

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C.

Docket No. ER06-406-000

ORDER ACCEPTING CONTESTED SETTLEMENT

(Issued September 8, 2006)

1. On May 30, 2006, PJM Interconnection, L.L.C. (PJM) filed a Settlement Agreement and Offer of Settlement (Settlement Agreement), and Explanatory Statement in this docket pursuant to Rule 602 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602 (2006). PJM asserts the Settlement will resolve the issues set for hearing in this proceeding without need for an evidentiary hearing or further proceedings. Allegheny Power and Allegheny Energy Supply Company, L.L.C. (collectively, Allegheny) oppose the Settlement. On July 7, 2006, the Administrative Law Judge (ALJ) filed with the Commission a Report on the Contested Settlement,¹ and on July 12 the Chief Judge issued an order terminating settlement judge procedures, there being no additional matters pending before the Office of Administrative Law Judges and subject to final action by the Commission.

2. Upon consideration of comments filed by Allegheny and other parties, the Commission here decides the contested issue on its merits. The Commission finds that the Settlement Agreement is just and reasonable. Based on these findings, the Commission approves the Settlement.

¹ *PJM Interconnection, L.L.C.*, 116 FERC ¶ 63,002 (2006) (July 7 Report).

I. Background

A. Original Filing

3. PJM operates an economic demand response program, under which, during periods of scarcity or high wholesale prices, PJM compensates program participants for reducing their energy demand. Pursuant to this program, when the Locational Marginal Price (LMP) reaches a pre-determined level, customers participating in the program reduce demand in response to a request by PJM.

4. On December 28, 2005, PJM submitted revisions to the PJM Open Access Transmission Tariff (PJM Tariff), the Amended and Restated Operating Agreement of PJM Interconnection, L.L.C. (Operating Agreement), and the PJM reliability assurance agreements to enhance demand response in the PJM region in a number of ways, including allowing demand resources to participate in PJM's ancillary services market by bidding into the PJM reserve markets.

5. In protests to this filing, the PJM Industrial Customer Coalition (PJMICC) and Gerdau Ameristeel Corporation (Gerdau) asserted that PJM's proposal was structured in a way that made it impossible for industrial customers to participate in the Synchronized Reserve program, and that this structure discriminated unduly against large industrial "batch load" customers such as Gerdau. PJM proposed to determine whether a party is actually reducing load when PJM declares a Synchronized Reserve Event (SRE) through a "one-minute snapshot" method – *i.e.*, measuring the party's usage one minute before and one minute after PJM calls the SRE. However, according to Gerdau,

its "batch load" manufacturing process consists of cycles each approximately one hour in duration, and that its [load] fluctuates between zero MW (which occurs during brief halts in the manufacturing process) and 80 MW (which is approximately its peak load), with an average usage of 50 MW. Gerdau claims that it is capable of responding to an SRE within ten minutes of PJM's dispatch instruction, and could significantly reduce or shut down its manufacturing process for the duration of the SRE. But, according to Gerdau, because it has brief periods of zero MW usage during its manufacturing cycle, if PJM happened to call an SRE during one of those zero usage periods, PJM's measurement method would make it appear that Gerdau had not reduced load: the first one-minute snapshot would show zero usage, and the second one-minute snapshot would show either

zero or low usage, so that it would appear that Gerdau had not reduced its usage in compliance with PJM's instructions.²

6. Gerdau asserted that PJM was unwilling to revise its measurement methodology to accommodate such batch load manufacturers, and that therefore PJM did not provide such demand side resources with an opportunity to provide demand response that was equivalent to the opportunity given to generation side resources and other manufacturing processes. Gerdau alleged that this constituted unduly discriminatory treatment of batch load demand resources.³

7. On February 24, 2006, the Commission accepted and suspended PJM's filing, but set for settlement judge and hearing the issues raised by Gerdau with regard to undue discrimination against batch load users. The Commission stated:

