UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

GenOn Power Midwest, LP	)	Docket No. ER12-1901-001

COMMENTS OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rules 211 and 602(f) of the Commission's Rules and Regulations,[1] Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM ("Market Monitor"),[2] submits these comments to the Settlement Agreement and Offer of Settlement filed in the above captioned proceeding May 8, 2013 by GenOn Power Midwest, LP ("GenOn") on behalf of itself and certain other parties ("GenOn RMR Settlement").[3] The Settlement provides for a total payment of $13,200,000 to GenOn for certain reliability must run ("RMR") services during the period from June 1 to September 30, 2012, provided under a tariff filed in this proceeding and Part V of the PJM OATT ("RMR Services"). The $13,200,000 is a "black box" value that has no support in the record. The Market Monitor opposes the settlement because there is no evidence that this level reflects GenOn's actual operating costs to provide RMR Services, because there is no evidence that the settlement complies with applicable provisions of the PJM OATT and because the settlement does not resolve the issues of fact set for hearing.

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1 18 CFR §§ 385.211 & 385.602(f) (2012).

2 PJM Interconnection, L.L.C. is a FERC approved Regional Transmission Organization. Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT").

3 These other parties include Duquesne Light Company, Duquesne Light Energy, LLC, FirstEnergy Solutions Corp., Duquesne Industrial Intervenors, PJM Industrial Customer Coalition, West Penn Power Industrial Intervenors, and Old Dominion Electric Cooperative.

A contested settlement must be evaluated on the merits, including under the standards set forth in the *Trailblazer Pipeline Co.* line of decisions ("*Trailblazer*").[4] The courts also have been clear that contested settlements cannot be accepted simply because certain parties agree to a value.[5] Certain parties having agreed to a black box $13,200,000 value is the only basis for the proposed settlement. A black box value having no record support defies evaluation on its merits. Supporting evidence, including actual costs, can only be obtained from GenOn.

The approach taken in the GenOn RMR Settlement contrasts with the Settlement and Offer of Settlement filed by the Market Monitor on February 28, 2013 ("IMM RMR Settlement"), and supported by the Maryland Public Service Commission ("PSC") and the New Jersey Board of Public Utilities ("BPU").[6] The IMM RMR Settlement does not state the value at which the parties settled but instead presents a streamlined process whereby GenOn may submit an audited statement of the actual expenditures that it incurred in order to provide RMR Services. Unlike the approach adopted in the GenOn RMR Settlement, the approach presented in the IMM RMR Settlement is consistent with the requirement in Section 119 of the PJM OATT that RMR services provided under that provision include only the "the entire cost of service of operating the generating unit."

It is particularly important that the Commission uphold the principles set forth in Part V of the PJM OATT because those principles are consistent with the Commission's policies of regulation through competition which include as a critical element the

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4 *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,082 (1998) ("*Trailblazer I*"); *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 at 62,341 ("*Trailblazer II*"), *order on reh'g*, 87 FERC ¶ 61,110 ("*Trailblazer III*"), *aff'd*, 88 FERC ¶ 61,168; *see also Pub. Utils. Comm'n of Cal. v. El Paso Natural Gas Co.*, 105 FERC ¶ 61,201 at P 44 (2003), *reh'g denied*, 106 FERC ¶ 61,315 (2004).

5 *See* Laclede Gas Company v. FERC, 997 F.2d 936, 947 (D.C. Cir. 1993).

6 *See* Motion for Leave to Comment of the New Jersey Board of Public Utilities, Docket No. ER12-1901-000 (March 1, 2013).

assignment of investment risk to shareholders and not to customers. Continued settlements at levels inconsistent with filed market rules would create a de facto rate that is higher than the rate consistent with the tariff, the filed rate.

The BPU has reviewed these comments and wholly endorses them, as affirmed by the signature below.

I. BACKGROUND

When an owner notifies PJM that it intends to deactivate a unit on an identified date, PJM may request and the owner may agree to provide continued service for a defined period after that date in order to allow PJM to address reliability issues on the system created by the deactivation. This continued service is termed Reliability Must Run (RMR) service. Part V of the PJM OATT provides that generating units that provide RMR service for PJM may receive compensation under a formula specified in Sections 114–115 of the PJM OATT or file to collect "the entire cost of service of operating the generating unit" under Section 119 of the PJM OATT. Part V allows only for recovery of avoidable incremental expenses and investment, less net operating revenues during the period of RMR service. The formula rate caps recovery of new project investment needed to provide RMR service (APIR) at $2 million. Part V does not permit the recovery of costs that would have been incurred if the unit deactivated and never provided RMR service. The formula rate also provides for an incentive adder based on the term of RMR service.

