149 FERC ¶ 61,091
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C. Docket Nos. EL14-95-000
ER14-2705-000

ORDER ADDRESSING PROPOSED TARIFF AND
OPERATING AGREEMENT REVISIONS

(Issued October 31, 2014)

1. On August 26, 2014, PJM Interconnection, L.L.C. (PJM) filed a complaint, pursuant to section 206 of the Federal Power Act (FPA),[1] seeking to revise section 6.4.2 of Schedule 1 of the PJM Operating Agreement,[2] which sets forth the rules related to Offer Price Adders for generation units making price-based offers that are frequently offer capped (Frequently Mitigated Units).[3] In a contemporaneous, companion filing, submitted pursuant to FPA section 205, PJM proposes parallel revisions to section 6.4.2 of Attachment K-Appendix of the PJM Open Access Transmission Tariff (OATT) and a related revision to section II.A.3 of Attachment M-Appendix of the OATT.[4]

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[1] 16 U.S.C. § 824e (2006).

[2] PJM states that its section 206 proposal was made necessary due to the failure of its stakeholder body to approve the Operating Agreement revisions at issue by the required two-thirds super-majority vote required to authorize a filing under FPA section 205, 16 U.S.C. § 824d (2006). The vote in favor totaled 65.6 percent.

[3] As explained below, a Frequently Mitigated Unit is a unit whose price-based energy offers has been capped for an applicable percentage of its run hours during the previous 12 months. *See* PJM Operating Agreement at Schedule 1, section 6.4.2(b).

[4] PJM submitted a section 205 filing, in Docket No. ER14-2705-000, under eTariff filing code 10, and proposed a 61-day effective date. As PJM has recognized, when it makes a section 206 proposal to change its Operating Agreement accompanied by a section 205 filing to revise related provisions of its OATT, it "cannot put the section 205

(continued ...)

2. For the reasons discussed below, we agree with PJM that the existing provisions of section 6.4.2 are unjust and unreasonable. We also accept PJM's proposed revisions as just and reasonable, to become effective November 1, 2014, as requested, subject to a compliance filing.

I. PJM's Existing Tariff

3. PJM states that, under existing section 6.4.2 of the OATT and Operating Agreement, generation units whose energy price offers have been frequently capped, due to their potential to exercise market power, may nonetheless be eligible for an Offer Price Adder. PJM notes that Offer Price Adders were first approved by the Commission in 2005 to ensure that units that were frequently needed to relieve transmission constraints had a reasonable opportunity to recover their going-forward costs.[5] As first implemented by PJM, only those generation units that had been offer-capped for more than 80 percent of their run hours over the prior 12 months were eligible to receive an Offer Price Adder.[6] Subsequently, this pricing structure was revised to recognize three separate adders for: (a) units that are offer-capped for 60 percent or more of their run hours, but less than 70 percent of their run hours (Tier 1 units); (b) units that are offer-capped for 70 percent

filing to revise its tariff and RAA into effect until after the Commission has completed action on the section 206 filing." *See PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, at P 13 (2006). Therefore, PJM should not have used a statutory filing code with a 61-day proposed effective date in making its filing in Docket No. ER14-2705-000. PJM could have filed using eTariff filing code 10 with an indeterminate proposed effective date (12/3/9998) or used a compliance filing code if it chose not to include these proposed revisions in its section 206 filing. However, since we are acting on both filings within the 60-day period, we will process the tariff provisions filed in Docket No. ER14-2705-000.

[5] *PJM Interconnection, L.L.C.*, 110 FERC ¶ 61,053, at P 25 (2005) (PJM 2005 Order). The Commission has defined going-forward costs as the costs that a generator must recover to stay in business for any appreciable period of time, such as fuel and variable costs like labor, and the avoidable component of annual out-of-pocket direct costs (e.g., repair parts, site electric and communications, and property taxes). *Id.* P 27, n. 31.

