

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

PJM Interconnection, L.L.C.)))	Docket No. ER13-535-001
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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”),² submits these comments on the response submitted in this proceeding by PJM Interconnection, L.L.C. (“PJM”) on March 4, 2013 (“March 4th Response”), to the inquiries included in the Commission’s notice of deficiency issued February 5, 2013 (“Deficiency Notice”).

I. COMMENTS

A. Whether It Is Reasonable to Mitigate a Unit with Lower Competitive Costs Than Those Assumed in the Default Offer Price.

The Commission asked:

Please explain why it is reasonable for a resource that fails to qualify for either the competitive entry exemption or the self-supply exemption to be mitigated to a default offer price even if that unit may have lower competitive costs than those assumed in determining the default offer price.³

¹ 18 CFR § 385.211 (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 provide in the PJM Open Access Transmission Tariff (“OATT”).

³ Deficiency Notice at 1–2 (Question No. 1).

PJM has reiterated the arguments raised in its initial filing, but has not answered the specific question posed here as to why it is just and reasonable to a participant to eliminate the current provision for unit specific reviews under the MOPR when a participant does not qualify for an exemption and has unit specific costs lower than the default.⁴ PJM does not explain why applying a significantly more restrictive MOPR threshold than is necessary to protect PJM markets does not create a barrier to entry harmful to those markets.

In its comments on the proposal when filed, the Market Monitor stated that, except in one limited circumstance, it “agrees that a generally available process for unit-specific review is not necessary for the MOPR to remain effective.”⁵ This statement assumed that the MOPR floor offer price reflects the actual costs of new entry. Given that under the current rules the MOPR floor offer price will not be set to a level reflecting the actual, competitive net cost of new entry, then provision for unit specific review does remain necessary for an effective MOPR that does not pose a barrier to entry to some participants.

1. Because PJM Incorrectly Calculates NACCONE At Levels Significantly Above Competitive Levels, an Individually Calculated Unit Specific Offer Is the Only Opportunity Available to Participants Not Eligible for an Exemption to Offer at a Competitive Level.

Removal of unit specific MOPR review will mean that new units that fail both the proposed Self-Supply Exemption or the Competitive Entry Exemption will be required to offer at a default offer level, defined as the Net Asset Class Cost of New Entry (NACCONE). In response to the Commission’s question, it is not reasonable for such a resource to be mitigated to a default offer price greater than its competitive offer level. In

⁴ The current and proposed MOPR are located in section 5.14(h) of the Attachment DD to the OATT (“Proposed MOPR”). Attachment DD of the OATT and the separate PJM Reliability Assurance Agreement (“RAA”) contain most of the rules for the PJM centralized capacity market, the Reliability Pricing Model (“RPM”).

⁵ Comments of the Independent Market Monitor for PJM, ER13-535 (December 28, 2013) at 13 (“IMM Dec. 28th Comments”).

addition, the default offer level, calculated per PJM's method, is not the correct threshold to apply, even if the rest of PJM's logic were correct.

Under the proposed MOPR, a resource not exempt from the rule must offer at the Net Asset Class Cost of New Entry (NACCONE).⁶ NACCONE is calculated based on the gross cost of new entry (CONE) for each asset class net of the estimated energy and ancillary services (E&AS) revenue for such asset class.⁷

The proposed rule provides for the calculation of E&AS revenues in a manner that incorrectly calculates market revenues. PJM's approach calculates the energy and ancillary services revenues to apply to a new unit for the delivery year three years in the future using average revenues earned in PJM over the past three calendar years.⁸ This approach will always, except by accident, provide an incorrect forecast of net revenues for the delivery year three years in the future. The problem gets worse when changes in market conditions result in substantial differences between historical and expected market revenues. Recent changes in market conditions including lower gas costs and improvements in CC technology mean that expected market revenues are significantly higher than historical average market revenues. This means that the E&AS offset used by a competitive entrant will be higher than the E&AS offset calculated using the three year average. This, in turn, means that a competitive offer, even using PJM's gross CONE, will be lower than PJM's MOPR threshold.

⁶ Proposed MOPR subsection (3).

⁷ *See Id.* Asset types include combustion turbine generators (CTs), combined cycle generators (CCs) and integrated gasification combined cycle generators (IGCC).

⁸ Proposed MOPR subsection (3)(ii) refers to section 5.10(a)(v)(A) of OATT Attachment DD for the calculation of estimated energy and ancillary services revenues.

The erroneous calculation of E&AS revenues is compounded by the level at which the current gross CONE has been set.⁹ The current gross CONE was the product of a settlement agreement which did not disclose the basis for the final number, and which will be immediately escalated using the Handy-Whitman Index.¹⁰ Competition among equipment manufacturers has led to lower gross CONE values than reflected in the current gross CONE level used by PJM in its calculation of the MOPR threshold and which are expected to be below the gross CONE level after escalation.

