UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.	)))))	**Docket Nos. ER05-1410-000, -010, -011** **EL05-148-000, -010, -011** **and ER09-412**

COMMMENTS OF THE
INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 211 of the Commission's Rules and Regulations, 18 CFR 385.211 (2008), Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM ("Market Monitor"), provides these comments on the proposed tariff revisions in the settlement agreement and offer of settlement filed by PJM Interconnection, L.L.C. ("PJM") on February 9, 2009 ("Settlement"). The Settlement (at 1) correctly identifies the Market Monitor as not opposed to the settlement.

The Market Monitor believes that some of the specific proposed revisions to the tariff, including, most notably, an increase to the Cost of New Entry, are necessary to ensure that PJM's capacity market operates effectively and efficiently. As discussed below, the Market Monitor has serious reservations about provisions in the settlement that set parameters for future discussions and filings about the development of an empirical basis for determining CONE. Despite these reservations, the filing parties do not request that the Commission rule on a specific empirical CONE proposal at this time, so the Market Monitor will refrain from full comment on this issue unless and until such a proposal has been filed.

I. COMMENTS

A. Net Cost of New Entry

1. Filed Revisions to CONE

The Market Monitor filed comments in this proceeding supporting PJM's proposal to adjust the gross Cost of New Entry ("CONE"), which PJM uses, net of revenues from the energy and ancillary services markets, to establish the Variable Resource Requirement ("VRR") Curve or demand curve used to clear the market for the portion of the capacity market subject to the Reliability Pricing Model ("RPM"). The settlement reduces the values for CONE included in Section 5.10(a)(iv)(A) of Attachment DD of the PJM Tariff by ten percent in the three respective CONE areas. If the sole basis for this reduction was that the parties had agreed to it, the Market Monitor could not support this reduction.

The CONE is a critical parameter for the design of the demand curve used in RPM and has an important influence on prices set in the Base Residual Auction. It is critical that the market price signals are accurate for RPM to work as intended. If RPM is to provide an incentive for new entry, the marginal price signal must be consistent with the actual cost of new entry. An artificial suppression of prices in RPM will likely result in billions of dollars of capacity payments without actually attracting new supply.

Lower prices benefit load in the short run but, if new entry does not occur, will result in reduced reliability and increased risks and costs in the long run. The use of a gross CONE value below the level based on current market analysis will ultimately harm the public interest in having the lowest possible long-run cost for wholesale electricity.

Lower prices also benefit existing suppliers. Suppliers who own existing assets receive billions of dollars in revenues, but such suppliers do not have an incentive to get prices right at the margin if they are not intending to build new units. The Market Monitor has concerns that the settlement process incents buyers and sellers to bargain on an acceptable price. A critical market parameter like CONE must be based on a reasoned process designed to reflect the current market value of new entry, if it is to work efficiently.

Despite the foregoing, the Market Monitor can support the CONE value resulting from this settlement because the Market Monitor has conferred with Ray Pasteris, President of Pasteris Energy, Inc., who was responsible for preparing the CONE values filed initially with RPM, who is an expert in this area and who has analyzed current market data. Based on this discussion, the Market Monitor has concluded that a 10 percent reduction from PJM's filed gross CONE is reasonably representative of current market conditions.

2. Empirical CONE

The settlement includes a serious effort by PJM and some of its stakeholders to develop an empirical CONE and it includes detailed design principles to guide the final empirical CONE ("Automated Net CONE Adjustment Procedure"). The Market Monitor has serious reservations about whether an attempt to develop an efficient process for determining CONE on an "empirical" or automated basis can be successful. It is essential that any method of calculating CONE determine an accurate price signal over the long run that reflects the actual current cost of new entry. Failure to do so will cause significant inefficiency. The principles in the settlement state that an upward or downward adjustment to net CONE will occur only if there has been a sustained excess or deficiency of capacity. Such an approach is questionable in light of the fact that requiring a sustained excess or deficiency forces the market to oscillate more rather than permitting a faster adjustment that accounts for the current cost of new capacity, regardless of whether there is a sustained excess or deficiency. The result is added risk and likely higher costs. This change would represent a fundamental modification to the RPM market design which assumed that gross CONE changes would reflect current market conditions for new generation.

II. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to these comments as it considers the settlement filed in this proceeding.

Respectfully submitted,

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Dated: February 23, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Eagleville, Pennsylvania,
this 23rd day of February, 2009.

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