

122 FERC ¶ 61,264
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 Nos. ER05-1410-006
EL05-148-006

ORDER ON COMPLIANCE FILING

(Issued March 21, 2008)

1. In this order, the Commission accepts a compliance filing by PJM Interconnection, L.L.C. (PJM) concerning PJM's Reliability Pricing Model (RPM) program, subject to further modifications.

I. Background

A. Initiation of RPM

2. As discussed extensively in our June 25 Order and prior orders in this proceeding,¹ based on a section 206 filing by PJM, the Commission found that PJM's capacity market as it existed prior to RPM was unjust and unreasonable, because it failed to procure sufficient capacity in local areas to enable PJM to fulfill its obligation to maintain a reliable transmission system.² To address this upcoming capacity problem, on

¹ See *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,318, at P 5-15 (2007) (June 25 Order); see also *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (December 22 Order) and *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 9-17 (2006) (April 20 Order).

² April 20 Order, 115 FERC ¶ 61,079 at P 1-6.

August 31, 2005, PJM proposed a capacity market under which capacity sellers would offer, and PJM would purchase, capacity on a multi-year forward basis through an auction mechanism, and prices for capacity would be derived through these forward auctions. Additionally, the RPM mechanism provided that different locations within PJM might have different prices, if necessary to reflect the amount of capacity that it would be necessary to acquire within each location. Under RPM, the offers submitted into each locally defined market determine a single clearing price for all capacity (i.e., the highest-priced offer accepted by PJM sets the price for all the capacity that PJM purchases).

3. On December 22, 2006, the Commission approved, with certain conditions, the RPM settlement.³ However, the Commission found that the settlement granted excessive discretion to the PJM Market Monitoring Unit (Market Monitor) in certain areas. Under the Settlement, there are objective criteria that determine when bids are potentially subject to mitigation. In these cases, the Market Monitor can allow bids that fail these objective screens to go forward, if those bidders either (a) provide financial data regarding their actual costs to PJM, or (b) accept a default bid developed by the Market Monitor. The Commission was concerned that the Market Monitor might exercise excessive discretion in developing these default bids, and therefore ordered PJM to revise its tariff so as to replace each of these discretionary provisions with objective factual criteria to be used in developing or reviewing default bids.

B. PJM's September 24 filing

4. PJM made the required compliance filing on September 24, 2007. PJM states that it conducted a stakeholder process to determine the necessary tariff changes, but could not reach consensus with its stakeholders. PJM therefore unilaterally made this filing in compliance with the Commission's order.

5. Notice of PJM's filing was published in the *Federal Register*, with interventions and protests due on or before October 15, 2007.⁴ Timely protests were filed by Indicated

³ See December 22 Order, 117 FERC ¶ 61,331 at P 1. In addition to its June 25, 2007 Order on rehearing of the December 22 Order, the Commission issued a further order on rehearing in *PJM Interconnection, L.L.C.*, 121 FERC ¶ 61,173 (2007) (November 15 Order).

⁴ 72 Fed. Reg. 57923 (2007).

Buyers⁵ and the Borough of Chambersburg, PA (Chambersburg). PPANJ also submitted a supplemental protest. Out-of-time protests were filed by the Virginia State Corporation Commission (Virginia Commission) and Rockland Electric Company (Rockland).

6. PJM and Capacity Buyers and Sellers (Capacity Buyers)⁶ filed answers to the protests.

7. Indicated Buyers and PPANJ filed answers in opposition to the answers filed by PJM and Capacity Buyers. PJM also filed a motion urging that the Commission reject Rockland's late-filed protest.

II. Discussion

8. Rule 211(b)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.211(b)(2) (2007), provides that "the Secretary may waive any procedural requirement of this subpart applicable to protests." The Commission will accept the protests filed out of time by the Virginia Commission and Rockland, on the basis of ensuring a more complete record.

⁵ The Indicated Buyers are Old Dominion Electric Cooperative, American Forest & Paper Association, Mittal Steel USA, D.C. Office of the People's Counsel, Maryland Office of People's Counsel, North Carolina Electric Membership Corporation, Pennsylvania Office of Consumer Advocate, Public Power Association of New Jersey (PPANJ), and the PJM Industrial Customer Coalition (PJMICC). PJMICC also filed a motion to intervene, which the Commission need neither grant nor deny as PJMICC has already been made a party to this proceeding.

⁶ The Capacity Buyers are Constellation Energy Commodities Group, Inc., Constellation NewEnergy, Inc., and Constellation PowerSource Generation, Inc. (Constellation); the Dayton Power and Light Company (Dayton); Edison Mission Energy, Edison Mission Marketing & Trading, Inc., and Midwest Generation EME, LLC (collectively, EME); Exelon Corporation, Exelon Generation, LLC, Commonwealth Edison Company, and PECO Energy Corporation (collectively, Exelon); Mirant Energy Trading, LLC, Mirant Chalk Point, LLC, Mirant Mid-Atlantic, LLC, and Mirant Potomac River, LLC (collectively, Mirant); PPL Electric Utilities Corporation, PPL EnergyPlus, LLC, PPL Brunner Island, LLC, PPL Holtwood, LLC, PPL Martins Creek, LLC, PPL Montour, LLC, PPL Susquehanna, LLC, PPL University Park, LLC, and Lower Mount Bethel Energy, LLC (collectively, PPL); PSEG Power LLC, and PSEG Energy Resources & Trade LLC (collectively, PSEG); and Reliant Energy, Inc. (Reliant).

9. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We will accept PJM's answer to the protests because it has provided information that assisted us in our decision-making process. We reject the answers of Capacity Buyers (to the protests) and Indicated Buyers and PPANJ (to the answers filed by PJM and Capacity Buyers). We will also reject PJM's motion to reject Rockland's protest.

10. The Commission accepts the compliance filing while requiring modifications.

A. Minimum Offer Price Rule

1. The Commission's Directive

11. The RPM settlement includes a “minimum offer price rule” providing for review, rejection, and substitution of new entry offers from market participants that are net capacity buyers, when such offers are deemed to be too low. If bids fall below 80 percent of the cost of new entry (CONE) of the applicable asset class (or if there is no applicable asset-class cost, 70 percent of the cost of new entry), the Market Monitor first gives the seller an opportunity to cost-justify its bid. If, in the Market Monitor’s judgment, the seller does not provide satisfactory justification, the Market Monitor replaces the bid with a price equal to 90 percent of the estimated asset class cost, or if there is no asset-class estimate, 80 percent of the cost for the generally applicable net cost of new entry. The Market Monitor also develops estimates of the cost of new entry for combustion turbine and combined cycle generators; two classes of assets that are likely to be the marginal price-setting resources. The Net Asset Class CONE is set at zero for: (i) base load resources, such as nuclear, coal and integrated gasification combined cycle, that require a period for development greater than three years; (ii) any facility associated with the production of hydroelectric power; (iii) any upgrade or addition to an existing generation capacity resource; or (iv) any planned generation capacity resource being developed in response to a state regulatory or legislative mandate.

12. The Commission found that:

We are concerned that the Market Monitor may have excessive discretion as proposed in the Settlement. . . . [W]e will require PJM to file within nine months of the date of this order, objective factual criteria to be used by the Market Monitor in reviewing bids under [section 5.14 and other sections] of the Tariff. Such objective criteria would replace the criteria included in the Settlement and the

near-term review procedures and would become effective no sooner than April 1, 2008.⁷

2. PJM's Filing

13. PJM proposes to eliminate the Market Monitor's discretion to develop estimates of the CONE for combustion turbine and combined cycle generators by specifying these asset-class estimates in its tariff. PJM has revised section 5.14(h)(1) to state that the Net Asset Class CONE for a combustion turbine generator shall be \$61,726/MW-year, and for a combined cycle generator shall be \$84,826/MW-year. PJM states that

Although these cost estimates now will be stated in the tariff, PJM is not removing the tariff language, originating from the RPM settlement, which states how such estimates are to be determined.⁸

14. PJM states that these estimates are determined on a basis that is consistent with the methodology used to develop the cost of new entry value in RPM's variable resource requirement curve, with the only difference being reliance on a "year-one" cost of service method. For the combustion turbine generator, this value is taken directly from the 2005 study that was used to support the RPM cost of new entry. PJM's cost-of-new-entry witness in the RPM proceeding, Mr. Pasteris, estimated a "total levelized" cost for a representative new entry combustion turbine plant of \$72,207/MW-year. This levelized value is used in the RPM tariff, at section 5.10(a)(iv)(A) of Attachment DD, to set the CONE parameter in RPM's variable resource requirement curve. The corresponding "first-year" number also appears in Mr. Pasteris's 2005 Cost of New Entry Study. The 2006 value "represents the first year of plant operation revenue requirements," is \$61,726.1. PJM states that this is the same value the Market Monitor would use in implementing this provision on a discretionary basis.

15. PJM states that the \$84,826/MW-year estimate for a combined cycle generator similarly is a first-year estimate determined consistent with the methodology used to develop the cost of new entry in RPM. PJM states that Mr. Pasteris prepared this estimate for PJM, using a similar approach to his 2005 study for RPM, and provided the estimate to the PJM Market Monitor, who then relied on the estimate in the 2006 PJM State of the Market Report.

⁷ December 22 Order at P 115.

⁸ September 24 filing at 5-6.

16. PJM states that it is not proposing to insert in the tariff multiple locational values for each of the two asset-class cost estimates. The current tariff provision grants the Market Monitor discretion to determine these values separately by location, but, according to PJM, the purposes of this provision can be adequately served with single stated estimates for each class, rather than multiple estimates for each class by location. PJM argues that the value of having stated locational estimates in the tariff does not outweigh the administrative effort of the results varied by less than three percent.

17. Any offer that does not meet the criteria shall be subject to possible rejection. An offer that fails the stated criteria will automatically become subject to the other (unchanged) portion of section 5.14(h) requiring rejection of offers that fail a quantitative price-impact test, unless the market participant obtains the Commission's prior approval to use the offer.

