

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

PJM Interconnection, L.L.C.)))	Docket No. ER12-513-000
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**MOTION FOR LEAVE TO ANSWER AND ANSWER
OF THE INDEPENDENT MARKET MONITOR FOR PJM**

Pursuant to Rules 212 and 213 of the Commission’s Rules and Regulations,¹ Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM² (“Market Monitor”), moves for leave to answer and answers the protest jointly filed by the Joint Consumer Advocates and the Demand Response Supporters³ in this proceeding on December 22, 2011. The Joint Consumer Advocates’ and Demand Response Supporters’ Witness Dr. James F. Wilson provides testimony that implies support for retention of the 2.5 Percent Holdback Rule (officially defined as the Short Term Resource Procurement Target⁴).⁵ This testimony is flawed because it ignores the economic implications of an

¹ 18 CFR §§ 385.212 & 385.213 (2011).

² PJM Interconnection, L.L.C. is a Commission approved Regional Transmission Organization. Capitalized terms used herein and not otherwise defined have the meaning provided in the PJM Open Access Transmission Tariff (“OATT”) or the PJM Reliability Assurance Agreement (“RAA”).

³ The Joint Consumer Advocates include: the Pennsylvania Office of Consumer Advocate; People’s Counsel of the District of Columbia; New Jersey Division of Rate Counsel; Maryland Office of People’s Counsel; and Delaware Division of the Public Advocate. The Demand Response Supporters include: the PJM Industrial Customer Coalition; Comverge, Inc.; EnergyConnect by Johnson Controls, Inc.; EnerNOC, Inc.; Viridity Energy, Inc.; and Wal-Mart Stores, Inc.

⁴ See OATT Attachment DD § 2.65.

artificial reduction in demand and fails to appreciate fundamental principles of RPM design, including, in particular the different roles of three year forward Base Residual Auctions (“BRAs”) and the subsequent Incremental Auctions (“IAs”). The Market Monitor also responds to the GenOn Parties’ failure to support components of its Gross CONE that result in a significantly higher value than the level proposed by PJM.⁶

I. ANSWER

A. The 2.5 Percent Holdback Rule Suppresses BRA Prices, Is Inconsistent with the Fundamental Features of the RPM Design, Is Contrary to the Interest of the Suppliers of Demand Resources, and Is Contrary to the Public Interest in Efficient and Competitive Markets.

Mr. Wilson asserts (at page 14) that the 2.5 percent shift in the demand curve cannot cause price suppression because some supply has the flexibility to participate in the Incremental Auctions for a delivery year rather than in the Base Residual Auction. The conclusion does not follow. Regardless of whether all or only some supply has a must offer requirement in the BRA, shifting the demand curve reduces the price in the BRA compared to the price without a shift in the demand curve. The only exception is a case where the supply curve is flat in the relevant portion, which has not been and is unlikely to be the case in RPM BRAs. As a result, the level of capacity that has some flexibility to offer is irrelevant.

⁵ Affidavit of James F. Wilson in Support of Protest of the Joint Consumer Advocates and Demand Response Supporters, attached to Protest of the Joint Consumer Advocates and Demand Response Supporters, Docket No. ER12-513-000 (December 22, 2011) (“Wilson Affidavit”).

⁶ Comments and Limited Protest of Genon Energy Management, LLC; Genon Mid-Atlantic, LLC; Genon Chalk Point, LLC; Genon Power Midwest, LP; and Genon Rema, LLC, Docket No. ER12-513-000 (December 22, 2011) (“GenOn”).

Mr. Wilson's logic suggests that price suppression reducing the price for new entry is not price suppression. Mr. Wilson actually concedes that the 2.5 percent shift in the demand curve does reduce price, but suggests that it does not matter because some capacity has the flexibility to offer in the IA. But the resultant price reduction affects all MW clearing in the BRA and affects the incentive for new entry.

One function of the BRA price is to incent the entry of new capacity when it is needed. New entry, in Mr. Wilson's view, would have the "flexibility" to not offer in a BRA. But this flexibility is illusory. A rational new entrant will not and should not be expected to offer in an IA instead of a BRA. IA prices have generally been substantially lower than BRA prices and there is more uncertainty associated with IA prices. If the RPM construct is to work and to incent new entry when it is needed, the BRA prices must reflect the economic fundamentals. An arbitrary reduction in the demand curve prevents the BRA prices from reflecting those fundamentals. This price reduction has served as a barrier to entry to new capacity and will continue to serve as a barrier unless eliminated.

Mr. Wilson does not define price suppression, but his definition appears to be that price suppression is any price reduction resulting when the 2.5 percent shift in the demand curve exceeds the supply MW that had a choice about whether to participate.

The correct definition of price suppression is the price reduction resulting from the 2.5 percent shift in the demand curve compared to what the price would have been without the shift in the demand curve. The 2.5 percent demand reduction clearly does reduce price.

