

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher.

PJM Interconnection, LLC

Docket Nos. ER04-539-005
ER04-539-006
ER04-539-007

EL04-121-000
EL04-121-001
EL04-121-002

ORDER SETTING FILINGS FOR HEARING

(Issued April 18, 2005)

1. In this order, the Commission sets for hearing two proposals by PJM Interconnection, LLC (PJM) regarding offer caps on generating units dispatched out of economic merit for reliability within control areas newly integrated into PJM. The Commission previously instituted an investigation into these matters under section 206 of the Federal Power Act (FPA),¹ and it now continues that investigation by setting PJM's proposals for hearing

I. Background

A. PJM's Current Market Mitigation Mechanisms

2. PJM's Operating Agreement (OA) currently enables PJM to mitigate the market power of certain generators by capping their offers to sell energy under particular conditions. If PJM determines that, due to limits on transmission capacity, a generating unit may be dispatched out of economic merit order, that generator's offers are capped at

¹ 16 U.S.C. 824e (2000).

various levels.² The cap will be in force for the entire operating day, unless PJM can determine the hours during which transmission limitations require the offer cap, in which case the resource's offers will be capped only for each such hour.³

3. As the test for when PJM may suspend offer capping, the OA provides that, with regard to generation resources that are affected by a particular limit on transmission capacity, PJM may suspend offer capping "for any hour in which there are not three or fewer [*i.e.*, when there are at least four] generation suppliers . . . that are jointly pivotal with respect to such transmission limit(s)."⁴ PJM defines a "pivotal supplier" for purposes of the offer capping rule as one whose output is required to meet relevant load. More than one supplier can be pivotal at any given time, if the output of any supplier or combination of suppliers is required to meet load affected by that transmission limit. If PJM's market monitoring unit determines that, notwithstanding the number of jointly pivotal suppliers in any hour, a reasonable level of competition will not exist, it may seek the Commission's approval to reimpose offer caps.⁵

4. However, the OA also provides that when generators are dispatched out of economic merit order due to constraints on particular transmission interfaces (the Western, Central and Eastern reactive limits in the classic PJM control area), they are not offer capped, on the basis that sufficient competition existed on each side of these constraints to prevent any generator from acquiring market power when the constraint develops.⁶

² PJM OA, section 6.4.1. The generator's offer may be capped at the weighted average Locational Marginal Price (LMP) at the generation bus at which energy from the capped resource was delivered; the resource's incremental operating costs plus 10 percent; or, for units that are frequently offer-capped, the resource's incremental operating costs plus the higher of \$40/megawatt-hour or the unit's going forward costs as reflected in an agreement between the generator and PJM. PJM OA, section 6.4.2(a).

³ PJM OA, section 6.4.1(a).

⁴ PJM OA, section 6.4.1(e).

⁵ PJM OA, section 6.4.1(e).

⁶ PJM OA, section 6.4.1(d).

B. The Commission's August 10 Order

5. In the past several years, and in part as a result of its re-formation as a Regional Transmission Organization (RTO), PJM has expanded significantly. Several new transmission-owning utilities have already integrated into PJM, including Allegheny Power (Allegheny), Commonwealth Edison (ComEd), American Electric Power (AEP), Dayton Power and Light Company (DP&L) and others, such as Dominion Virginia Power (VEPCO), are in the process of joining PJM. As a result, multiple new control areas have been added to "classic" (*i.e.*, pre-expansion) PJM.

6. In preparation for the integration of ComEd, PJM made a filing under section 205 of the Federal Power Act (FPA)⁷ proposing to add market mitigation mechanisms to its OA that it intended would apply during the period for which ComEd, but not AEP, was a member of PJM, so that transmission between the ComEd and PJM control areas would occur by means of a 500 MW pathway across AEP. PJM proposed, *inter alia*, to extend its offer capping regimen to the ComEd control area when this 500 MW pathway was constrained.