18. PJM proposes to retain the currently effective rejection/replacement threshold as 80 percent of CONE for the applicable asset class, or if there is no applicable asset-class cost, 70 percent of CONE for the combustion turbine "reference resource." PJM also retains the provision that establishes that the price used in place of the rejected offer will be at a level equal to 90 percent of the estimated asset class cost, or if there is no asset-class estimate, 80 percent of the cost for the generally applicable net cost of new entry (i.e., that based on a combustion turbine).

19. PJM is also revising the language of other sections of the minimum offer price rule to ensure consistency with these changes.

3. Protests

20. Indicated Buyers argue that rather than comply with the Commission's directives, PJM has filed for changes to the RPM tariff sheets that eliminate Market Monitor participation. They argue that this was not required by the December Order. Moreover, they argue, PJM's proposed changes will substantially alter the Settlement as negotiated by the parties and approved by the Commission. With regard to the minimum offer price rule specifically, they propose alternative tariff language that, in their view, would ensure that the Market Monitor does not have discretion to determine whether a seller's bid is cost-justified, and instead bids that fall below the objective criteria of the tariff shall be replaced with a price determined by the parameters set forth in the Tariff.

21. Similarly, Chambersburg and the Virginia Commission argue that PJM seeks to eliminate the Market Monitor's role altogether, as described in significant detail in Indicated Buyers' protest. They argue that the Commission policy is clear that compliance filings are restricted to compliance with specific directives in Commission orders. They state that PJM's proposed modifications to the settlement not only

impermissibly go well beyond the requirements of the December 22 Order, but also eliminate a crucial benefit negotiated by representatives of load-serving interests consumers in the settlement process and thus significantly alter the balance of supplier and buyer interests reflected in the as-filed and generally approved settlement.

4. Commission Ruling

22. The Commission accepts PJM's compliance filing proposing to replace the Market Monitor's discretionary determination of the Net Asset Class Costs of New Entry with a bright-line test to establish clearly in the tariff the level at which a new entry offer would be rejected because it is too low. This elimination of discretion in the calculation of an input to the Market Monitor's discretionary review of offers under the minimum offer price rule complies with the directive of our order.⁹ As we stated in the June 25 Order, the Market Monitor should not be allowed "to use its sole judgment to determine inputs that can ultimately set the market clearing price." In our June 25 Order, we directed PJM to propose changes "that would eliminate the Market Monitor's discretion and would substitute objective criteria." We emphasized that the tariff should "remov[e] the discretion granted to the Market Monitor." The compliance filing does exactly that. Indeed, Indicated Buyers, Chambersburg and the Virginia Commission do not argue that PJM has failed to meet the Commission's directives to eliminate the discretion granted to the Market Monitor. To the contrary, protestors argue that PJM has gone too far, stating that the Commission envisioned some ongoing role for the Market Monitor. However, our order did not require PJM to retain some ministerial role for the Market Monitor after its discretionary role has been eliminated. Moreover, protestors have not explained what role they are proposing for the Market Monitor that would avoid giving the Market Monitor either impermissible discretion or unnecessary and inefficient ministerial duties.

23. In addition, protestors provide no evidence that the numbers PJM proposes to include in the tariff for the CONE estimates for combustion turbine and combined cycle generators do not accurately reflect the costs of new entry; they object only to stating those figures in the tariff. In fact, the levels PJM proposes for the two asset classes are the same the Market Monitor currently would use for its analysis under the minimum offer price rule. The combustion turbine number was expressly stated in the study supporting the CONE value PJM uses for the variable resource requirement curves in the RPM auctions; and the combined cycle number is taken from the Market Monitor's 2006

⁹ We note, further, that the tariff provisions governing the responsibilities of PJM's market monitor may need to be modified upon resolution of the Commission's Notice of Proposed Rulemaking, Wholesale Competition in Regions with Organized Electric Markets, 122 FERC ¶ 61,167, 73 Fed. Reg. 11003 (2008).

State of the Market report. We find that stating these numbers in the tariff enhances transparency and predictability, and ensures that all stakeholders are protected when changes to these numbers are proposed, since such changes will require a section 205 tariff filing.

24. In their protest, Indicated Buyers provide to the Commission Tariff revisions proposed by the Market Monitor, and urge the Commission to accept such revisions in place of those proposed by PJM. However, in the June 25 Order, we made it clear that, as here, where there was no consensus in stakeholder discussions, “PJM, as a public utility, needs to satisfy the conditions of the December 22 Order by filing to amend its [T]ariff. . . .” PJM’s filing conforms with the Commission’s regulations, which state that an “[RTO] must have exclusive and independent authority under section 205 of the Federal Power Act (16 U.S.C. 824d), to propose rates, terms and conditions of transmission service provided over the facilities it operates,” and that an RTO “must administer its own transmission tariff.” In this case, and in light of the lack of consensus in stakeholder discussions, PJM properly filed the compliance filing, which reflects its determination of how best to comply with the Commission’s directives. We find that PJM’s resolution of the problem of excessive discretion granted to the market monitor is just and reasonable.