The goal of the tariff language is to ensure that a generation owner who operates a unit past its intended retirement date for reliability reasons is compensated for all the incremental costs that it incurs in order to provide that service. The formula rate at sections 114–115 of the OATT includes a defined incentive adder. Section 119 allows recovery under a tariff filed at the FERC of operating costs, including a return on and of investment needed to continue operating during the period of RMR service, but does not provide for an incentive adder. The goal of the tariff language is not to provide the generation owner an

opportunity to earn windfall profits or recover otherwise unrecoverable costs because the unit retirement causes a reliability problem.

On February 19, 2012, GenOn notified PJM that it intended to retire the Niles Generating Station Unit 1 ("Niles") and the Elrama Generating Station Unit 4 ("Elrama") as of May 31, 2012. Notice occurred 92 days prior to the requested date of deactivation, two days more than the 90 days required. At the time of notice, neither unit had investment value on GenOn's books because GenOn "wrote off the book value in 2010 to reflect the loss of economic value associated with uncompetitive generation assets."[7] GenOn would have retired the units on May 31, 2012, but for PJM's request that, for reliability reasons, the units remain in service for the summer period from June 1 through September 30. GenOn agreed to provide RMR service and filed to receive compensation under Section 119 of the PJM OATT.

GenOn proposed to recover for RMR service during the four-month period approximately $10.4 million for Niles and $14 million for Elrama. The request anticipated approximately $1.1 million project investment for Niles and $1.9 million for Elrama. GenOn also proposed to recover the investment costs that it had already fully written off in 2010.

The Market Monitor filed comments on June 12, 2012, arguing that such recovery was unjust and unreasonable under section 205 of the Federal Power Act because GenOn was attempting to shift to ratepayers significant costs associated with investment risk assigned to GenOn under the prevailing regulation through competition model by filing recovery under the different and superseded traditional cost of service model. The unit was retired because it was not economic in a competitive market, had no prospects of being economic and its value had already been entirely written on for that reason. The Market Monitor objected to the sudden change of regulatory paradigm which was based solely on PJM's need for GenOn's units for four months of RMR service. PJM needed the unit because

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[7] GenOn GPM-1 (Direct Testimony of John. D. Stewart) at 9 *l*.18–21.

the 92 days notice that GenOn provided was not sufficient for PJM to put in the place transmission system upgrades needed to accommodate the deactivation.

GenOn clarified in its answer filed July 6, 2012, that it was claiming recovery under Section 119. The Market Monitor filed an answer July 20, 2012, objecting that Section 119 does not permit the recovery of fixed costs incurred prior to the deactivation date regardless of what GenOn may or may not recover under section 205 of the Federal Power Act.

By order issued January 30, 2012 ("January 30th Order"), the Commission found that GenOn's proposed rate for RMR Services "raises issues of material fact that cannot be resolved based on the record before us."[8] One issue identified by the Commission is that "GenOn's proposed cost-of-service formula includes estimated levels of depreciation expense for the RMR Units even though GenOn had stopped recording depreciation on these units in 2010 because the units were fully depreciated."[9] The January 30th Order set the matter for hearing and settlement procedures.

The parties, including parties intervening after the July 30th Order, have been engaged in settlement discussion since that time. GenOn completed its RMR service on September 30, 2012.

Because GenOn has now completed its RMR Service, it can determine its actual costs to provide RMR Service to PJM. Although Section 119 does not provide for an incentive adder, the Market Monitor offered to settle this matter for GenOn's actual verified costs plus a ten percent adder in the IMM RMR Settlement filed February 28, 2012. The IMM RMR Settlement would compensate GenOn for the RMR Services in a manner consistent with the formula rate at Sections 114–115 of the PJM OATT. The IMM RMR Settlement includes a ten percent adder and does not require any review of whether the costs actually

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8 140 FERC ¶ 61,080 at PP 32–34.

9 GenOn RMR Settlement § 9 at 4.

incurred and verified by GenOn are prudent. These elements are an incentive for settlement on just, reasonable and non-discriminatory terms that do not violate the PJM OATT, and are consistent with the Commission's structuring policies. Moreover, acceptance of the IMM RMR Settlement would avoid any need for the parties to incur any further expenditure of time and resources for continued litigation in this matter. The Maryland PSC and the New Jersey BPU both support the IMM RMR Settlement.