IAs are residual auctions. IAs provide a mechanism for suppliers of generation and Demand Resources to cover obligations when an expected resource is unavailable or to sell excess if it becomes available. PJM also uses IAs to fine tune the level of capacity procured relative to its forecast needs for reliability. There is no reason to expect price convergence

between the BRA and the subsequent IAs for a delivery year. The goal of the market design is not to create price convergence between the two markets. The goal of the market design is to have the prices in both the BRA markets and the IA markets reflect the market fundamentals at the time of the markets. The fundamentals of the IAs result in large part from changes in the time period between the BRA and the IAs.

The RPM design includes the three year forward element for a reason. The three year forward market was incorporated explicitly to permit more competition from new entry of all kinds, including Demand Resources. The three year forward element of the design has tradeoffs. But it is not possible to have a three year forward market with a must offer requirement and a must buy requirement, but then append a one year market to it, or spread the purchase of capacity over the three years. That is effectively the stated rationale for the 2.5 percent holdback. Demand Resources are entirely capable of participating in a three year forward market, as they have demonstrated. Demand Resources do not need protection from the market. Demand Resources can participate in the market on a comparable basis.

Although Mr. Wilson represents various demand side interests, Demand Resources do not have an interest in lower prices in the BRA. Most Demand Resources clear in the BRA. Those resources have the option to sell out of their positions in subsequent incremental auctions. That flexibility created by the market design provides Demand Resources the ability to hedge the risk associated with long lead times. The flexibility created by the market design is preferable to reducing demand in the BRA because it combines the correct price signals with the ability to hedge the risks associated with the RPM three year forward construct. It is preferable for Demand Resources and for all other market participants.

Suppressing prices in BRAs damages the interests of all suppliers, including Demand Resource suppliers. Suppressing prices in BRAs damages the interests of load seeking maximum competition from new entry to discipline energy and capacity prices. Suppressing prices damages the public interest in efficient and competitive energy markets.

Mr. Wilson makes various assertions (at pages 14–21) about withholding from the capacity market. Mr. Wilson does not appear to assert that there is withholding occurring that would violate the market power mitigation rules. Rather, Mr. Wilson’s concern appears to be with the design of some of the market power mitigation rules, including the rule governing the inclusion of Avoidable Project Investment Recovery Rate (APIR) in the offer caps. It may be appropriate to revisit and tighten the market power mitigation rules for RPM, but in this proceeding, the argument appears to be that it is acceptable to reduce demand in the capacity market because of concerns about other aspects of market design. This is not an acceptable or reasonable approach to market design. The goal is not to build a design with approximately offsetting errors but to create a design that reflects economic fundamentals, that provides incentives to load and to supply based on those fundamentals, and that fully addresses market power issues.

B. GenOn’s Proposed Gross CONE Does Not Support the Inflated Values for a Number of Components Relative to the Values Proposed by PJM and Supported by the Brattle Group Analysis.

The study filed by GenOn supports a gross CONE for the CT technology almost 100 percent higher than the gross CONE value supported by the Brattle Group’s Analysis. The Market Monitor’s calculations are generally consistent with the Brattle Group’s calculations. The primary differences between the GenOn study and the Brattle Group’s study include the plant proper Engineering, Procurement and Construction Contract (EPC) costs, about 1.3 times greater, the transmission interconnection costs, about 19.2 times greater, and the

financial/closing fees, about 12.8 times greater. The GenOn study does not adequately support the inclusion of the much higher values for these items than the values included in the Brattle Group Report. The Market Monitor agrees that it would be appropriate to include transmission interconnection costs based on the interconnection costs for units in the queues rather than for completed projects and to do so by region. Those interconnection costs would be higher than in the Brattle Group Report but not as high as those in the GenOn study.

II. MOTION FOR LEAVE TO ANSWER

The Commission's Rules of Practice and Procedure, 18 CFR § 385.213(a)(2), do not permit answer to answers or protests unless otherwise ordered by the decisional authority. The Commission has made exceptions, however, where an answer clarifies the issues or assists in creating a complete record.⁷ In this answer, the Market Monitor provides the Commission with information useful to the Commission's decision-making process and which provides a more complete record. Accordingly, the Market Monitor respectfully requests that this answer be permitted.

⁷ See, e.g., *N.Y. Indep. Sys. Operator, Inc.*, 121 FERC ¶61,112 at P 4 (2007) (answer to protest accepted because it provided information that assisted the Commission in its decision-making process); *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,318 at P 36 (2007) (accepted answer to answer that "provided information that assisted ... decision-making process"); *California Independent System Operator Corporation*, 110 FERC ¶61,007 (2005) (answer to answer permitted to assist Commission in decision-making process); *New Power Company v. PJM Interconnection, L.L.C.*, 98 FERC ¶ 61,208 (2002) (answer accepted to provide new factual and legal material to assist the Commission in decision-making process).

III. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to this answer 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: January 6, 2012

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 6th day of January, 2012.



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