25. With regard to the protesters’ arguments that PJM’s compliance filing deviates from the RPM settlement and alters the settlement’s balance of benefits between suppliers and buyers, we note that the Commission already considered this question in its June 25 Order on rehearing of the December 22 Order accepting the settlement. In our June 25 Order, we denied Indicated Buyers’ request for rehearing of our directive to remove the Market Monitor’s discretion,¹⁰ stating that “as we found in the December 22 Order, those provisions still leave the Market Monitor with discretion. . . . Instead of relying on the Market Monitor’s discretion, objective criteria should be developed for use in such instances so that predictable results will emerge.”¹¹ We then stated:

¹⁰ See Indicated Buyers’ request for rehearing of the December 22 Order at 16 (the Commission’s ruling regarding the Market Monitor’s discretion is “but one example of modifications to the Settlement Agreement where the Order has unreasonably upset the balance of benefits and burdens reached by the Settling Parties In order to restore the balance reached in the Settlement Agreement, and retain a just and reasonable capacity market model, Indicated Buyers urge the Commission, on rehearing, to approve for implementation the RPM Settlement Agreement . . . as filed”).

¹¹ June 25 Order at P180.

As to Indicated Buyers' point that the objective criteria required by the Commission should be developed in a stakeholder process, we agree and clarify our December 22 Order accordingly. . . . [W]e expect the modifications required by our Order to use the stakeholder process to arrive at consensus results on these issues, if possible. *If, however, no consensus is possible, PJM, as a public utility, needs to satisfy the conditions of the December 22 Order by filing to amend its tariff by removing the discretion granted to the Market Monitor.*¹²

26. The Commission thus made clear that, if the stakeholders could not find a mutually agreeable way to remove the Market Monitor's inappropriate discretion, we would require PJM to make a unilateral filing. No party sought rehearing of this determination. As discussed above, the stakeholder process did not produce a consensus, and PJM has now complied with the Commission's directive by unilaterally filing new tariff provisions which eliminate the inappropriate discretion granted to the Market Monitor in the settlement. The Commission will not, therefore, revisit the question of the appropriate amount of discretion granted to the Market Monitor, which was settled in its December 22 and June 25 Orders.

B. New Entry Mitigation

1. The Commission's Directive

27. The original RPM filing deemed new entry competitive and exempted it from offer-capping. The RPM settlement, however, introduced the possibility of mitigation of new entry offers, providing that new entry offers that met certain screens would be reviewed by the Market Monitor, who would determine, based on stated factors, whether the offer was competitive, or whether it should be capped at a percentage of the administratively determined CONE.

28. The relevant section 6.5(a)(ii)(C) of Attachment DD of the PJM tariff states:

Where the two conditions stated in Paragraph (B) are not met, or the Sell Offer is pivotal, the Market Monitoring Unit shall (1) compare each such Sell Offer to Sell Offers submitted in other LDAs (with due recognition for locational differences) and to the Cost of New Entry for the LDA in which the offer otherwise would clear and

¹² *Id.* at P 181, emphasis added.

other LDAs (with due recognition for locational differences); (2) evaluate potential barriers to new entry on the basis of interviews with potential suppliers and other market participants; and (3) determine (subject to the procedures in section 6.2(c) of this Attachment), based on that analysis, whether to reject such Sell Offer as non-competitive. Following the conduct of the applicable auction and before the final determination of clearing prices, in accordance with Section 6.2(b) above, the Market Monitoring Unit shall notify a Capacity Market Seller whose Sell Offer is deemed non-competitive and allows such Capacity Market Seller an opportunity to submit a revised Sell Offer. The Office of the Interconnection then shall clear the auction with such revised Sell Offer in place if the Market Monitoring Unit determines that such revised offer is competitive in accordance with the above criteria. If the revised Sell Offer is not deemed competitive, it will be rejected.

29. In the December 22 Order, the Commission objected that this approach required the Market Monitor to “use discretion,” and also expressed further concern that the Market Monitor could employ similar discretion to reject an alternative offer submitted by a seller after the Market Monitor rejects the first offer.

2. PJM's Filing

30. PJM states that it is revising section 6.5(a)(ii)(A) of the tariff to eliminate the statement that new entry offers “may be rejected if found by the [Market Monitor] not to be competitive in accordance with the criteria and procedures” stated in the tariff, and replacing it with the statement that a new entry offer “shall be rejected if it meets the criteria” stated in the tariff, unless the prospective seller obtains the Commission's approval for use of such offer prior to the deadline for submission of such offers in the applicable auction. PJM is also revising section 6.5(a)(ii)(C) to remove the current description of a process in which the Market Monitor analyzes whether a new entry offer is competitive based on other factors (other indications of the cost of new entry and potential barriers to entry) and replace this process with a test under which a new entry offer is rejected if the offer price is greater than 140 percent of a comparative calculation of the cost of new entry, based on factors enumerated in the tariff.

3. Protests

31. The Indicated Buyers argue that the Commission directed only that PJM develop objective criteria to be applied by the Market Monitor, not that the Market Monitor be eliminated from the RPM process altogether. As an alternative, they propose that instead

of making a final determination that the offer is non-competitive, the Market Monitor will make a recommendation to the Commission that the offer is non-competitive.