[6] The Offer Price Adder was $40 per Megawatt hour (MWh), or the relevant unit's going-forward costs.

or more of their run hours, but less than 80 percent of their run hours (Tier 2 units); and (c) units that are offer-capped for 80 percent or more for their run hours (Tier 3 units).[7]

4. PJM states that, over time, these Offer Price Adders have led to windfall revenues for most sellers of Frequently Mitigated Units. PJM states that, since 2005, its markets have evolved to include, among other things, an annual capacity market auction permitting a unit to recover its going-forward costs. In addition, PJM states that Offer Price Adders were intended to compensate peaking combustion turbine units operating for a small number of run hours per year and needed to relieve thermal transmission constraints, but now some units have become eligible to receive Offer Price Adders in the course of supplying reactive power support and automatic load rejection for black start service.[8]

5. For these reasons, PJM asserts that the primary justification for an Offer Price Adder – providing a unit with a reasonable opportunity to recover its going-forward costs – no longer exists for most units that are frequently-mitigated.[9] PJM argues that, as such, section 6.4.2 now allows for the payment of windfalls that are unjust and unreasonable and unduly discriminatory, as between Frequently Mitigated Units and all other units.

II. Proposed Revisions

6. To ensure that Offer Price Adders will operate as a backstop mechanism only for those Frequently Mitigated Units not recovering going-forward costs, PJM proposes to vest additional authority in the Market Monitor (subject to PJM's oversight) to examine,

[7] For Tier 1 units, the Offer Price Adder is either (i) incremental cost plus 10 percent or (ii) incremental cost plus $20 per MW/h. For Tier 2 units, the Offer Price Adder is either (i) incremental cost plus 15 percent, not to exceed incremental cost plus $40 per MW/h, or (ii) incremental cost plus $30 per MW/h. For Tier 3 units, the Offer Price Cap is either (i) incremental cost plus 10 percent; (ii) incremental cost plus $40 per MW/h; or (iii) the agreed unit-specific going-forward costs of the unit as reflected in an agreement entered into by PJM and the relevant seller, pursuant to section 6.4.2(a)(iv).

[8] Transmittal, Docket No. EL14-95-000, at 9-10, n. 22.

[9] PJM cites to a 2013 report issued by its Independent Market Monitor (Market Monitor), showing that, for the prior year, 75 percent of all Frequently Mitigated Units covered their Avoidable Cost Rate – a proxy for these units' going-forward costs. PJM explains that the Avoidable Cost Rate is essentially the cost that a unit would avoid paying if it were to retire rather than remain operational.

on a monthly, per-unit basis, whether these units are receiving adequate revenues to cover their going-forward costs and thus should be eligible to receive an Offer Price Adder.[10] PJM states that if a Frequently Mitigated Unit receives adequate revenue through its participation in PJM's markets during the previous 12 calendar months to cover its going-forward costs, the unit would not qualify for an Offer Price Adder for the following month.

7. PJM also proposes that, to qualify as a Frequently Mitigated Unit, no portion of the unit may be included in a Fixed Resource Requirement (FRR) Capacity Plan, or be receiving compensation as a deactivated unit.[11] PJM asserts that units that are included in FRR Capacity Plans or receive compensation as deactivated units are receiving going-forward costs outside of PJM's markets, and any additional compensation from PJM's markets would be redundant. PJM also proposes to clarify that, consistent with its current operational practices, Offer Price Adders will apply only to units when their market-based offer was greater than their cost-based offer.

8. PJM proposes to revise the offer cap for Tier 2 units. Specifically, PJM proposes to revise the percentage-based incremental Tier 2 adder from 15 percent to 10 percent.[12] PJM asserts that this revision is appropriate, noting that the percentage-based adder for Tier 1 and Tier 3 units is currently 10 percent. In addition, PJM proposes to delete, as unnecessary, the specification that a Tier 2 adder will not exceed $40 per MW/h. PJM argues that this language is unnecessary given that the applicable dollar cap for Tier 2 units is $30 per MW/h.

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[10] *See* proposed Operating Agreement at Schedule 1, section 6.4.2(b)(ii). The revised criterion provides that a Frequently Mitigated Unit will qualify for an Offer Price Adder if, among other things:

> the unit's Projected PJM Market Revenues plus the unit's PJM capacity market revenues on a rolling 12-month basis, divided by the unit's MW of installed capacity (in $/MW-year) are less than its accepted unit specific Avoidable Cost Rate (in $/MW-year) (excluding [the Avoidable Project Investment Recovery Rate)] and [Avoidable Refunds of Project Investment Reimbursements], or [if applicable] its default Avoidable Cost Rate (in $/MW-year)[.]