In the settlement judge and hearing process, the parties should explore whether alternative approaches to the verification process can be implemented. These can include different measurement time periods, as well as the installation of communication and metering facilities that may be needed to accommodate batch load resources, or the use of automatic controls.⁴

8. The Commission further stated that it would set for hearing the appropriateness of PJM's proposed "two strikes and you're out" rule, under which resources were required to requalify for participation if they failed to curtail usage after two SREs.⁵ The Commission set for hearing the question of whether PJM was treating demand side resources in a discriminatory fashion by applying this penalty to demand side resources only.⁶

9. The parties then engaged in settlement negotiations under the auspices of Commission Settlement Judge Dring, and on May 30, 2006, PJM submitted the instant

² *PJM Interconnection, L.L.C.*, 114 FERC ¶ 61,201 at P 10 (2006) (February 24 Order).

³ *Id.* at P 11.

⁴ *Id.* at P 20.

⁵ *Id.*

⁶ *Id.*

Settlement Agreement, on behalf of itself and the participants who had joined the Agreement (the Settling Parties), who are PJM and Gerdau. It stated that the Settlement Agreement resolved all issues in this proceeding without the need for an evidentiary hearing, and that PJM and the Settling Parties were unaware of any opposition to the settlement. They urged the Commission to approve the Settlement Agreement on that basis.

B. Settlement Agreement

10. The Settlement Agreement proposes a new definition for a Batch Load Demand Resource that would encompass companies such as Gerdau, that go from significant to zero usage at intervals determined by the needs of their manufacturing process.⁷ It further provides that a Batch Load Demand Resource may provide Synchronized Reserve in the PJM Interchange Energy Market if it pre-qualifies to participate in the market by providing PJM with acceptable documentation showing six months of one minute increment load history of the Batch Load Demand Resource, or in the event such history is unavailable, other such information or data acceptable to PJM.⁸

11. The Settlement Agreement then provides that a Batch Load Demand Resource may participate in the Synchronized Reserve market as follows. If the demand resource clears the market, it is required to respond to PJM's calling of an SRE in one of two ways. If the SRE occurs during the on-cycle stage of the resource's production cycle, the resource must reduce load as quickly as possible and keep its consumption at or near zero megawatts for the entire length of the SRE following the reduction. If the SRE occurs during the off-cycle stage of the resource's production cycle, the resource must reduce any load that is present at the time as quickly as possible and delay the restart of the on-cycle stage of its production cycle. Failure to respond as described above shall be considered noncompliance with PJM's dispatch instruction associated with an SRE.⁹

⁷ The Settlement Agreement defines a Batch Load Demand Resource as "a demand resource that has a cyclical production process such that at most times during the process it is consuming energy, but at consistent regular intervals, ordinarily for periods of less than ten minutes, it reduces its consumption of energy for its production processes to minimal or zero megawatts." Explanatory Statement at 3; Settlement Agreement at Part II, section 5.

⁸ Explanatory Statement at 3.

⁹ *Id.* at 6.

12. The Settlement Agreement provides that the demand response provided by a Batch Load Demand Resource may be measured by two methods, either the "one-minute snapshot" method discussed above, or a second method:

the difference between (a) the qualified Batch Load Demand Resource's consumption at the end of the Synchronized Reserve Event and (b) the qualified Batch Load Demand Resource's consumption during the minute within the ten minutes after the end of the Synchronized Reserve Event in which the Batch Load Demand Resource's consumption was highest and for which its consumption in all subsequent minutes within the ten minutes was not less than fifty percent of the consumption in such minute; provided that, the magnitude of the response shall be zero if, when the Synchronized Reserve Event commences, the scheduled off, cycle stage of the production cycle is greater than ten minutes.¹⁰

13. The Explanatory Statement also notes that, while in its original filing, PJM had provided that demand resources that fail to provide assigned amounts of reserves during any two consecutive events would be required to re-qualify by demonstrating adequate response for three events during a single month, now, "[a]s a result of the settlement, this re-qualification requirement (or 'two strikes and you're out' rule) will not be required for demand resources, including Batch Load Demand Resources."¹¹

