

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

PJM Interconnection, L.L.C.)
) Docket No. ER19-664-000
)

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 ("Market Monitor") for PJM Interconnection, L.L.C. ("PJM"),² submits these comments responding to the filing submitted by PJM Interconnection, L.L.C. ("PJM") on December 21, 2018 ("December 21st Filing"). The December 21st Filing would include provisions for compensating generators for what PJM terms, "Gas Contingency Switching Costs." The Market Monitor acknowledges PJM's responsibility for maintaining reliability but PJM should rely on market mechanisms and not on manual, out of market intervention, recognizing that there are some extreme emergency conditions that require nonmarket intervention. Effective markets need to work at times of high stress as well as at times of low stress. The December 21st Filing is effectively an admission that the Capacity Performance design is not working and that PJM does not believe that it can rely on the market to respond to high stress conditions in the markets. The December 21st Filing goes beyond the steps needed to ensure reliability at times of real system emergencies and

¹ 18 CFR § 385.211 (2018).

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").

instead involves a major potential transfer of financial/commercial risk from power suppliers to PJM customers. PJM would substitute its judgment for the market incentives. PJM's proposal deeply involves it in the fuel supply decisions and contractual arrangements for generators' procurement of fuel. A potential consequence is that PJM customers will incur some or all financial responsibility for fuel procurement decisions. Recent system events have shown that such decisions can generate significant financial burdens. Under the current law, responsibility falls squarely on suppliers.³ PJM's proposal undercuts the foundational assumptions of current law.

A policy shift of the significance proposed by PJM in the December 21st Filing requires careful deliberation and should not be approved as filed. PJM does not have any incentives to minimize the costs of fuel procurement. PJM has not demonstrated that it, rather than power suppliers, is the entity best suited to manage fuel supply procurement. Such a transfer of risk and responsibility will deprive PJM consumers of the benefits PJM customers should be receiving from the wholesale power market competition that resulted from electric industry restructuring. Indeed, the policy implications raised by this filing are better suited to a rulemaking proceeding that would involve the entire industry. Such a rulemaking proceeding should be open to alternative solutions to the issues identified by PJM, and such a proceeding should focus at least as much on how interstate natural gas pipelines are regulated and organized as it does on RTOs, including consideration of an independent gas ISO.

To resolve this proceeding, PJM's proposal should be rejected and PJM should be directed to include provisions in its Market Rules that narrowly define the emergency conditions under which PJM is authorized to take specific, defined out of market actions. PJM should also be directed to make modifications to the capacity market rules to ensure

³ See, e.g., *Duke Energy Corp. v. FERC*, 892 F.3d 416 (2018); *Old Dominion Elec. Coop. v. FERC*, 892 F.3d 1223 (2018).

that Capacity Performance resources can actually perform in highly stressed market conditions and that Capacity Performance resources have the appropriate incentives to perform under all market conditions.

I. BACKGROUND

PJM has the responsibility as Reliability Coordinator, Transmission Operator and Balancing Authority of the PJM region to maintain system reliability. Under normal conditions, this authority is enforced by providing generators with commitment and dispatch instructions, i.e. when to start, when to shut down and how much power to produce. Generators provide offers which are used by PJM to determine the least cost solution to meet the demand and ancillary services requirements. PJM achieves this goal by having a market design that provides proper incentives to generators to perform when needed and penalties when they do not.

Under emergency conditions, PJM has the authority to direct generators to take certain actions. These instructions include staffing units in order to be able to start during critical periods, cancelling noncritical outages, categorizing units as maximum emergency or reducing their maximum run time, and directing units to switch fuel sources.⁴

Under emergency conditions, PJM may rely on these nonmarket instructions to ensure reliability. These instructions go beyond PJM's commitment and dispatch instructions. PJM has relied on this practice after the implementation of markets. This is clear in PJM's analysis of the cold weather events experienced in January 2014. PJM stated that "PJM requested units which could not acquire their primary fuel to switch to the alternate fuel" and "coordinated with generator owners to ensure fuel-limited and/or

⁴ See PJM Manual 13 Emergency Operations, Section 3.

environmentally-limited units were placed into the maximum emergency generator status and then scheduled to run only when needed.”⁵

Some instructions have been addressed by market design changes. For example, with the implementation of Capacity Performance, the notification and start times of Capacity Resources are approved by PJM under the assumption that these units are staffed or can be remotely started. Therefore, there is no need for PJM to instruct Capacity Performance Resources to staff the units. With the implementation of Capacity Performance, generators face potential nonperformance charges if they cannot meet their capacity obligation because they are on outages not approved by PJM.

