

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

PJM Interconnection, L.L.C.)
) Docket No. ER16-372-003
)

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 PJM (“Market Monitor”), submits these comments on the compliance filing submitted in the above captioned proceeding by PJM Interconnection, L.L.C. (“PJM”) on March 6, 2017 (“March 6th Filing”).² The March 6th Filing includes clarifications to PJM’s Fuel Cost Policy approval process. The March 6th Filing requires further clarification. The March 6th Filing does not adequately clarify the timing and details related to the Market Monitor’s input to PJM. The March 6th Filing proposed new standards for Fuel Cost Policy review include a requirement, inconsistent with the purpose of Fuel Cost Policies, to base costs on fuel procurement practices instead of the market value of fuel. The March 6th Filing proposed additions to Operating Agreement Schedule 2 would create a process for PJM review and approval of nonfuel cost-based offer inputs that does not include a standard for review and that the Commission did not request or require in its February 3rd Order.³ The March 6th

¹ 18 CFR § 385.211 (2016).

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

³ *PJM Interconnection, L.L.C.*, 158 FERC ¶ 61,133 (2017) (“February 3rd Order”).

Filing also includes a provision that would require applying the 10 percent adder twice to cost-based offers.

I. COMMENTS

A. The 10 Percent Adder to Cost-Based Offers Should Be Applied Only Once.

Section 6.4.2 of Schedule 1 to the OA describes the level of the energy market offer cap. The offer cap is “the incremental operating cost of the generation resource as determined in accordance with Schedule 2 of the Operating Agreement and the PJM Manuals (“incremental cost”), plus 10% of such costs.”⁴ Schedule 1 provides for a 10 percent adder to be applied to the incremental cost defined in Schedule 2.

The February 3rd Order required PJM (at P 53) to list the “ten percent adder” in the section of Schedule 2 defining incremental costs, apparently not realizing that Section 6.4.2 of Schedule 1 to the OA already includes the adder. As a result, the March 6th Filing which inserts the ten percent adder language in Schedule 2 would result in the double application of the 10 percent adder: a 10 percent adder to incremental costs times the additional 10 percent adder in the offer cap, which would result in a 21 percent adder.

The Market Monitor believes that this was not the intended outcome. No change to Schedule 2 is needed to include the 10 percent adder in the market rules. The Commission should require PJM to remove the “ten percent adder” from Schedule 2.

B. The Market Monitor Supports the Requirement for New Units to Have Provisional Fuel Cost Policies.

The February 3rd Order (at P 52) directed PJM to incorporate a mechanism in Schedule 2 of the OA granting new resources a 90 day window after the commencement of commercial operation before they are required to submit their actual Fuel Cost Policy. In its March 6th Filing, PJM provides in Schedule 2.2 for the 90 day window. PJM also adds a

⁴ For Frequently Mitigated Units, the offer cap is the greater of incremental cost plus 10 percent or incremental cost plus \$20, \$30, or \$40 per MWh. *See* OA Schedule 1 § 6.4.2(a)(iii).

requirement to submit a provisional fuel cost policy no later than 45 days prior to the expected first cost-based energy offer submittal. The provisional fuel cost policy would ensure that participants are required to submit verifiable and systematic fuel cost policies for all offers, even within the 90 day window, and would ensure that PJM and the Market Monitor have the ability to review cost-based offers during the 90 day window.

The Market Monitor recommends that the same rules apply when the ownership of a generating resource is transferred.

C. The Market Monitor's Input is a Milestone in the Fuel Cost Policy Review Process.

The February 3rd Order (at P 52) required PJM to add to Schedule 2 specific milestones in the Fuel Cost Policy approval process. One such milestone is PJM's and the Market Seller's receipt of input from the Market Monitor. The March 6th Filing does not include this milestone, which is needed for transparency and assurance that the Market Monitor will provide its timely input for PJM's consideration. The February 3rd Order responded (at P 33) to PJM's argument that the previous Fuel Cost Policy approval process did "not discuss in detail the role of the IMM" and that, "as a result, there was confusion among stakeholders as to whether it is PJM or the IMM that approves Fuel Cost Policies." The revised Schedule 2 and Attachment M - Appendix provide less detail regarding the Market Monitor's process for evaluating Fuel Cost Policies than did the previous Cost Development Guidelines to which PJM refers.⁵ Revised Schedule 2 does not address the process by which the Market Monitor communicates its input to PJM.

The February 3rd Order determined (at P 68) that PJM's revisions do not "substantively change" the role of the Market Monitor in evaluating Fuel Cost Policies. The Market Monitor maintains the responsibility to review Fuel Cost Policies and hold

⁵ See PJM Manual 15: Cost Development Guidelines," Rev. 28 (October 18, 2006) at Section 2.3.1.

discussions with Market Sellers.⁶ The Market Monitor has committed to provide the results of its Fuel Cost Policy evaluation to Market Sellers and its input to PJM by August 1 each year in PJM's annual review process.⁷ It will provide similarly timely input in the 45 day review process described in proposed Schedule 2, Section 2.2. The Market Monitor's input will include its recommendation as to whether PJM should accept the Fuel Cost Policy.⁸

The Commission should require PJM to include in Section II. A of Attachment M-Appendix to the OATT a statement that the Market Monitor will provide input to PJM regarding the compliance of the Fuel Cost Policy with Schedule 2 and the Cost Development Guidelines, and to include in Schedule 2, Section 2.2, the milestone that the Market Monitor will provide that timely input to PJM and the Market Seller.

