

¹⁷ *Edison Mission Energy v. FERC*, 394 F.3d 964 (D.C. Cir. 2005) (*Edison Mission*) (a Commission order putting into place a mitigation scheme must demonstrate that the mitigation scheme could distinguish between market power and scarcity pricing, and therefore, will do more good than harm).

¹⁸ PPL Companies Request for Rehearing at 8-12.

¹⁹ *Citing Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252, *clarified*, 121 FERC ¶ 61,260 (2007), *order on*

Commission's standards require market power analysis in the context of stable, predictable geographic markets, and that they measure the ability to exercise market power on a seasonal basis. PPL Companies argue that the May 16, 2008 Order lacks any discussion of a relevant market in which market power has been shown to be exercised, and provides no demonstration that the interface exemptions provide generators with the ability to exercise market power.²⁰ PPL Companies state that the Commission, instead, relies on the three-pivotal-supplier test for the identification of market power. PPL Companies state that the three-pivotal-supplier test should not substitute for the analysis under the well-established Commission precedents.

15. PPL Companies state that the May 16, 2008 Order ignores the fact that the interface exemptions were part of a mitigation scheme that resulted from a settlement agreement that offsets the over-mitigation caused by the three-pivotal-supplier test. PPL Companies contends that the three-pivotal-supplier test has never been found by the Commission to be just and reasonable, and as a result, the May 16, 2008 Order has not met the FPA section 206 burden of establishing a just and reasonable replacement with the elimination of the mitigation exemptions. PPL Companies goes on to assert that the Commission has failed to demonstrate that the three-pivotal-supplier test will do more good than harm.²¹ In the alternative, PPL Companies request that the Commission reinstate the mitigation exemptions, and include the issue in the FPA section 206 proceeding to examine the three-pivotal-supplier test.

16. NRG Companies argue that the Commission did not have an adequate factual record to support elimination of the mitigation exemptions, and contends that the May 16, 2008 Order will result in regulatory uncertainty and have unintended consequences.²² Specifically, NRG Companies point to the use of the price cap exemption by units with limited run times to control when and how often they are dispatched. NRG Companies recommend that, in order to provide for an orderly and deliberate transition to a new market design, that the Commission consider stakeholder input before enacting changes to the existing PJM market design.

reh'g, Order No. 697-A, 73 Fed. Reg. 25,832 (May 7, 2008), FERC Stats. & Regs. ¶ 31,268 (2008). *Citing also Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997).

²⁰ PPL Companies Request for Rehearing at 15.

²¹ *Id.* at 18, *citing Edison Mission*, 394 F.3d at 968-69.

²² NRG also joins in the request for rehearing of PJM Power Providers.

17. Maryland PSC filed a motion for leave to answer and answer to the requests for rehearing. Maryland PSC contends that, given the widespread impact of the May 16, 2008 Order, good cause exists to allow an answer. Maryland PSC states that its answer will clarify both factual and legal issues, aid in the prompt resolution of those issues, assure a more complete record, and otherwise assist the Commission in its determination. PJM Power Providers contend that Maryland PSC's answer reiterates its prior pleadings and adds nothing new to the record.

III. Discussion

A. Procedural Issues

18. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure prohibits answers to a request for rehearing.²³ Accordingly, the motion for leave to answer, and answer of Maryland PSC are denied.

B. Rehearing Discussion

19. We deny the requests for rehearing. As we described in the May 16, 2008 Order, the history of mitigation in the PJM market has involved a continual process of seeking to balance the efficiencies created by a competitive energy market, the need at certain times and in certain circumstances to protect against the potential exercise of market power, the need to provide generators with the opportunity to earn just and reasonable revenues during mitigation, and the effect of new developments that have enabled PJM to accomplish such balancing on a real-time basis.²⁴

20. Under the FPA, the Commission regulates the rates within PJM to ensure that these rates are just and reasonable and not unduly discriminatory or preferential.²⁵ The Commission has found that market-based rates may be just and reasonable "when competition is sufficient to limit market power."²⁶ When the Commission cannot be confident that competition within the PJM market is sufficient, it has required that mitigation be applied. The bedrock principle of mitigation within PJM from its inception

²³ 18 C.F.R. § 385.713(d)(1) (2008).

