

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Monongahela Power Company and)
Alleghey Energy Supply Company, LLC) Docket No. EC17-88-000
)
)

COMMENTS OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 211 of the Commission’s Rules and Regulations,¹ Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM² (“Market Monitor”), submits these comments on the request of FirstEnergy Corporation subsidiaries Monongahela Power Company (“Mon Power”) and Allegheny Energy Supply Company, LLC (“AE Supply” and, together “FE”) for authorization to transfer ownership (“Transaction”) of the Pleasants Power Station (“Pleasants”) on March 7, 2017.³ FE fails to demonstrate that the Transaction is in the public interest. The Transaction amounts to providing subsidies for an uneconomic unit, which, if approved, would harm the public interest in a well functioning PJM competitive market design.

It is essential to protect the PJM competitive market design from the harmful effects of subsidizing uneconomic decisions on market entry and exit. FE has itself recognized the

¹ 18 CFR § 385.211 (2016).

² Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff (“OATT”), the PJM Operating Agreement (“OA”) or the PJM Reliability Assurance Agreement (“RAA”).

³ The request is pursuant to Sections 203(a)(1)(A) and 203(a)(1)(D) of the Federal Power Act (“FPA”), 16 U.S.C. § 824b(a)(1)(A) and (D) (2012); 18 CFR Part 33.

same threat to the public interest in other contexts.⁴ FE has cited inadequate market prices as justification for receiving subsidies.⁵ The answer is to uniformly protect the competitive markets, and not to pursue a hopeless effort to offset one flawed scheme with another.

The Transaction is the result of a flawed RFP process, in addition to its flawed substance.

FE fails to show that the Transaction protects against affiliate preferences. The RFP process relied upon for that purpose does not meet the applicable principles. FE fails to show how the process meets the “fundamental objective” in *Ameren* (at P 69) that the selection process “ensure that wholesale customers receive the benefit of the marketplace, including an unbiased assessment of the full range of choices, whether the soliciting utility provides service at cost- or market-based rates.”⁶ The Transaction does not meet the four *Ameren* principles for evaluating competitive solicitations (transparency, definition, evaluation and oversight).⁷ Specifically, the RFP process fails the transparency and product

⁴ See, e.g., Request for Rehearing, Reconsideration, and Clarification of the FirstEnergy Companies, Docket No. ER13-535-000, et al. (June 3, 2013) at 1 (“As predicted in the FirstEnergy Companies’ prior pleadings in this docket, the results of the 2016/2017 Base Residual Auction (“BRA”) illustrate that the MOPR framework—as amended by PJM and the MOPR Order—permits units to offer and clear on an uneconomic basis. The result is depressed auction clearing prices. As the 2016/2017 BRA demonstrates, these depressed market prices are distorted even further when other market factors compound uneconomic entry.”) (“FE 2013 Request for Rehearing”).

⁵ *In the Matter of the Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Provide for a Standard Service Offer Pursuant to R.C. 4928.143 in the Form of an Electric Security Plan, Application, Ohio P.U.C. Case No. 14-1297-EL-SSO* (August 4, 2014), Direct Testimony of Donald Moul (“The economic viability of the Plants is in doubt. Market-based revenues for energy and capacity have been at historic lows and are insufficient to permit FES to continue operating the Plants and to make the necessary investments” (2:17–18); “Markets have not, and are not, providing sufficient revenues to ensure continued operation of the Plants” (3:5–6).) (“FE 2014 Moul Testimony at OPUC”).

⁶ *Ameren Energy Generating Co.*, Opinion No. 473, 108 FERC ¶ 61,081, at P 69 (2004) (*Ameren*).

⁷ See *Ameren* at P 12, citing in *Boston Edison Company Re: Edgar Electric Co.*, 55 FERC ¶ 61,382 (1991); at P 79 n.68, citing *Allegheny Energy Supply Company, LLC*, 108 FERC ¶ 61,082 (2004).

definition principles. FE does not meet its burden to demonstrate that the Transaction satisfies the evaluation and oversight principles.

The Transaction should not be approved.