32. PJM in its answer states that under the approach proposed by the Indicated Buyers, it is not clear what manner of Commission proceeding the Market Monitor's new-entry recommendation would require. PJM states that this does not appear to be a Market Monitor referral to the Commission, for which the Commission might open a confidential investigation. Rather, argues PJM, it seems to be a formal proposal for affirmative relief—rejection of a sell offer—on an expedited basis prior to an RPM auction. According to PJM, the relative roles and burdens of the Market Monitor, the affected seller, and PJM are unspecified, and there is no applicable Commission precedent to illuminate the parties' rights following such a recommendation. Moreover, argues PJM, protestors' proposal requires the Commission's intervention in the RPM auction process every time the Market Monitor finds a new entry offer noncompetitive, which would be administratively cumbersome, a drain on the Commission's resources, and an undesirable level of regulatory agency involvement in the details of what is intended to be a self-implementing auction process. Protestors' proposal also seems necessarily to require delay in closing the RPM auction until after the Commission acts on the Market Monitor's recommendation.

33. PJM argues that under the approach contained in the compliance filing, the Commission's involvement is likely to be very limited. New entry offers will be rejected only if they exceed 140 percent of a comparative calculation of the cost of new entry, based on offers from similar new generators, if available, or based on the applicable net cost of new entry. The Commission will become involved only if a proposed new entrant wishes to submit an offer exceeding that threshold. PJM adds that the risks of unfavorable or untimely Commission action on such a filing fall solely on the seller proposing a non-conforming offer; no RPM auctions need be delayed to accommodate a seller seeking such relief.

4. Commission Ruling

34. The Commission approves PJM's proposed revision. Under that proposal, the new entry offers will be rejected based on the criteria stated in the tariff, instead of requiring the market monitor to decide whether each such new entry offer is competitive. PJM's approach retains flexibility, however, by allowing a capacity seller that believes its offer is justified even though the offer will likely exceed the threshold to obtain Commission approval to use the offer prior to the relevant RPM auction. The burden in such a filing clearly would be on the seller seeking to depart from the tariff. PJM's proposal also moots the related area of concern cited in our prior orders, i.e., the Market Monitor's discretion to reject alternative bids. Under PJM's proposal, if a seller's offer exceeds the

threshold, it is rejected, and the only substitute offer the seller may submit is one that does not exceed that threshold.

35. Moreover, under PJM's approach, the Commission's involvement is likely to be very limited. New entry offers will be rejected only if they exceed 140 percent of a comparative calculation of CONE. The Commission will become involved only if a proposed new entrant wishes to submit an offer exceeding that threshold. The risks of unfavorable or untimely Commission action on such a filing fall solely on the seller proposing a non-conforming offer; no RPM auctions need be delayed to accommodate a seller seeking such relief.

36. By contrast, the protestors' proposed alternative approach, as originally proposed by the Market Monitor, includes no additional objective criteria or clearly-stated tests. Rather, their proposal preserves, unchanged, the discretionary process in which the Market Monitor compares submitted new entry offers with other indications of the cost of new entry (with far less specificity than proposed in PJM's bright-line test), evaluates potential barriers to entry based on interviews with potential suppliers and other market participants, and then comes to a conclusion, based on that analysis, whether the offer is non-competitive. This approach would do nothing to temper the excessive discretion that the Commission previously found to be granted to the Market Monitor by the settlement.

37. We also note that none of the protestors take issue with PJM's net asset class of new entry cost estimates or the proposed methodologies to evaluate new entry offers. No party has asserted that PJM's estimates are not just and reasonable. Similarly, no party has opposed PJM's proposed methods for evaluating new entry offers, which reflect an unopposed proposal from stakeholder discussions. Therefore, the Commission will approve PJM's proposal, and reject the protestors' alternative approach.

C. Default Avoided Cost Rates

1. The Commission's Directive

38. Under RPM, PJM uses a preliminary screen to determine if a specific Locational Delivery Area (LDA) is likely to become subject to offer capping. Sellers in those LDAs must provide the Market Monitor two months in advance of the auction with calculations of the caps that would apply to their particular resources if the LDA is ultimately subject to offer capping. However, if a seller agrees to commit to certain default levels, it is not required to provide these calculations to the Market Monitor. The default bids which are intended for use only in situations where an LDA market is not competitive, are intended to approximate, as closely as possible, what a resource's going-forward or avoidable costs would be – i.e., the costs that a resource does not incur if it is not required to maintain its capacity in such a way as to enable it to participate in energy and ancillary services

markets. As originally proposed at section 6.7(c),¹³ the Market Monitor would have discretion to develop default bids, based on its estimate of avoidable costs, for each class of generators.

2. PJM's Filing

39. PJM proposes to revise this section to remove the Market Monitor's discretion to develop the default avoidable cost rate rates, and instead will state these rates in the tariff. PJM states:

As is done currently, sellers committing to a default offer will conform the cost portion of their offers to these stated amounts, and then offset those generic asset-class cost levels with a calculation of the projected revenues the specific resource is expected to receive in the PJM energy and ancillary service markets. As is done today, the Market Monitor will verify that such projection is made in accordance with the tariff, which provides that such projection must equal the average of actual revenues received by the specific unit at issue over a specified historic period. This required adherence to averages of actual historic revenues avoids the discretion that might otherwise be associated with making a projection of future revenues.¹⁴

PJM states that it is adding the default avoidable cost rates in a table at the end of section 6.7(c).

