

elimination of the FMU construct is appropriate, the Market Monitor supports PJM's proposal and recommends that PJM's proposal should be accepted as filed.

PJM has not proposed the complete removal of the FMU rules. PJM's proposal retains the FMU adders but adds a screen that avoids continued unjust, unreasonable and inefficient transfers of wealth from customers to suppliers. PJM's proposal was developed with the Market Monitor and enjoys broad support from stakeholders. Under the rule as proposed, FMUs failing to recover their Avoidable Cost Rate (ACR), or going forward costs, will continue to have the opportunity to submit cost-based energy offers with FMU adders, and there is no valid basis for protest from the owners of potential FMUs.

Because this answer is necessary to resolve any confusion that may be created by Indicated Suppliers' answer and to facilitate the decision making process, the Market Monitor respectfully requests that it be accepted and included in the record for this proceeding.

I. ANSWER

A. Ample Evidence Exists that the Current FMU Rule Provides a Windfall

Indicated Suppliers state (at 4): "PJM's August 26 Filings are remarkable for their failure to provide supporting evidence for PJM's contention that the existing FMU Adders result in "a de facto windfall for the majority of Market Sellers with Frequently Mitigated Units." The FMU adders addressed deficiencies in the market design for certain units that resulted from the absence of a functional capacity market and scarcity pricing. Since that time, PJM has corrected both deficiencies, and PJM continues to work to further improve the capacity market. Rules that permit increased offers, prices and revenues based on a non-existent problem provide a windfall by definition.

The windfall is a double payment for ACR, once through the capacity market and once through the FMU adder.

As part of the stakeholder process related to FMUs, the Market Monitor provided data on FMUs which showed that of the 112 FMUs in 2013, that 28 did not cover ACR in

2013. (Table 1) Thus, 84 of the 112 units covered avoidable costs in 2013 without the FMU adders and thus received a windfall not available to other units in PJM markets. Of the 28 units that did not cover avoidable costs in 2013, 22 of those units are planning to retire and will receive FMU adders until they retire, and the remaining six units will continue to qualify for FMU status if the facts remain unchanged. Contrary to the Indicated Suppliers, the facts demonstrate that the 84 units did not and will not need the FMU adder to cover avoidable costs.² PJM’s proposal would continue to provide FMU adders to units that do not cover avoidable costs.

Table 1 Frequently mitigated units at risk of retirement

	No. of Units	MW
Units that received FMU payments in 2013	112	14,763
FMUs that did not cover ACR in 2013	28	5,342
FMUs that did not cover ACR in 2013 that are scheduled to retire	22	3,908
FMUs that did not cover ACR in 2013 that are not scheduled to retire	6	1,434

Continuing to provide FMU adders to these 84 units and other similarly situated units in the future would be unjust and unreasonable.

B. The Rationale for FMUs Assumes That No Capacity Market Exists to Provide Resource Adequacy.

Indicated Suppliers cite to statements made by the Commission in approving FMUs in 2005 explaining the rationale for FMU rules.³ They argue that “FMU Adders continue to act as a necessary complement to market-based revenues.”⁴ Indicated Suppliers completely ignore major developments in the PJM market design that have made its arguments

² See, the 2014 State of the Market Report for PJM: January through June, Section 3: Energy Market, Table 3-30 at 89, (August 14, 2014).

³ Indicated Suppliers at 5–8, citing *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112 at P 14 (2004) (“*PJM*”), *on reh’g*, 110 FERC ¶ 61,053, *on reh’g & clarification*, 112 FERC ¶ 61,031 (2005).

⁴ *Id.*

obsolete. These Indicated Suppliers' arguments also ignore the fact that PJM has not proposed to eliminate FMU adders.

The Market Monitor proposed the FMU rules as an interim measure to address revenue shortfalls for a subset of units in PJM. The FMU rules were proposed because the PJM market design did not include an effective capacity market or scarcity pricing rules at that time. That is no longer true. Since 2005, PJM has implemented a new capacity market design and scarcity pricing rules.