I. COMMENTS

A. The Transaction Harms the Public Interest in Competition.

FE explains (at 1–2): “AE Supply is a market-regulated merchant generation affiliate of Mon Power. Mon Power is a vertically-integrated utility with captive customers. FE further explains: “The Commission has found that ‘in the context of an acquisition of affiliated generation, a competitive solicitation is the most direct and reliable way to ensure no affiliate preference,’” citing *Ameren* at P 67.

FE characterizes (at 17) the Transaction as nothing more than an internal corporate reorganization. FE concludes (at 17–18) there is “no possibility” of “any adverse impacts on cost-based wholesale power sales customers,” pointing to continued wholesale sales under its market based rates authorization. It is not clear how the asserted competitive solicitation could be a substitute for an internal corporate reorganization.

In its haste to narrow the focus on the *Ameren* principles for competitive solicitations, FE ignores the more important *Ameren* criterion, which provides (at P 59) that “[t]he public interest requires policies that do not harm the development of vibrant, fully competitive generation markets.”

Ameren states (at P 59):

In determining that such acquisitions are consistent with the public interest, as section 203 requires, the Commission must assure that a public utility’s acquisition of a plant from an affiliate is free from preferential treatment. The public interest requires policies that do not harm the development of vibrant, fully competitive generation markets.

Ameren further explains:

Preferential procurement of an affiliate asset by a public utility may harm competition in electricity markets in a number of ways.

These include raising entry barriers, increasing market power and impeding market efficiency. Such harm can adversely affect existing market conditions or impede innovation and efficiency in the long run. As noted by the FTC, 'utilities may have both incentives and the ability to exercise market power and harm consumers by discriminating in favor of their own affiliates and against independent suppliers.'[footnote omitted]

Potential non-affiliated generators that perceive that affiliated generators have a 'safety net' available to them may be discouraged from entering the market. While after-the-fact prudence reviews by regulators may insulate ratepayers from the effects of a purchase price that is too high, they will not remedy the foreclosure of additional competitors from the market. The Commission must decide at the time of a section 203 application whether an acquisition will adversely affect competition or the public interest. Our responsibility under section 203 is to protect the public interest, and Congress intended us to take action before the disposition of facilities is consummated.[footnote omitted]

Affiliate preference in procurement may harm competition and thereby efficiency. If non-affiliated generators (i.e., wholesale competitors) leave or do not enter the market due to preferential procurement competition in wholesale markets will be harmed, and market concentration and market power may even increase. Further, if the utility's affiliate preference causes less efficient generation to be used and more efficient capacity to exit or not enter the market, the costs of providing power are unnecessarily higher. One such example would be when a more efficient generator exits the market because a key buyer, the franchised local utility, acquires a less efficient generating facility from an affiliate. In a competitive market, the less efficient generator would exit, resulting in more efficient dispatch and lower prices. [footnote omitted]

Preferential procurement also raises entry barriers by increasing the cost of unsuccessful entry. One of the factors a potential entrant would rationally consider before entering a market is the extent to which it is likely to recover its investment in fixed assets. A franchised public utility is generally a major purchaser of generation resources in a region and thus may have some degree of buyer market power, or monopsony power. Purchase of an asset through a utility procurement to serve the utility's franchised load may be the best opportunity in some regions for a

power plant investment to succeed or, in the event of failure, to recover its investment. In a less concentrated buyer's market (less monopsony power), a firm seeking to exit a particular market would sell its assets to other market participants for a fair market value. However, if a franchised utility has buyer market power, the price that the exiting firm will recover is likely to be less. This increased proportion of total costs likely to be unrecoverable by an exiting firm is a barrier to entry. [footnote omitted]

Ameren identifies (at P 59) "raising entry barriers, increasing market power and impeding market efficiency" as examples of harms that affiliate preferences inflict. The Transaction implicates each such concern.

1. Erecting Barriers to Entry.

The proposed Transaction would suppress prices by artificially keeping an uneconomic resource in the PJM capacity and energy markets that would otherwise retire. Mon Power customers would be required to subsidize an uneconomic asset rather than purchasing capacity at the market price. A transaction that suppresses market prices has an adverse impact on rates. In a competitive market, prices that are suppressed below the competitive level require customer subsidies, deter economic investment decisions, undermine competition and result in excessive prices for customers in the long run. In the short run, price suppression from subsidies denies market sellers competitive compensation. FE recognizes these basic facts and has argued the point itself in a number of fora.⁸

2. Increasing Market Power

There is ample cause for concern that the Transaction will allow FE to receive higher compensation for energy and capacity produced at Pleasants than it would receive from the PJM markets.