40. PJM notes that it is calculating these default avoidable cost rates in the same manner as that previously used by the Market Monitor, with one exception. The default avoidable cost rates were based on assumptions as to the various costs for each type of asset (coal, nuclear, combustion turbine, etc.).¹⁵ For each such cost category, the market

¹³ See proposed Section 6.7(c), Attachment DD, PJM Tariff.

¹⁴ September 24 filing at 14, footnotes omitted.

¹⁵ Those costs include operation and maintenance, maintenance, administrative expenses, variable expenses, taxes, fees and insurance, carrying charges, corporate level expenses, and project investment cost recovery for each of the twenty different asset classes. These estimates also include "all pertinent plant parameters, detailed staffing estimates, and all pertinent assumptions underlying estimates of such items as fuel inventories and plant investment." September 24 filing at 14-15.

monitor assumed that the resource was mothballed for one year. Under this approach, the assumption is that the resource must be maintained in a state that allows it to be placed back in service after a year, so that certain costs are not "avoidable." By contrast, PJM assumes that the resource is permanently retired, under which assumption all costs are assumed to be avoidable.

41. PJM states that it made this choice because (a) the avoidable cost rate formula used in RPM was patterned on, and is almost identical to, the deactivation avoidable cost rate formula in section 115 of PJM tariff, which assumes permanent retirement of the resource; (b) the formula references property taxes, which could not be avoided if the formula assumed mothballing, and (c) to interpret the formula as contemplating only mothballing also would create problems in the reliability planning process, and would bring about undesirable incentives for resources to seek reliability-must-run (RMR) agreements. PJM states that, for reliability purposes, it is necessary to assume that a unit that is unavailable has been permanently retired. As to the problem regarding RMR agreements, PJM states that if the RPM formula is interpreted in such a way that it always will produce lower compensation than the generation deactivation formula, sellers would have an incentive to announce retirement and seek generation deactivation credits. According to PJM, assuming mothballing under the RPM formula and retirement under the deactivation formula would have exactly that effect.

3. Protests

42. Indicated Buyers again argue that in order to comply with the Commission's directives regarding this provision, PJM needed only to address the Market Monitor's discretion in calculating the avoidable cost rates. Indicated Buyers assert that this could be achieved by allowing the Monitor to determine avoidable cost rates every year, but then file those avoidable cost rates every year with the Commission; or by working with stakeholders to develop objective criteria to be used by the Market Monitor in establishing the avoidable cost rates. The Indicated Buyers argue that PJM should not have eliminated the Market Monitor's role in calculating the avoidable cost rates.

43. Chambersburg argues that PJM's proposed changes to the avoidable cost rate provisions in the tariff are not mere clarifications of the tariff, but significant modifications to the bargain negotiated by the parties and approved by the Commission in the December 22 Order. Chambersburg states that PJM's proposed modifications, while discussed in stakeholder meetings in PJM, did not receive consensus support, especially from stakeholders representing consumer interests. Chambersburg states that the Commission should therefore reject PJM's unilateral attempt to revise significant elements of a settlement that it agreed to just one year ago and that the Commission largely approved in December 2006.

44. In addition, Indicated Buyers disagree with PJM's proposal to assume, for purposes of determining the percent of the costs in certain categories that are avoidable, that a unit is not mothballed but rather is retired. Indicated Buyers state that PJM's proposal will result in all of the costs in the appropriate categories being avoidable, as opposed to only a percentage based on the assumption that the unit would return to service after one year; thus, the practical impact of PJM's unilateral change will be higher default bids (since the default bid consists of avoidable cost calculations), and potentially higher capacity payments by customers.

45. Indicated Buyers further argue that PJM's proposal is flawed because PJM is using assumptions appropriate to the deactivation avoidable cost rate calculation, which is applicable only to retiring generators, to set the default bid that will be used by all manner of resources, the majority of which are not at risk of retirement. Therefore, Indicated Buyers argue, the avoidable cost rate calculation in RPM, if based on a retirement assumption, will result in an incorrect calculation of avoidable or going-forward costs for the majority of resources.

46. Indicated Buyers also state that PJM's attempt to tie the avoidable cost rate calculation to planning does not justify its retirement assumption proposal. According to Indicated Buyers, PJM's argument would only be correct if the use of a mothballed assumption for avoidable cost rate purposes resulted in the transmission planning process ignoring a resource that does not clear, but that this is not the case: the basis of determining a competitive offer under RPM and prudent action for transmission planning are not linked in RPM. Indicated Buyers also disagree with PJM's proposition that generators will have the incentive to seek RMR contracts because the mothball assumption would result in lower generator compensation than the generation deactivation formula. They argue, first, that if the generator truly intends to retire a unit and believes that the RPM avoidable cost rate is insufficient, then it should legitimately pursue generator deactivation. Second, if the perverse incentive cited by PJM is a reality, it would mean that a unit that does not truly intend to retire and is perhaps economic depending on where the market clears would seek RMR status in search of a higher price cap, even though doing so puts the unit in the position of seeking retirement. Indicated Buyers argue that even if there is merit to PJM's claim that a mothball assumption for the RPM avoidable cost rate would result in increased RMR contracts (which they claim has not been proven), the solution is not a systematic inflation of all offer caps in a manner inconsistent with the opportunity costs of nearly every resource.