PJM's argument to remove unit specific MOPR assumes that a generally accurate NACCONE is in place. That assumption is not correct. Use of an inflated gross CONE, compounded by the use of inaccurate E&AS revenues, creates a NACCONE that bears no relation to a reasonable test of competitive entry levels. This means that the proposed MOPR, if approved, would require a new entrant not eligible for an exemption to offer above its competitive costs. This constitutes a barrier to entry and is not just and reasonable.

Thus, individual unit specific review under MOPR is the only mechanism available to permit a new entrant to submit a competitive offer when no exemption applies. Such review is entirely consistent with participant confidence in the markets and is more so than would result from reliance on an incorrect MOPR price floor.

2. Some of the Proposed Exemptions Complement Unit Specific MOPR Review.

Although NACCONE is not the correct threshold to evaluate projects that do not qualify for an exemption, the Market Monitor supports the proposed Competitive Entry Exemption.¹¹ The Self Supply Exemption is acceptable if limited to public power and subject

⁹ See *PJM Interconnection, L.L.C.*, 142 FERC ¶ 61,079 (2013)..

¹⁰ *Id.* at PP 60, 64.

¹¹ IMM Dec. 28th Comments at 7–11.

to continued evaluation of the operation of the exemption.¹² The Market Monitor agrees that a unit that meets appropriate criteria under this approach does not require unit specific MOPR review.

In addition, in its earlier comments, the Market Monitor identified a particular circumstance where unit specific MOPR review should continue to apply.¹³ In a situation where a state believes it must address a reliability issue that PJM does not agree exists, based on information received from PJM, and, based on a documented process defining a short term reliability issue and its duration, such state could procure capacity in a process that excludes existing and imported resources. Any new project selected under this process would be subject to a unit-specific review using appropriate and consistent standards. This approach avoids an outcome that could otherwise be perceived as subjecting state reliability decisions to PJM's administrative discretion.

Allowing such unit specific MOPR review may meet concerns raised by state commissions without compromising the protection afforded to PJM's markets.¹⁴

3. PJM's Arguments That the MOPR Cannot Be Consistently Applied Have No Merit.

PJM argues (at 1–4) that the MOPR allows undue discretion in the conduct of unit specific MOPR reviews. MOPR review can be consistently applied provided that common modeling assumptions are required and costs and revenues are documented and verified. Clarity as to who reviews the offers for MOPR compliance from a market power perspective also facilitates consistency.

¹² *Id.* at 12–13.

¹³ *Id.* at 9–11.

¹⁴ Motion for Leave to Answer and Answer of the New Jersey Board of Public Utilities, ER13-535 (February 4, 2013) at 11–12;

PJM filed rule changes establishing the differences between PJM's role and the IMM's role in the tariff.¹⁵ PJM explained its role, which was included in the OATT as new section 12A and revisions to section 5.8 of Attachment DD to the OATT:

Throughout the Tariff and Operating Agreement there are references to PJM making determinations regarding whether an exception request is acceptable, whether a bid or offer is acceptable and in general whether a market participant's actions are consistent with the Tariff, Operating Agreement and PJM Manuals. However, nowhere in these agreements is there a definitive explanation as to PJM's exact role in making this determination. Consequently, PJM proposes to incorporate revisions to clarify, among other things, that in making its determinations, it is considering whether an offer, bid, components of an offer or bid, decision not to offer, or exception request is compliant with the PJM Market Rules set forth in the Tariff, Operating Agreement and PJM Manuals. The proposed revisions also make clear that PJM does not make determinations of market power. Of course, PJM does perform the formulaic application of its market power mitigation tools, such as the three pivotal supplier test and the Market Structure Test pursuant to the provisions of Section 6 of Attachment DD of the Tariff.

In addition, the Tariff revisions put Market Participants on notice that if an offer or bid is consistent with the requirements of the Tariff, PJM will accept that offer or bid even if the IMM has made a finding that the offer or bid raises market power concerns, and that PJM's acceptance of the offer or bid does not take into consideration whether that offer or bid represents the potential exercise of market power. In other words, even if PJM accepts the offer or bid, if the IMM believes the offer or bid raises market power concerns it may address with the Commission its concerns that the offer or bid nonetheless reflects the exercise of market power. The tariff language intends to clarify that it would be improper for a market participant to characterize PJM's evaluation of Tariff compliance as a determination of market power that

¹⁵ Letter Order, *PJM Interconnection, L.L.C.*, ER13-149 (November 28, 2012).