[11] *Id.* at proposed section 6.4.2(b)(iii).

[12] *Id.* at proposed section 6.4.2(a)(iii)(b).

9. PJM also proposes to eliminate the option for Tier 3 units to receive an adder equal to the agreed unit-specific going-forward costs of the individual unit.[13] PJM asserts that the $40 per MW/h cap is sufficient to cover the going-forward costs for Tier 3 units, given that no unit, to date, has sought to utilize the unit-specific adder option.

10. In addition to its proposed revisions to section 6.4.3, PJM also proposes to make conforming changes to section II.A.3 of the Attachment M-Appendix, specifying the process by which the Market Monitor will determine, in accordance with section 6.4.2, as revised, whether an offer-capped unit is eligible for an Offer Price Adder.[14]

11. In support of its filings, PJM states that its proposed revisions are generally consistent with the Market Monitor's current practice of examining: (i) offer-capping; (ii) the eligibility of a unit to qualify as a Frequently Mitigated Unit; and (iii) the application of the relevant Offer Price Adder. In addition, PJM states that recent analytical improvements now permit PJM and the Market Monitor to accurately calculate whether given units are recovering their going-forward costs.

III. Notice of Filings and Responsive Pleadings

12. Notice of PJM's filings was published in the *Federal Register*, 79 Fed. Reg. 53,054 (2014) with interventions and protests due on or before September 16, 2014. Notices of intervention and timely-filed motions to intervene were submitted by the entities listed in the Appendix to this order. Motions to intervene out-of-time were submitted on July 17, 2014, by FirstEnergy Services Company (FirstEnergy) and on October 1, 2014 by Old Dominion Electric Cooperative ((ODEC). Answers were submitted on October 1, 2014, by PJM, and on October 2, 2014, by the Market Monitor.

A. Supporting Comments

13. The Market Monitor, the PJM Industrial Customer Coalition (PJM-ICC), and Dominion Resources, Inc. (Dominion) agree with PJM that the existing provisions of section 6.4.2 are unjust and unreasonable. PJM-ICC notes that, since the implementation of PJM's capacity market auctions, adequate revenues are now being provided to most

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[13] *Id.* at proposed sections 6.4.2(a)(iii)(c) and 6.4.2(a)(iv).

[14] The revised language provides that the Market Monitor is required to issue a written notice of the applicable Offer Price Adder to the relevant seller for each unit that meets the relevant criteria, with a copy of that determination to be provided to PJM. *See* proposed PJM OATT, at Attachment M-Appendix, section II.A.3.

sellers of Frequently Mitigated Units. Dominion adds that the current distribution of Offer Price Adders is likely resulting in unnecessarily high compensation to some market participants to the detriment of other market participants, like Dominion.

14. Commenters also support PJM's proposed revisions. The Market Monitor urges the Commission to accept PJM's proposed revisions as a reasonable compromise, vis a vis the Market Monitor's own preference that Offer Price Adders be eliminated altogether. PJM-ICC and Dominion note that PJM's proposed revisions will appropriately ensure that Offer Price Adders will address the concern for which they were originally implemented, i.e., to ensure that Frequently Mitigated Units are able to recover their going-forward costs, while ensuring that over-collections are avoided.

B. Protest

15. NRG Companies and American Electric Power Service Corporation (Indicated Suppliers) argue that PJM's proposal fails to carry its FPA section 206 burden. Indicated Suppliers asserts that PJM's proposal, while focusing on the asserted need to reduce uplift payments, fails to address the underlying modeling deficiencies (i.e., the failure of PJM's existing pricing mechanisms to account for, or address, system constraints) and related issues that have caused certain units to become frequently mitigated. Indicated Suppliers further assert that PJM's approach deprives owners of resources that are needed for reliability of needed revenues.

16. Indicated Suppliers argue that PJM's central claim – that Offer Price Adders provide windfalls – is unsupported. Indicated Suppliers assert that, in fact, Offer Price Adders are a necessary component of just and reasonable rates. Indicated Suppliers note that PJM calculates variable maintenance expenses for generation assets based on the maintenance expense history of the unit over a 10- or 20-year period.[15] Indicated Suppliers assert that, as such, cost-based offers for a Frequently Mitigated Unit, when considered alone (i.e., without an Offer Price Adder), do not permit recovery of the accelerated wear and tear that will result if a generator is frequently dispatched out-of-merit.