Some instructions remain a concern. PJM can instruct generators to put themselves in maximum emergency status or reduce their maximum run times to preserve a scarce fuel. PJM can instruct generators to switch to a different fuel source to preserve a scarce fuel or, as described in the December 21st Filing, to address potential gas pipeline contingencies.

PJM’s December 21st Filing requests additional authority to direct actions and additional authority to make out of market payments to generation owners.

In 2017, PJM incorporated rules in Manual 13 (Emergency Operations) that include actions PJM can take and generators must follow when PJM determines potential loss of generation due to predefined gas infrastructure contingencies. PJM argues that it is their responsibility to maintain the reliability of the PJM system, therefore if there are credible gas pipeline contingencies that could result in loss of generation, and therefore loss of load, PJM must take actions to prevent such emergency. These actions include directing dual fired generation to use an alternate fuel or generation sourced from multiple pipelines to

⁵ See PJM Analysis of Operational Events and Market Impacts During the January 2014 Cold Weather Events at 33, which can be accessed at: <https://www.pjm.com/~media/library/reports-notices/weather-related/20140509-analysis-of-operational-events-and-market-impacts-during-the-jan-2014-cold-weather-events.ashx>.

procure gas from a different pipeline. These actions can also be taken in addition to PJM increasing the amount of reserves needed.

These Manual changes defined PJM's authority to direct actions too broadly and under too broad a set of conditions. While PJM should have the authority to act in true emergencies, the Manual changes are not directed at true emergencies. PJM should develop market options and mechanisms to address the issues in the Manual. PJM routinely address situations that could result in loss of load through market mechanisms. That is the point of having a market.

II. COMMENTS

A. PJM's Actions Are Not Just and Reasonable in a Competitive Market.

PJM's actions should be driven by PJM's market design, as the Commission recognized in ISO-NE, "suppliers, not consumers, are in the best position to assess and price the performance risk associated with their resources."⁶

Contradicting the purpose of the Capacity Performance reforms to the PJM capacity market, PJM's out of market actions to ensure generator performance, together with PJM's proposed compensation mechanism, transfer the performance risk of gas fired generators from suppliers to consumers. PJM argued in the Capacity Performance Filing that "rather than establishing prescriptive eligibility requirements such as delineating acceptable fuel transportation arrangements, storage requirements for dual fuel capable units, or weatherization requirements, PJM proposes that an offer as a Capacity Performance Resource includes a representation that the Capacity Market Seller has made, or will make, the necessary investment to ensure the resource has the capability to provide energy when called upon by PJM."⁷

⁶ *ISO New England Inc.*, 147 FERC ¶ 61,172, at P 64 (2014) ("ISO-NE Pay for Performance").

⁷ Capacity Performance (CP) Filing, Docket No. ER15-623-000 (December 12, 2014) at 22.

By analyzing gas pipeline contingencies and determining which generators are at risk of not performing, PJM is making a determination of which generators may not meet their Capacity Performance requirement. PJM's actions to intervene in generator decision making will dilute generators' incentives to make the necessary economic decisions to be able to meet their obligation when needed. If PJM has determined that a generator may or will not be able to meet its Capacity Performance obligation, PJM rules should make it PJM's responsibility to not allow such generator to continue to be a Capacity Performance resource.

PJM needs to consider modifications to the Capacity Performance rules to require capacity resources to meet defined characteristics, including those related to fuel supply arrangements. Generation owners should not be permitted to put the PJM system at risk with the assurance that PJM will bail them out in extreme circumstances. PJM's proposed approach does not provide the appropriate incentives to capacity resources. Market incentives would require generation owners to make investments and to pay the consequences for the failure to have secure fuel supplies. The incentives proposed by PJM in the December 21st Filing are the opposite of those intended by the Capacity Performance construct. Rather than incentives to invest in reliable fuel supplies, PJM's proposed approach would provide incentives to not spend funds on secure fuel supplies but to lean on the PJM and gas pipeline systems with the assurance that they will be made whole for any related expenses.

Under the PJM proposal, gas fired generators that fail to make the investments necessary to perform when needed, would benefit from gas pipeline contingency conditions. PJM actions would transfer the risk from those generators who failed to invest not only to consumers but also to other gas fired generators that did make the investment necessary to fulfill their market obligations. For example, if two gas fired generators have the same firm transportation contract but one decided to also install oil capability, the one with oil capability will face greater financial and operational risk under a gas contingency. Under such condition, PJM can direct the dual fuel generator to switch to oil. The dual fuel

generator will face uncertain financial costs, reduced profits, and operational costs and the general inability to rely on the investments made in response to market incentives. Even if all such costs were reimbursed by customers, this outcome would be unjust and unreasonable. The extra profits earned by the generation owner that did not invest in dual fuel capability would be retained by the generation owner. This example is one small illustration of the unintended consequences of attempting to add cost of service regulation to a market. The two approaches do not mix.

