148 FERC ¶ 61,140
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Cheryl A. LaFleur, Chairman;
Philip D. Moeller, Tony Clark,
and Norman C. Bay.

FirstEnergy Solutions Corp. Docket No. EL14-36-000

PJM Interconnection, L.L.C. Docket No. EL14-94-000

ORDER GRANTING PETITION FOR DECLARATORY ORDER AND ESTABLISHING PAPER HEARING PROCEDURES

(Issued August 25, 2014)

1. On April 2, 2014, FirstEnergy Solutions Corp. (FirstEnergy) submitted a petition for Declaratory Order (Petition) with respect to the calculation of Market Seller Offer Caps in the PJM Interconnection, L.L.C. (PJM) Reliability Pricing Model (RPM) capacity market. In this order, we grant the Petition, and establish paper hearing procedures pursuant to section 206 of the Federal Power Act (FPA) to investigate whether the provisions for calculating Projected PJM Market Revenues in the determination of Market Seller Offer Caps has become unjust and unreasonable, and unduly discriminatory or preferential.[1]

I. Background

2. The PJM Open Access Transmission Tariff (Tariff) includes the RPM capacity market to ensure resource adequacy for the PJM region. The RPM accomplishes this objective by obtaining commitments of capacity through a PJM-administered Base Residual Auction that occurs three years before the capacity delivery year.

[1] 16 U.S.C. § 824e (2012).

3. Section 6 of Tariff Attachment DD.6 includes the provisions for market power mitigation that apply to the RPM.[2] The Tariff establishes a market structure screen,[3] and establishes mitigation measures for generation resources that fail the market structure test.[4] Mitigation is applied on a unit-specific basis if the Sell Offer of capacity from an Existing Generation Capacity Resource (1) is greater than the Market Seller Offer Cap, and (2) would, absent mitigation, increase the capacity resource clearing price in the relevant auction. If such conditions are met, the Sell Offer is set equal to the Market Seller Offer Cap.

4. Section 6.4(a) of Tariff Attachnment DD.6 provides that the Market Seller Offer Cap for an existing generation capacity resource shall be the avoided cost rate less the projected PJM market revenues. The Tariff specifies a formula for calculating the Avoided Cost Rate, and provides for determination of the Projected PJM Market Revenues. Specifically, in determining Projected PJM Market Revenues, the Tariff provides:

> Projected PJM market revenues for any generation capacity resource to which the avoidable cost rate is applied shall include all actual unit-specific revenues from PJM energy markets, ancillary services, and unit-specific bilateral contracts from such generation capacity resource, net of marginal costs for providing such energy *(i.e., costs allowed under cost-based offers pursuant to Section 6.4 of Schedule 1 of the Operating Agreement)* and ancillary services from such resource.[5]

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[2] *See* PJM Interconnection, L.L.C., Intra-PJM Tariffs, OATT ATTACHMENT DD.6. MARKET POWER MITIGATION (8.0.0) (Tariff Attachnment DD.6), http://etariff.ferc.gov/TariffSectionDetails.aspx?tid=1731&sid=145214.

[3] The current market power screen is referred to as the three-pivotal-supplier test. Under the three-pivotal-supplier test, PJM implements market mitigation measures when there are three or fewer generation suppliers available for redispatch that are jointly pivotal with respect to a transmission limit. If there are three such pivotal suppliers, PJM subjects to mitigation only those generation units whose owner, when combined with the two largest other generation suppliers, is jointly pivotal.

[4] Tariff Attachnment DD.6, Section 6.5.

[5] Tariff Attachnment DD.6, Section 6.8(d), emphasis added. *See* PJM Interconnection, L.L.C., Intra-PJM Tariffs, OA Schedule 1 Sec 6.4 Offer Price Caps., 2.0.0, http://etariff.ferc.gov/TariffSectionDetails.aspx?tid=1731&sid=140903. *See* also PJM Interconnection, L.L.C., Intra-PJM Tariffs, Schedule 2, OA Schedule 2, 2.1.0, http://etariff.ferc.gov/TariffSectionDetails.aspx?tid=1731&sid=100696.