II. COMMENTS

The GenOn RMR Settlement would settle this case for $13,200,000 for the RMR Services.[10] The GenOn RMR Settlement is a black box settlement. The agreed upon value is not explained, and no evidence supports it. The reasons that any party agreed to this total payment are unknown. There is no evidence that any party believes that $13,200,000 equals the operating costs incurred by GenOn to provide the RMR Services.

In order to approve a contested settlement, the settlement must be evaluated on its merits.[11] The Commission's decision in *Trailblazer* sets forth standards for evaluating the merits of a settlement.[12]

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[10] GenOn RMR Settlement § 9 at 4.

[11] *Trailblazer III* at 61,438, citing Mobil Oil Corp. v. FERC, 417 U.S. 283, 314 (1974) ("the Supreme Court has held that where a settlement is contested, the Commission must make "an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates.'") Rule 602(h)(1)(i) provides that the Commission may decide the merits of contested settlement issues only if the record contains substantial evidence upon which to base a reasoned decision or the Commission determines that there is no genuine issue of material fact. 18 CFR § 602(h)(1)(i).

[12] *See Trailblazer II*, which summarizes (at 61,436 n.5) four approaches for the Commission to approve contested settlements: "Approach No. 1, where the Commission renders a binding merits decision on each of the contested issues; Approach No. 2, where approval of the contested settlement is based on a finding that the overall settlement as a package provides a just and reasonable result; Approach No. 3, where the Commission determines whether the benefits of the settlement out balance the nature of the objections, in light of the limited interest of the contesting party in the outcome of the case; and Approach No. 4, where the Commission approves the settlement as uncontested for the consenting parties, and severs the contesting parties to litigate the issues."

Two approaches included in *Trailblazer* are relevant here.[13] Under "Approach No. 1," the Commission renders a binding merits decision on each of the contested issues.[14] Under "Approach No. 2," the Commission may approve the contested settlement "based on a finding that the overall settlement as a package provides a just and reasonable result."[15] Whether considered issue by issue (Approach No. 1) or as a package (Approach No. 2), the black box settlement at $13,200,000 does not survive an analysis based on its substantive merits.[16]

Because the settlement specifically does not explain the basis for the proposed black box value, it defies substantive analysis on the merits under Approach No. 1.

Approach No. 2 does not avoid analysis of the settlement on the merits, it holds only that a settlement can be approved if the overall settlement has merit and adequate support as a package even if some elements of that package are "problematic."[17] This path further provides for "a balancing of the benefits of the settlement against the costs and potential effects of continued litigation."[18]

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13 Because the nature of the recovery allowed under the law for RMR services is the core issue of this proceeding, the objections cannot be found "limited" under Approach No. 3, and the issue cannot be severed under Approach No. 4. Accordingly, the Market Monitor will address these approaches only if another party asserts that one or both apply.

14 *Id.*

15 *Id.*

16 *Id.*; *Trailblazer III* at 61,440 n.21 ("In *Mobil Oil Corp. v. FPC, 417 U.S. 283, 314 (1974),* the [Supreme] Court explained that the Commission can approve an uncontested settlement if it is in the public interest, and can also approve a contested settlement rate if there is substantial evidence in the record to support an finding that the settlement rate is just and reasonable. Both approvals are decisions on the merits, as opposed to procedural decisions. Thus, there are different types of merits decisions, and approval of the settlement as a whole as reasonable does not involve a merits decision on each issue in the proceeding.").

17 *Trailblazer III* at 61,440.

18 *Id.* at 61,439.

Because the GenOn RMR Settlement concerns a single element, a black box value for RMR Services, it is not a package settlement, and application of Approach No. 2 is not appropriate. Even if the GenOn RMR Settlement were nonetheless found to constitute a package, because the GenOn RMR Settlement specifically does not explain the basis for the proposed black box value and includes no information about the actual costs incurred by GenOn to provide the RMR Services, it is impossible to evaluate Approach No. 2 element by element to determine whether it is just and reasonable as a package.

A consideration when applying *Trailblazer* Approach No. 2 is a "balancing of the benefits of the settlement against the costs and potential effects of continued litigation." Approval of the GenOn RMR Settlement is not needed to avoid continued litigation. The IMM RMR Settlement, which can be approved on the merits and is consistent with the PJM OATT, establishes a process that fairly compensates GenOn for the RMR Services with no need for continued litigation. Continued litigation could lead to exactly the same result as the IMM RMR Settlement. Indeed, GenOn could terminate the litigation immediately and obtain full and fair compensation for the RMR Services under the formula rate at Sections 114–115 of OATT. The decision to continue litigating this matter is GenOn's, and the motivation to do so must be a belief that it can obtain through settlement greater compensation that what would be available to it under the methods approved by PJM stakeholders and accepted by the Commission in the PJM tariff.