contradicts (or supports) determinations on market power issues made by the IMM.¹⁶

PJM also explained certain clarifications to the Market Monitor role in Attachment M–Appendix to the OATT:

PJM proposes to incorporate general provisions into Attachment M to clarify, among other things, that in making its determinations, the IMM is considering whether an exception request, offer, level of offer or cost inputs raises market power concerns, including whether an offer, level of offer or decision not to offer a resource may constitute physical or economic withholding (prohibited manipulative behavior is, in this construct, a subset of the behavior constituting an exercise of market power).¹⁷

The Base Residual Auction in May 2013 for the 2016/2017 Delivery Year is the first auction to which this tariff change applies. These clarifications should contribute to more consistent determinations for all of the unit specific reviews applied to mitigation inputs, including unit specific MOPR inputs.

The Market Monitor has consistently argued that the modeling assumptions used to calculate net costs for a new entrant under the MOPR rule should be identical to the modeling assumptions used to develop the NACCONE.¹⁸ This limits the unit specific MOPR review to establishing offers based on competitive cost differences and not based on modeling assumptions. The Market Monitor believes that this approach should be specified in the rule.

¹⁶ PJM Transmittal Letter, ER13-149 (October 16, 2012) at 12–13.

¹⁷ *Id.* at 14.

¹⁸ *See* Complaint of the Independent Market Monitor for PJM v. Unnamed Participant, Docket No. EL12-63-000 (May 1, 2012); Motion for Clarification of the Independent Market Monitor for PJM, Docket No. ER11-2875-000, et al. (February 17, 2012); Protest of the Independent Market Monitor for PJM, Docket No. ER11-2875-002 (June 2, 2011).

With clear rules, the unit specific exemption process can and does work very well and is clearly superior to the application of the inaccurate MOPR threshold. The addition of the proposed exemption for competitive projects proposed by PJM in this proceeding would improve the process.

4. The Impacts of Particular Offers Matter in PJM Markets.

PJM claims that, “supply curves have become more elastic in the PJM capacity market in recent years, which moderates the price impacts of any particular offer.”¹⁹

The price elasticity of supply measures the change in the quantity supplied as a result of a change in price. Contrary to the assertions of PJM, a single elasticity number does not describe supply curves in RPM. PJM has presented no information that supports the claim that supply curves in RPM have become more elastic. Elasticity varies over the RPM supply curves, from very elastic at relatively low prices to very inelastic at relatively high prices. Elasticity can also vary substantially between points anywhere on the supply curve based on the nature of the specific offers that comprise the supply curve. Whether demand has intersected supply and set the clearing price at a relatively elastic point or relatively inelastic point on the supply curve does not have any implications for the necessity of a MOPR rule or the appropriateness of an exemption for vertically integrated utilities. Such a point is as likely to reflect the unique characteristics of a specific offer as the broader characteristics of the supply curve. The fact remains that individual offers can and do significantly affect clearing prices.

However, PJM’s argument, that the ability to directly benefit from suppressing the RPM price is a direct function of the MW exposed to the price, is correct. PJM’s results also demonstrate that behavior consistent with the proposed MOPR rules could have a substantial price suppressing impact on RPM markets. This is cause for concern.

¹⁹ PJM at 4, Affidavit of Andrew L. Ott on behalf of PJM Interconnection, L.L.C. (“Ott Affidavit”).

B. Whether Application of the MOPR to Integrated Gasification Combined Cycle Plants Is Justified.

The Commission asked:

Please provide a justification for why PJM proposes to apply the MOPR to integrated gasification combined cycle plants.²⁰

The proposed MOPR applies only to CTs, CCs and IGCCs. The MOPR should apply to all generation units that enter the market without regard to type.²¹

Unlike CTs and CCs, IGCC projects are not viable without some form of subsidy.²² Allowing unmitigated entry to subsidized units of any type is not consistent with the promotion of competitive wholesale markets. While PJM's argument (at 11) that application of the MOPR to IGCCs is needed to prevent participants from proposing a CC project disguised as an IGCC solely to evade MOPR review is not plausible, the Market Monitor agrees that IGCCs should remain subject to the MOPR rules.

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,



Joseph E. Bowring
Independent Market Monitor for PJM
President

Jeffrey W. Mayes
General Counsel

²⁰ Deficiency Notice at 2 (Question No. 3).

²¹ *See ISO New England Inc.*, 142 FERC ¶ 61,107 (2013); *New England States Commission on Electricity v. ISO New England Inc.*, 142 FERC ¶ 61,108 (2013).

²² *See* 2012 State of the Market Report for PJM at 195–196.

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Dated: March 25, 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 25th day of March, 2013.



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