5. Section 6.4(b) of Tariff Attachnment DD.6 establishes a process, with specific timelines, in which a potential capacity market seller submits unit-specific data and documentation.[6] Under PJM's tariff, each Existing Generation Capacity Resource that wishes to submit a non-zero sell offer must submit a proposed Market Seller Offer Cap to the Independent Market Monitor for PJM (IMM) and PJM prior to the auction.[7] PJM reviews the data submitted by the Capacity Market Seller, and makes a final determination to either accept or reject the requested Market Seller Offer Cap, and notifies the capacity market seller and the IMM of its determination.[8]

II. Petition for Declaratory Order

6. FirstEnergy explains that it seeks a determination from the Commission that PJM's Tariff requires a generator's Market Seller Offer Cap to reflect the unit's cost-based energy offers in the determination of net Projected PJM Market Revenues. FirstEnergy contends that the IMM calculates the marginal cost using the lower of the price-based offer and the cost-based offer submitted each hour of each day by the Capacity Market Seller into PJM's markets. FirstEnergy contends that the IMM's methodology contradicts the plain reading of the Tariff, which states that the calculation of marginal cost shall utilize the cost-based offer submitted into PJM's energy markets using the costs allowed under cost-based offers pursuant to Section 6.4 of Schedule 1 of the Operating Agreement.

7. FirstEnergy argues that the phrase "net of marginal costs for providing such energy (i.e., costs allowed under cost-based offers pursuant to Section 6.4 of Schedule 1 of the Operating Agreement)" does not provide the IMM with the flexibility to choose its own method for calculating the marginal cost of providing energy for purposes of Market Seller Offer Caps. FirstEnergy states that its interpretation of the Tariff is consistent with the standard meaning of the abbreviation "i.e.," which has the discrete meaning of "that is" or "in other words."[9] FirstEnergy argues that if PJM, the IMM, and the other

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[6] Tariff Attachnment DD.6, Section 6.6 of the Tariff provides offer requirements, and Section 6.7 details data submission requirements.

[7] Tariff Attachment DD.6, Section 6.4.

[8] Tariff Attachment DD.6, Section 6.4(b) also establishes a process if the capacity market seller does not notify the IMM and PJM of the Market Seller Offer Cap to be utilized eighty days prior to the commencement of the offer period for the applicable RPM auction. Should this occur, the Market Seller Offer Cap shall be determined using the applicable default avoidable cost rate specified in Section 6.7(c) of the Tariff.

[9] Petition at 8 (citing Black's Law Dictionary 814 (9th ed. 2009)).

participants in the RPM Settlement meant to afford flexibility with respect to the calculation of marginal cost, they would have used the abbreviation "e.g." instead of "i.e." in the Tariff provision.

8. FirstEnergy argues that there are legitimate reasons why a unit would bid into the energy market below marginal cost. FirstEnergy contends that bidding into the energy market at prices at or near zero reflects a desire by the bidding unit to continue running regardless of the clearing price, and that the operational characteristics of some power plants require this strategy at times to maximize efficiency and reduce long term costs caused by cycling on and off in succession. Similarly, FirstEnergy argues that there are legitimate reasons why a unit would bid into the energy market above marginal cost. For example, FirstEnergy states that a unit may wish to hedge against the risk of failing to perform in real time.

9. FirstEnergy argues that the IMM's "lower of cost- or price- based offer" methodology does not recognize these efficient behaviors and in fact punishes the unit by calculating a Market Seller Offer Cap that may prevent the unit from recovering its "missing money." FirstEnergy argues that market rules should not deter participants from offering below short-run marginal cost as this market behavior minimizes average operational costs or increases unit availability and represents a stand-alone legitimate business purpose. FirstEnergy maintains that, given the variety of factors that can influence a price-based offer, such as the operational characteristics of the unit and the desire to maximize efficiency of a unit in the long-run, market based offers do not serve as a reliable proxy for marginal cost.

10. FirstEnergy requests an order from the Commission finding that the Tariff requires the use of cost-based energy offers rather than the lower of cost-based or price-based energy costs in the calculation of net PJM Market Revenues for the Market Seller Offer Cap prior to the commencement of the 2014 Base Residual Auction.

III. Notice and Responsive Pleadings

11. Notice of the filing was published in the *Federal Register*, 79 Fed. Reg. 21,232 (2014), with interventions and protests due by April 18, 2014.

12. Notices of intervention were filed by the Public Utilities Commission of Ohio (Ohio Commission), Delaware Public Service Commission, Maryland Public Service Commission, and the Illinois Commerce Commission. Timely motions to intervene were filed by PJM Industrial Customers Coalition (PJM Industrial Customers), Monitoring Analytics, Inc.,[10] Consumer Advocate Division of the Public Service Commission of

[10] Monitoring Analytics, Inc. as the PJM IMM.