Comments on the Settlement

14. Initial comments were filed by Commission Trial Staff (Trial Staff) and Allegheny. Trial Staff supported the Settlement Agreement as "a fair and reasonable compromise" which "allows for a more robust participation by batch load demand resources in PJM's Interchange Energy Market."¹² Allegheny, however, opposed the Settlement Agreement, stating that, if the Commission accepted the settlement, it should condition that acceptance upon reinstatement of the "two strikes and you're out" rule.¹³

¹⁰ Explanatory Statement at 4-5, *citing* proposed section 3.2.3A(1). The Settlement Agreement also sets forth the conditions under which a Batch Load Demand Resource should use each method.

¹¹ Explanatory Statement at 8.

¹² Trial Staff initial comments at 5.

¹³ Allegheny comments at 2.

Allegheny argued that it:

oppose[s] the elimination of this rule because it will weaken PJM's ability to ensure that demand response providers perform when called upon and will impair the integrity of the interconnected grid. Although demand response providers are subject to penalties for failing to perform, repeat violators should be subject to disqualification, especially when failing to perform and paying penalties may be more economically advantageous than performing.¹⁴

Allegheny further noted that:

Synchronized reserves are used to maintain the integrity of the system. Any provider, whether generation or demand response, participating in the [Synchronized Reserve] Market should not be allowed to place the integrity of the system over its economic interests.¹⁵

15. Reply comments were filed by PJM, Trial Staff, and Gerdau and PJMICC (filing together) in response to Allegheny's opposition. PJM states that Allegheny is now seeking to disrupt the settlement, yet it did not choose to participate in the settlement process. PJM further states that the parties who did participate in a settlement conference on March 14, 2006 agreed that, to address the Commission's and Gerdau's concern that the "two strikes and you're out rule" might be discriminatory, PJM would eliminate that proposed rule.¹⁶ PJM states:

Allegheny did not attend the March 14 settlement conference. Therefore, it is now estopped from objecting to the agreements reached at that conference. Rule 601(b)(3) specifically states: "[I]f any party fails to attend the conference such failure will constitute a waiver of all objections to any order or ruling arising out of, or any agreement reached at, the conference." The Settlement was reached by the parties at the settlement conference. In particular, at the settlement conference, the parties agreed to exclude the proposed two strikes you're out rule from PJM's rules regarding the participation of demand resources in the Synchronized

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ PJM reply comments at 3.

Reserve market. Simply put, by not participating in the settlement conference, Allegheny waived its right to object to the elimination of the proposed two strikes you're out rule.¹⁷

16. Further, PJM stated, Allegheny's opposition raises no issues of genuine material fact, and does not address the concern raised by the Commission, namely, whether having a "two strikes and you're out" rule solely for demand resources was discriminatory, whereas the resolution reached by the settling parties does address that concern by eliminating that rule.¹⁸

17. Trial Staff in its reply comments similarly notes that the settling parties agreed to eliminate the "two strikes out and you're out" rule on the basis of the Commission's concern about potential discrimination. Trial Staff states that this resolution of the issue results in the treatment of demand side resources in the same fashion as other participants in PJM's synchronized reserves markets, while Allegheny's proposal to retain the rule would effectively create a separate category within PJM's synchronized reserves markets, subject to potentially discriminatory rules.¹⁹

18. Gerdau and PJMICC state in their reply comments that, if Allegheny had participated in the settlement negotiations, it would know that the Settlement Agreement imposes several restrictions on customers providing Synchronized Reserves that address the PJM concerns that originally prompted its "two strikes" proposal. Gerdau and PJMICC point to the Settlement Agreement's requirement that Batch Load Demand Resources must pre-qualify to provide Synchronized Reserves by, as discussed above, providing acceptable documentation to PJM that the resource can provide Synchronized Reserve. Gerdau and PJMICC also point to the fact that section 11, Part IV of the Settlement Agreement gives PJM authority to decrease the number of Batch Load Demand Resources that are permitted to provide Synchronized Reserves, if reliability concerns should so require. Therefore, Gerdau and PJMICC argue, Allegheny's proposal to reinstate the "two strikes" rule is unnecessary.²⁰

¹⁷ *Id.* at 4, *citing* 18 C.F.R. § 385.601(b)(3) (2006).