17. Indicated Suppliers also cite to the Market Monitor's 2013 State of the Market Report as confirmation that, even with PJM's existing Offer Price Adders, Frequently Mitigated Units have not been adequately compensated. Specifically, Indicated Suppliers

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[15] Indicated Suppliers Protest at 6 (citing PJM Manual 15: Cost Development Guideline at 14).

note that, as revealed by the Market Monitor, 28 out of 112 units, in 2012, were unable to cover their Avoidable Cost Rate, with 22 of these 28 units now scheduled to retire.[16]

18. Indicated Suppliers also challenge PJM's assumption that recovery of costs in excess of going-forward costs is unjust and unreasonable. Indicated Suppliers argue that, in considering the rationale behind an Offer Price Adder in a 2004 order, the Commission made clear that Frequently Mitigated Units "need to be compensated at a level that adequately covers their fixed and variable costs."[17] Indicated Suppliers also cite to more recent precedents, from other organized markets, supporting the proposition that units that are frequently mitigated, but needed for reliability purposes, should not be limited in their recovery to their going-forward costs.[18]

19. Even assuming that it is appropriate to impose limitations on the resources eligible to use Offer Price Adders, Indicated Suppliers assert that the qualification criteria proposed by PJM are unduly narrow. Specifically, Indicated Suppliers challenge PJM's proposal to exclude consideration of certain project costs, namely the Avoidable Project Investment Recovery rate and Avoidable Refunds Project Investment Reimbursements, in determining whether a unit qualifies as a Frequently Mitigated Unit.[19] Indicated Suppliers argue that, while PJM's OATT, at Attachment DD, section 6.8(a), allows generators to recover these project investment costs as an Avoidable Cost Rate, PJM has offered no justification for a disparate treatment applicable to Frequently Mitigated Units. Indicated Suppliers argue that PJM's proposed exclusion of these inputs will unduly restrict the ability of generators that have made project investments to qualify for Offer Price Adders.

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[16] *Id.* (citing 2013 State of the Market report at 85).

[17] *Id.* at 7 (citing *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112, at P 40 (2004) (PJM 2004 Order)).

[18] *Id.* (citing *California Indep. Sys. Operator Corp.*, 126 FERC ¶ 61,150, at P 88 (2009) (CAISO 2009 Order) (holding that adder mechanisms for frequently mitigated units are intended to ensure that these units "have the opportunity to recover some contribution toward fixed costs[.]"); *Midcontinent Indep. Sys. Operator, Inc.*, 148 FERC ¶ 61,057, at PP 84-86 (2014) (MISO 2014 Order) (finding that it was unjust and unreasonable to limit generators needed for reliability to recovery of their going-forward costs and that such generators were also entitled to recover their fixed costs of existing plant)).

[19] *See* proposed section 6.4.2(b)(ii).

C. **Answers**

20. PJM, in its answer, responds to Indicated Suppliers' argument that PJM's filings fail to demonstrate that PJM's existing rules are unjust and unreasonable. PJM reiterates the arguments that it made in its section 206 filing, maintaining that new operational and market trends have led to some units becoming eligible for Offer Price Adders for reasons that were not originally envisioned.[20]

21. PJM also responds to Indicated Suppliers' claim that, under PJM's proposal, units that are frequently mitigated will no longer have an opportunity to receive revenues in excess of their going-forward costs, or an opportunity to recover their variable costs. PJM disputes both claims. Specifically, PJM asserts that, under its proposal, Frequently Mitigated Units will continue to have the opportunity to receive revenues in excess of their going-forward costs, and the opportunity to cover their variable costs, as applicable.[21] PJM adds, however, that these revenue opportunities exist in PJM's markets, while the Offer Price Adder is appropriately limited to the opportunity of Frequently Mitigated Units to recover their going-forward costs.