D. Standard of Fuel Cost Policy Review

The Commission determined in the February 3rd Order (at P 51) that PJM's proposed Schedule 2(f) did not include sufficient clarity for its approval standards. The March 6th Filing includes a new section 2.3(a) in an attempt to provide the requested clarity.

1. The Market Monitor Supports the Standard of Accuracy.

The March 6th Filing includes a statement in new section 2.3 that "PJM shall reject Fuel Cost Policies ... that do not accurately reflect the applicable costs." The Market Monitor supports the standard of accuracy. Accuracy is a standard currently applied in the Market Monitor's review of Fuel Cost Policies to prevent market power abuse. Market Sellers have an incentive to overstate costs in the Fuel Cost Policy to avoid market power

⁶ See OATT Attachment M-Appendix §§ IV.E-1 and IV.D-1.

⁷ See "Incorporating Market Monitoring Review in the Manual 15 Fuel Cost Policy Process," Monitoring Analytics memo to the PJM Markets Implementation Committee (March 8, 2017), which can be accessed at: <http://pjm.com/~media/committees-groups/committees/mic/20170308/20170308-item-07b-imm-suggested-m15-edits-for-annual-review.ashx>.

⁸ See February 3rd Order at P 69.

mitigation. Without the standard of accuracy, Market Sellers may include, either deliberately or inadvertently, inaccurate market pricing sources, fixed costs associated with fuel availability, or unrealistic market risk adjustments, for example. The standard of accuracy of incremental costs addresses the potential overstatement of incremental costs.

2. The Standard of Review Should Include the Requirement That Fuel Cost Policies Be Systematic.

In the February 3rd Order, the Commission found (at P 57) that “PJM’s proposal requires that Fuel Cost Policies be verifiable and systematic,” but the Commission also found (at P 51) that proposed Schedule 2 “does not discuss how PJM would make a determination or evaluate a Fuel Cost Policy.” The February 3rd Order requires (at P 51) that PJM incorporate the standard of review and explain how a Market Seller would be found to be noncompliant with this standard.”

In response, the March 6th Filing proposes a new Section 2.3(a), which includes provisions to support the verifiability of costs included in Fuel Cost Policies. New Section 2.3(a) does not include a requirement that Fuel Cost Policies be systematic. The March 6th Filing makes no mention of “a standardized method or methods for calculating fuel costs including objective triggers for each method.”⁹

PJM has been much more clear in its public statements to Market Sellers about PJM’s Fuel Cost Policy review process. PJM has stated that its standard of review is “verifiable and systematic” meaning “a series of steps that are followed to get to the creation of the cost-based offer,” where “these steps should have thresholds and triggers associated with them; the steps should be able to be followed logically; explanations for liquid and poor

⁹ See February 3rd Order at P 57.

liquidity markets should be defined;” and “an auditor should be able to follow the steps and arrive at the cost-based offer.”¹⁰

PJM’s Standard of Review in new Section 2.3(a) does not provide such detail.

The Commission should require PJM to add these additional details, consistent with PJM’s public statements on this issue.

3. A Description of a Market Seller’s Fuel Procurement Process Is Not a Necessary Requirement of a Fuel Cost Policy.

The March 6th Filing includes (at 4) in its standard a requirement that the Fuel Cost Policy accurately reflect the Market Seller’s fuel procurement practices. But, Fuel Cost Policies are required to incorporate the current market value of the fuel, the cost of procuring the fuel, or a combination of the two. For the majority of units using natural gas that select the market value option, the cost of procurement may be much higher or much lower than the current market value. Only the current market value is relevant for those participants.¹¹ For that reason, many currently approved Fuel Cost Policies contain no details about the procurement of fuel. Market Sellers may procure their fuel well in advance of the operating day through long term contracts. The market value of the previously procured fuel is accurately described in the Fuel Cost Policy. The replacement cost of the fuel is based on current market conditions for the operating day. While the details of fuel procurement are relevant for calculating fuel costs in cases where the market participant uses them, they are not relevant for calculating fuel costs when the market participant selects the market value option. In fact, most of PJM’s natural gas-fired generation is priced

¹⁰ “Fuel Cost Policies and Hourly Offers Filing,” PJM presentation to the Markets Implementation Committee (March 8, 2017), which can be accessed at: <<http://pjm.com/~media/committees-groups/committees/mic/20170308/20170308-item-07a1-fcp-update.ashx>>.

