

150 FERC ¶ 61,020  
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 No. EL15-31-000

ORDER ACCEPTING PROPOSED TARIFF REVISIONS AND ORDERING  
FURTHER FILINGS

(Issued January 16, 2015)

1. On December 15, 2014, pursuant to section 206 of the Federal Power Act,<sup>1</sup> PJM Interconnection, L.L.C. (PJM) filed proposed revisions to multiple sections of Attachment K – Appendix of its Open Access Transmission Tariff (Tariff) and the equivalent provisions in Schedule 1 of the Amended and Restated Operating Agreement of PJM (Operating Agreement) to allow for relief from the currently effective \$1,000/MWh energy offer cap (offer cap) in anticipation of the possibility that, as occurred in the winter of 2013/2014, fuel costs incurred by generators may cause their marginal costs to exceed the offer cap.<sup>2</sup> PJM requests expedited Commission action and an effective date of January 9, 2015. As discussed below, PJM’s proposed Tariff revisions are hereby accepted, to be effective from the date of the issuance of this order. PJM is further required to make a compliance filing no later than February 27, 2015 to remove these provisions effective April 1, 2015, as proposed.

**I. Background**

**A. Temporary Waivers**

2. In January 2014, severely cold weather caused natural gas prices to spike due to increased demand and natural gas pipeline deliverability issues. Consequently, according to PJM, Market Sellers incurred natural gas costs that caused generator marginal costs to

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<sup>1</sup> 16 U.S.C. § 824e (2012).

<sup>2</sup> Capitalized terms used but not defined herein are intended to have the meaning given to such terms in the Tariff and the Operating Agreement, as applicable.

exceed the \$1,000/MWh offer cap.<sup>3</sup> However, because their cost-based offers were capped at \$1,000/MWh,<sup>4</sup> Market Sellers of certain generation units were not allowed to reflect their marginal costs to produce energy in their cost-based offers. PJM states that, in the case of some Generation Capacity Resources which are required to offer into the day-ahead energy market every day, Market Sellers were being forced to either sell energy into the market at prices that did not reflect their marginal costs to produce that energy or take a forced outage on their units.<sup>5</sup>

3. In response to these unprecedented conditions, on January 23, 2014, PJM filed concurrently two requests for a temporary waiver of section 1.10.1A(d) of Schedule 1 of the Operating Agreement and the equivalent section of Attachment K-Appendix of the Tariff, in Docket Nos. ER14-1144-000 and ER14-1145-000. In Docket No. ER14-1144-000, PJM requested a temporary waiver to permit Market Sellers of Generation Capacity Resources with cost-based offers that had costs, determined and documented in accordance with PJM's Cost Development Guidelines, that exceeded the applicable market clearing price (limited to the \$1,000/MWh offer cap) to receive make-whole payments covering the difference between their actual costs and the market clearing price.<sup>6</sup> PJM requested that the temporary waiver commence on January 24, 2014 and end on the earlier of March 31, 2014 or the date on which the Commission granted the second waiver. On January 24, 2014, the Commission issued an order granting the requested waiver in Docket No. ER14-1444-000.<sup>7</sup>

4. In Docket No. ER14-1145-000, PJM requested a separate temporary waiver to allow Market Sellers to base their cost-based offers on their marginal costs, even if that caused their offer price to exceed the \$1,000/MWh offer cap, and for such offers to set the Locational Marginal Price (LMP), if applicable.<sup>8</sup> On February 11, 2014, the

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<sup>3</sup> PJM Interconnection, L.L.C., December 15, 2014 Filing at 3 (PJM Transmittal).

<sup>4</sup> Section 1.10.1A(d) of Schedule 1 of the Operating Agreement provides that offers in the day-ahead energy market shall not exceed an energy offer price of \$1,000/MWh.

<sup>5</sup> PJM Transmittal at 3-4.

<sup>6</sup> PJM Interconnection, L.L.C., Waiver Request, Docket No. ER14-1144-000 (filed January 23, 2014).

<sup>7</sup> *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,041 (2014) (January 2014 Waiver Order), *order on reh'g*, 149 FERC ¶ 61,059 (2014).

<sup>8</sup> PJM Interconnection, L.L.C., Waiver Request, Docket No. ER14-1145-000 (filed January 23, 2014).

Commission issued an order granting the requested waiver in Docket No. ER14-1145-000, which superseded the waiver granted in Docket No. ER14-1144-000.<sup>9</sup>

**B. PJM's Instant Filing**

5. PJM initiated a stakeholder process to address whether Tariff revisions were needed in anticipation of the possibility that, as occurred in the winter of 2013/2014, fuel costs incurred by generators may cause their marginal costs to exceed the offer cap. However, PJM states that stakeholders were unable to reach a compromise agreement on whether changes should be made to the rules related to the offer cap for cost-based offers. As a result, PJM submitted the instant filing to avoid having to file waivers seeking immediate Commission action as it did in January 2014. PJM posits that allowing the status quo to remain for this 2014/2015 winter season, risking the need for emergency waiver requests similar to those it filed in January 2014, is unjust and unreasonable.<sup>10</sup> PJM argues that maintaining a \$1,000/MWh cost-based offer cap that does not allow recovery of demonstrated, justified fuel costs is unjust and unreasonable, and necessitates a tariff change pursuant to section 206 of the FPA.<sup>11</sup>

6. PJM proposes revisions to its Tariff and the Operating Agreement to allow for short-term, temporary relief during the winter of 2014/2015 from the \$1,000/MWh offer cap should a rise in natural gas prices or other system conditions force generation resources to incur fuel costs that cause their marginal costs to exceed the offer cap. Specifically, PJM proposes to allow cost-based offers to be submitted and to set LMP up to \$1,800/MWh for this 2014/2015 winter period, and to allow generators to recover actual incurred costs above that cap through uplift payments, with such costs being subject to an after-the-fact review by PJM and the Independent Market Monitor (IMM). PJM contends that this approach is reasonable because the \$1,800/MWh offer cap is based on last winter's highest cost-based offer of \$1,725/MWh submitted by a Market Seller of a generation resource and appropriately balances the concerns presented by its stakeholders.<sup>12</sup>

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<sup>9</sup> *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,078 (2014) (February 2014 Waiver Order), *order on reh'g*, 149 FERC ¶ 61,060 (2014).

