

issues. The Settlement describes the proposed values as a “black box.”⁶ This means that the settling parties “agreed simply on the values; there was no agreement on any assumptions, estimates, or methodologies to calculate those specific values.”⁷

PJM’s initially filed values are the best supported values in the record and should be approved. In order to address the Commission’s concerns about the issues raised, the Commission should require PJM to immediately begin developing a new CONE filing with the expectation that it be submitted in time to be effective for the May 2014 BRA, which is consistent with the triennial review process defined in the OATT.⁸ Proceeding to hearing in this matter is impractical because it is unlikely to conclude before being superseded by a future filing.

The Settlement also includes a component which compounds the problem of the proposed excessive black box gross values: the immediate and substantial upward adjustment of those settlement values by the Handy-Whitman Index for the next Base Residual Auction (“BRA”) scheduled for May 2013, for the 2016/2017 Delivery Year, the first BRA to which they would apply. There is no support in the record or the Settlement for the application of an index-based adjustment to the first BRA in which Commission approved values would apply.

The Settlement commits PJM to conduct a stakeholder process for the development of improvements to the periodic CONE review process and the method for updating CONE values in the intervening period. The Commission should strengthen this requirement, and direct PJM to develop, support and file new CONE values in a timely manner so as to permit these values to become effective prior to the May 2014 BRA for the 2017/2018 Delivery Year.

⁶ Explanatory Statement at 9.

⁷ *Id.*

⁸ OATT Attachment DD § 5.10(a)(vii)(C).

I. BACKGROUND

The settlement would establish values for the Gross Cost of New Entry (“CONE”) for a combustion turbine unit (“CT”) and a combined cycle unit (“CC”) in the five designated CONE areas. The CT CONE is an important factor for calculating the Variable Resource Requirement Curve (“VRR Curve”), which is the demand curve for capacity in RPM BRAs. The CONE level for a CT has a significant effect on where the supply and demand curve(s) intersect and, consequently, RPM prices. The CC Cone is used to establish the default offer level under the Minimum Offer Price Rule (“MOPR”), which protects the market from buyer-side market power. A CC CONE that is too low is not sufficiently protective. A CC CONE that is too high poses a barrier to new entry.

Calculating the CONE level is a difficult exercise, and even the best result is likely to be an approximation of the costs of competitive entry in the five RPM locations. This challenge, however, is not an invitation to engage in an arbitrary process or an irrelevant negotiation between supply and load to establish a mutually acceptable CONE parameter. From start to finish, the administrative process that defines CONE must be directed towards the regulatory objective, to establish CONE values that reflect real world costs of competitive entry in PJM. If the process does not do this, it will undermine public confidence that PJM capacity markets serve the public’s legally protected interest in efficient and competitive wholesale energy prices.

II. COMMENTS

A. The Adjustments Included in the Settlement to the PJM’s Filed Gross CONE Values Are Unsupported in the Record and Should Be Rejected.

The record remains the same, except that PJM Witness Samuel A. Newell testifies that if one takes PJM’s filed values and adds to them some or all of certain upward adjustments advocated by certain other parties, and ignores all other upward or downward adjustments advocated by others, then one can arrive at the settlement values. Witness Newell argues that the result is reasonable because the Settlement values “fall with the

range of those detailed estimates” provided by PJM and two suppliers, PSEG and GenOn.⁹ The Market Monitor does not challenge Witness Newell’s math, which is beside the point. This settlement resolves none of the issues set for hearing. If it provides any meaningful support, and the Market Monitor does not concede that it does, Witness Newell’s testimony offers no support superior to the support provided by PJM Witness Newell and his associate for PJM’s initially filed values.¹⁰

The January 30th Order found (at P 39) that intervenors had raised issues that “could not be resolved based on the submitted record.” This Settlement provides no record basis for the resolution of any issue nor does it provide any meaningful evidence in support of the “black box” values it includes. PJM’s values remain the best supported values. This will not change without further development of the record.

The Commission could determine to send the matter to hearing in order to obtain a record basis adequate for a decision. Proceeding to hearing is a superior alternative to accepting arbitrary CONE values. The Market Monitor, however, does not prefer this approach. The time of all involved would be more productively spent developing and filing as soon as possible a new proposal and an associated new method. The record and the analyses relied upon in this case are already obsolete. A hearing likely would not conclude in time for the May 2013 BRA. A hearing may well not conclude before PJM files new CONE values.

The best way forward is to reject the Settlement values, which are unsupported, accept for use in the May 2013 BRA PJM’s filed values, which are best supported, and, to account for the Commission’s determination that the record is inadequate and fails to

⁹ Affidavit at 10.

¹⁰ See Affidavit at 4–5, citing Response of Dr. Samuel A. Newell and Dr. Kathleen Spees on behalf of PJM Interconnection, L.L.C., dated January 13, 2012 at P 5 (“our affidavit disputed much of the protestors’ evidence and reaffirmed our belief that our original estimate was in the “range of reasonableness” and that the protestors’ estimates were not”).

resolve a number of issues, condition its approval on PJM's immediate commencement of a new CONE filing. This is the best way to achieve a practical and lawful outcome.

B. The Handy-Whitman Index Should Not Adjust the CONE Values in the First BRA to Which They Apply.

The Settlement provides for the immediate, substantial upward adjustment of the settlement values by the Handy-Whitman Index for the first BRA to which they would apply, the Base Residual Auction ("BRA") scheduled for May 2013 for the 2016/2017 Delivery Year. If the Commission chooses to approve the "black box" values included in the Settlement, for which no support exists, then there is no reason to provide a substantial upward adjustment for them in the first BRA in which they are used. Those numbers are higher than the values filed by PJM, which do have support.