West Virginia (West Virginia Consumer Advocate), Dayton Power and Light Company, Exelon Corporation, Organization of PJM States, Inc. (OPSI), AEP Generation Resources, Inc., Electric Power Supply Association (EPSA), PJM Power Providers Group (P3), Maryland Office of the Peoples Counsel (Maryland People's Counsel), Duke Energy Corporation (Duke), New Jersey Division of Rate Counsel (New Jersey Rate Counsel), Dominion Resources Services, Inc., NRG Companies, Delaware Division of Public Advocate (Delaware Public Advocate), Retail Energy Supply Association, PJM, American Municipal Power, Inc., North Carolina Electric Membership Cooperative, Citizens Utility Board of Illinois (Illinois Citizens Board), Pennsylvania Office of Consumer Advocate (Pennsylvania Consumer Advocate), District of Columbia Office of the People's Counsel (DC People's Counsel), and Office of the Ohio Consumers' Counsel (Ohio Consumers' Counsel). Late filed motions to intervene were filed by PSEG Companies (PSEG) and Old Dominion Electric Cooperative (Old Dominion).

13. Comments supporting the filing were received by PJM, Duke, and P3 and EPSA.

14. Protests and comments opposing the filing were submitted by OPSI, the Ohio Commission, PJM Consumer Representatives,[11] the Ohio Consumers' Counsel, and the PJM IMM. Answers were submitted by FirstEnergy, the IMM and PJM.

IV. Discussion

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2013), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Given the early stage of this proceeding and the absence of undue prejudice or delay, we grant the unopposed out-of-time motion to intervene submitted by PSEG and Old Dominion.

16. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2)(2013) prohibits an answer to a protest or to an answer unless otherwise ordered by the decisional authority. We will accept the answers filed in this proceeding because they have provided information that assisted us in our decision-making process.

[11] PJM Consumers Representatives are PJM Industrial Customers, West Virginia Consumer Advocate, Maryland People's Counsel, New Jersey Rate Counsel, Delaware Public Advocate, Illinois Citizens Board, Pennsylvania Consumer Advocate.

B. Petition

1. Comments

17. PJM disagrees with the IMM's interpretation of Section 6.8(d) of the Tariff, and states that the cost-based offer, not the lower of price-based and cost-based offers is required by the Tariff. PJM adds that it, not the IMM, has authority to determine whether an offer complies with PJM market rules. PJM notes that a Capacity Market Seller and the IMM should attempt to agree on the Market Seller Offer Cap, but if an agreement is not reached, PJM must review and make a determination whether it will accept or reject the requested Market Seller Offer Cap.

18. Duke, P3, and EPSA support First Energy's view that the PJM Tariff clearly states that the calculation of the Market Seller Offer Cap shall utilize a unit's cost-based offers to determine its Projected PJM Market Revenues, not the lower of the cost-based offer and the price-based offer as the IMM believes. Duke, P3, and EPSA also support FirstEnergy's request for Commission action prior to the upcoming Base Residual Auction.

19. The IMM contends that the Tariff requires capacity market sellers to calculate the Market Seller Offer Cap based on their marginal cost of providing energy, not their cost-based offers. The IMM states that the parenthetical in Section 6.8(d) limits those components that can be included in the calculation of marginal cost to those allowed under Schedule 2 of the Operating Agreement and the PJM Cost Development Guidelines (PJM Manual 15). The IMM contends that if the purpose of the Tariff had been to require the use of cost-based offers, the Tariff would have simply stated "cost based offers" rather than "costs allowed under cost based offers."[12] The IMM argues that cost-based offers include components such as a ten percent adder for fuel uncertainty that are not included in Schedule 2 of the Operating Agreement and the PJM Cost Development Guidelines, thus meaning that cost-based offers are not equivalent to marginal cost.

20. The IMM further argues that the behavior of PJM market participants shows that cost-based offers are not equivalent to marginal costs. The IMM states that a significant number of units in PJM submit price-based energy offers that are less than their cost-based offers because they reflect actual marginal cost.[13] The IMM contends that this behavior is consistent with competitive market conditions and those non-zero price-based offers below offer price caps are evidence of the participant's actual marginal costs. The

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[12] IMM Protest at 7.

[13] IMM Protest at 10 (citing 2013 State of the Markets Report at 95).

IMM states that offers at or near zero are not used to calculate Projected PJM Market Revenues and are not at issue between FirstEnergy and the IMM.

21. The IMM contends that the Petition will raise offer caps in the capacity market above the competitive level by overstating marginal costs and potentially allow the exercise of market power. The IMM contends that if FirstEnergy disagreed with the longstanding, widely-accepted and established practice for the calculation of net revenues, it could have filed with the Commission well before the auction deadline. Therefore, the IMM argues, FirstEnergy cannot make a credible case that this matter requires urgent attention.