<sup>10</sup> PJM Transmittal at 6-7.

<sup>11</sup> *Id.* at 1.

<sup>12</sup> *Id.* at 8-9.

7. Second, PJM proposes to revise the Tariff so that the cost-based adder will be the lesser of 10 percent of the cost-based offer or \$100/MWh. Currently, PJM explains that a 10 percent adder is included in cost-based offers to account for uncertainty in computing cost-based offers.<sup>13</sup> However, according to PJM, as prices rise, the 10 percent adder could permit an amount to be included in a unit's cost-based offer that would not account for uncertainty in costs in a generation resource's costs, and instead cause the cost-based offer to be artificially and unreasonably high. Hence, PJM states that its proposed revision to the 10 percent adder provision will have the effect of keeping the adder as it is now for offers with calculated costs below \$1,000/MWh, but capping the adder at \$100/MWh for offers with calculated costs above \$1,000/MWh.<sup>14</sup>

8. Additionally, PJM proposes to raise the offer cap on market-based offers to a level equal to a Market Seller's cost-based offer, which, as discussed above, PJM proposes to allow to be as high as \$1,800/MWh. The purpose of this proposed revision is to account for the fact that when Market Sellers submit their cost-based and market-based offers, PJM's software system automatically selects the lower of the two offers. Without this revision, PJM's system would automatically select the lower, market-based offer, which would still be capped at \$1,000/MWh. PJM notes that the revision will not allow Market Sellers that do not have cost-based offers greater than \$1,000/MWh to submit market-based or cost-based offers greater than \$1,000/MWh.<sup>15</sup>

9. Finally, PJM proposes a few minor revisions, including changing the name reference of Generation Capacity Resources to generation resource since implementation of its proposal will require market changes for all resources and not just capacity resources, and to clarify that if the effective offer price for a market-based offer is greater than \$1,000/MWh and greater than the Markets Seller's lowest available and applicable cost-based offer, the Market Seller will not receive any credit for Operating Reserves.<sup>16</sup>

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<sup>13</sup> Generally, resources must submit two types of offers into PJM's day-ahead energy market, a cost-based offer and a market-based offer. Cost-based offers are based on short-run marginal costs and developed in accordance with Schedule 2 of PJM's Operating Agreement and PJM Manual 15 (Cost Development Guidelines). A resource's market-based offer may exceed or fall below its cost-based offer at the discretion of the resource. If a resource's offer is mitigated, its offer is replaced by the lesser of its cost-based and market-based offer. *See* PJM Transmittal at 3.

<sup>14</sup> *Id.* at 10.

<sup>15</sup> *Id.* at 11.

<sup>16</sup> *Id.* at 13.

10. PJM notes that it is aware that the Commission is currently considering whether changes should be made on a national level to both cost-based and market-based offer caps. PJM states it does not wish to preempt or undercut broader action that the Commission may take on these issues, and that it believes national action on this issue is appropriate. PJM also emphasizes that raising the offer cap in one Independent System Operator (ISO) or Regional Transmission Organization (RTO) while leaving it at \$1,000/MWh in others could create seams issues between ISOs/RTOs and, therefore, any long-term changes to the offer caps should be led by the Commission and implemented on a national level.<sup>17</sup>

11. In this filing, PJM does not propose any changes to the offer cap beyond the 2014/2015 winter. PJM's proposal in this case is limited to the 2014/2015 winter in order to give the Commission the ability to address the larger issues using its processes already underway. By making its proposed revisions temporary, PJM states it believes that its approach strikes an appropriate balance between providing certainty to the market during the winter, and not prejudicing Commission action on broader issues.

12. PJM requests expedited action on this proposal with a shortened comment deadline of December 23, 2014 and an effective date of January 9, 2015. PJM asks that the Commission accept the filing subject to compliance obligation by March 31, 2015 to remove the proposed revisions and relevant eTariff sheets, effective April 1, 2015.

## **II. Notice and Responsive Pleadings**

13. Notice of PJM's filing was published in the *Federal Register*, 79 Fed. Reg. 76,999 (2014), with protests and interventions due on or before December 23, 2014. Timely motions to intervene were filed by the following entities: AEP Generation Resources, Inc., American Electric Power Service Corporation (AEP), American Municipal Power, Inc., American Public Power Association, Calpine Corporation, Champion Energy Services, LLC, Champion Energy Marketing, LLC, The Dayton Power and Light Company (Dayton), Duquesne Light Company, Electric Power Supply Association (EPSA), FirstEnergy Service Company, Illinois Citizens Utility Board, Inertia Power I, LLC, Maryland Office of People's Counsel, Monitoring Analytics, LLC – as the Independent Market Monitor for PJM (IMM), New Jersey Division of Rate Counsel, North Carolina Electric Membership Corporation, NRG Companies,<sup>18</sup> Pennsylvania Office of Consumer Advocate, PJM Power Providers Group (P3), PPL PJM Companies

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<sup>17</sup> *Id.* at 7.

<sup>18</sup> For purpose of this filing, NRG Companies include NRG Power Marketing LLC and GenOn Energy Management, LLC.

