

124 FERC ¶ 61,065
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C.

Docket Nos. ER05-1410-007
EL05-148-007

ORDER CONDITIONALLY ACCEPTING COMPLIANCE FILING

(Issued July 18, 2008)

1. In this order, the Commission accepts, subject to conditions, a compliance filing by PJM Interconnection, L.L.C. (PJM) concerning the use of avoided cost rates for default bids in PJM's Reliability Pricing Model (RPM) program. We also require a further compliance filing.

I. Background

A. Use of Avoided Cost Rate Bids in RPM

2. As discussed extensively in our June 25, 2007 order and prior orders in this proceeding,¹ 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 Subsequently, the Commission approved a capacity market under which capacity sellers would offer, and PJM would purchase, capacity on a multi-year forward basis through an auction mechanism. Under RPM, the offers submitted into each locally defined market

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 (2006) (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.

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). On December 22, 2006, the Commission approved the RPM settlement.³

3. The Commission found, however, that the settlement granted excessive discretion to PJM's Market Monitoring Unit (MMU) in certain areas. The RPM settlement provided criteria to determine when the bids of resources in a particular location might potentially be subject to mitigation, due to the possibility of market power abuse in that location. If the MMU finds that bids must be mitigated, a resource can either (a) go forward with its bid, if it provided financial data regarding its actual costs to the MMU, or (b) accept a default bid developed by the MMU, based on the class of the resource (coal, nuclear, combustion turbine, etc.), which will replace its actual bid.⁴ Because the Commission was concerned that, in developing these default bids, the MMU might exercise excessive discretion, it ordered PJM to replace the discretionary provisions with objective factual criteria to be used in developing or reviewing default bids.⁵

4. In its compliance filing, made on September 24, 2007, PJM proposed to amend its tariff to remove the MMU's discretion to set default rates altogether, and placed a default bid for each class of resource in its tariff. PJM stated that it had developed these default bids in the same manner that the MMU had developed default bids previously, with one exception. The MMU had based its determination of avoidable costs on the assumption that the resource involved would be mothballed for a single year, but must be maintained in a state that allows it to be placed back in service, so that certain costs are not avoidable. PJM, instead, assumed that the resource would be permanently retired, so that all of its costs would be avoidable for the future. Use of the retirement assumption is, therefore, likely to result in higher default bids than use of the mothball assumption.

5. In an order issued on March 21, 2008,⁶ the Commission accepted PJM's proposal to establish default bid rates in its tariff. The Commission found, however, that PJM had not justified its use of the retirement assumption:

³ See December 22 Order, 117 FERC ¶ 61,331 at P 1.

⁴ The default bids 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 will 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.

⁵ *Id.* P 115.

⁶ *PJM Interconnection, L.L.C.*, 122 FERC ¶ 61,264 (2008) (March 21 Order).

[M]itigation of market power under RPM relies on the concept of avoidable cost as the basis for mitigating non-competitive offers from existing resources. . . .

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.⁷

6. The Commission therefore required PJM to make a further compliance filing that would either retain the retirement assumption and demonstrate why that assumption is just and reasonable, or provide an alternative just and reasonable proposal.

B. PJM's Compliance Filing

7. PJM submitted the instant compliance filing on May 20, 2008. It states that it and its stakeholders have chosen to provide an alternative proposal, rather than to support PJM's previous proposal.

8. PJM's new compromise proposal incorporates two sets of default bids in its tariff: one based on the mothball assumption, the other incorporating the retirement assumption.⁸ PJM states that the one-year mothball assumption will apply to all sellers and all generating units, unless a seller submits to PJM and the MMU a written, notarized

⁷ *Id.* P 56-57.

⁸ PJM states that the two sets of rates are the same as those included in its September 24th filing (in which PJM filed the bids incorporating the retirement assumption, but also presented the bids incorporating the mothball assumption for informational purposes), although the rates incorporating the mothball assumption have been adjusted for annual inflation.

statement from one of its corporate officers that the seller intends to retire its resource if it does not receive at least the applicable retirement avoided cost rate during the relevant capacity delivery year.