22. PJM also challenges Indicated Suppliers' reliance on the PJM 2004 Order in support of their asserted claim that, in that order, the Commission found that Offer Price Adders should cover costs in excess of going-forward costs. PJM argues that the cited finding in the PJM 2004 Order was later interpreted by the Commission in the PJM 2005 Order as a more limited directive, i.e., as a directive "to develop a policy that would provide [Frequently Mitigated Units] a reasonable opportunity for recovery, at a minimum, of their going forward costs."[22]

23. PJM also challenges Indicated Suppliers' reliance on the CAISO 2009 Order and the MISO 2014 Order. PJM asserts that neither of these precedents stands for the proposition that mitigated units, operating in PJM's market, must be given the opportunity, via an Offer Price Adder, to recover more than just their going-forward

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[20] *See supra* P 4 and P 5. The Market Monitor, in its Answer, makes similar arguments defending PJM's filings.

[21] PJM notes, for example, that when a Frequently Mitigated Unit is mitigated to its cost-based offer, such an offer includes the unit's variable costs, as prescribed by Schedule 2 of the PJM Operating Agreement and PJM Manual 15.

[22] PJM Answer at 8-9 (citing PJM 2005 Order, 110 FERC ¶ 61,053 at P 20).

costs. As noted above, PJM argues that these opportunities are already afforded to sellers in PJM's markets.

24. PJM responds to Indicated Suppliers' argument that PJM's proposal fails to address the underlying modeling flaws (i.e., the constraints giving rise to frequent out-of-merit dispatch) that, if corrected, could decrease the number of units that are frequently mitigated. PJM argues that these modeling issues are beyond the scope of this proceeding. PJM adds that its proposed changes will allow Frequently Mitigated Units to receive an Offer Price Adder if they meet the applicable eligibility requirements, regardless of whether PJM makes any future changes to its modeling practices. PJM notes that its stakeholder body is currently considering these issues and that PJM will continue to participate in the Commission's ongoing proceeding, in Docket No. AD14-14-000, addressing price formation issues in organized markets, including issues related to uplift and mitigation of generation units.[23]

25. Finally, PJM defends its proposed criterion for determining whether a unit qualifies as a Frequently Mitigated Unit, including its proposal to exclude Avoidable Project Investment Recovery rate and Avoidable Refunds Project Investment Reimbursements values from the determination of going-forward costs. PJM asserts that its proposed exclusion is warranted, given that the Avoidable Project Investment Recovery rate and Avoidable Refunds Project Investment Reimbursements values included in a seller's offer for a given resource are, in many cases, a function of values attributable to hundreds of distinct projects under the seller's control that may have varying recovery periods. PJM describes the task of analyzing this data as unworkable and burdensome. PJM adds that excluding these values will not impede its ability to determine whether a given generation resource is receiving adequate revenues to cover its going-forward costs.

26. The Market Monitor, in its answer, defends PJM's proposed exclusion of Avoidable Project Investment Recovery rate and Avoidable Refunds Project Investment Reimbursements from the criterion the Market Monitor will be required to rely upon in determining whether a unit qualifies as a Frequently Mitigated Unit. The Market Monitor notes that the Avoidable Cost Rate is defined as the costs which a unit must incur each year in order to remain in service and which a unit could avoid by not operating for a year and that such costs include maintenance costs, not fixed costs (i.e., a return on and of capital). The Market Monitor explains that the Avoidable Project Investment Recovery rate is defined as the fixed costs of additional investments in a capacity resource.

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[23] *See also* Market Monitor Answer at 5 (asserting that PJM's Offer Price Adder rules have no relation to any asserted modeling or planning deficiency).

27. The Market Monitor argues that Avoidable Project Investment Recovery rate should not be included in this test because it provides for fixed cost recovery and is not part of the marginal cost of capacity. The Market Monitor further asserts that if a unit is not recovering the Avoidable Project Investment Recovery rate, it will still be economically rational to operate. The Market Monitor also argues that Avoidable Refunds Project Investment Reimbursements provides for the reimbursement of funds by a generation owner under a Reliability Must Run contract associated with a planned retirement if the unit decides to continue to operate after PJM no longer needs the unit for local reliability.

IV. Procedural Matters

28. Pursuant to Rule 214 of the Commission's Rule of Practice and Procedure, 18 C.F.R. § 385.214 (2014), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to the proceedings in which these interventions were filed. In addition, given the early stage of these proceedings and the absence of undue prejudice or delay, we grant the unopposed, late-filed interventions submitted by FirstEnergy and ODEC.

29. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure prohibits an answer to a protest unless otherwise ordered by the decisional authority.[24] We accept the answers submitted by PJM and the Market Monitor because they have provided information that has assisted us in our decision-making process.

V. Discussion

30. For the reasons discussed below, we accept PJM's proposed tariff revisions, subject to a compliance filing, to become effective November 1, 2014, as requested. As a threshold matter, we agree with PJM and commenters that PJM's existing Offer Price Adders for generation units making price-based offers that are Frequently Mitigated Units have been rendered unjust and unreasonable due to evolving market mechanisms, including PJM's implementation of its capacity market auctions. As the Market Monitor has found in its 2013 State of the Market Report, these market mechanisms have allowed a large percentage of sellers with Frequently Mitigated Units to cover their Avoidable Cost Rates, i.e., their going-forward costs, such that additional revenues, as provided via an Offer Price Adder, operate as windfalls.

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[24] PJM Answer at 8 (citing PJM 2005 Order, 110 FERC ¶ 61,053 at P 20).

31. We also find that PJM's proposed revisions to its tariff are just and reasonable. As revised, section 6.4.2 will appropriately operate as a backstop mechanism giving Frequently Mitigated Units an opportunity to recover their going-forward costs when they otherwise will not have the opportunity to do so. We also agree that PJM's proposed changes to its OATT at Attachment M-Appendix are appropriate in addressing the Market Monitor's duties vis a vis PJM's revised section 6.4.2 criterion.[25]

32. We reject Indicated Suppliers' argument that PJM's proposal fails to demonstrate that PJM's existing rules are unjust and unreasonable. We find that PJM has met its FPA section 206 burden by showing that its existing Offer Price Adders allow for unwarranted windfalls. PJM has demonstrated that PJM's existing Offer Price Adders are not being used for the purpose that they were originally intended, as addressed by the Commission in the PJM 2005 Order.[26] The intention of the PJM 2005 Order was to allow units to recover their going-forward costs through Offer Price Adders;[27] however, many units are now recovering their going-forward costs through participation in PJM's markets, including PJM's capacity markets. As a result, Offer Price Adders represent windfall revenue to such units.

33. Additionally, as PJM explains in its filing, Offer Price Adders were originally designed and used to compensate a peaking combustion turbine unit operating for only a small number of run hours per year, as needed to relieve a constraint – not a continuously running, uneconomic automatic load rejection unit. PJM states that as a result of new operation and market trends, Offer Price Adders have been increasingly applied to base load units running thousands of hours per year, which was not the original intent of the adders.[28]

34. Indicated Suppliers also argue that Offer Price Adders are necessary to ensure that Frequently Mitigated Units are appropriately compensated. However, Indicated Suppliers ignore the fact that PJM only proposes to eliminate Offer Price Adders for a subset of units, i.e., for those units that are already covering their going-forward costs,

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[25] These changes merely expand on the Market Monitor's existing duty, pursuant to 6.4.2, to designate, on a prospective basis, whether a unit qualifies as a Frequently Mitigated Unit.

[26] PJM 2005 Order, 110 FERC ¶ 61,053 at P 25.

[27] *Id*.

[28] PJM Transmittal, Docket No. EL14-95-000 at 9-10.

but would otherwise retain these adders for Frequently Mitigated Units that are not recovering these costs. In fact, in submitting its proposal, PJM stated that, "complete removal of [Offer Price Adders] is inappropriate because in some instances, Market Sellers are not recovering their Frequently Mitigated Unit's going-forward costs through the unit's other PJM market revenues and still need the [Offer Price Adder] to help cover these costs."[29] To the extent that Indicated Suppliers are concerned that a unit that does not qualify for Offer Price Adders under PJM's proposal will not be able to recover certain expenses (such as accelerated wear and tear that goes into its variable maintenance expense), we note that such expenses may be reflected in a unit's cost-based offer and that sufficient options exist by which a resource may appeal for higher maintenance expenses, if necessary, to recover these costs. Specifically, PJM's Manuals specify a process by which a resource may seek review of its maintenance adder with the Market Monitor; if it disagrees with the Market Monitor's determination, it may submit a review request to PJM.[30]