(PPL Companies),<sup>19</sup> Public Power Association of New Jersey, Rockland Electric Company, Southern Maryland Electric Cooperative, Inc., and West Virginia Consumer Advocate Division. Notices of Intervention were filed by the Delaware Public Service Commission (Delaware PSC), Illinois Commerce Commission, New Jersey Board of Public Utilities, Maryland Public Service Commission (Maryland PSC), New York State Public Service Commission, Pennsylvania Public Utility Commission (Pennsylvania PUC), and Public Service Commission of West Virginia. Allegheny Electric Cooperative, Inc. (Allegheny) and Exelon Corporation (Exelon) filed motions to intervene out-of-time.

14. Motions to intervene and comments were filed by America's Natural Gas Alliance (ANGA), DC Energy, LLC (DC Energy), Direct Energy Services, LLC (Direct Energy),<sup>20</sup> Dominion Resources Services, Inc. (Dominion Services), New York Independent System Operator (NYISO), and Old Dominion Electric Cooperative (ODEC).

15. Additionally, PSEG Companies (PSEG)<sup>21</sup> filed a motion to intervene, comments in support and a limited protest. Office of the Ohio Consumers' Counsel (Ohio CC) filed a motion to intervene and protest. Comments and/or protests were filed by AEP and Dayton (together, AEP/Dayton), Delaware PSC, EPSA, IMM, Maryland PSC, Pennsylvania PUC, P3, and PPL Companies. Additionally, PJM Load Group<sup>22</sup> filed a

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<sup>19</sup> For purpose of this filing, PPL Companies include PPL EnergyPlus, LLC; PPL Brunner Island, LLC; PPL Holtwood, LLC; PPL Ironwood, LLC; PPL Martins Creek, LLC; PPL Montour, LLC; PPL Susquehanna, LLC; Lower Mount Bethel Energy, LLC; PPL New Jersey Solar, LLC; PPL New Jersey Biogas, LLC; and PPL Renewable Energy, LLC.

<sup>20</sup> For purpose of this filing, Direct Energy includes Direct Energy Services, LLC, Direct Energy Business, LLC, and Direct Energy Business Marketing, LLC.

<sup>21</sup> For purpose of this filing, PSEG includes Public Service Electric and Gas Companies, PSEG Power LLC and PSEG Energy Resources & Trade LLC.

<sup>22</sup> For purpose of this filing, PJM Load Group includes the following entities: American Municipal Power, Inc., American Public Power Association, the Consumer Advocate Division of West Virginia, the Delaware Public Service Commission, the Division of the Public Advocate for the State of Delaware, Duquesne Light Company, the Illinois Citizens Utility Board, the Maryland Office of People's Counsel, New Jersey Board of Public Utilities, New Jersey Division of Rate Counsel, the Office of the People's Counsel for the District of Columbia, PJM Industrial Customer Coalition, Public Power Association of New Jersey, and Southern Maryland Electric Cooperative, Inc.

motion to dismiss or, in the alternative, protest and a motion for extension of time. On January 5, 2015, PJM filed an answer.

**A. Comments/Protests**

**1. Offer Cap**

16. Some commenters support PJM's proposal to raise the cost-based offer cap to \$1,800/MWh for the 2014/2015 winter as a measure to avoid the same scenario as last winter.<sup>23</sup> DC Energy, Dominion Services and ODEC believe that PJM's proposal represents a reasonable compromise that balances the interests of stakeholders in PJM.<sup>24</sup> ODEC states that the increased offer cap will allow greater recovery of costs for generators while simultaneously allowing for a "stop loss" mechanism for load.<sup>25</sup> Direct Energy states that the increase in offer cap will allow for better market transparency since "where LMPs reflect the true cost of the marginal unit there is price transparency."<sup>26</sup> PSEG "strongly" supports PJM's proposal as a temporary solution; however, it states it does not believe that the proposal will be workable as a long-term solution because it does not resolve the inefficient market design issues associated with limiting the ability of Market Sellers to sell energy into the market at their actual marginal costs.<sup>27</sup>

17. While the IMM generally supports PJM's proposal for the \$1,800/MWh offer cap, it disagrees that the \$1,724/MWh cost-based offer cited by PJM was a valid cost-based offer during the 2013/2014 winter. Instead, the IMM contends that the highest valid cost-based offer it reviewed was less than \$1,500/MWh. Additionally, the IMM states that the Commission should direct PJM to include clarifying language in the Tariff to specify: (1) that only natural gas fuel costs should be allowed to justify cost-based offers that exceed the \$1,000/MWh cap; and (2) to explain what would happen if cost-based offers between \$1,000/MWh and \$1,800/MWh applied during scarcity conditions. The IMM requests that PJM clarify that, during scarcity conditions, the maximum price of

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<sup>23</sup> See, e.g., Dominion Services Comments at 3-4; DC Energy Comments at 1; ODEC Comments at 3; IMM Comments at 1.

<sup>24</sup> DC Energy Comments at 3; ODEC Comments at 4; Dominion Comments at 4.

<sup>25</sup> ODEC Comments at 4.

<sup>26</sup> Direct Energy Comments at 2.

<sup>27</sup> PSEG Comments at 3-4.

energy would never be greater than the current maximum scarcity price even if offers exceed \$1,000/MWh.