22. In opposing the Petition, OPSI and the Ohio Commission argue that FirstEnergy's interpretation of the Tariff is narrow and inconsistent with the actual Tariff language. While they maintain that the IMM's current practice is consistent with the Tariff, if the Commission finds that the meaning of the Tariff is unclear, OPSI and the Ohio Commission request that FirstEnergy be allowed to refile its proposal as a complaint under a section 206 of the FPA, or that the proceeding be held in abeyance to consider more evidence to determine the meaning of the Tariff. OPSI and the Ohio Commission contend that granting FirstEnergy's petition may create an opportunity to exercise market power and result in higher Base Residual Auction clearing prices.

23. The PJM Consumer Representatives argue that FirstEnergy has known about the IMM's net revenue calculation for many years and therefore it cannot make a credible case that this matter requires expedited action. The PJM Consumer Representatives also contend that FirstEnergy's interpretation of the Tariff is incorrect and that the Commission should interpret the tariff in accordance with the IMM's longstanding practice. The PJM Consumer Representatives request that, if the Commission determines that the Tariff requires the use of only administratively calculated marginal costs, the Commission should clarify that only the "allowed costs" for each seller are used, and that such allowed costs should be calculated on a unit-specific basis. The PJM Consumer Representatives argue that certain offer price caps that define a seller's cost-based offer pursuant to Section 6.4 of Schedule 1 of the Operating Agreement allow a ten percent adder, and that this is not a cost that should be included as a seller's marginal cost.

2. <u>Answers</u>

24. FirstEnergy contends that, if the parties to the RPM settlement had intended the IMM's interpretation to prevail, the parties would have provided clearer language to that effect. First Energy states that the Tariff language in question makes no reference to price-based offers, but rather links marginal cost exclusively to the cost-based offers as defined in Section 6.4 of the Operating Agreement. FirstEnergy also states that the Tariff neither mentions a "lower of" methodology, nor does it suggest that the determination of marginal cost should be left to the discretion of the IMM.

25. FirstEnergy states that the IMM's interpretation of the Tariff wrongly conflates "marginal-cost" with "price-based offers" and reiterates that there are a number of reasons market participants may bid above or below their actual marginal costs. FirstEnergy also maintains that the Petition for a declaratory order is the appropriate procedural vehicle to clarify its dispute and disagrees with parties that encourage the Commission to defer action on the Petition until after the May 2014 Base Residual Auction.

26. The IMM argues that FirstEnergy's answer misrepresents its reading of the Tariff. The IMM states that it does not claim that the Tariff references price-based offer. Rather, the IMM argues that the Tariff requires a calculation of marginal cost and that a non-zero price-based offer lower than a cost-based offer is strong evidence for what the participant believes is its own marginal cost. The IMM argues that FirstEnergy's reading of the Tariff ignores the term "marginal cost" and gives no meaning to the phrase "costs allowed under cost-based offers" and instead takes "cost-based offers" out of context and gives meaning to these words alone.

27. The IMM argues that its long-standing implementation of Section 6.8(d) without controversy refutes FirstEnergy's claims that the IMM's interpretation of the Tariff cannot be practically applied because "price-based offers…do not contain *any* cost detail or explanation of the derivation of the offer price." The IMM also contends that the plain language of Section 6.8(d) excludes the ten percent adder and that FirstEnergy has never claimed that, for the units that lead to the filing of the Petition, the ten percent adder represents actual costs. The IMM further argues that this approach does not accord the IMM excessive discretion as asserted by FirstEnergy since the IMM cannot force any Capacity Market Seller to use its calculated offer caps.

28. In its response to the answer of the IMM, PJM argues that the Tariff language at issue clearly equates cost-based offers with marginal costs.[14] PJM maintains that the ten percent adder "is not on top of the marginal costs, but, rather, a component of marginal costs,"[15] and that the IMM has stated as such in prior proceedings.[16] PJM states that it was unaware of the IMM's "inaccurate interpretation of Section 6.8(d)" to calculate past Market Seller Offer Caps, and that past practice is not dispositive of the proper

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[14] PJM April 30, 2014 Answer to IMM Answer at 2.

[15] *Id*. at 5.