35. We also reject Indicated Suppliers' argument that, even under PJM's existing rules, Frequently Mitigated Units have not been adequately compensated, as borne out by the Market Monitor's 2013 State of the Market Report finding that 28 out of 112 units over the relevant period were unable to cover their Avoidable Cost Rate, with 22 of these 28 units scheduled to retire. In fact, as this data also reveals, a significant number of the units in question have received windfall revenues – a circumstance that sufficiently supports PJM's proposal. The fact that 84 out of the 112 units were able to cover going-forward costs without the addition of an Offer Price Adder gives substantial weight to PJM's proposal. Of the remaining 28 units, all were eligible, and in fact received, an Offer Price Adder to help cover going-forward costs.[31] Nor has Indicated Suppliers shown that the 22 units that are scheduled to retire did not recover their going-forward costs. There could have been other reasons why these units retired, including large investments needed due to major upgrades.

36. Indicated Suppliers also cite to Commission precedent in support of their claim that Offer Price Adders, as approved for PJM and in other markets, are designed to cover costs in excess of going-forward costs. We disagree. In the PJM 2005 Order, the Commission accepted PJM's proposal for the Offer Price Adder, stating that such a

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[29] *Id.* at 11.

[30] PJM Manual 15 (Cost Development Guidelines) at 4 and 14, Schedule 1, section 6 of PJM Operation Agreement

[31] 2013 PJM Market Monitor State of the Market Report at 85.

proposal would help the units recover going-forward costs only.[32] Indicated Suppliers cite to an earlier order that emphasizes that the "minimum" a Frequently Mitigated Unit should receive is going-forward costs.[33] However, we find that it is appropriate that the Offer Price Adder should cover only the marginal cost of a unit in the short run, which is consistent with the PJM competitive market design. It would be inappropriate for the unit to receive a guaranteed margin of recovery past the going-forward or marginal costs of a unit. This is consistent with the previous Commission Order "to establish mitigated prices that reasonably reflect offers in a competitive market" and "to rely upon markets and proper market design, and to use non-market solutions only as the last resort" regarding reliability compensation.[34]

37. Nor does the Commission's findings in the CAISO 2009 Order or the MISO 2014 Order impose a requirement that PJM's Offer Price Adders operate in a manner that will allow sellers of Frequently Mitigated Units to recover revenues in excess of their going-forward costs. Even though, in the CAISO 2009 Order cited by Indicated Suppliers, the Commission stated that it approved a bid adder for frequently mitigated units as a way to ensure that they have the opportunity to recover some contribution toward fixed costs, [35] the Commission was referring to the recovery of certain fixed maintenance expenses, which PJM already permits to be recovered as part of going-forward costs.[36] The CAISO 2009 Order did not establish a Commission policy that frequently mitigated units should be permitted to recover their full cost of service.

38. While the 2014 MISO order found that a generation owner should be permitted to recover more than its variable costs, the Commission made this finding in the context of a

[32] PJM 2005 Order, 110 FERC ¶ 61,053 at P 27.

[33] PJM 2004 Order, 107 FERC ¶ 61,112 at P 14, *order on reh'g*, 110 FERC ¶ 61,053, *order on reh'g & clarification*, 112 FERC ¶ 61,031 (2005).

[34] PJM 2005 Order, 110 FERC ¶ 61,053 at P 114.

[35] CAISO 2009 Order, 126 FERC ¶ 61,150 at P 88.

[36] CAISO 2008 Order 125 FERC ¶ 61,053 at n.26 ("Going-forward costs are defined for purposes of the CAISO proposal as the sum of fixed operation and maintenance, ad valorem, and administrative and general costs. ICPM Transmittal at 4 n.5. Going-forward costs are generally understood to be the minimum fixed costs that a resource needs to recover in order to remain available for operation and does not include capital and financing costs.").

System Support Resource agreement (the general equivalent of PJM's Reliability Must Run Agreements) and the Midcontinent Independent System Operator, Inc.'s authority under its tariff to compel a generating unit that seeks to retire or suspend its operations to remain in service until the identified reliability issues are resolved.[37] Although it may be appropriate that a unit that qualifies for a Reliability Must Run agreement, and thus is a last resort option to maintain reliability, recover more than its going-forward costs, such additional, guaranteed compensation is not appropriate for a Frequently Mitigated Unit that is operating voluntarily in a competitive marketplace.