¹⁸ PJM reply comments at 4-5.

¹⁹ Trial Staff reply comments at 4.

²⁰ Gerdau reply comments at 2-3, *citing to* Settlement Agreement, Part IV, section 11 ("Qualified Batch Load Demand Resources may provide up to 20 percent of the total PJM Synchronized Reserve requirement in any hour; provided, however, that in the event

II. Discussion

19. For the reasons discussed below, the Commission finds that this contested Settlement is just and reasonable and accordingly the Commission approves the Settlement without condition. In order to approve a contested settlement, such as the instant Settlement, the Commission must make "an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates."²¹ Consistent with this requirement, Rule 602(h)(1)(i) of the Commission's settlement rules²² provides that the Commission may decide the merits of contested settlement issues if the record contains substantial evidence upon which to base a reasoned decision or the Commission finds that there is no genuine issue of material fact.

20. The Commission here finds that there is no genuine issue of material fact, and it finds that the Settlement is just and reasonable and not unduly discriminatory. Allegheny's argument consists of an assertion that the elimination of the "two strikes" rule will weaken PJM's ability to ensure that demand response providers perform when called upon and will impair the integrity of the PJM system. However, Allegheny provides no factual support for this assertion. By contrast, as Gerdau points out (and as Allegheny does not rebut), PJM's tariff and the Settlement Agreement provide other mechanisms to that help to ensure that demand resources and generators will comply with their Synchronized Reserve obligations.

21. PJM provides in its tariff that either a generator or a demand responder that fails to meet its reserve obligation will have to incur an additional reserve obligation in the same amount as the shortfall, as follows:

In the event a generation resource or Demand Resource that either has been assigned by the Office of the Interconnection or self-scheduled by the

that PJM determines in its sole discretion that satisfying 20 percent of PJM's Synchronized Reserve requirement from Batch Load Demand Resources is causing or may cause a reliability degradation, PJM may reduce the percentage of the total PJM Synchronized Reserve requirement that may be satisfied in any hour by Batch Load Demand Resources to as low as 10 percent").

²¹ *Mobil Oil Corp. v. FERC*, 417 U.S. 283, 314 (1974), *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 (1998).

²² 18 C.F.R. § 385.602(h)(1)(i) (2006).

owner to provide Tier 2 Synchronized Reserve fails to provide the assigned or self-scheduled amount of Synchronized Reserve in response to an actual Synchronized Reserve Event, the owner of the resource shall incur an additional Synchronized Reserve Obligation in the amount of the shortfall for a period of three consecutive days with the same peak classification (on-peak or off-peak) as the day of the Synchronized Reserve Event at least three business days following the Synchronized Reserve Event.²³

22. Additionally, Part II, Section 6 of the Settlement Agreement provides that Batch Load Demand Resources must pre-qualify to provide Synchronized Reserves by providing acceptable documentation to PJM that the resource can provide Synchronized Reserve. Part IV, section 11 of the Settlement Agreement gives PJM authority to decrease the number of Batch Load Demand Resources that are permitted to provide Synchronized Reserves, if reliability concerns should so require. In addition, unlike the tariff provision cited above which applies to both generation and demand resources, the "two strikes" rule applies only to demand resources, and the removal of this provision helps to ensure that the competitive resources are treated equally. We therefore find that elimination of the two strikes rule as proposed by PJM is just and reasonable.

The Commission orders:

The Offer of Settlement filed by PJM and the Settling Parties on May 30, 2006 is approved.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

²³ PJM Open Access Transmission Tariff at Sixth Revised Sheet No. 384B, section 3.2.3A(j).