7. In the Commission's first order in this proceeding, we rejected this proposal, stating that PJM had not explained why it should not offer an exemption from cost capping for the ComEd control area similar to the exemption that PJM already provides for the Eastern, Western and Central reactive limits within PJM.⁸ The Commission further required PJM, pursuant to its authority under section 206 of the FPA,⁹ to file an explanation as to why "an exception should not be added to section 6.4 of the tariff for NICA and PJM in instances when the 500 MW pathway is constrained in either direction."¹⁰ PJM provided the required explanation. In the Commission's August 10

⁷ 16 U.S.C. 824d (2000).

⁸ *PJM Interconnection, LLC*, 106 FERC ¶ 61,277 at P 33-34 (2004) (October 24 Order).

⁹ 16 U.S.C. 824e (2000).

¹⁰ October 24 Order at P 34.

Order, we found that, as PJM proposed, there was sufficient competition to justify an exemption for offer capping for the ComEd control area when the 500 MW pathway was constrained from west to east, and directed PJM to amend its OA accordingly.¹¹

8. The Commission also addressed the question of whether PJM's current rules regarding offer caps continued to be appropriate for these new control areas. Since in classic PJM, generators dispatched to relieve constraints on the Western, Central and Eastern reactive limits are exempt from offer capping because those interfaces are in sufficiently competitive areas, the Commission stated:

We are concerned that as PJM expands, there is not in place a mechanism for determining whether other major transmission constraints into and/or out of the newly integrated areas should also be exempted from triggering mitigation of some or all generators called out of merit. Currently, the burden is placed on individual generators to seek an exception to PJM's mitigation procedures, or they will, by default, be subject to mitigation. It is our view that, as new members join PJM and new control areas come under PJM's control, the onus should be on PJM to demonstrate why generators in those control areas should be mitigated when constraints on the major transmission interfaces into the control area arise.¹²

9. Therefore, pursuant to section 206 of the FPA, the Commission required PJM to provide a competitive analysis of whether constraints on the major transmission interfaces into and/or out of the newly-integrated control areas (Allegheny, ComEd, AEP, DP&L, and VEPCO) justified offer capping.¹³ Additionally, the Commission required PJM to either justify the current provisions of its tariff, or to "propose a revision to that provision that will require PJM to perform the competitive analysis to determine whether an exemption from mitigation is appropriate when new control areas are added to PJM."¹⁴ The Commission further noted that, "because of the concerns with respect to the offer

¹¹ *PJM Interconnection, LLC*, 108 FERC ¶ 61,187 at P 64 (2004) (August 10 Order). The Commission did not require PJM to exempt sellers from offer capping when the 500 MW pathway was constrained from east to west.

¹² August 10 Order at P 75.

¹³ *Id.* at P 76.

¹⁴ *Id.* at P 75.

capping of all units, as discussed above, we will require PJM to address in its response whether offer capping should be limited to those generators that fail the market power test."¹⁵

C. Related Commission Proceedings in Docket No. EL03-236-006

10. The test set forth by PJM in section 6.4.1(e) of the OA, *supra*, for when offer caps are unnecessary because a market area is competitive – namely, when there are more than three jointly pivotal suppliers – was accepted by the Commission in an order issued on January 25, 2005.¹⁶ In that order, however, in Docket No. EL03-236-006, the Commission also initiated an investigation under section 206 to determine whether this approach was just and reasonable. The Commission stated that PJM's test might be excessively restrictive and impose mitigation even in competitive areas, and thus required PJM to address whether modifications of its three-pivotal supplier test would be appropriate, such as using only two pivotal suppliers, rather than three.¹⁷

11. The Commission further noted that it had previously adopted market screens for determining whether an entity could charge market based rates,¹⁸ and that this test differed from the three-pivotal supplier test. It further required PJM to explain "why [the

¹⁵ *Id.*

¹⁶ *PJM Interconnection, LLC*, 110 FERC ¶ 61,053 (2005) (Pivotal Supplier Investigation Order).