Trailblazer expressly recognizes that the Commission must reject the "rationale that the settlement was appropriate because it was in the mid-range of the parties' various proposals."[19] The courts have squarely rejected settlements that attempt to split the

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[19] *Trailblazer II mimeo* at 43, citing Laclede Gas Company v. FERC, 997 F.2d 936 (D.C. Cir. 1993). The Laclede court stated (at 947): "FERC's confidence in the reasonableness of the settlement amount appears to rest primarily on the observations that (1) the $ 19 million refund 'is much less than what [the] Enforcement Staff argues for, but much more than United has conceded it owes,' [citation omitted]; and (2) Enforcement's high-end estimate, which was based on the ALJ's proposed methodology, would prove accurate only if all of the outstanding issues were resolved

difference and required a "meaningful review of the objections" to the settlement.[20] No meaningful evaluation under Approach No. 1 or Approach No. 2 is possible if GenOn does not provide information about its actual operating costs incurred to provide the RMR Services.

Although the Commission may consider customers' support as a factor when evaluating a contested settlement,[21] such a finding does not avoid the need for a decision on the merits.

PJM customers rely on Commission-approved PJM market rules to protect their interests. The GenOn RMR Settlement does not provide any evidence that recovery of $13,200,000 is consistent with the requirement in the PJM OATT that funds for RMR Services collected under Section 119 of the PJM OATT constitute "the entire cost of service of operating the generating unit[s]." Whether the GenOn RMR Settlement is consistent with the applicable law cannot be evaluated under either *Trailblazer* approach. There is every

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against United, [citation omitted] Turning to the first of these two rationales, the mere fact that the settlement figure fell somewhere within the vast gulf between United's estimate of its own liability (approximately $ 1 million) and the alternative advanced by Enforcement (approximately $ 53 million by the time of the order denying rehearing) provides scant support for the Commission's decision. As an initial matter, it is entirely possible that the preliminary liability estimate of a party in United's position might reflect a strategy designed to strengthen its position in the ensuing settlement negotiations or litigation. More importantly, relying solely on such estimates would lead to the untenable result that if United initially estimated its liability at one dollar, a settlement of a penny more would be "within the expected range of recovery."

20 *Id.*, quoting Laclede at 947.

21 *See* NorAm Gas Transmission Co. v. FERC, 148 F.3d 1158, 1164–65 (D.C. Cir. 1998) ("As we have explained before, the Commission is clearly entitled to give weight to the support of customers when deciding whether to approve a settlement offer.[citation omitted] However, customer support is not dispositive, even when a settlement offer is uncontested. Even if Tennessee's customers had unanimously supported the proposed settlement, the Commission would still have the responsibility to make an independent judgment as to whether the settlement is 'fair and reasonable and in the public interest.' 18 C.F.R. § 385.602(g)(3); [additional citation omitted]. Although the Commission may take widespread customer support into account, such support is not an excuse to ignore arguments raised by a competitor who opposes the settlement.").

reason to presume this amount exceeds what Part V and section 119 of the OATT would allow.

The GenOn RMR Settlement does not resolve the issues that the Commission set for hearing. The January 30th Order found that the record failed to support the costs included in GenOn's proposed rate for RMR Services.[22] The GenOn RMR Settlement includes no information about the costs on which the $13,200,000 rate is based. The failure is significant given that GenOn must have records of its actual expenditures for the RMR Services, which were completed as of September 30, 2012. This information is needed by the Commission in order for it to determine whether the proposed settlement value is just and reasonable, whether the standard set forth in Section 119 of the PJM OATT has been satisfied and whether the compensation for RMR Services is constituent with restructuring through competition, particular the principle that GenOn's shareholders and not PJM customers should bear the risk of unrecovered competitive investment in generation assets.

The GenOn RMR Settlement should be rejected. Instead, either the IMM RMR Settlement should be approved, as revised in whatever manner the Commission determines is appropriate, or the matter should be set for hearing and decided on the basis of a complete record and the applicable law.

III. 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.

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[22] 140 FERC ¶ 61,080 at PP 32–33.

Respectfully submitted,

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The New Jersey Board of Public Utilities has reviewed these comments and wholly endorses them:

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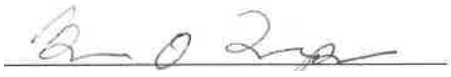
By: 

Brian O. Lipman
Deputy Attorney General
State of New Jersey
Office of the Attorney General

Dated: May 28, 2013

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 28th day of May, 2013.

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