²⁴ See, e.g., *PJM Interconnection, LLC*, 107 FERC ¶ 61,112 (2004) (addressing the need to balance generator compensation with market mitigation procedures).

²⁵ July 5, 2005 Order, 112 FERC ¶ 61,031 at P 44.

²⁶ *Id.* (citing *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993), and *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir. 1984)).

is that generators are subject to individual, seller-specific offer caps only when transmission constraints serve to isolate particular areas so that competition from outside those areas is unable to serve demand in those areas:

While the Commission has found that overall the PJM marketplace is sufficiently competitive to grant market based rates, it has also recognized that due to transmission constraints in load pockets, generators can exercise market power within these load pockets and it has accepted a mitigation plan to deal with these situations.²⁷

When electricity from generators submitting lower bid prices from outside the constrained area cannot be transmitted into the constrained area, the generators remaining in the constrained area may be able to exercise market power.²⁸ Generally, when subject to mitigation, generators' bids are limited to marginal cost plus a 10 percent adder,²⁹ although the Commission has recognized limitations in administratively defining marginal cost and has provided additional compensation for frequently mitigated generation.³⁰

21. Over the intervening years, PJM, and the Commission, have refined the offer capping mechanism to eliminate mitigation in situations when market power is unlikely to be exercised. PJM and its stakeholders developed through a settlement a market power test (three-pivotal-supplier test) under which generators that would have been mitigated under the transmission constraint test will not be mitigated if they pass a market power screen applied in real-time. The Commission further has recognized that, during periods of scarcity, market prices will rise above the mitigated prices set by the PJM tariff and the PJM tariff was revised to remove individual, seller-specific offer caps during periods of

²⁷ July 5, 2005 Order, 112 FERC ¶ 61,031 at P 44; *see also PJM Interconnection, LLC*, 110 FERC ¶ 61,053, at P 58 (2005) (January 25, 2005 Order).

²⁸ *See* January 25, 2005 Order, 110 FERC ¶ 61,053 at P 26 (in the absence of offer caps, when transmission in a portion of the system is constrained and there is insufficient competition among generators in the load pocket, generation resources in the affected load pocket could extract monopoly profits because the constraint requires PJM to call upon the units to operate to maintain reliable service in an affected area).

²⁹ Mitigated generators will still receive the market clearing price for energy.

³⁰ January 25, 2005 Order, 110 FERC ¶ 61,053 at P 26-27.

scarcity.³¹ Finally, PJM and the Commission have recognized that payment through the energy market with mitigation alone may not provide sufficient incentives for generation to meet the reliability needs of PJM. To address such concerns, PJM has adopted a capacity market (the RPM) to help ensure that generators, as well as other capacity resources that may contribute to meeting PJM's reliability needs, have an opportunity to receive overall just and reasonable revenues.

22. The exemptions at issue in this case pre-date many of these revisions and innovations. The exemption from mitigation for new construction began at the outset of the PJM market and was based on a concern that the existing offer capping mechanism might impede needed investment.³² But PJM, and the Commission, reconsidered the blanket exemption for new construction in 2003, and eliminated the exemption for those units built after 2003. The Commission grandfathered units that were built during the time of the exemption because investors may have relied on the exemption in committing funds to a project.³³ But, even at that time, the Commission recognized that revisions to other provisions of the PJM tariff could cause further refinements to the mitigation provisions such that the remaining exempt generators and their investors would have an opportunity to earn sufficient revenues.³⁴

23. The interface exemption was instituted in 1999 based on a market power analysis of the original PJM configuration. Using data from 1994-95, the Commission determined that, when constraints existed across the East, West, and Central interfaces, sufficient competition remained such that mitigation need not be applied. Since 1999, PJM's configuration has changed significantly, with the addition of AEP, ComEd, and Dominion, and the interface exemption was expanded to include these areas as a result of a settlement.

³¹ PJM Operating Agreement, Schedule I, § 6A (No offer capping under section 6.4 of this Schedule may be initiated or continued in the scarcity pricing region while scarcity pricing is in effect); January 27, 2006 Order, 114 FERC ¶ 61,076 at P 4 (accepting the November 2005 settlement).