¹⁷ Pivotal Supplier Investigation Order at P 84.

¹⁸ *See AEP Power Mktg., Inc.* 107 FERC ¶ 61,018 (Market Based Rates Order), *order on reh'g*, 108 FERC ¶ 61,026 (2004). In this order, the Commission adopted two indicative screens for assessing generation market power: a pivotal supplier analysis based on the control area's annual peak demand, and a market share analysis applied on a seasonal basis. The Commission further ruled that if an applicant passes both screens, there would be a rebuttable presumption that the applicant does not possess market power in generation. The Commission further found that if an applicant fails either screen, that would create a rebuttable presumption that market power exists in generation, which the applicant could rebut by using a "more robust" market power study (the delivered price test). Market Based Rates Order at P 36-37, footnotes omitted.

screens in the Market Based Rates Order] or reasonable derivations of these screens, are not appropriate for determining when load pockets are sufficiently competitive to permit relaxation of mitigation."¹⁹

D. PJM's Filings in Response to the August 10 Order

1. Exemption for pathway between ComEd and PJM

12. On September 9, 2004, PJM filed an amendment to its OA to provide for an exception to the offer capping provisions of section 6.4 when the 500 MW pathway between classic PJM and ComEd was constrained from west to east. PJM's September 9 filing was noticed in the *Federal Register*, with protests, comments and motions for intervention due on September 30, 2004.²⁰ None was filed.

13. On October 26, 2004, PJM made a second compliance filing. In that filing, PJM also revised section 6.4.1(d) to remove the exemption of the PJM-ComEd 500 MW pathway when it is constrained from west to east, as that pathway no longer exists and the exemption is now moot.²¹

2. Mechanism for providing exemptions from offer capping

14. In its October 26 compliance filing, PJM also submitted proposed amendments to its OA to revise its offer capping rules along with an analysis of whether to exempt the new PJM control areas from mitigation, as it has exempted the Eastern, Western and Central reactive limits in classic PJM. To provide a mechanism to determine whether transmission constraints into and/or out of newly integrated areas should be exempted from offer capping, PJM proposes to amend section 6.4.1(d) of its OA to provide that it will conduct periodic competitive analyses of transmission constraints and, if the results of such analyses warrant, will file further amendments to include additional exemptions from its offer capping rules. PJM states that it will conduct this analysis annually, with the first analysis to be conducted after six months of experience with the integration of AEP, DP&L and VEPCO.²²

¹⁹ Pivotal Supplier Investigation Order at P 84.

²⁰ 69 Fed. Reg. 56,214 (2004).

²¹ October 26 Compliance Filing at 4.

²² October 26 Compliance Filing at 3-4.

15. PJM also states that its market monitor conducted an analysis of the major transmission constraints into and/or out of Allegheny, ComEd, AEP and DP&L, and determined, on the basis of the delivered price test, that the interface between classic PJM and Allegheny control areas (the APS South interface) should be exempt from offer capping, but that an exemption from offer capping was not supported for the other transmission facilities the market monitor studied.

16. PJM's October 26 compliance filing was noticed in the *Federal Register*, with protests, comments and motions for intervention due on November 16, 2004.²³ Motions to intervene were filed by American Electric Power Service Corporation (AEP), Constellation Energy Commodities Group, Inc. (Constellation), the Maryland People's Counsel, and Exelon Corporation (Exelon). A motion to intervene and protest was filed by Old Dominion Electric Cooperative (ODEC). A joint protest was filed by the Mirant Companies (Mirant) and Constellation, and comments were filed by the Electric Power Supply Association (EPSA). PJM filed an answer to the protests.