9. PJM notes that the proposal seeks to implement the Commission's view that the mothballing approach would be more appropriate for the majority of PJM's capacity resources, but also enables the use of the retirement assumption in cases where a resource would genuinely be retired, absent that higher default rate. PJM asserts that requiring the use of default bids incorporating the mothballing assumption may encourage resources to retire. PJM states that the generation deactivation credits provided elsewhere in the PJM tariff⁹ are designed using the retirement assumption. If all default bids incorporated the mothball assumption, a resource owner would be forced to choose between keeping its unit in service and accepting a default bid based on the mothballing assumption, or retiring its unit and receiving deactivation credits based on the retirement assumption, which would provide that owner with greater financial compensation. Thus, PJM states, so as not to provide a unit with a greater incentive to retire than to accept a default bid for its capacity, units that are genuinely on the cusp of retirement should be able to obtain a default bid predicated on the retirement assumption.

10. PJM further states that its proposed test for the election of a retirement default bid provides adequate assurance that such bids will only be used when warranted. PJM states:

If a corporate officer submits a sworn, notarized statement, it is reasonable to conclude that the company does indeed intend to retire the unit if it does not receive a rate as high as the retirement [default bid]. Given the evolution of the Commission's enforcement and penalty regime, including recent clarifications, PJM is confident that the requirement of a sworn statement, signed by an officer of the company, will deter any effort to misrepresent a company's intention regarding the retirement of a unit. PJM will not hesitate to refer an inquiry to the Commission's Office of Enforcement if it sees evidence that this rule is being abused. Furthermore, if the PJM Market Monitor suspects that a false statement was provided, he has the right to refer the matter to the Commission's staff.

⁹ Generation deactivation credits are used to compensate Reliability Must Run (RMR) units, which receive a special rate as an incentive to those units not to retire.

Moreover, even if it is conceivable that someone might submit a false sworn statement in other circumstances, that is less likely here. In this case, the only gain from a false statement is that the company avoids providing the data necessary to support an avoidable-cost calculation for its specific unit. In other words, submitting a false statement is not the Market Seller's only means of obtaining a higher [default bid]. It always has the option of submitting its own . . . calculation of avoidable costs. Thus, the potential exposure and liabilities from submitting a false statement would greatly outweigh the potential gain from submitting a false statement.¹⁰

11. Notice of PJM's compliance filing was published in the *Federal Register*, with motions to intervene, notices of intervention, comments and protests due by June 10, 2008.¹¹ American Electric Power Service Corporation filed a timely request to intervene, and Dayton Power and Light Company filed a motion to intervene out of time. Indicated Customers (the Maryland Public Service Commission, the District of Columbia Public Service Commission and the Public Power Association of New Jersey) filed a timely protest. PJM filed a motion for leave to answer, and an answer to Indicated Customers' protest.

12. In their protest, Indicated Customers urge the Commission to reject any use of the retirement assumption. They state that the retirement assumption "is unnecessary and subject to abuse" and "provides too much temptation to those entities that have an incentive to economically withhold capacity to increase prices for the balance of their portfolios."¹² Indicated Customers argue that the only benefit of a default bid including the retirement assumption is that the seller avoids providing the data necessary to support the calculation of a bid specifically for its unit. Indicated Customers further state that, of more than 1,000 units (160,000 MW) presently on the PJM system, only five units (401 MW) have actually been retired in PJM since the first RPM auction 14 months ago, and since that time only five more units (523 MW) have submitted new requests to deactivate.¹³ Indicated Customers also state that, while it is likely that the number of retirements will increase in future RPM auctions, at best, "unless abused, this tariff

¹⁰ PJM May 20, 2008 compliance filing at 3-4, footnote omitted.

¹¹ 73 Fed. Reg. 31,855 (2008).

¹² Indicated Customers protest at 3.

¹³ *Id.* at 3.

provision would be a minor administrative convenience to very, very few generation resource owners."¹⁴ Indicated Customers further argue that a unit that is on the verge of retiring has undoubtedly already performed the calculation as to the benefits of retiring its unit and receiving deactivation credits, as well as the benefits of participating in RPM with a bid based on its specific unit costs, and presumably made its choice on that basis. Thus, Indicated Customers suggest that the option of receiving a default bid with the retirement assumption built into it is not necessary.