[16] *Id.* at n.17 (citing *Reply Comment of the Independent Market Monitor for PJM*, Docket No. EL08-47-000 at 4 (Nov. 5, 2008) ("the definition of costs includes a 10 percent adder to calculate short-run marginal costs. . . in order to account for the potential uncertainties in measurement.")).

interpretation of the Tariff.[17] PJM states that if the Commission grants the Petition before the May 2014 BRA, it believes that FirstEnergy will need a waiver of the Tariff deadline for the submission of its preferred Market Seller Offer Cap. In its answer to PJM, FirstEnergy states that, although it disagrees such a deadline exists, it requests any necessary waivers to allow the use of the offer cap that reflects the guidance in the instant Commission order.[18]

3. Commission Determination

29. We grant the Petition for a declaratory order. Further, as discussed below, we establish paper hearing procedures to determine whether the Tariff provisions for the calculation of Projected PJM Market Revenues in the determination of Market Seller Offer Caps are unjust and unreasonable, and unduly discriminatory or preferential.

30. Section 6.8 of Attachment DD.6 states, in relevant part, that the projection of PJM market revenues shall include all actual unit specific revenues "net of marginal costs for providing such energy (i.e., costs allowed under cost-based offers pursuant to Section 6.4 of Schedule 1 of the Operating Agreement)." We interpret this provision as requiring a Capacity Market Seller to calculate its marginal costs using a unit's cost-based offer as determined through the methodology under Section 6.4 of Schedule 1, and, contrary to the IMM's argument, PJM's Tariff does not provide for the use of the lower-of cost-based or price-based offers in the calculation of marginal cost. The term "i.e.," as defined by Black's Law Dictionary, is an abbreviation of the Latin *id est* meaning "that is."[19] The tariff therefore is defining the term marginal costs to be the cost-based offers under Section 6.4 of Schedule1. In addition, the Tariff neither mentions a "lower-of" methodology as proposed, nor does it suggest that the determination of marginal cost is subject to the interpretation of the IMM. Indeed, the final interpretation is made by PJM under the Tariff, and our interpretation is also consistent with PJM's own reading of its Tariff.

31. The IMM contends that non-zero price based energy offers less than cost-based offers reflect actual marginal cost and that this behavior is consistent with competitive market conditions. OPSI and the Ohio Commission argue that the best information should be used to calculate marginal costs, and price-based offers should be used to calculate Market Seller Offer Caps. Similarly, the PJM Consumer Representatives

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[17] *Id.* at 6.

[18] FirstEnergy April 30, 2014 Answer to PJM Answer at 1.

[19] *See Buckhannon Board & Care Home, Inc., et al. v. West Virginia Department of Health And Human Resources, et al.*, 532 U.S. 598 (2001).

contend that non-zero offers below a Market Seller's Offer Cap provides the best indication of the units' true and actual marginal costs.

32. Given the concerns raised by the IMM and other entities, we have reason to believe that the existing Tariff may be unjust and unreasonable, and unduly discriminatory or preferential. Accordingly, we are establishing paper hearing procedures pursuant to section 206 of the FPA to investigate the justness and reasonableness of the Tariff provisions for the calculation of Projected PJM Market Revenues in the determination of Market Seller Offer Caps.[20] Sixty days after publication in the *Federal Register*, PJM is required to submit a brief to show that its Tariff provisions for the calculation of Projected PJM Market Revenues in the determination of Market Seller Offer Caps continues to be just and reasonable. Reply briefs are due thirty days after the date of PJM's submission of its brief.

33. Upon the establishment of procedures pursuant to section 206 of the FPA, the Commission must establish a refund effective date that is no earlier than the date of publication of notice of the Commission's intent to institute a proceeding, and no later than five (5) months subsequent to that date. We will establish a refund effective date as the date of publication of the issuance of this order. The Commission is also required by section 206 to indicate when it expects to issue a final order. The Commission expects to issue a final order in this section 206 investigation within 180 days from the date of publication of the issuance of this order.

The Commission orders:

(A) The FirstEnergy Petition for a declaratory order is granted, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act, and by the FPA, particularly section 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure, and the regulations under the FPA (18 C.F.R., Chapter I), we are establishing paper hearing procedures concerning the calculation of Projected PJM Market Revenues in the determination of Market Seller Offer Caps.

(C) PJM must submit a brief, as discussed in the body of the order, no later than sixty days after publication in the *Federal Register*.

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[20] Requests for rehearing or other pleadings related solely to the FirstEnergy Petition must be filed under Docket No. EL14-36-000. Pleadings related to the paper hearing must be filed under EL14-94-000.

(D) Reply briefs are due thirty days after submission of PJM's brief.

(E) The Secretary is directed to publish a notice of this section 206 proceeding in the *Federal Register*.

By the Commission.

(S E A L)

Kimberly D. Bose
Secretary.