³² January 25, 2005 Order, 100 FERC ¶ 61,053 at P 58.

³³ *Id.* P 60.

³⁴ July 5, 2005 Order, 112 FERC ¶ 61,031 at P 45 (“once the Commission determines the appropriate test for market power within load pockets, that test also would be appropriate to determine when the grandfathered units have sufficient market power to warrant mitigation”).

24. In the May 16, 2008 Order, while we were still concerned about new entry and any impact of rule changes on generators that may have relied on the prior exemption, we found that due to the changes in the PJM market, these absolute exemptions may permit the exercise of market power in some circumstances and were no longer necessary to preserve investors' expectations. These changes included: the development of a real-time test for market power that can be applied both to load pockets and to the interfaces, in place of the static market power analysis used previously; the adoption of higher bid adders for frequently mitigated units; the adoption of scarcity pricing that protects generators against low prices resulting from mitigation during those periods and times when prices should rise; and the development of RPM, which provides compensation to generators for providing reliability and means that generators are no longer solely dependent on revenues from the energy markets.

25. The rehearing requests maintain that, despite these changes, the Commission is not permitted to remove exemptions without having conducted a factual inquiry into whether any of the exempt generators have exercised market power. But the issue before us is not whether a particular generator can be shown to have exercised market power on a particular day or in a particular circumstance, it is whether the rate design in PJM, on balance, continues to achieve an appropriate balance among numerous regulatory goals, such as encouraging competitive pricing, preventing the exercise of market power, and encouraging new entry.³⁵ With the development of a real-time test for determining market power, and the institution of scarcity pricing and RPM, we have concluded that the PJM tariff creates the appropriate balance without the need for blanket exemptions.

26. The real-time market power test is better suited than the prior test to a dynamic and ever changing energy market in which market power may be exercised in some situations and at some times, but not in others. Because this real-time test did not exist in the past, we relied on snapshot analysis and blanket exemptions. But with the development of a real-time test, we no longer need to rely on blanket determinations. Certainly, no market power test is perfect, and we have instituted a proceeding to examine the need for improvements to the PJM mitigation provisions. But possible imperfections in the real-time test are no reason to continue to rely on snapshot analysis and blanket exemptions.

³⁵ *Colorado Interstate Co. v. FPC*, 324 U.S. 581, 589 (1945) (rate design involves judgment on a myriad of facts; it has no claim to an exact science); *Wisconsin v. FERC*, No. 06-1408, slip op at 8 (D.C. Cir. Oct. 31, 2008) (deference accorded ratemaking determinations); *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996) (ratemaking involves "complex industry analyses and difficult policy choices").

27. Similarly, the construction exemption was not based on a determination that new generators could not exercise market power. It was a pragmatic approach to achieve other goals: encouraging new entry and honoring investors' expectation. But the subsequent refinement of PJM's market to limit mitigation to those situations in which it is appropriate, to permit scarcity pricing, and to provide a capacity market in addition to an energy market achieves the same goals. Accordingly, as we did earlier, we again find it appropriate to eliminate these exemptions and to treat all generators within PJM according to the same rules.

28. We address below the more specific rehearing requests.

1. Application of Section 206 of the Federal Power Act

29. PJM Power Providers and PPL Companies contend that the Commission did not satisfy the two-pronged requirement of FPA section 206, because although the Commission found that the construction and interface exemptions in PJM's existing tariff had become unjust and unreasonable, the Commission failed to apply the second requirement of section 206 by determining a just and reasonable alternative. PJM Power Providers and PPL Companies also contend that, with the elimination of the mitigation exemptions, the effect of the May 16, 2008 Order is to impose a new rate on previously exempt generators that had not been determined to be just and reasonable, in violation of the requirements of FPA section 206.