18. Several commenters argue that setting the offer cap at \$1,800/MWh is arbitrary and, without any supporting evidence, will prevent generators from submitting cost-based offers that fully reflect their costs.<sup>28</sup> EPSA contends that, similar to the current \$1,000/MWh offer cap, the proposed offer cap could artificially suppress market prices and result in inefficient resource selection.<sup>29</sup> AEP/Dayton contends that the proposed offer cap would result in inefficient dispatch queues because generators would be subject to a market structure where they were told to operate at a loss.<sup>30</sup> AEP/Dayton supports eliminating the offer cap but, in the alternative, advises the Commission to reset the offer cap to \$8,720/MWh, which is approximately five times the highest fuel cost during last winter. AEP/Dayton states that, in 2002, PJM used this proportional formula to justify the current \$1,000/MWh offer cap.<sup>31</sup> ANGA asserts that PJM's proposed offer cap "may interfere with price signals based on market fundamentals."<sup>32</sup> PSEG supports PJM's proposal but objects to the fact that cost-based offers above \$1,800/MWh are not eligible to set LMP and will instead receive make-whole payments.<sup>33</sup> AEP/Dayton, PPL Companies, P3 and EPSA request that the Commission implement the same energy market offer cap waiver that it approved for last winter, allowing cost-based offers based on verifiable marginal costs to set the market clearing price.<sup>34</sup>

19. In contrast, protesters argue that there is no basis for concluding that the existing offer cap is unjust and unreasonable.<sup>35</sup> For instance, Pennsylvania PUC and the PJM Load Group assert that one cost-based offer of \$1,724/MWh is not a valid justification to

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<sup>28</sup> See, e.g., P3 Protest at 5; EPSA Comments at 2.

<sup>29</sup> EPSA Comments at 6.

<sup>30</sup> AEP/Dayton Protest and Comments at 5.

<sup>31</sup> *Id.* at 4.

<sup>32</sup> ANGA Comments at 3.

<sup>33</sup> PSEG Comments at 2-3.

<sup>34</sup> EPSA Comments at 10-11; AEP/Dayton Protest and Comments at 7; PPL Companies Protest at 8; P3 Protest at 2.

<sup>35</sup> See, e.g., Pennsylvania PUC Protest at 6; Maryland PSC Protest at 3; Ohio CC Protest at 3.

increase the offer cap, especially when the IMM has determined that the highest offer accepted was in fact below \$1,500/MWh.<sup>36</sup> Ohio CC argues that PJM has provided no evidence that the current energy cap harms generators.<sup>37</sup> Also, Maryland PSC contends that there is no basis for raising the offer cap because, out of the \$588,774.38 additional compensation requested by generators during the February 11-March 31, 2014 period last winter, the IMM approved only \$9,118.43.<sup>38</sup> Maryland PSC states that, according to reports detailing the effect of the January 2014 cold weather on the electric and natural gas systems, high natural gas costs were limited to three natural gas gate stations and only a few generators in these three gate stations suffered extreme pricing conditions. Maryland PSC argues that it would be unjust and unreasonable to allow atypical and very high costs incurred by one or few generators to set the market clearing price for the majority of other generators not experiencing such costs.<sup>39</sup> Additionally, Delaware PSC posits that offering up to \$1,800/MWh to set LMP without allowing for a reasonable review to determine actual fuel costs could result in great economic harm to ratepayers.

20. Additionally, several protesters maintain that PJM's proposal is not just and reasonable, arguing that the Commission should not raise the existing offer cap. They contend that allowing high costs to set market clearing prices will create a windfall for generators and burden consumers.<sup>40</sup> Pennsylvania PUC asserts that increasing the offer cap will give generators additional opportunity to exercise market power, especially market participants that own several units.<sup>41</sup> Pennsylvania PUC contends that market participants with multiple resources could "leverage" some of those resources and take outages during peak periods to enhance total market revenues.<sup>42</sup> Similarly, Maryland PSC contends that the purpose of PJM's filing is to create profit opportunities for generators whose costs do not exceed the offer cap rather than to permit the recovery of generator fuel costs, as PJM asserts.<sup>43</sup> Pennsylvania PUC also asserts that raising the

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<sup>36</sup> Pennsylvania PUC Protest at 6; PJM Load Group Protest at 19-20.

<sup>37</sup> Ohio CC Protest at 3.

<sup>38</sup> Maryland PSC Protest at 2-3. *See also* Delaware PSC Protest at 6.

<sup>39</sup> Maryland PSC Protest at 3.

<sup>40</sup> PJM Load Group Protest at 20; Maryland PSC Protest at 3; Pennsylvania PUC Protest at 4-5.

<sup>41</sup> Pennsylvania PUC Protest at 4.

<sup>42</sup> *Id.*

<sup>43</sup> Maryland PSC Protest at 3.

cap will increase volatility, which increases costs to consumers and weakens competition.<sup>44</sup> Ohio CC argues that increasing LMP will not enhance reliability of individual resources or address non-performance concerns. Ohio CC also states that the existing \$1,000/MWh offer cap protects consumers against windfall profits to all generators.<sup>45</sup>

21. Rather than increasing the offer cap, Pennsylvania PUC and Ohio CC support recovery of fuel costs through make-whole payments, consistent with the January 2014 Waiver Order.<sup>46</sup> Ohio CC notes that allowing individual generators to recover actual costs through uplift payments would better address the concerns of those generators who fail to procure firm fuel supplies while still protecting consumers against providing windfalls to all generators in the region.<sup>47</sup>

22. Maryland PSC also takes issue with the justness and reasonableness of cost offer bids produced in accordance with the PJM Manual 15 fuel cost guidelines, specifically urging the Commission that these guidelines are far from rigorous in what it permits as cost recovery.<sup>48</sup> Lastly, Maryland PSC takes an additional issue with the PJM proposal because it fails to provide for IMM/PJM review of cost-offer bids between the \$1,000/MWh and \$1,800/MWh level and only reviews bids above the \$1,800/MWh level.