47. Indicated Buyers are also concerned that in the past RPM auction PJM may have calculated the avoidable cost rate based on an assumption that the unit is retired. They ask the Commission to institute an investigation, *sua sponte*, into this matter.

48. PPANJ joins Indicated Buyers' protest and also argues that PJM's proposed retirement assumption results in higher avoidable costs and higher bid caps, and, as a likely result, higher RPM clearing prices.

49. In its answer, PJM objects to Indicated Buyers' proposal to allow the Market Monitor to determine avoidable cost rates and to file these with the Commission. PJM states that it is not clear what manner of filing this would be, or what rights would be afforded to objecting parties. PJM notes that the Market Monitor is not a public utility, has no tariff, and has no right to submit filings under section 205.

50. With regard to Indicated Buyers' request to start an investigation to determine whether application of PJM's tariff interpretation to non-default avoidable cost rates violated PJM's tariff, PJM argues that this request is procedurally defective and that Indicated Buyers should have filed a separate complaint. On the merits, however, PJM argues that it has not compelled the Market Monitor to abandon his mothballing interpretation and adopt PJM's retirement interpretation for purposes of the recent RPM auction. To the contrary, the default avoidable cost rates currently posted by the Market Monitor, and effective for all RPM transition auctions, reflect his mothballing interpretation. Accordingly, argues PJM, the Commission should reject the Indicated Buyers' improper demand for an investigation.

51. Rockland disagrees with the protesting parties that the December 22 Order requires PJM to eliminate the Market Monitor's ability to consider supporting data before rejecting bids from load-serving entities subject to the minimum offer price rule that are below 70-80 percent of the Net Asset-Class Cost of New Entry. Rockland submits that allowing the Market Monitor to consider the data on the actual costs and revenues for each supply resource, does not constitute "excessive discretion," if the acceptable cost and revenue categories are clearly delineated. Rockland argues that PJM proposes to maintain the Market Monitor's authority to verify and reject bids by suppliers not subject to the minimum offer price rule. In addition, Rockland believes that the RPM Settlement allows load serving entities subject to the minimum offer price rule to submit zero bids for baseload units that require more than three years for development, but does not specify that such units may not include gas-fired combined cycle plants. Rockland believes that combined cycle resources constitute baseload resources eligible to bid at zero, and that a Net Asset-Class CONE is, therefore, not necessary.

4. Commission Ruling

52. For generators that choose not to provide unit-specific cost data, the RPM settlement provided that the Market Monitor would determine the default avoidable cost rates for each asset class "in its discretion," and also would determine which asset classes were not likely to include the marginal price-setting resource. In our past orders, we

identified the Market Monitor's discretion to determine such default avoidable cost rates as one of the areas that needed to be replaced with objective criteria that would lead to predictable results. PJM proposes to resolve this problem simply by stating the default avoidable cost rate levels in PJM's filed tariff.

53. The Commission endorses PJM's approach, which clearly establishes objective criteria in the tariff. The tariff rates will remain in effect, and can be relied on by market participants as part of the filed rate, unless and until changed. And if there is a need to change any of the default asset-class avoidable cost rates in the future, they may be changed only through a tariff-change filing, with all of the well-established protections such a filing affords to interested parties.

54. By contrast, the Market Monitor proposed, and the Indicated Buyers endorse, that the Market Monitor should continue his discretionary determination of new avoidable cost rates every year, but then file those avoidable cost rates every year with the Commission. It is not clear what manner of filing this would be, or what rights would be afforded to objecting parties. As PJM stated earlier, the Market Monitor is not a public utility, has no tariff, and has no right to submit filings under section 205. We also note that the Market Monitor will continue to play an important role in market power mitigation in the RPM auctions. RPM generally requires sellers in areas that fail a preliminary market structure screen to supply, well in advance of the RPM auction, detailed cost information for their resources, to allow the Market Monitor time to verify that resource-specific caps are calculated appropriately and in accordance with the tariff's rules. This process ensures that offer caps can be correctly applied if required by application of the final market structure screen to the offers submitted in the auction. This procedure is left intact.

55. While Chambersburg suggests that PJM's proposed revisions would leave suppliers without adequate protections, it fails to recognize that the Commission's review of the rates and procedures set forth in the compliance filing will provide a clear check against any attempted exercise of market power. The compliance filing reflects PJM's reasonable interpretation of the Commission's directives for PJM to "remove" and "eliminate" the impermissible discretion afforded to the Market Monitor and should be accepted. Indeed, by setting forth clear parameters to be applied, PJM's proposed revisions provide all market participants with the certainty required for efficient market operations.