30. We find that we have properly applied FPA section 206. We first determined that, in light of the changes to the PJM market, the existing exemptions from the standard mitigation process that applies to all generation in PJM were no longer just and reasonable and were unduly discriminatory.³⁶ We determined that the generators mitigated by the construction and interface exemptions have the same potential to exercise market power as those generators subject to mitigation and that the rationales for treating these generators differently no longer apply. The construction exemption was not predicated on a determination that the previously exempt generators would be unable to exercise market power; rather it was a practical determination by the Commission made as part of an effort to balance investor expectations against the need to protect against the exercise of market power. As discussed above, the changes in the PJM market justify a rebalancing of those interests. Similarly, the original East, Central, and West interface exemptions were based on a 1994-95 market power study, but these studies did not include the current considerably expanded geographic configuration and membership participation of PJM. Moreover, the current blanket exemption failed to take into account that, even across the interfaces, the ability to exercise market power can

³⁶ May 16, 2008 Order, 123 FERC ¶ 61,169 at P 40.

vary from hour-to-hour as demand, supply, and transmission availability change such that continued use of static analysis could miss the potential exercise of market power.³⁷

31. Having found that the exemptions were no longer just and reasonable, and were unduly discriminatory, we ended the discrimination and applied the same just and reasonable standard to this generation as is generally applicable to all other generation within PJM.³⁸ As we explained, the justifications for treating certain units differently, such as the need to provide adequate revenues and valuation, had been addressed within the PJM market, so that application of the same tariff provisions to the previously exempt generators was just and reasonable. In fact, the generators themselves were on notice that the exemptions were not meant to be permanent and were subject to being eliminated based on changes to the PJM market.³⁹ Once the Commission determines that a particular exemption from otherwise applicable tariff provisions is unjust, unreasonable, and unduly discriminatory, it is appropriate to eliminate that exemption and apply the same tariff provisions to all similarly-situated parties.

32. The parties seeking rehearing argue that the Commission cannot find the application of the existing market power test to be just and reasonable while at the same time instituting a proceeding to examine whether these provisions need to be revised. In the current proceeding, the Commission determined that treating generation dissimilarly was no longer just and reasonable and, therefore applied the same just and reasonable tariff provision to all generation. The section 206 proceeding that the Commission established to examine the reasonableness of the existing market power test was not limited only to the proper test for exempt generation, but for all generation. Those seeking rehearing do not provide sufficient reason for finding that the current market power test should be any less applicable to previously exempt generators than to all other generators within PJM. In this situation, in this proceeding the Commission can rectify the unjust and unreasonable exemptions immediately by applying the current tariff on file

³⁷ *Id.* P 48.

³⁸ *Id.* P 32.

³⁹ *See* July 5, 2005 Order, 112 FERC ¶ 61,031 at P 45 (“once the Commission determines the appropriate test for market power within load pockets, that test also would be appropriate to determine when the grandfathered units have sufficient market power to warrant mitigation”).

to protect customers against the exercise of market power, while in the section 206 proceeding examining the generic issue of whether to change the tariff for all generators going forward.⁴⁰

33. In originally accepting the three-pivotal-supplier test as a market mitigation screen, the Commission recognized the concerns “that this test may be too restrictive and will impose mitigation even in markets that are workably competitive.”⁴¹ While accepting the three-pivotal-supplier test, the Commission there too instituted a proceeding under section 206 of the FPA to determine whether this approach is just and reasonable and needs to be revised.⁴² As the Supreme Court found in *FPC v. Tennessee Gas Transmission Co.*, the Commission has the authority to institute interim rate orders, and to bifurcate its determination of issues in order “to protect consumers against exploitation.”⁴³

⁴⁰ As we explained in the May 16, 2008 Order, when changes in market design are at issue, we generally exercise our discretion and try not to order refunds that require re-running the market. May 16, 2008 Order, 123 FERC ¶ 61,169 at P 49. In order to provide relief to customers as soon as possible, as contemplated by the statute, 16 U.S.C. § 824e (2006), we determined that the exemptions should be removed as of the date of our order.

⁴¹ January 25, 2005 Order, 110 FERC ¶ 61,053 at P 83.

⁴² *Id.*; see also July 5, 2005 Order, 112 FERC ¶ 61,031 at P 83, (*citing FPC v. Tennessee Gas Transmission Co.* 371 U.S. 145, 150-52 (1962); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 584 (1942)).

