

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

February 12, 2004

In Reply Refer To:
PJM Interconnection, L.L.C.
Docket No. ER04-361-000

Wright & Talisman, P.C.
Attn: Paul M. Flynn
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1200 G Street, NW
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Washington, D.C. 20005-3802

Dear Mr. Flynn:

1. On December 31, 2003, you submitted on behalf of PJM Interconnection, L.L.C. (PJM), revisions to the PJM Open Access Transmission Tariff (Tariff) and the Amended and Restated Operating Agreement of PJM Interconnection, L.L.C. (Operating Agreement). The purpose of the tariff revisions is to provide market-based credits to generation owners that adjust active power output at PJM's direction to provide increased reactive support to the transmission system. PJM also requests waiver of Section 35.3 of the Commission's regulations, 18 C.F.R. § 35.3 (2003), to allow the proposed changes to become effective January 1, 2004.
2. Notice of the filing was published in the Federal Register, 68 Fed. Reg. 2,588 (2004), with comments, protests, and interventions due on or before January 21, 2004. American Municipal Power-Ohio, Inc. (AMP-Ohio); Delaware Municipal Electric Corp., Inc. (DEMEC); Detroit Edison Company; District of Columbia Office of the People's Counsel; Dominion Resources, Inc.; Duke Energy North America, LLC and Duke Energy Trading & Marketing, LLC; Dynegy Power Marketing, Inc. & Dynegy Midwest Generation, Inc.; Maryland People's Counsel; and Reliant Resources, Inc. (Reliant) filed motions to intervene. AMP-Ohio, DEMEC, and Reliant also filed comments. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the timely unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.
3. PJM states that to help maintain reliability, market sellers with generating resources in the PJM region are required to respond to PJM's directives to change the

reactive output levels of their resources.¹ When PJM directs a unit to increase its reactive power generation, the facility operator may need to scale back its active power generation, thus denying the operator the opportunity to sell the active power it would have otherwise produced. Schedule 2 of the PJM Tariff recognizes that generating facilities are operated to produce or absorb reactive power as needed to maintain transmission system voltages within acceptable levels. PJM states that generators should be compensated for providing reactive power since transmission customers benefit from reactive power voltage support. However, PJM states that the Schedule 2 revenue requirements do not include opportunity costs incurred by suppliers of reactive power. PJM explains that when it directs a unit to increase its reactive power generation, the facility operator may need to scale back its active power generation, thus denying it the opportunity to sell the active power it would have otherwise produced.

4. PJM's existing market rules recognize and compensate generators for this lost opportunity cost, but its rules in this area are limited and do not explicitly apply to reactive supply services. Specifically, under Sections 3.2.3(e) and (f), a market seller that operates as requested by PJM, including any quantity deviations at the direction of PJM's dispatchers, receives credits based on the difference between the offered price and value of its energy. Although the Commission recently approved PJM's expansion of the provisions of Section 3.2.2(f) to address and clarify different circumstances that warrant payment of opportunity costs, those provisions do not cover all situations in which opportunity costs arise for changes in output to provide reactive power support.²

5. PJM states that its current tariff language does not provide sufficient detail on the calculation of credits for generators that adjust their active power output to provide reactive support. PJM also recognizes that the current allocation of the cost of those credits does not correspond to the localized system benefits from changed output from units that provide reactive power support. PJM and its stakeholders therefore developed the proposed changes to the market rules to detail opportunity cost credits for reactive support. In this instant filing PJM draws upon the opportunity cost provisions that were approved in Docket No. ER03-1086-000, but supplement those by adding new provisions to allocate reactive support opportunity costs in a manner that reflects the benefit to the system of increased reactive support.

6. PJM proposes to add a new Section 3.2.3B "Reactive Services" to its Tariff and Operating Agreement describing the calculation and allocation of opportunity cost payments to market sellers that make active power adjustments at PJM's direction to provide reactive power support. PJM states that the proposed revisions were unanimously endorsed and recommended for approval by the PJM Market

¹ See PJM Operating Agreement, Schedule 1, Section 1.7.20(b).

² See PJM Interconnection, L.L.C., 104 FERC ¶ 61,291 (2003).

Implementation Committee and the PJM Electric Markets Committee. The proposed language was also approved by the PJM Tariff Advisory Committee and unanimously approved by the PJM Members Committee.

7. In its comments, Reliant states that it fully supports PJM's proposal since it will appropriately provide generators in the PJM control area with an opportunity to receive payment for providing necessary reactive power, thereby maintaining system reliability. DEMEC, however, expresses concern regarding the provisions allowing market-based credits representing lost opportunity costs to generation owners in PJM, because actual lost opportunity costs are hard to quantify and difficult to audit. As such, DEMEC requests that the Commission examine PJM's approach to lost opportunity costs to ensure that generators in PJM are not being over compensated for services. Finally, while AMP-Ohio generally supports the concept of compensating generators for reactive power when they are ordered to produce the power, it believes that PJM's proposal appears deficient in that it lacks a mechanism to monitor the level of claimed revenue requirements from a generator that produces necessary reactive power.

8. While the Commission recognizes AMP-Ohio's and DEMEC's concerns, we find that PJM has sufficient provisions and safeguards in both the Tariff and the Operating Agreement to ensure generators are not being over compensated and to monitor the level of claimed revenues from generators that provide reactive services.³ Furthermore we find that PJM is merely revising its tariff to provide the same compensation for reactive power as for other services.

9. However, the Commission finds that PJM's formula for computing lost opportunity cost is the subject of a rehearing in Docket No. ER03-1086. We will therefore accept the filing, to be effective January 1, 2004, subject to the outcome of the proceeding in Docket No. ER03-1086.

By direction of the Commission.

Magalie R. Salas,
Secretary.

cc: All Parties

³ See PJM Operating Agreement and PJM Open Access Transmission Tariff, Sections 3.2.3B(m).