C. The Net CONE Value for the PJM Region Should Equal the Lowest Net CONE Area Value; The Value Specified in the Settlement is Unsupported in the Record and Should Be Rejected.

The settlement proposes a region-wide gross CONE of \$128,000/MW-year. This level is higher than the level in both CONE Area 5 (\$127,500/MW-year) and CONE Area 3 (\$114,500/MW-year). A rational competitive investor that could invest anywhere in the PJM Region and expect to receive the same revenues will not incur costs of \$128,000/MW-year when it could instead incur costs of \$114,500/MW-year. An investor concerned about the bottom line does not care what factors account for the lowest cost location.

An illogical and unreasonable assumption about economic behavior is implicit in the Settlement's proposal. The proposed values have no relevance to the market signal a demand curve for the PJM Region is designed to convey. The Commission has explicitly recognized in that January 30th Order (at P 63) that the lowest CONE value is the appropriate regional value:

Within the unconstrained portion of the PJM region, developers would have an incentive to build any new peaking capacity that is needed where such capacity can be constructed at the lowest net cost. Therefore, it is reasonable to establish a VRR Curve for the unconstrained area based on the net entry cost within the

unconstrained area where a peaking unit can be built at lowest net cost.[footnote omitted] Establishing a VRR Curve at a higher cost would provide more revenues to new entrants than are needed to encourage efficient entry in the unconstrained area.

The Settlement proposal for region-wide gross CONE does not comply with this determination, which was the basis for rejecting the value originally proposed by PJM.¹¹ The Settlement proposes a region-wide gross CONE value higher than the lowest CONE Area value. If the same, region-wide, net energy and ancillary service (E&AS) revenues are applied to all gross CONE values, then the lowest gross CONE is the same as the lowest net CONE.

The Settlement states that “there is no agreement on a methodology for determining the PJM Region Gross CONE.”¹² Witness Newell does not offer support for the proposed value. Accordingly, the Settlement’s proposed region-wide gross CONE of \$128,000/MW-year is illogical, inconsistent with the Commission’s findings in this proceeding, unsupported, and should be rejected. Consistent with the Commission’s determination that the regional net CONE should be determined on the basis of “where a peaking unit can be built at lower net cost,” the PJM rules should establish that the Region-Wide Gross CONE is always equal to the CONE area with the lowest net CONE.

The current rules do not go as far they could to determine the lowest net CONE. As the Commission notes (at P 62), “region-wide Net CONE is calculated by subtracting region-wide E&AS Revenues from the lowest Gross CONE value of any CONE Area.” This calculation could and should be improved. Rather than use region-wide net revenues with CONE area gross CONE values, it would be more accurate to use the lowest net CONE of any CONE Area based on the area gross CONE value less the area Net Energy and

¹¹ *Id.* at P 65.

¹² Explanatory Statement at 4.

Ancillary Market Revenue Offset (“E&AS”). PJM already calculates the area E&AS value, which it could use in place of the regional value.¹³

The Commission has identified the appropriate method, and no further process is required to refine it. PJM should be directed to file the only method fully consistent with the Commission’s determination, establishing region-wide net CONE equal to the lowest net CONE of any CONE Area.

D. The Settlement Should Explicitly Require New CONE Values to Take Effect Prior to the May 2015 BRA; The Commission Should Also Encourage Process Improvements.

The Settlement includes an agreement that “PJM shall conduct a stakeholder process to identify any desired changes in the CONE triennial review process in light of lessons learned from the most recent triennial review process, including an assessment of the current effective OATT’s Handy-Whitman Index adjustment method for Gross CONE, with a PJM filing of any resulting tariff changes with FERC in sufficient time to govern the 2014 triennial review, or the filing of a status report at such time if there is no stakeholder consensus on such changes.”¹⁴ The Market Monitor supports this provision, except that the Commission should strengthen it.

PJM should be required to immediately begin development of new CONE values in the expectation that it would file those values in time to take effect prior to the BRA scheduled in May 2015 for the 2018/2019 Delivery Year. Currently, stakeholders are considering changing from a three year to a five year period for evaluating CONE values. If the period for CONE evaluation changes, this should not affect the Settlement’s requirements that an evaluation and filing occur in time to become effective for the May

¹³ See OATT Attachment DD § 5.10(a)(v)(B).

¹⁴ *Id.* at 19; see Settlement § II.F.

2015 BRA. The outcome of that proceeding would form the basis for any future review process.

The Settlement's description of the process going forward is too weak. The provision applies only to "any desired changes" and allows for a status report in place of an actionable filing.¹⁵ This standard is weak in light of the clear need to improve the periodic CONE evaluation process and the method to annually escalate those values. Serious effort is needed to better and more comprehensively define the components of Gross CONE and the inputs to those components. To the extent possible, the components of Gross CONE should be identified and agreed upon in advance. It may also be possible to identify objective sources and pre-defined methods to generate the value input for some or all components, including the cost of capital. A more accurate method than reliance on the Handy-Whitman Index should be developed. The effort to agree upon components, sources and methods could greatly streamline future evaluations of Gross CONE. A better method could be developed for updates in the intervening periods. A strong indication of Commission support for process improvements would promote a more constructive stakeholder process.

¹⁵ *Id.* at 17; see Settlement § II.F.

III. CONCLUSION

The Market Monitor respectfully requests that the Commission consider these comments as the Commission resolves the issues raised in this proceeding.

Respectfully submitted,



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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 11th day of December, 2012.



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