⁴³ *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. at 153-54; the Court stated:

True, the old and undecided zone rate structure under attack as discriminatory was left in effect by this order and survives a bit longer. But the probabilities present in that situation are more than offset by the certainty of the Commission's actions in finding the 7% rate unlawful, fixing the 6 1/8% lawful return and giving timely effectiveness, including refunds, to the latter. Perhaps discrimination may later be found in the allocation of cost between some zones, but it would affect only the customers in those zones while the postponement of the interim order here would be of continuing detriment to all customers in all zones.

(continued)

2. Evidence Justifying the Elimination of the Exemptions

34. PJM Power Providers contend that the Commission ignored expert testimony on material issues, and as a result failed to engage in reasoned decision-making. PJM Power Providers raised concerns with the PJM Market Monitor's mark-up analysis of the construction exempt generators upon which the Maryland PSC relied to argue that market power had been exercised. In its testimony, PJM Power Providers argues that it detailed further concerns regarding the mark-up analysis.

35. As discussed above, our determination to remove the exemptions was not based on the mark-up analysis or a factual finding that any particular generator had exercised market power. We reevaluated PJM's rate design based on the changes that had occurred since the exemptions were instituted and determined that the exemptions, i.e., treating these generators differently than all other generators in the PJM market, was no longer justified. In particular, while PJM's tariff contained a provision under which PJM could make a section 205 filing to mitigate "significant" market power, based on PJM's own comments, we found the existing provision imprecise and difficult for PJM to administer, and hence unjust and unreasonable. Rather than continuing with such an imprecise standard, we determined to apply to the previously exempt generators the same standards that apply to all generators.

36. PJM Power Providers also contend that the Commission ignored its testimony regarding the three-pivotal-supplier test. On rehearing, PPL Companies contend that the three-pivotal-supplier test was adopted by settlement and has never been found by the Commission to be just and reasonable.

37. Again, as we explained above, upon finding that the existing exemptions were unjust and unreasonable and unduly discriminatory, we eliminated the exemptions and applied the otherwise-applicable, existing tariff provisions on file to all generation including the previously exempt generators. The fact that the three-pivotal-supplier test was adopted by settlement does not change the fact that it is part of the current tariff on file with the Commission and here the Commission has merely applied the existing tariff to all similarly situated generators.

38. NRG Companies contend that the Commission erred in its decision to eliminate the construction and interface exemptions. NRG Companies state that the Commission

See BP West Coast Prods., LLC v. FERC, 374 F.3d 1263, 1305 (D.C. Cir. 2004). *See also United States v. City of Fulton*, 475 U.S. 657, 668-69 (1986) (allowing rates to become effective subject to further examination); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 584-85 (when existing rates are found to be unjust and unreasonable, an order decreasing revenues may be filed without establishing a specific schedule of rates).

did not take into consideration that the May 16, 2008 Order undermines reliance and certainty without sufficient consideration of the regulatory compact created by the Commission for units which relied on the exemption when constructed. NRG Companies contend that this is in contravention of the public interest.

39. In seeking to determine the proper balance in designing PJM's rates, we examined all relevant factors, including the reasons for providing these exemptions in the first place, investors' expectations, and whether other changes to the PJM market addressed those concerns. Although we recognize the benefits of regulatory certainty, we find in this case that in balancing buyers' and sellers' interests, the elimination of the exemptions will help to ensure just and reasonable rates without significantly jeopardizing investors' legitimate expectations and return on investment. The generators had been on notice that the construction exemption was limited and might be eliminated as the PJM market evolved. In continuing this exemption, the Commission specifically stated that the exemption could be eliminated "once the Commission determines the appropriate test for market power within load pockets, [and] that test also would be appropriate to determine when the grandfathered units have sufficient market power to warrant mitigation."⁴⁴ With this in mind, we examined the other factors involved in granting such exemptions, including investors' interests in a return on their investments and concluded that, with the changes that had been implemented within the PJM market, the balance had shifted such that it was appropriate to eliminate the exemptions. As we stated in the May 16, 2008 Order:

In determining to remove the construction exemption, we are balancing the exempt generators' reliance interest on the exemption as a source of revenue with the need to protect against the potential exercise of market power, and find that given the development of a capacity market, as well as the other changes that reduce the scope of mitigation, the balance has shifted in favor of mitigating these units on the same basis as all other generation in PJM.⁴⁵

40. PPL Companies on rehearing challenge only the elimination of the interface exemptions. They argue that the Commission did not have evidence to suggest that these markets were not workably competitive and that PJM had done analyses after 1994-1995 that showed that the markets resulting from the interface exemptions remained competitive. PPL Companies argue that applying the three-pivotal-supplier test to the interface exemptions is inconsistent with Commission's precedent in Order No. 697. It

⁴⁴ July 5, 2005 Order, 112 FERC ¶ 61,031 at P 45.

⁴⁵ May 16, 2008 Order, 123 FERC ¶ 61,169 at P 44.

maintains that the generators mitigated have all been granted market based rates by the Commission. It also argues that the three-pivotal-supplier test does not examine whether market power is significant and sustainable in predictable geographic markets. PPL Companies conclude that the three-pivotal-supplier test is not a suitable substitute for the identification of the ability to exercise market power.

41. In the May 16, 2008 Order, the Commission recognized that “[w]hile these interfaces may be liquid as a general matter, when the interfaces are constrained, the possibility exists that such a constraint may lead to the exercise of market power during that period.”⁴⁶ An individual, seller-specific offer cap is applied in PJM only when electricity from generators submitting lower bid prices from outside the constrained area cannot be transmitted into the constrained area and when a generator fails the current three-pivotal-supplier test, a real-time test of whether market power can be exercised. In contrast, the blanket interface exemptions do not account for the changing nature of energy markets in which the ability to exercise market power can vary from day-to-day and even hour-to-hour depending on transmission and other constraints. Because a real-time test did not exist in the past, the Commission relied on periodic, snapshot analysis and blanket exemptions.⁴⁷ But continuation of such periodic, snapshot analysis is unnecessary once a real-time test has been developed.⁴⁸ Further, with settlement provisions which limit mitigation during scarcity and provision which modified the mitigation rules for frequently-mitigated units, in addition to the adoption of a capacity market for PJM (i.e., RPM), possible over-mitigation is not as detrimental as it would have been previously.

42. Moreover, contrary to PPL Companies’ argument, the record did contain evidence that suggests that, when interfaces are congested, competition is not as robust as had previously been assumed. The PJM Market Monitor’s analysis of the three-pivotal-supplier test for March 2006-June 2007 showed that the test was failed in about half of

⁴⁶ *Id.* P 48.

⁴⁷ To evaluate whether additional interfaces should be exempt or whether existing exemptions should be terminated, PJM’s Tariff provided for an analysis conducted on a quarterly basis. Tariff, § 6.4.1(d)(ii).

⁴⁸ *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018, at P 190 (2004) (recognizing that evaluation of market power to determine mitigation in RTO markets generally does not depend “upon a snapshot test of the size or concentration of ownership of any seller,” but rather on “daily and hourly oversight of seller's pricing behavior to ensure that prices do not exceed competitive levels”).

peak and off-peak tested intervals for the AP South interface.⁴⁹ The PJM Market Monitor's analysis also showed that interface-exempt offers of generation are much higher than their marginal costs during periods in which the three-pivotal-supplier test was failed.⁵⁰ While the PJM Market Monitor's analysis does not conclusively show the exercise of market power, it does show that the existing periodic analyses may be missing the exercise of market power and the PJM Market Monitor's analysis shows that real-time analysis is needed. In fact, based on this data and the ability to perform real-time tests, the PJM Market Monitor recommended the elimination of the interface exemptions.⁵¹

43. We also find no inconsistency between our elimination of the interface exemption and Order No. 697. The Commission recognized in Order No. 697 that the granting of market-based rates is subject to compliance with the RTO's mitigation plan and that these protections work in tandem to protect against the exercise of market power.⁵² In organized markets, in which hour-to-hour transmission and other constraints may limit competition and can cause dramatic price swings, the mitigation provisions in RTO tariffs protect against the potential for short-term exercise of market power that may not be captured by the market power analyses of Order No. 697.