23. PJM Load Group argues that PJM's filing is deficient, does not meet the burden under section 206 and, therefore, should be dismissed.<sup>49</sup> If not dismissed, PJM Load Group requests the Commission to establish hearing procedures with a refund effective date to protect consumers. PJM Load Group asserts that a complete evidentiary hearing is required to determine any deficiency of the current offer cap and the costs and benefits associated with increasing it.<sup>50</sup> Moreover, PJM Load Group argues that the proposed increase to the offer cap constitutes impermissible retroactive ratemaking because PJM is

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<sup>44</sup> Pennsylvania PUC Protest at 4; Ohio CC Protest at 7.

<sup>45</sup> Ohio CC Protest at 7.

<sup>46</sup> Pennsylvania PUC Protest at 3.

<sup>47</sup> Ohio CC Protest at 7.

<sup>48</sup> Maryland PSC Protest at 4.

<sup>49</sup> PJM Load Group Protest at 10-11.

<sup>50</sup> *Id.* at 8.

effectively asking the Commission to change the obligations that attached to Generation Capacity Resources that cleared in a Base Residual Auction or Incremental Auction. PJM Load Group maintains that such *post hoc* actions are unjust, unreasonable, and unlawful, because “they require customers to pay capacity prices for the Cleared Capacity Resources while losing the benefit of the \$1,000/MWh offer-price cap that applied to those resources *vis-à-vis* the Day-Ahead Energy Market.”<sup>51</sup> If PJM’s proposal is permitted, however, PJM Load Group requests that the revenue in excess of the \$1,000/MWh bid cap be credited to ratepayers through the Reliability Pricing Model capacity charge. Finally, PJM Load Group requests an extension of time to amplify its protest with additional evidence and to allow others to comment and intervene.<sup>52</sup>

24. Finally, several commenters and protesters emphasize the need for a long-term solution on the issue of offer caps. For example, EPSA requests that the Commission direct PJM to work with market participants and other stakeholders on a long-term solution to remove arbitrary restrictions on energy price formation, including offer caps, to promote efficient investment decisions. Further, EPSA states that, in a separate proceeding, the Commission should require all ISOs/RTOs to undertake such an effort, and should broadly issue specific guidance and require implementation for next winter or by an earlier date certain.<sup>53</sup> PSEG also believes that the Commission should take a leadership role on the appropriate offer cap levels for each ISO/RTO. Accordingly, it requests that the Commission establish a technical conference and create a forum for the industry and all of the ISOs/RTOs to come together to develop a permanent solution.

25. Similarly, NYISO supports regional coordination of comparable offer caps in order to limit potential seams issues between neighboring regions, provide reliability, and avoid inefficient market outcomes. NYISO states that regional or national coordination to establish appropriate offer caps is essential to avoid shutting out one region’s access to fuel in favor of another region.<sup>54</sup> Like PJM, NYISO supports the Commission’s efforts on this issue and encourages the Commission to continue exploring offer caps at the regional or national level. PJM Load Group asserts that if the Commission approves PJM’s proposal without making corresponding changes in neighboring ISOs/RTOs, the impact on the region could be detrimental. PJM Load Group also states that changing the market rules from winter to winter is not a good way to create efficiency in the market.

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<sup>51</sup> *Id.* at 22.

<sup>52</sup> *Id.* at 25-26.

<sup>53</sup> EPSA Comments at 3, 14.

<sup>54</sup> NYISO Comments at 2-3.

Instead, according to PJM Load Group, a reliable and thoughtful process should be followed to provide confidence to all participants that market rules will be long term.<sup>55</sup>

## **2. Ten Percent Adder**

26. Dominion Services, P3, PSEG, AEP/Dayton, and PPL Companies protest the proposed changes to limit the 10 percent cost-based adder to the lesser of 10 percent or \$100/MWh.<sup>56</sup> PSEG and PPL Companies both argue that this modification is arbitrary and that PJM has not provided any support for the proposed changes.<sup>57</sup> PSEG and Dominion Services argue that there might be more volatility during extreme weather events and that the cost-based adder is the only mechanism afforded to generators to cover risks of generator offers and becomes more critical when natural gas prices create volatility between the day-ahead energy market and the real time energy market costs.<sup>58</sup> P3 and AEP/Dayton claim that the adder was created 40 years ago to account for the uncertainty in utilizing heat rate to calculate the marginal cost of production and this amount does not change whether there is a cost cap of any value level.<sup>59</sup> P3 states that optimum heat rates are only achieved at steady state full load. Additionally, AEP/Dayton states that this adder recognizes the uncertainty in converting fuel costs into electric prices because average heat rates based on steady-state unit operation may not reflect actual heat rates that may vary due to different operational conditions such as changing temperatures or pressures during unit load changes. PJM Load Group objects to payment of any adder that requires customers to pay estimated costs for offers in excess of \$1,000/MWh, stating that such offers should be entirely cost-justified and not based on estimates.<sup>60</sup>

### **B. PJM's Answer**

27. In responding to the IMM, PJM states that limiting its proposal only to increases in natural gas fuel prices may create unintended consequences, potentially denying

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<sup>55</sup> PJM Load Group Protest at 21.

<sup>56</sup> Dominion Services Comments at 5; P3 Protest at 3; PSEG Comments at 4-5; AEP/Dayton Protest and Comments at 7; PPL Companies Comments at 12.

<sup>57</sup> PSEG Comments at 4; PPL Companies Protest at 12.

<sup>58</sup> PSEG Comments at 4; Dominion Services Comments at 5.

<sup>59</sup> P3 Protest at 6; AEP/Dayton Protest and Comments at 7.