17. Staff requested further information from PJM by letter dated January 5, 2005, and PJM submitted its response to the data request on February 4, 2005. PJM's response to staff's data request was noticed in the *Federal Register*, with protests, comments and motions for intervention due on February 25, 2005.²⁴ EPSA filed comments, and Mirant filed a protest and motion for consolidation of this proceeding with the investigation commenced by the Commission's Pivotal Supplier Investigation Order, Docket No. EL03-236-006.

II. Discussion

A. Procedural Issues

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the timely, unopposed motions to intervene of AEP, Exelon, the Maryland People's Counsel, ODEC and Constellation serve to make them parties to the proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept PJM's answer because it has provided information that assisted us in our decision-making process.

²³ 69 Fed. Reg. 64,746 (2004).

²⁴ 70 Fed. Reg. 7,929 (2005).

B. Analysis

19. After reviewing the filings by the parties, the Commission finds that it cannot determine, pursuant to its authority under section 206, whether PJM's existing tariff with respect to mitigation in control areas of the new PJM companies is just and reasonable nor, if it is unjust and unreasonable, what an appropriate just and reasonable provision would be. In addition, the parties have raised issues with respect to confidential treatment of relevant information that are better resolved at a formal hearing. The Commission, therefore, is directing the Chief Administrative Law Judge to establish a hearing to examine the issues.

20. The Commission recognizes that there is an interrelationship between the three-pivotal supplier test in this proceeding and the Commission's investigation of whether that is an appropriate test for market power in load pockets in Docket No. EL03-236-006. The ALJ assigned to this matter, therefore, should proceed in this case to resolve other issues, such as the treatment of confidential information or further discovery, but should hold in abeyance any proceedings with regard to resolution of the three-pivotal supplier issue in this docket until the Commission has determined how to proceed on that issue in Docket No. EL03-236-003. At that time, the Commission may provide the parties with additional clarification of the issues to be resolved in this proceeding.

21. In the August 10 Order, as noted above, the Commission instituted an investigation under section 206 of the FPA to determine "whether PJM has identified the appropriate triggers for offer[] capping mitigation in the control areas of" the new PJM members,²⁵ and required PJM to provide an analysis of whether "constraints on the major transmission interfaces into and/or out of Allegheny, ComEd, AEP, DP&L, and VEPCO should also trigger offer capping as those companies move into PJM."²⁶

22. In response, PJM submitted a report of its market monitor, Joseph Bowring, in which Mr. Bowring developed a list of eleven significant transmission constraints, based on their association with the fifteen most frequently constrained facilities in the PJM expanded footprint. PJM determined which were the fifteen most frequently constrained facilities on the basis of the frequency with which congestion at those facilities was required to be relieved through the use of transmission loading relief procedures (TLRs)

²⁵ August 10 Order at P 72.

²⁶ *Id.* at P 76.

prior to the integration of the expansion companies into PJM.²⁷ Based on this study, the market monitor concluded that the APS South interface (*i.e.*, the interface between the Allegheny and classic PJM control areas) was sufficiently competitive that it should be exempted from offer capping, but that the remainder of the constraints that PJM studied did not have sufficient competitive supply alternatives to support an exemption from offer capping.²⁸

23. The parties raised a number of issues in response to PJM's filing. Mirant/Constellation and EPSA assert that PJM has not provided enough information to make it possible to determine whether it has fulfilled the Commission's directive. Mirant/Constellation state that PJM has not provided the back-up data or workpapers with regard to any of the analyses performed by the market monitor that would be necessary to enable parties to evaluate the market monitor's conclusions, or the information necessary. Mirant/Constellation further assert that PJM has not provided the necessary information to understand how it selected the specific interfaces and facilities that it studied, how it divided the load levels into four quartiles for each constraint, and how it determined unit-specific distribution factors (DFAX). Both EPSA and Mirant/Constellation argue that a fuller explanation of PJM's process is needed to determine whether PJM's process was reasonable. EPSA states that, if necessary, its members will enter into protective orders to obtain this information. ODEC largely supports PJM's filing, but raises issues as to what period PJM should have studied, and also the timing of the exemption of APS South from offer capping, given that the upcoming integration of VEPCO into PJM (on which PJM based its decision to exempt APS South) is as yet unknown.