44. PJM Power Providers and PPL Companies contend that the May 16, 2008 Order fails to meet the standard of *Edison Mission*, which found that automatic mitigation is inconsistent with markets that are workably competitive. In *Edison Mission*, the court reviewed the Commission's approval of the New York Independent System Operator (NYISO) imposition of an automatic mitigation procedure (AMP) in areas outside of New York City. The court began with the premise that the Commission had not taken issue with the statement that the market outside of New York City is "workably competitive." The court then found that workable competition would suggest that many, perhaps most, possibly all, of the bids triggering mitigation will be due not to market

⁴⁹ Maryland PSC Complaint at 22-23.

⁵⁰ *Id.* at 23-24.

⁵¹ 2006 *State of the Market Report* (Volume 1) at 14, Docket No. ZZ07-4-000 (filed April 2, 2007), <http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=11321337>.

⁵² Order No. 697 at P 290 ("single market with Commission-approved market monitoring and mitigation and transparent prices provides added protection against a seller's ability to exercise market power"); Order No. 697-A at P 110 ("dual protections of individual market power analyses and mitigation rules of the RTO/ISOs provide the Commission with better ability to discern and protect against potential market power").

power but to temporary scarcity. And, the court found that the scarcity pricing explanation would apply “unless the conduct-impact tests somehow differentiated between bid increments due to scarcity and ones due to market power--which the Commission doesn't claim.”⁵³ But the court also noted that the automatic mitigation test might be appropriate “where it is tied to structural market power problems [internal ellipses] where generators would otherwise be in a position to name their price.”⁵⁴ The court found that the Commission had not responded to the scarcity arguments and had not articulated a satisfactory explanation for accepting AMP:

The AMP may well do some good by protecting consumers and utilities against price increments caused by the exercise of market power. But the Commission gave no reason to suppose that it does not also wreak substantial harm--in curtailing price increments attributable to genuine scarcity that could be cured only by attracting new sources of supply. "The crucial question--one the Commission left unaddressed-- is whether the program FERC approved will do more good than harm."⁵⁵

45. The situation in PJM is distinguishable from *Edison Mission*. First, in *Edison Mission*, automatic mitigation was being applied to the entirety of the outside of New York City market. In PJM's case, all of the generators (with the exception of those generators qualifying for the exemption) were already subject to the same mitigation -- found in the tariff already on file -- we are now applying to the exempt generators. The only issue here is whether the exemptions should be continued; the issue of whether to impose mitigation in the first place has already been resolved in other proceedings; it is part of the tariff on file.

46. Second, as explained above, individual, seller-specific offer caps are not applied in PJM unless structural transmission constraints serve to isolate certain areas, thereby limiting competition from generators outside of the constrained area.⁵⁶ Even when this

⁵³ *Edison Mission*, 394 F.3d at 968.

⁵⁴ *Id.*

⁵⁵ *Id.* at 969 (citing *Maryland People's Counsel v. FERC*, 761 F.2d 780, 788-89 (D.C. Cir. 1985)).

⁵⁶ See *Midwest Indep. Transmission Sys. Operator, Inc*, 111 FERC ¶ 61,043, at P 82 (2005) (applying mitigation to market participants that have the ability to affect the price in defined constrained areas does not penalize actions that may be associated with genuine scarcity and thereby discourage participation in the market).

structural test is failed, individual, seller-specific offer caps will not be imposed unless a second structural test, the three-pivotal-supplier, also is failed. Both of these tests comport with the court's recognition that mitigation can be appropriate "where it is tied to structural market power problems."⁵⁷ Further, in this case, the issue of applying mitigation in scarcity situations, the issue that troubled the court in *Edison Mission*, does not apply, because the PJM tariff provides that no individual, seller-specific offer caps will be applied during scarcity conditions.

The Commission orders:

The requests for rehearing are hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

⁵⁷ As discussed above, with respect to the interface exemption, the record did contain evidence indicating that legitimate concerns with market power do exist during certain conditions, unlike the situation in the market outside of New York City in *Edison Mission*.