PJM's proposed actions would have affect pipeline tariffs. But pipeline tariffs will prevent PJM's actions from having the intended result. Pipelines are required to treat their customers in a nondiscriminatory manner. When there are conditions on a pipeline that reduce pipeline capacity, the contractual entitlements of customers with the same level of firmness are reduced proportionally based on their contractual capacity. PJM instructions to gas fired generators to switch fuel sources would force generators to renounce their contractual entitlements, but PJM has no authority to prevent other (nongeneration owning) pipeline customers from exercising their rights to the pipeline capacity made available by PJM's instruction.

B. PJM Mischaracterizes Its Gas/Electric Coordination.

PJM's gas/electric coordination process is mainly an information sharing process. Information from pipelines is used by PJM to identify potential gas fired generators at risk. PJM states that "PJM coordinates with pipelines serving generation in the PJM Region to ensure that PJM dispatch does not trigger or further exacerbate a pipeline contingency that may be imminent or has already arisen."⁸ PJM does not and cannot provide operational instructions to pipelines. For example, PJM cannot instruct a pipeline to stop taking nominations after a PJM generator switches to a different fuel source.

⁸ December 21st Filing at 4.

When PJM instructs a generator to not use a pipeline because of a pipeline contingency, PJM is infringing the rights of the generator as a pipeline customer, for which the generator paid, and it is taking actions supposed to be taken by the pipeline in a nondiscriminatory manner.

True coordination and interoperability across pipelines would require a gas ISO. A gas ISO could also develop rules for coordinating with PJM and other RTO/ISOs.

C. Gas Pipeline Constraints are Reflected in Gas Prices.

Market prices for gas prices reflect market supply and demand conditions when limited pipeline capacity exists. Gas prices increase when gas demand is high and there is reduced capacity available. PJM's proposed actions would have a direct impact on gas prices. Gas suppliers and consumers make business decisions based on numerous variables that include weather forecasts, existing pipeline capacity, storage conditions, etc. PJM's proposed actions would disrupt the decisions made by gas suppliers and consumers. PJM will indirectly become another gas market player. When PJM instructs a generator to switch fuel sources from gas to oil, the demand for gas on that segment or hub of the pipeline decreases, and when demand decreases, prices decrease. This provides the incorrect long term and short term economic incentives to maintain or enhance the capacity and the reliability of both systems.

D. Extreme Emergency Conditions.

PJM and other RTOs should have the ability to prevent catastrophic reliability issues under extreme emergency conditions such as major pipeline failures, other extreme fuel related issues for all fuel types, or terrorist attacks.

Under these conditions, generators should be made whole to the costs incurred, these costs should be reviewed by market monitors and RTO/ISOs and filed at the Commission for a decision.

E. PJM’s Proposal is not a Make Whole Calculation. It is Partial Cost of Service Regulation

PJM’s proposal is partial cost of service regulation, not an uplift or make whole calculation. PJM’s proposal only includes reimbursing generators for costs incurred as a result of a switching fuel sources. PJM’s proposal does not take into account the revenues received by generators. PJM’s proposed language states these costs are “in addition, but not to be duplicative of, their normal PJM Market Costs.” It is unclear what constitutes “normal” PJM Market Costs. It is unclear which entity is going to validate that the Gas Contingency Switching Costs are not duplicative of these “normal” PJM Market Costs.

PJM’s proposal does not include offsetting the costs incurred by generators with their revenues. This will compensate generators above their costs incurred.

PJM’s proposal does not include the required submission of supporting information or a required review by the Market Monitor or PJM.

F. PJM’s Proposal Would Allow the Recovery of Pipeline Penalties.

PJM’s proposal includes potential compensation for pipeline penalties. PJM argues that their proposal “draws a clear line of demarcation between costs and penalties.” The only line is that PJM will compensate “costs” prior to FERC’s approval and “penalties” after FERC’s approval. It is not clear how the Commission could deny compensation for pipeline penalties when these are going to be explicitly allowed under PJM’s tariff.

PJM should not include potential compensation from penalties. PJM acknowledges that the Commission has not allowed compensation of gas pipeline penalties or charges due to unauthorized gas use in CAISO and NYISO, but PJM proposes to include these provisions in the PJM tariff regardless.⁹

⁹ December 21st Filing at P 9, citing *Cal. Indep. Sys. Operator Corp.*, 155 FERC ¶ 61,224 at P 96 (2016); *N.Y. Indep. Sys. Operator, Inc.*, 154 FERC ¶ 61,111 at P 39 (2016).

III. 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,



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Dated: January 11, 2019

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 11th day of January, 2019.



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