<sup>60</sup> PJM Load Group Protest at 25.

resources the ability to recover legitimate costs due to difficulties in determining whether such costs are associated with “increases in natural gas fuel prices” in the Tariff and Operating Agreement.<sup>61</sup> PJM asserts that its proposed revisions to the Cost Development Guidelines provide reasonable limits on the type of costs that may be included in any cost-based offers. However, PJM states that, if the Commission shares the IMM’s concerns and believes that cost-based offers should only be permitted to rise above \$1,000/MWh as a result of an increase in natural gas fuel prices, the Commission should order PJM to submit a compliance filing with Tariff and Operating Agreement revisions that will accomplish this outcome.<sup>62</sup> PJM submits that its proposed revised Tariff language, included in its Answer, has been reviewed and accepted by the IMM.<sup>63</sup>

28. With respect to the IMM’s recommendation about shortage prices, PJM states that its proposal would allow maximum shortage prices to rise above their current levels if energy offers above \$1,000/MWh are permitted to set the LMP.<sup>64</sup> PJM argues that limiting energy prices to \$2,700/MWh when Reserve Penalty Factors are applicable and cost-based offers are greater than \$1,000/MWh would depress reserve prices below appropriate levels, reduce resource incentives to follow dispatch instructions during critical periods, and increase out-of-market uplift payments and undermine price

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<sup>61</sup> PJM Answer at 2.

<sup>62</sup> *Id.* at 3.

<sup>63</sup> PJM proposes to revise Section 1.10.1A(d) of Schedule 1 of the Operating Agreement as follows:

(viii)[s]hall not exceed an energy offer price of \$1,000/megawatt-hour for all generation resources, unless the resource’s cost-based offer, calculated in accordance with Schedule 2 of the Operating Agreement, section 6.4.2 of Attachment K-Appendix of the Tariff and the parallel provisions of Schedule 1 of the Operating Agreement, and PJM Manual15, exceeds \$1,000/megawatt-hour, in which case the resource may submit an offer **that accounts for the increased cost to procure fuel, but for which no other component of the calculation used to determine the resource’s cost-based offer is changed, and is** no greater than an amount equal to that cost-based offer which shall not exceed \$1,800/megawatt-hour; and . . .

<sup>64</sup> PJM Answer at 4.

signals.<sup>65</sup> PJM believes this would reduce the incentive for resources to follow dispatch instructions during the most critical operating periods and create out-of-market uplift payments that undermine pricing signals. Given the temporary nature of the proposal, PJM does not propose altering PJM's shortage pricing provisions included in its December 15, 2014 filing. However, if the Commission believes that current maximum allowable shortage prices should not be permitted to rise above \$2,700/MWh even if cost-based offers are submitted above \$1,000/MWh and set LMP, PJM requests that the Commission direct PJM to submit a compliance filing to revise its Tariff to achieve this outcome.<sup>66</sup>

29. Finally, in response to the IMM's comments about the highest offer reviewed during the winter of 2013/2014, PJM clarifies that the \$1,724/MWh offer was the highest cost-based offer submitted and was in accordance with PJM's Cost Development Guidelines.<sup>67</sup> PJM states that the lower, revised offer that the IMM referenced in its comments was calculated based on an after-the-fact review of actual natural gas costs, imputed heat rates, and the 10 percent adder that is included in all cost-based offers. PJM reiterates that the proposed \$1,800/MWh offer cap is part of a reasonable and temporary proposal that alleviates the current unjust and unreasonable application of the \$1,000/MWh energy offer cap and constitutes a reasonable compromise between two diametrically opposed interests. PJM also reiterates that its proposal allows resources to recover costs above \$1,800/MWh through make-whole payments, which, although not ideal, is a just and reasonable approach given the limited time to address potential gas/electric coordination issues this winter.<sup>68</sup>

### **III. Discussion**

#### **A. Procedural Matters**

30. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2014), notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

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<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 5.

<sup>68</sup> *Id.* at 6.

31. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2014), the Commission will grant Allegheny's and Exelon's late-filed motions to intervene given their interests in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

32. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2014), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We accept PJM's answer because it has provided information that assisted us in our decision-making process.

## **B. Substantive Matters**

33. As discussed below, we find that PJM has demonstrated that the current offer cap of \$1,000/MWh in PJM is unjust and unreasonable for the winter months.<sup>69</sup> We further find PJM's proposal for this winter to be just and reasonable. Accordingly, we accept PJM's proposed Tariff revisions, to become effective from the date of the issuance of this order. The Commission is in the process of considering measures to ensure fuel assurance and other price formation matters,<sup>70</sup> and we find that PJM's proposal for the coming winter while the Commission continues its broader review of price formation issues is reasonable. We address several issues below, including (1) the unjustness and unreasonableness of the existing \$1,000/MWh offer cap and the justness and reasonableness of the proposed \$1,800/MWh offer cap; (2) the ten percent offer adder; and (3) seams issues and broader price formation issues. Additionally, we require a compliance filing and an informational filing, as directed below.

### **1. Offer Caps**

#### **a. Unjustness and Unreasonableness of Existing Offer Cap**

34. As demonstrated by experiences during the winter of 2013/2014, fuel costs during winter periods may increase to the point that the current \$1,000 offer cap no longer adequately compensates generators for their costs and prevent energy and ancillary services prices from reflecting the marginal cost of serving load. In particular, natural

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<sup>69</sup> We note that PJM has not argued, and we do not make a generic finding here, that a \$1,000/MWh offer cap is unjust and unreasonable.