⁸ FE 2013 Request for Rehearing at 1.

FE's rationale for the Transaction and its explanation for why the Transaction serves the public interest are contradictory. In its application to approve the transfer pending at the West Virginia Public Service Commission ("W. Va. PSC"), FE explains that "market prices are currently low in relative terms."⁹ FE further explains that the Transaction will insulate West Virginia customers from "reliance on wholesale and capacity markets" to set prices.¹⁰ FE attempts to justify the Transaction, however, on the risk of wholesale market price increases. There is no evidence that such increases will occur, and, if they do occur, would not be competitive, long run lowest cost prices, reflecting an efficient wholesale market. FE has argued that wholesale market prices are suppressed.¹¹ FE has not explained why it is in the interests of West Virginia customers to be denied the benefits of market competition so that they can pay for an uneconomic resource that FE shareholders have rejected and that apparently cannot be sold at any price in the market for resources.

If FE believed that the opportunity for increased market prices exceeds the risks of stagnant or decreased market prices, and that acquisition by Mon Power of the Pleasants presents an "opportunity," then the rational response from AE Supply would be either to retain the unit or sell it at fair market value.¹² Such response would be consistent with FE's and AE Supply's fiduciary duties to make such decisions in the interests of their shareholders. FE's representation that the Transaction is an "opportunity" for West Virginia customers conflicts with those duties and conflicts with the facts.¹³

FE's argument (at 2) that the Pleasants Facility is an "extremely desirable asset" is not convincing when FE explains (at 6) that the facility's value has dropped about 80

⁹ See FE Petition at W. Va. PSC at 15.

¹⁰ FE Petition at W. Va. PSC at 5.

¹¹ FE 2013 Request for Rehearing at 1.

¹² FE Petition at W. Va. PSC at 6.

¹³ *Id.*

percent in four years. FE has decided that the facility is not a desirable asset for its shareholders. FE has decided not to actually determine the market value of the facility by offering the facility for sale to the highest bidder.

FE cannot reasonably justify acquisition of the facility to hedge against the risk of high market prices while recognizing (at 15) that “market prices are currently low in relative terms,” asserting that structural design issues and regulatory interference are suppressing market prices and providing no reasons to expect higher prices.¹⁴ Market prices are at historic lows in PJM and coal fueled plants face intense competition from gas fired units.¹⁵ FE does not explain how it accounted for performance related risks under PJM’s CP market design that AE Supply would transfer to West Virginia customers under the Transaction.¹⁶ FE has never suggested buying a similar asset from another generation owner in order to make ratepayers better off.

In short, FE’s argument is that the unit is uneconomic for shareholders because capacity market prices are low and that therefore customers should pay a high and above market price for the unit rather than purchase capacity in the market at available low prices. FE’s argument is that it is better for customers to pay a certain high and above market price for the unit and lock it in for a long term rather than pay low market prices because the low prices in the market may change from year to year.

¹⁴ FE 2013 Request for Rehearing at 1; FE 2014 Moul Testimony at OPUC at 2–3 .

¹⁵ Market Monitor, *2016 State of the Market Report for PJM*, Vol. 2 (March 9, 2017) at 300 (Table 7-30) (41 percent of coal fired units fully recovered avoidable costs from all markets last year) (“*2016 State of the Market Report*”).

¹⁶ FE does acknowledge that these new risks exist. See FE at 8 (“Under the CP market design, generation resources with a capacity obligation that fail to perform when needed to maintain reliability during peak demand periods are subject to significant penalties.”).

FE's argument makes no more sense for customers than it makes for shareholders. FE has rejected its own argument on behalf of shareholders. For the same reasons, FE should not impose this uneconomic Transaction on customers.

FE has not explained what it means by volatility and why a fixed above market price is preferable to low prices that change from year to year.

FE has not explained why, if the goal is to hedge against potential higher capacity market prices, FE does not enter into a financial hedge on behalf of customers. FE has not analyzed the relative values of relying on the markets with no hedge, relying on a financial hedge and relying on a high priced and uneconomic unit as a physical hedge.