24. In its response, PJM states that it has provided sufficient information to enable market participants and the Commission to understand the market monitor's analysis, including the exemption from offer capping for APS South. PJM further states that it cannot provide all of the information on which the market monitor based its analysis, since some of that data is confidential and would injure generators' competitive position if released.

25. Mirant/Constellation argue that the market monitor has misapplied the pivotal supplier test by evaluating whether three or more unaffiliated suppliers failed the test, and since under the Market Based Rates Order, the function of the pivotal supplier test is to

²⁷ See Report of the PJM Market Monitor (Market Monitor Report), attached to October 26 Compliance Filing, at P 7-10.

²⁸ *Id.* at P 17.

determine whether a single supplier can exercise market power unilaterally, rather than to determine whether three or more suppliers are jointly pivotal in a market. ODEC asks the Commission to clarify that the three pivotal supplier test is the operative test for determining market power. PJM states in its answer that the market monitor properly applied a pivotal supplier analysis. In its protest of PJM's data responses, Mirant asks the Commission to consolidate this proceeding with the ongoing investigation in Docket No. EL03-236-006, ordered in the Pivotal Supplier Investigation Order. EPSA, in its comments on PJM's data responses, asks the Commission to clarify that the result of that investigation will be taken into account and used by the Commission in this proceeding.

26. Mirant also asserts that PJM did not address whether offer capping should be limited solely to those generators that fail the market power test, which improperly places the burden on a specific generator to prove that it cannot exercise market power, rather than placing the burden on PJM to prove that it can. PJM states that even when an individual supplier passes the market power tests over an extended period of time, it may still set the market clearing price for all generation in a constrained area on many days and for several hours, and that this case therefore raises the question of whether the Commission's market power test is appropriate for use in a single clearing price market such as PJM's; PJM further notes that, in granting market based rate authority to some generators, the Commission has relied on the fact that those generators operate within an RTO, so that the RTO's market monitor can mitigate the exercise of market power when situations arise that so require. PJM asks the Commission to consider this question broadly within its generic review of its current market power standard, rather than in this specific proceeding.

27. The Commission recognizes that, by proposing to conduct periodic analyses of the most significant transmission constraints, and to exempt transmission constraints from offer capping if appropriate on the basis of those competitive analyses, PJM has attempted to provide a mechanism to review, on a periodic basis, whether offer capping is still appropriate for particular constraints. However, based on the record provided, the Commission finds that it cannot determine whether PJM's existing OA provisions are just and reasonable or whether its proposed revisions to its OA are just and reasonable. In addition to the questions raised by the parties, *supra*, the Commission also questions whether (a) annual competitive analyses are sufficient, or whether PJM should conduct more frequent analyses, and (b) whether APS South should be exempt from offer capping. Therefore, the Commission has determined to continue the investigation of these matters through trial-type hearing procedures.²⁹

²⁹ As noted above, PJM filed an amendment to its OA with respect to the 500 MW pathway between classic PJM and ComEd . The Commission finds the September 9

The Commission orders:

(A) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly section 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), a public hearing shall be held in Docket No. EL04-121-000 concerning the remainder of PJM's proposed revisions to its Operating Agreement, as discussed in the body of this order.

(B) Within 30 days of this order, pursuant to section 375.304 of the Commission's regulations, 18 C.F.R. § 375.304 (2004), a presiding administrative law judge, to be designated by the Chief Administrative Law Judge, shall convene a conference in this docket in a hearing room of the Federal Energy Regulatory Commission, 888 First Street NE, Washington, D.C. 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates as discussed in the body of the order, and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Deputy Secretary.

filing moot, because AEP has now integrated into PJM, and any issues regarding the pathway are now moot.