39. Indicated Suppliers argue that PJM's proposed Tariff revisions are not just and reasonable because PJM excludes from its calculation of going-forward costs existing project cost inputs, i.e., Avoidable Project Investment Recovery rate and Avoidable Refunds Project Investment Reimbursements, in determining whether a given unit qualifies for an Offer Price Adder. We find that PJM's calculation of going-forward costs is just and reasonable. As the Market Monitor points out, in its answer, Avoidable Project Investment Recovery rate is appropriately excluded from PJM's criterion, given that it provides for fixed cost recovery, i.e., a recovery item beyond the intended function of PJM's Offer Price Adder.

40. We find that the exclusion of the Avoidable Project Investment Recovery rate is consistent with the prior rules for Offer Price Adders, as this item was specifically excluded when a Frequently Mitigated Unit entered into an agreement to receive its unit-specific going-forward costs as an adder.[38] The Market Monitor also correctly points out that Avoidable Refunds Project Investment Reimbursements provides for the a generator to reimburse PJM for funds received under a Reliability Must Run contract associated with a planned retirement unit when PJM no longer needs the unit for reliability. These costs therefore are also not related to continued participation by the unit in the market, thus are not relevant to Frequently Mitigated Units.

41. We also reject, as beyond the scope of this proceeding, Indicated Suppliers' argument that PJM's proposed revisions fail to address the broader modeling issues that may account for why PJM needs to frequently mitigate a given unit. We agree with PJM

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[37] MISO 2014 Order, 148 FERC ¶ 61,057 at P 86.

[38] Specifically, the previous section 6.4.2(d) of the Operating Agreement and PJM OATT provided that, "the unit-specific going forward costs determined by agreement between the Office of the Interconnection and the Market Seller shall include only the costs included in the Deactivation Avoidable Cost Rate, *excluding costs associated with the Avoidable Project Investment Recovery Rate*…" (emphasis added).

that, while improved modeling could potentially limit the number of units it is required to frequently mitigate, improved modeling alone will not address the unjust and unreasonable windfall that underlies PJM's filings.

42. Finally, we note that PJM's tariff submissions, at section 6.4.2(a)(iii) of the PJM Operating Agreement and PJM OATT, omit the words "greater of" when determining whether the Offer Price Adder will be either the incremental cost plus 10 percent, or the specific incremental adder.[39] We find that without this language, it is unclear what the Offer Price Adder would be for a specific unit. Accordingly, we direct PJM to amend these provisions in a compliance filing, within 30 days from the date of this order.

<u>The Commission orders</u>:

(A) PJM's proposed revisions, in Docket No. EL14-95-000, are hereby accepted, effective November 1, 2014, as discussed in the body of this order.

(B) PJM's proposed revisions, in Docket No. ER14-2705-000, are hereby accepted, effective November 1, 2014, as discussed in the body of this order.

(C) PJM is hereby directed to submit a compliance filing, within 30 days of the date of this order, as discussed in the body to this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[39] PJM clarifies in its transmittal that a unit would receive the greater of the incremental cost plus 10 percent or the specific incremental adder. *See* Transmittal, Docket No. EL14-95-000 at 14.

Appendix

EL14-95-000
List of Intervenors

American Electric Power Service Corporation
American Municipal Power, Inc.
The Dayton Power and Light Company
Dominion Resources Services, Inc.
Exelon Corporation
FirstEnergy Service Company *
NRG Companies
Maryland Public Service Commission
Monitoring Analytics, LLC, acting as PJM’s independent market monitor *
North Carolina Electric Membership Corporation
Old Dominion Electric Cooperative *
PJM Industrial Customer Coalition
PSEG Companies

* motions to intervene out-of-time

ER14-2705-000
List of Intervenors

American Electric Power Service Corporation
American Municipal Power, Inc.
The Dayton Power and Light Company
Dominion Resources Services, Inc.
Exelon Corporation
FirstEnergy Service Company *
NRG Companies
Maryland Public Service Commission
Monitoring Analytics, LLC, acting as PJM’s independent market monitor
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