3. Impeding Market Efficiency

A transaction that implicates the viability of the wholesale competitive market design has an adverse impact on regulation within the existing analytical framework of Section 203 analyses. FE states, "We have made our decision that over the next 12 to 18 months we're going to exit competitive generation and become a fully regulated company." FE can exit the competitive generation market without requiring its customers to subsidize its existing market assets. The sale of FE's market assets to competitive market participants, and the deactivation of noneconomic assets that cannot be sold, would be a competitive, market based solution that would better serve the public interest and the interests of its customers. FE states that it will pursue one of these competitive alternatives if the Transaction is not approved.¹⁷ FE should be encouraged to do so.

The Transaction is not just an internal corporate reorganization, as FE purports (at 16-17). Approval of the Transaction changes the applicable regulatory paradigm. Competition is the preferred regulatory approach because it better serves the public interest

¹⁷ FE Petition to W. Va. at 6.

and that should determine the outcome of this case. Even if the Commission were neutral on this point, the transfer would still adversely impact regulation.

FE justifies the Transaction based on the assertion that market outcomes are not good for customers and to avoid the market valuation of the facility under the PJM competitive market design.¹⁸ The Commission has promoted reliance on competitive market design, and regulation through competition, based on its determination that competitive markets, and regulation through competition, can be relied upon to obtain rates at the lowest cost to consumers and therefore serve the public interest.

Market outcomes are better for sellers at times and better for buyers at times. If market sellers are allowed to change the applicable regulatory paradigm when markets are better for buyers, buyers would not be allowed to benefit from markets. Buyers did not switch back to cost of service rates when market rates were high in 2008. Once a unit becomes a market based unit, it should remain a market based unit.

The Transaction inflicts harm on all PJM customers, not just those located in West Virginia. The Transaction amounts to yet another one of the proliferating schemes for subsidizing uneconomic resources that threaten to undermine PJM's competitive wholesale market design.¹⁹ The Transaction is not in the public interest, fails the core public interest test in *Ameren*, and should not be authorized.

FE fails to attach any significance to that fact that the Transaction serves primarily to move an uneconomic asset from an affiliate operating in the competitive market paradigm, where FE shareholders bear the risks, into another affiliate operating in a regulated cost of

¹⁸ FE Petition to W. Va. PSC at 2, 4, 5.

¹⁹ 2016 *State of the Market Report* at 1–2 (“The issue of external subsidies emerged more fully in 2016. These subsidies are not directly part of the PJM market design but nonetheless threaten the foundations of the PJM capacity market as well as the competitiveness of PJM markets overall.”).

service paradigm, where FE customers bear the risks. FE ignores how such a transaction would impact the PJM wholesale market and other participants in that market.

B. The Competitive Solicitation Fails the *Ameren* Principles for Competitive Solicitations.

FE claims that the Transaction meets the *Ameren* standards for competitive solicitations for transparency, product definition, evaluation and oversight. FE has not demonstrated that it has met any of the *Ameren* requirements. FE plainly violates the *Ameren* standards for transparency and product definition.

1. The Competitive Solicitation Is Not Transparent and the Product Is Not Properly Defined (*Ameren* Principles 1 and 2).

Ameren (at P 77) provides:

An RFP should not be written to exclude products that can appropriately fill the issuing company's objectives. This is particularly important if such exclusions tend to favor affiliates.

The Transaction violates the *Ameren* principle for product definition. The selection criteria are tailored to match characteristics of the facility offered by its affiliate. The RFP fails the transparency requirement for the same reason.²⁰ An open collaborative process or the involvement of an independent third party might have produced a product definition consistent with the interests of Mon Power customers. Such process or involvement might have produced an objective for the RFP designed to serve the interests of Mon Power customers.

²⁰ See *Ameren* at P 74 ("If the RFP is to be designed through a collaborative process, the entire process should be widely publicized and open. An independent third party can ensure meaningful participation by nonaffiliates and eliminate characteristics that improperly give an advantage to the affiliate, e.g., the only acceptable interconnection point for a new nonaffiliate plant is at an affiliate's existing plant.").