<sup>70</sup> FERC, *Price Formation in Energy and Ancillary Services Markets Operated by Regional Transmission Organizations and Independent System Operators*, Notice Inviting Post-Technical Workshop Comments, Docket No. AD14-14-000 (January 16, 2015).

gas prices in parts of the PJM region reached an average on some days of \$120/dth.<sup>71</sup> With such high natural gas prices last winter, the \$1,000/MWh offer cap proved to be inadequate; thus, the Commission agreed with PJM that a waiver of the \$1,000/MWh offer cap was necessary to address the “untenable” situation.<sup>72</sup> With the onset of winter this year, PJM faces the possibility that, as occurred in the winter of 2013/2014, fuel costs incurred by generators may cause their marginal costs to exceed the offer cap. Thus, given the potential for high natural gas prices this winter, we find that increasing the \$1,000/MWh offer cap for cost-based offers during the 2014/2015 winter is necessary. Otherwise, if similar weather and natural gas supply conditions materialize this winter, some resources may again face the untenable position of being forced to offer electricity at levels below their marginal costs. Moreover, revising the existing offer cap does not create an unreasonable concern with the exercise of market power since PJM’s market power mitigation procedures will still remain effective. Therefore, we find that maintaining an offer cap that may prevent prices from reflecting the marginal cost of serving load and may not allow recovery of demonstrated, justified fuel costs is unjust and unreasonable.

**b. Justness and Reasonableness of the Proposed Offer Cap**

35. We find PJM’s proposal to be just and reasonable. As noted by PJM and other commenters, the proposed \$1,800/MWh offer cap is a reasonable approach at this time that appropriately balances multiple potential sources of market inefficiency for the 2014/2015 winter. Based on last winter’s experience, the \$1,800/MWh cap covers a reasonable range of potential bids as it is sufficient to capture all such offers during the 2013/2014 winter. PJM’s proposal also provides additional protection to customers by requiring that Market Sellers provide cost justification for all bids above \$1,000/MWh according to PJM’s Cost Development Guidelines, in order to set the LMP. Therefore, we dismiss protesters’ arguments that unsupported market-based offers may exceed the current \$1,000/MWh cap. Also, this is consistent with the waiver order issued last winter and with the construct of the PJM market, in which LMPs reflect the marginal cost of production. As we found in the February 2014 Waiver Order, allowing these offers to set LMP promotes efficient resource selection and sends clear market signals so that resource costs are reflected in transparent market prices.<sup>73</sup>

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<sup>71</sup> February 2014 Waiver Order, 146 FERC ¶ 61,078 at P 40.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

36. Some protests object to the use of an \$1,800/MWh offer cap as being inconsistent with the waiver granted last winter in the February 2014 Waiver Order which did not include any offer cap. The waiver request and the order in 2014 were based on an emergency situation confronting PJM. After reflection on the events of last winter, PJM concluded that an \$1,800/MWh cap reasonably includes most generation offers and we find that this approach is reasonable given the concern about seams issues discussed in more detail below.<sup>74</sup>

37. PJM has proposed a means of compensation in the event that a resource can document costs in excess of \$1,800/MWh through make-whole payments. We accept this proposal for the coming winter. Disallowing resource costs that have been verified through an *ex post* review would result in unjust and unreasonable compensation to resources.<sup>75</sup>

38. We disagree with the PJM Load Group that the PJM proposal will result in retroactive ratemaking because it changes understandings that parties may have with respect to prior capacity auctions. The tariff provisions revise offers solely in the energy market and are prospective, as of the date of this order. They, therefore, have no retroactive effect on past offers or energy prices. The fact that PJM runs a capacity market with three-year commitments does not freeze all changes to PJM's tariff for the three-year period covered by the auction. The Commission has previously found that

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<sup>74</sup> While the Commission is still evaluating these issues, and other reasonable approaches may exist, we find that based on this record PJM's proposal is just and reasonable. See "Complex" *Consol. Edison Co. v. FERC*, 165 F.3d 992, 1004 (D.C. Cir. 1999), *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, at P 85 (2006) (when choosing between competing just and reasonable options, the Commission will accept the proposal of a utility if it is just and reasonable, rather than other competing just and reasonable proposals), *aff'd on rehearing, PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,318, at P 115 (2007); *California Power Exchange Corporation*, 92 FERC ¶ 61,093, at 61,372 and n.10 (2000) (accepting a proposal by the utility and rejecting an alternative proposal, finding "we emphasize ... that we do not necessarily consider this aspect of CalPX's proposal to be the only acceptable methodology for tracking the ISO's ten-minute settlement mechanism").

<sup>75</sup> PJM is proposing to add a new section 3.2.3(r) to Attachment K-Appendix of the Tariff to provide that a Market Seller who incurs costs greater than \$1,800/MWh will be eligible for make-whole payments only after the PJM's and IMM's review of documents supporting the cost-based offer greater than \$1,800/MWh. See discussion *supra* P 6.

changing elements of the energy market rules by which capacity resources must abide does not necessarily constitute retroactive ratemaking.<sup>76</sup>

39. After considering the record, including PJM's answer, we do not find PJM's proposal to be unjust and unreasonable without the changes proposed by the IMM. As discussed earlier, we find reasonable and consistent with Commission precedent the proposal to allow any cost-based offer up to \$1,800/MWh to be eligible to set the LMP, regardless of resource fuel type. While the Commission recognizes that natural gas is the fuel most likely to cause LMPs to exceed \$1,000/MWh, we find that restricting the proposal to natural gas costs alone would be unduly preferential to those sellers whose electricity is from natural gas-fired generation. The aim of PJM's proposal is to allow generators – regardless of fuel type – to recover their marginal costs if they exceed the existing \$1,000/MWh offer cap.