¹¹ The only exception to the use of current market value, for participants who select the market value option, is a cost-based offer over \$2,000 per MWh. See *Offer Caps in Markets Operated by Regional Transmission Organizations and Independent System Operators*, FERC Order No. 831, 157 FERC ¶ 61,115 (2016).

using the market value option, with no reference to procurement. PJM's proposed standard with respect to fuel procurement would invalidate a large portion of the currently effective fuel cost policies that are otherwise compliant with the conditionally accepted Schedule 2 and the Cost Development Guidelines.

PJM's proposed addition to Schedule 2.3(a)(ii) contains the same issue. It would require that the Market Seller's method of calculating fuel cost reflect "the way fuel is purchased or scheduled for purchase."¹² This requirement is not necessary for market participants that select the market value option for calculating fuel cost that accurately reflects the market value of the fuel at its generation location for the operating day. The procurement standard would invalidate a large portion of the currently effective fuel cost policies that are otherwise compliant with the conditionally accepted Schedule 2 and the Cost Development Guidelines.

E. The New Review and Approval Processes for Emissions and VOM Costs Include No Standards.

The February 3rd Order (at P 55) required PJM to reorganize Schedule 2 to clarify which provisions did and did not apply to fuel cost policies. It further stated that "Market Sellers are not required to include the emissions allowances/adders or variable operation and maintenance (VOM) adders in their Fuel Cost Policy submissions to PJM and the IMM."¹³ In response, the March 6th Filing included new sections three and four in Schedule 2 for emission allowance costs and VOM costs.¹⁴ The two new sections include new PJM review and approval processes for emission allowances costs and VOM costs. The proposed reviews for emission allowance costs and VOM costs do not include a standard of approval.

¹² See March 6th Filing at 171.

¹³ February 3rd Order at n.75.

¹⁴ See March 6th Filing at 8.

The standards should be that the emission allowance costs and VOM costs are accurate and incremental costs.

The February 3rd Order did not require new PJM review and approval processes for these cost inputs. These provisions are out of scope and therefore should be rejected. If the Commission deems that the new provisions are in scope for compliance, the Commission should require that PJM add to Schedule 2 the same level of clarity and definition and transparency for these review standards as it has for Fuel Cost Policies.

F. The February 3rd Order Did Not Reassign Solely to PJM the Role of Evaluating Cost Inputs.

PJM also included in its March 6th Filing proposed language in Schedule 2, Section 5.1 stating that a penalty shall apply when “PJM determines that any portion of the cost-based offer is not in compliance with this Schedule 2.” PJM retains the language accepted in the February 3rd Order that includes the Market Monitor in the determination of penalties with respect to Fuel Cost Policies. PJM proposes that penalties would apply if the Market Monitor determines that that the offer is not in compliance with the Market Seller’s PJM-approved Fuel Cost Policy and PJM agrees with the Market Monitoring Unit’s determination.

The proposed Section 5.1 excludes the Market Monitor from the determination of penalties with respect to other cost-based offer inputs. PJM specifies that the penalty generally applies when “PJM determines that any portion of the cost-based offer is not in compliance with this Schedule 2.”¹⁵

PJM’s proposal directly contravenes the June 17th Order. The June 17th Order plainly required that a penalty will apply if PJM or the Market Monitor determines that a cost-

¹⁵ March 6th Filing at 12.

based offer does not comply with the rules.¹⁶ PJM's additions are out of scope for a compliance filing and are inconsistent with the Commission's previous direction and order in this matter.

PJM should be directed to modify its filing to comply with the June 17th Order.

G. The Definition of Flexible Resources Should be Updated in Accordance with the Commission's Finding.

PJM's proposed definition of Flexible Resource is:

"Flexible Resource" shall mean a generating resource that must have a combined Start-up Time and Notification Time of less than or equal to two hours; and a Minimum Run Time of less than or equal to two hours.¹⁷

In the February 3rd Order (at P 111), the Commission found that the definition proposed by PJM should apply to both cost-based and price-based offers. In the March 6th filing, PJM does not file any updates to the definition of Flexible Resources. The Market Monitor recommends that PJM clarify in the definition that the parameter limits for the combined Start up and Notification time and for the Minimum Run Time apply to both cost-based and price-based offers. The Market Monitor proposes the following update to the definition for clarity:

"Flexible Resource" shall mean a generating resource that must have a combined Start-up Time and Notification Time of less than or equal to two hours; and a Minimum Run Time of less than or equal to two hours, **in both its cost-based offers and its price-based offers.**

¹⁶ The Commission required "a penalty structure that will be applicable in the event that PJM or the IMM determines that a resource has submitted a cost-based offer that does not comply with Schedule 2 of the Operating Agreement or the Cost Development Guidelines in Manual 15." *PJM, Interconnection*, 155 FERC ¶ 61,282 at P 63 (2016).

¹⁷ March 6th Filing, Attachment A, PJM Proposed OA § (Definitions).

II. CONCLUSION

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

Respectfully submitted,



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

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

Catherine A. Tyler
Senior Economist
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8050
catherine.tyler@monitoringanalytics.com

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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 27th day of March, 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