56. However, we find that PJM has not shown that its specific proposal is based on a just and reasonable estimate of a generator's expected competitive offer to supply

capacity. As we stated previously,¹⁶ mitigation of market power under RPM relies on the concept of avoidable cost as the basis for mitigating non-competitive offers from existing resources. Just as marginal cost is used as a measure of a competitive bid in mitigating in the energy markets, avoidable cost is a good measure of a competitive bid for bid mitigation in the RPM forward capacity markets. A competitive seller of capacity is expected to bid its going-forward costs, i.e., the fixed annual operating expenses that would not be incurred if a unit were not a capacity resource for a year.

57. The purpose of setting a generic default bid is to enable all generators to choose that bid in lieu of submitting specific cost information for their individual plants. The default bid therefore should attempt to reflect a competitive bid submitted by the widest range of generating units. PJM's proposal, however, would set the default bid based on an assumption that the generator would retire if it were not included in RPM. But PJM has not provided evidence that most generators in PJM would be expected to retire. A default value developed on that assumption, therefore, would seem to overstate the avoidable costs of the majority of PJM's capacity resources, and potentially to significantly overstate them. PJM, therefore, has not sufficiently justified its proposed default rate based on the retirement assumption, and PJM will need to make a further compliance filing that either retains the retirement assumption and demonstrates why it is just and reasonable, or provides an alternative just and reasonable proposal.

58. Therefore, the Commission finds that PJM's approach, which removes the Market Monitor's discretion to develop the default avoidable cost rate rates, and instead states these rates in section 6.7(c) of Attachment DD to the tariff, is just and reasonable. We will, however, require PJM, within 60 days of the date of this order, to become effective 60 days after the date of that filing, to make a further compliance filing, in which PJM must either demonstrate why use of the retirement assumption is just and reasonable as the basis for the rates in the tariff, or propose rates in the tariff based on a different assumption and demonstrate use of that assumption is just and reasonable. The Commission recognizes that this timeframe will not permit PJM to implement the changes in section 6.7(c) in time for the May auction. As a result, the current version of section 6.7(c) will remain in effect until the Commission accepts this second compliance filing.

59. With regard to Rockland's argument that a capacity market seller that submits an offer which fails the objective thresholds should be permitted to justify its offer to the PJM Market Monitor, we note that our December 22 Order expressly directed PJM to eliminate the Market Monitor's discretion to determine whether a seller can adequately

¹⁶ June 25 Order at P 138.

cost-justify an offer that fails the tariff's objective criteria. The December 22 Order highlighted, as one of the areas of excessive discretion, the RPM settlement provision that allows a seller whose offer "fall[s] below certain objective criteria that would otherwise require rejection of the bid" an opportunity "to cost-justify its bid," and then leaves to "the Market Monitor's judgment" whether the seller has "provide[d] satisfactory justification." Therefore, we have already rejected what Rockland now seeks, i.e., an opportunity for a seller that submits an offer that does not comply with the tariff criteria to convince the market monitor, in its discretion, that the seller's offer should be accepted nonetheless.

60. Rockland also argues that the existing provision (unchanged by PJM's filing) allowing a zero-price offer from base load resources, such as nuclear, coal, and integrated gasification combined cycle, that require a period for development greater than three years, categorically includes all combined cycle generators. On this basis, Rockland objects to PJM's proposal in the compliance filing to specify a non-zero price for the combined-cycle asset class. The Commission need not interpret, in this compliance filing case, the unchanged provision of the minimum offer price rule referencing "base load" resources. That existing provision allowing zero price offers under certain circumstances already states that it applies regardless of the specification of particular non-zero prices for particular asset classes.

The Commission orders:

(A) The Commission accepts PJM's filing, subject to conditions listed in Paragraph (B) below, effective April 1, 2008.

(B) PJM is required to submit a compliance filing, within 60 days of the date of this order, to become effective as of 60 days after the compliance filing, making the changes in section 6.7(c) of Attachment DD to the tariff, as discussed in the body of the order. Until the Commission acts on PJM's compliance filing, the existing version of section 6.7(c) will remain in effect, as discussed in the body of the order.

By the Commission. Commissioner Kelly concurring with a separate statement attached.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.

Docket Nos. ER05-1410-006
EL05-148-006

(Issued March 21, 2008)

KELLY, Commissioner, *concurring*:

This order addresses, among other things, a proposal offered by PJM Interconnection Inc. (PJM) to develop default Avoidable Cost Rates in the Reliability Pricing Model (RPM). In developing these rates, PJM proposes to assume that the resource is permanently retired, whereas the Market Monitor assumed that the resource was mothballed for one year. Indicated Buyers have argued that the tariff language implementing RPM implies that the calculation of the default Avoidable Cost Rates should be based on the mothballing assumption. I have found this argument persuasive and support the order's finding that PJM has failed to sufficiently justify its proposal and requiring PJM to demonstrate why its use of the retirement assumption is just and reasonable. I would encourage PJM to consider the use of the mothballing assumption in the formulation of its compliance filing.

For these reasons, I respectfully concur with this order.

Sudeen G. Kelly