40. We also agree with PJM that the IMM's proposal to limit shortage prices to existing levels (*i.e.*, levels associated with a \$1,000/MWh offer cap) would depress reserve prices below appropriate levels. PJM's existing tariff specifies a formulaic relationship between the offer cap, Reserve Penalty Factors, and the LMP during shortage conditions. The record does not show that this existing relationship is unjust or unreasonable.<sup>77</sup>

## **2. Ten Percent Adder**

41. Several parties object to PJM's proposed revisions limiting the cost-based offer adder to the lesser of 10 percent or \$100/MWh for offers above \$1,000/MWh, stating that PJM has not proven that the current adder is unjust and unreasonable and that the same level of uncertainty exists regardless of the offer cap level. We disagree. PJM explains that as prices get higher, the 10 percent adder is less likely to provide a reasonable representation of cost uncertainty. Instead, the 10 percent adder could "cause the

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<sup>76</sup> See *ISO New England Inc.*, 145 FERC ¶ 61,095, at P 28 (2013) (concluding that any expectations of market participants, as distinguished from retroactive ratemaking, do not outweigh the reliability benefits resulting from the change in rates).

<sup>77</sup> Our acceptance would mean that the LMP during shortage pricing conditions would equal \$1,800/MWh plus the primary and synchronized Reserve Penalty Factors, plus or minus congestion and marginal loss impacts.

cost-based offer to be artificially and unreasonably high.”<sup>78</sup> Accordingly, we accept PJM’s proposal.

### **3. Seams Issues and Broader Price Formation Issues**

42. Some commenters and protesters have raised concerns about seams issues and the need for a long-term regional or national solution related to offer caps in ISOs/RTOs. While PJM’s proposal may exacerbate seams issues by creating an incentive for external resources to attempt to sell into PJM when energy prices exceed \$1,000/MWh, PJM is proposing only a short-term, temporary change applicable over the next few months to address the possibility that the events of last winter may recur this winter. In addition, the proposed offer cap, which PJM states is sufficient to capture all offers during the 2013/2014 winter, limits the extent of any potential seams issues with neighboring ISOs/RTOs that may have different offer caps. Moreover, as noted earlier, the Commission is currently exploring potential improvements to market design and operational practices in order to ensure appropriate price formation in energy and ancillary service markets operated by ISOs/RTOs, which involved four staff papers and a series of workshops.<sup>79</sup> In the associated request for comments issued concurrently with this order, we seek additional information on possible alternative offer caps and how any alternative offer cap formulation could be constructed to mitigate possible seams issues.<sup>80</sup> However, we find that, while the Commission considers these issues, PJM’s proposal to address potential problems on its system this winter is just and reasonable. Moreover, we decline to establish hearing procedures for PJM’s proposal, as some protests and comments suggest. We also deny PJM Load Group’s motion for extension. We find that the current situation requires immediate relief and any further discussion regarding changes to the offer cap beyond the 2014/2015 winter are more appropriately addressed in the Docket No. AD14-14-000 proceeding.

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<sup>78</sup> PJM Transmittal at 10. We note that, contrary to PJM Load Group’s assertion, PJM did not propose that any adder would be applicable to make-whole payments for costs above \$1,800/MWh. *See* PJM Transmittal at 14.

<sup>79</sup> *See supra* note 70; *see also* FERC, *Price Formation in Organized Wholesale Electricity Markets: Staff Analysis of Uplift in RTO and ISO Markets*, Docket No. AD14-14-000 (Aug. 2014); FERC, *Price Formation in Organized Wholesale Electricity Markets: Staff Analysis of Shortage Pricing*, Docket No. AD14-14-000 (Oct. 2014); FERC, *Price Formation in Organized Wholesale Electricity Markets: Staff Analysis of Energy Offer Mitigation in RTO and ISO Markets* (Oct. 2014); FERC, *Price Formation in Organized Wholesale Electricity Markets: Staff Analysis of Operator-Initiated Commitments in RTO and ISO Markets*, Docket No. AD14-14-000 (Dec. 2014).

<sup>80</sup> *See supra* note 70.

#### 4. Compliance and Informational Filings

43. PJM states in its transmittal letter that it intends these provisions to expire on April 1, 2015. Nothing in the proposed tariff language, however, contains an expiration date for these provisions. As a ministerial matter, PJM must correct eTariff by reinstating the existing \$1,000/MWh offer cap. Accordingly, we are requiring PJM to make a compliance filing no later than February 27, 2015 to remove the proposed provisions herein as of April 1, 2015. Also, because this will be a ministerial compliance filing, no protest will be entertained by the Commission.

44. Finally, given the unique nature of PJM's request, we direct the IMM to submit an informational filing within 30 days of the expiration of these temporary provisions that identifies: (1) the total amount in MWh and the total as-bid costs in dollars of energy with incremental energy offers between \$1,000/MWh and \$1,800/MWh that cleared the energy market; (2) the total amount in MWh and the total as-bid costs in dollars of energy associated with cost-based offers above \$1,800/MWh that cleared the energy market; (3) the total amount of make-whole payments that were granted to resources that submitted offers in excess of \$1,800/MWh based on the IMM's *ex post* review; and (4) a list of the intervals, including time stamps, when PJM's LMPs exceeded \$1,000/MWh. The time period of this informational filing should cover the date of this order through March 31, 2015.

#### The Commission orders:

(A) PJM's proposed tariff revisions are hereby accepted, subject to a compliance filing, to become effective from the date of the issuance of this order, as discussed in the body of this order.

(B) PJM is required to make a compliance filing no later than February 27, 2015 to remove the temporary provisions as of April 1, 2015, as discussed in the body of this order.

(C) The IMM is required to make an informational filing within 30 days of the expiration of PJM's temporary provisions, as discussed in the body of this order.

By the Commission. Commissioner Honorable is not participating

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.