13. If the Commission accepts the default bids incorporating the retirement assumption, Indicated Customers ask the Commission to provide additional safeguards against abuse. They ask PJM to require the sworn, notarized statement made by resource owners to include a specific date by which the unit would be retired, absent the default bid incorporating the retirement assumption, and also to state specifically that absent this bid, the unit will be retired because its operation would be uneconomic. Indicated Customers also ask the Commission to require PJM to publish the number of units and MW in each location that use the retirement-based default bids, and to require the MMU to review each use of the retirement-based default bid and publish its opinion that the unit would be uneconomic without the higher payment.

14. In its answer, PJM states that, if any units could legitimately be entitled to the retirement-based default rates, including just one unit per auction as Indicated Customers allege, that would warrant offering such a rate as an option available for use by qualifying participants in the RPM auctions. PJM further argues that it would result in an unjust and unreasonable and punitive outcome to deny such a unit a rate that captures the full extent of the unit's legitimate avoided costs. PJM also states, however, that it would not object to the additional safeguards against abuse requested by Indicated Customers.

II. Discussion

A. Procedural issues

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214 (2008)), the notices of intervention and the timely-filed unopposed motions to intervene serve to make the entities filing them parties to this proceeding. The motions to intervene and to file a notice of intervention out-of-time are granted, given the early stage of the proceedings, the parties' interest and the absence of undue prejudice or delay.

¹⁴ *Id.*

16. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2008), prohibits an answer to a protest or an answer 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.

B. Analysis

17. We will accept PJM's filing, subject to the condition that PJM add the modifications discussed below, because it satisfies the requirements established by the Commission in its prior orders. As we indicated in our March 21 Order, the default bids must reflect competitive bids submitted by the widest range of generating units. Since the majority of PJM capacity resources are not actively pursuing retirement, a reasonable basis for calculating a competitive default bid is the mothball assumption, and we find PJM's proposal to use the mothball assumption generally appropriate. However, such a default bid could understate the costs underlying a competitive offer from a resource considering retirement. We agree with PJM that the addition of the default option for retiring units will increase their incentive for remaining available for the RPM auctions. We find that requiring generators to provide a notarized affidavit confirming their intention to retire is a reasonable verification measure.

18. While, as Indicated Customers maintain, a customer does have an option of submitting data to develop a unit specific offer, the purpose of developing the generic default bid was to eliminate the burden and cost of developing and reviewing unit specific bid data. Providing a generic bid option for a generator contemplating retirement, therefore, will provide that generator with similar bid options to those of other generators. As PJM points out, its generator deactivation provisions are established based on a retirement option, and providing a retirement option for default bids in RPM will provide an incentive for generators to keep units in service rather than choose to deactivate.

19. We find that the affidavit required by PJM, with the conditions required below, together with the Market Monitor and the Commission's ability to investigate the claims made in the affidavit is sufficient protection against abuse. Indicated Customers suggest, and PJM has agreed to implement, additional safeguards. In particular, Indicated Customers request that the unit owner be required to provide in its sworn statement additional information, such as the date on which the unit would be retired and a statement that "the unit would be retired because it would be uneconomic without the retirement" rates, so as to avoid the potential for abuse. Indicated Customers further request that the Commission require that PJM publish the number of units and the number of megawatts per Locational Deliverability Area that use the retirement default rates. We find that these additions to the PJM proposal are justified. Therefore, we will accept PJM's offer to implement them, and will request PJM to make a filing within 30 days of the issuance of this order to reflect these changes in its tariff.

20. In addition, Indicated Customers' request that the Commission require PJM's MMU to write and publish its opinion on whether a particular unit would be uneconomic without the higher retirement default ACR payment is unnecessary. As PJM has noted, the MMU already has the authority to inquire into any suspected abuse of PJM's market rules, and, if appropriate, refer any such abuse to the Commission's Office of Enforcement, in accordance with the Policy Statement on Market Monitoring Units.¹⁵ We will, therefore, not require PJM to insert this provision into its tariff.

The Commission orders:

(A) PJM's compliance filing is hereby accepted, subject to conditions, as discussed in the body of the order.

(B) PJM is required to make a compliance filing, as discussed above, within 30 days of the date of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

¹⁵ *Market Monitoring Units in Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,267 (2005).