FE states that the purpose of the RFP was to procure capacity for Mon Power sufficient to meet a “1,005 MW deficit in the amount of generation capacity needed to serve West Virginia customers.”²¹

The stated purpose is an unconvincing rationale for the Transaction. Mon Power is not required to take any measures to procure capacity outside of the PJM capacity market in order to maintain reliable and least cost service to the customers of Mon Power. If FE could support the assertion that a longer term contract was in the interests of Mon Power customers, FE could have entered into a market based contract, or a contract for differences, for capacity.

An RFP for such a market based contract would have allowed broad participation and a price that resulted from an open, competitive process. The terms of the actual RFP, however, contained numerous unnecessary and limiting restrictions.

Such restrictions include: (i) specification of “ownership of a dispatchable generation facility” as opposed to a contract (RFP § 4); (ii) specification that “facilities must be located inside the Allegheny Power Systems (“APS”) zone” (RFP § 4.1.2.2.); specification that a unit in development have executed an Interconnection Service Agreement and an engineering, procurement and construction (EPC) contract; and (iii) specification of a 2017 acquisition date.

None of these restrictions are relevant to the objective of providing provide reliable, least cost service to customers. Each of these restrictions tended to favor Mon Power affiliates.

The RFP and the resulting Transaction fail the *Ameren* transparency and product definition principles.

²¹ FE Petition to W. Va. at 1.

2. FE Fails to Show that It Provided for Proper Evaluation (*Ameren* Principle 3).

FE reveals that the Transaction was not evaluated against any comparable offers in its competitive solicitation process. AE Supply offered Pleasants for \$195 million.²² FE states that the next closest offer was for \$1.66 billion.²³ Such a significant cost disparity suggests that the products were not comparable. No comparable offers means that the application of proper evaluation criteria cannot be demonstrated.

FE never compared the Transaction price to the price of capacity in the PJM capacity market, which is the benchmark for any capacity transaction in the PJM footprint.

In the absence of an appropriate product definition, the appropriate evaluation criteria were not established or applied.

3. FE Fails to Show that It Provided for Independent Oversight (*Ameren* Principle 4).

FE states (at 9) that it retained a consultant to design and administer an RFP process. FE states (at 14) that its consultant “is not affiliated with Mon Power or any of its affiliates.” FE does not indicate that it took any measures to ensure that the selected consultant could provide an independent assessment. In *Ameren*, the Commission provided an example of an arrangement that satisfies the independent oversight standards (at P 70 & n.68):

We note that in a section 205 proceeding involving an affiliate power sales contract that is being issued concurrently, an independent consultant was selected by the state commission, and its compensation determined by the state commission, to monitor the RFP process. The independent consultant reported its findings to the state commission, which also supervised other aspects of the RFP process. See *Allegheny Energy Supply Company, LLC*, 108 FERC ¶ 61,082 (2004).

²² FE Petition at W. Va. PSC at 3.

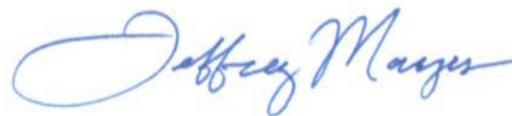
²³ *Id.*

FE has not shown how the arrangement with the selected consultant is consistent with the Commission's example or explained how it provided comparable alternative safeguards. FE's statement (at 9) that its consultant "worked with Mon Power to define the process objectives and requirements for obtaining the needed capacity resources" does not explain the circumstances where the consultant had the authority to independently establish or influence process objectives and requirements lacking consent from or in spite of objections raised by Mon Power. FE has not met its burden to show independent oversight.

II. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to these comments as it resolves the issues raised in this proceeding.

Respectfully submitted,



Jeffrey W. Mayes

Joseph E. Bowring
Independent Market Monitor for PJM
President
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8051
joseph.bowring@monitoringanalytics.com

General Counsel
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8053
jeffrey.mayes@monitoringanalytics.com

Dated: May 26, 2017

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 26th day of May, 2017.



Jeffrey W. Mayes

General Counsel

Monitoring Analytics, LLC

2621 Van Buren Avenue, Suite 160

Valley Forge Corporate Center

Eagleville, Pennsylvania 19403

(610) 271-8053

jeffrey.mayes@monitoringanalytics.com