The RPM capacity market was explicitly designed to address the missing money problem. Offers in the PJM capacity market are defined to include avoidable costs net of net revenues. Every unit has the opportunity to make an offer in the capacity market equal to avoidable costs net of net revenues. If the unit's offer clears in RPM, the unit will recover avoidable costs from a combination of energy and ancillary services revenues and capacity market revenues. This RPM design objective is exactly the same as the original design objective for the FMU adder. Thus there is no reason to retain the FMU adder.

The only reason that a cleared unit might not cover its avoidable costs through the capacity market is if it chooses to offer less than its avoidable costs net of net revenues. That is a choice available to a unit owner but unit owners should not have a special FMU rule designed to cover the shortfall that results from their decisions about how to offer in the capacity market. That option is not available to non-frequently mitigated units.

Indicated Suppliers also assert that the FMU adder should provide revenues in excess of avoidable costs. Again, Indicated Suppliers ignore the fact that the capacity market is designed to address all of the identified cost recovery issues. There is no reason to have a special extra-market source of revenues available only to frequently mitigated units. If there is an issue with the revenues provided in the capacity market, the capacity market should be fixed rather than creating a discriminatory special source of revenues for a subclass of units.

PJM's proposed modifications to the FMU adder rules do not mean that units do not have the opportunity to cover all costs in PJM markets. The PJM market design provides

that opportunity without the FMU adders and PJM's proposal permits FMU adders when PJM markets do not cover avoidable costs for specific units.

C. The FMU Rules Have Nothing to Do with Out of Market Payments or Revealing System Operational or Planning Problems.

Indicated Suppliers (at 2) that "PJM's August 26 Filings simply focus on reducing *payments* to the owners of units that are subject to cost-based offer caps because they have been dispatched out of merit for reliability reasons, thereby creating new problems by depriving owners of resources needed for reliability of needed revenues and leaving the underlying problems that necessitate the out-of-merit dispatch of these resources unresolved" [emphasis in original].

Indicated Suppliers also argue (at 9) that rather the proposing to limit the applicability of FMU adders, that "PJM should instead direct its efforts to ensuring that the constraints causing frequent out-of-merit dispatch of these units are properly modeled." Indicated Suppliers are confused about the relationship between the FMU rules and the underlying reasons for out of merit dispatch. The FMU rules have nothing to with any steps that could resolve "underlying problems that necessitate the out-of-merit dispatch." Out-of-merit order dispatch occurs when transmission lines are constrained and the cheapest available energy cannot be delivered to a constrained area and a unit must be turned on out of economic merit order. This is a routine occurrence and only infrequently results in offer capping. The most efficient grid is not one in which out-of-merit order dispatch never occurs and in which there is no congestion. There is no related "underlying problem" that needs to be solved.

The arguments about modelling of constraints in PJM are ongoing and are being addressed in the stakeholder process in the Energy Market Uplift Senior Task Force. The modelling of constraints has nothing to do with FMU adders and is purely a distraction from the PJM filing.

Indicated Suppliers arguments about modelling and out-of-merit order dispatch (at 9–10) are incorrect and irrelevant to this matter, and, accordingly, should be rejected.

D. APIR and ARPIR Are Appropriately Excluded from the Calculation of Going Forward Costs.

Indicated Suppliers assert (at 10) that it is inappropriate to use only avoidable costs as the metric for receiving an FMU adder and that APIR and ARPIR should also be included. ACR is the avoidable cost rate, which is defined as the costs which a unit must incur each year in order to remain in service and which a unit could avoid by not operating for a year.⁵ Such costs include maintenance expenses but do not include fixed costs, i.e. a return on and of capital. ACR is the marginal cost of capacity. APIR is the avoidable project investment recovery rate, which is defined as the fixed costs of additional investments in capacity resources.⁶ APIR includes fixed costs. ARPIR is the avoidable refunds of project investment reimbursements.⁷ ARPIR provides for the reimbursement by a generation owner of funds received under an RMR (reliability must run) contract associated with a planned retirement if the unit decides to continue to operate after PJM no longer needs the unit for local reliability.⁸ It is not clear why Indicated Suppliers included ARPIR in their filing as it is not relevant to their point.

The goal of the FMU adder was never to approximate cost of service regulation by covering all fixed and variable costs, which appears to be the view of Indicated Suppliers. The original goal of the FMU adder was to provide an opportunity for peaking units that were frequently mitigated to recover their avoidable costs.⁹ In the extreme case, if a peaking

⁵ See OATT Attachment DD § 6.8.

⁶ See OATT Attachment DD § 6.8(a).

⁷ *Id.*

⁸ See *Id.*; see also OATT Schedule 6A.

⁹ See, e.g., *PJM Interconnection, L.L.C.*, 110 FERC ¶61,053 at P 114 (2005) (“...[A] transparent market process is preferable to cost-of-service rates that can cause high uplift payments. These offers are based on reasonable cost adders or going forward costs for the units involved and, therefore, should set the market clearing price. Defining the appropriate cost basis for mitigated offers is not

unit offers and is dispatched entirely at its short run marginal costs and it is always the marginal unit, then the unit's only logical course of action is to shut down. In such a case, the unit is losing money every year by operating. The amount of money the unit loses every year is the avoidable cost. If the unit is covering its avoidable cost, it is economic to continue operating.

The Market Monitor believes that the FMU adder should be eliminated entirely because the introduction of the RPM capacity market in 2007 meant that the peaking units would cover or more than cover their avoidable costs through a combination of energy and ancillary services revenues and capacity market revenues. That is the design objective of the capacity market. The goal of the capacity market is to cover the net cost of new entry in equilibrium. Units which do not cover their avoidable costs from market revenues, including capacity market revenues, are receiving a market signal to retire. Multiple units have retired in the PJM market for this reason. Multiple units have entered the PJM market in response to the incentives provided by the markets including the capacity market. The capacity market continues to require reform, but the situation now is not comparable to the situation in 2005 when the capacity market design did not recognize the missing money problem.

PJM's proposal, which the Market Monitor supports, is a compromise. The compromise does not eliminate the FMU adder but permits the adder only when total market net revenues do not cover avoidable costs. This is a rational test because avoidable costs are the marginal cost of capacity, the costs that must be covered in order for it to be economic to continue operating a unit. APIR should not be included in this test because APIR provides for fixed cost recovery. APIR fixed costs are not part of the marginal cost of capacity. It is economically rational to continue to operate if the unit covers ACR but does

an exact science, but the approach adopted here seeks to establish mitigated prices that would reasonably reflect offers in a competitive market. ”).

not cover APIR. Including APIR in the FMU test would be equivalent to guaranteeing FMU units a margin through an FMU adder. No other units in the PJM markets are guaranteed a margin.

Most units in PJM offer at short run marginal cost because that is a competitive offer.¹⁰ The fact that units are being offer capped means only that they are being required to make competitive offers in the energy market when they would otherwise exercise market power. That is not a hardship that must be compensated through a special tariff provision like the FMU adder when there is a capacity market. It is certainly not a hardship that requires a guaranteed margin that is not available to other market participants.

Unit offers in the capacity market may include both ACR and APIR. If a unit makes a competitive offer in the capacity market, it will recover at least its ACR and its APIR, if any, through the capacity market. That is the reason for the creation of the capacity market. The only reason that a unit would not recover its ACR and its APIR through the capacity market would be if the unit made an offer for less than its ACR and APIR. If the unit decided to make such an offer, the decision means that the unit did not require such revenues in order to remain in business. Nonetheless, the compromise filed by PJM uses the ACR as a threshold for paying an FMU adder. It is not appropriate, in such a circumstance, to guarantee such a unit an additional margin through an FMU adder in the energy market, equal to APIR, that is not subject to competitive pressures. If the unit made an offer in the capacity market and did not clear, the market is sending a signal that the unit is not needed for reliability.

Indicated Suppliers are asking for a discriminatory, out of market, payment to guarantee a margin equal to APIR over and above the results of the competitive PJM markets. Such a payment is not necessary and such a payment is inconsistent with competitive markets. Such a payment would be unjust and unreasonable.

¹⁰ See Market Monitor, 2013 State of the Market Report for PJM (March 13, 2014) at 94–101.

II. MOTION FOR LEAVE TO ANSWER

The Commission's Rules of Practice and Procedure, 18 CFR § 385.213(a)(2), do not permit answers 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.¹¹ 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.

¹¹ See, e.g., *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); *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).

III. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to this pleading 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 2nd day of October, 2014.



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