

## Ancillary Service Markets

The FERC defined six ancillary services in Order No. 888: scheduling, system control and dispatch; reactive supply and voltage control from generation service; regulation and frequency response service; energy imbalance service; operating reserve—synchronized reserve service; and operating reserve—supplemental reserve service.<sup>1</sup> PJM provides scheduling, system control and dispatch and reactive on a cost basis. PJM provides regulation, energy imbalance, synchronized reserve, and supplemental reserve services through market mechanisms.<sup>2</sup> Although not defined by the FERC as an ancillary service, black start service plays a comparable role. Black start service is provided on the basis of formulaic rates or cost.

The MMU analyzed measures of market structure, conduct and performance for the PJM Synchronized Reserve Market, the PJM DASR Market, and the PJM Regulation Market for the first six months of 2018.

**Table 10-1 The tier 2 synchronized reserve market results were competitive**

Market Element	Evaluation	Market Design
Market Structure: Regional Markets	Not Competitive	
Participant Behavior	Competitive	
Market Performance	Competitive	Mixed

- The tier 2 synchronized reserve market structure was evaluated as not competitive because of high levels of supplier concentration.
- Participant behavior was evaluated as competitive because the market rules require competitive, cost-based offers.
- Market performance was evaluated as competitive because the interaction of participant behavior with the market design results in competitive prices.
- Market design was evaluated as mixed. Market power mitigation rules result in competitive outcomes despite high levels of supplier concentration. However, tier 1 reserves are inappropriately compensated when the nonsynchronized reserve market clears with a nonzero price.

<sup>1</sup> 75 FERC ¶ 61,080 (1996).

<sup>2</sup> Energy imbalance service refers to the Real-Time Energy Market.

**Table 10-2 The day-ahead scheduling reserve market results were competitive**

Market Element	Evaluation	Market Design
Market Structure	Not Competitive	
Participant Behavior	Mixed	
Market Performance	Competitive	Mixed

- The day-ahead scheduling reserve market structure was evaluated as not competitive because market participants failed the three pivotal supplier test in 11.4 percent of all cleared hours in the first six months of 2018.
- Participant behavior was evaluated as mixed because while most offers were equal to marginal costs, a significant proportion of offers reflected economic withholding.
- Market performance was evaluated as competitive because there were adequate offers in every hour to satisfy the requirement and the clearing prices reflected those offers, although there is concern about offers above the competitive level affecting prices. Offers above \$0.00 were part of the clearing price in 99 percent of cleared hours.
- Market design was evaluated as mixed because the DASR product does not include performance obligations, and the three pivotal supplier test and appropriate market power mitigation should be added to the market to ensure that market power cannot be exercised.

**Table 10-3 The regulation market results were competitive**

Market Element	Evaluation	Market Design
Market Structure	Not Competitive	
Participant Behavior	Competitive	
Market Performance	Competitive	Flawed

- The regulation market structure was evaluated as not competitive because the PJM Regulation Market failed the three pivotal supplier (TPS) test in 84.7 percent of the hours in the first six months of 2018.
- Participant behavior in the PJM Regulation Market was evaluated as competitive for the first six months of 2018 because market power mitigation requires competitive offers when the three pivotal supplier test

is failed and there was no evidence of generation owners engaging in noncompetitive behavior.

- Market performance was evaluated as competitive, despite significant issues with the market design.
- Market design was evaluated as flawed. The market design has failed to correctly incorporate a consistent implementation of the marginal benefit factor in optimization, pricing and settlement. The market results continue to include the incorrect definition of opportunity cost. The result is significantly flawed market signals to existing and prospective suppliers of regulation.

## Overview

### Primary Reserve

PJM's primary reserves are made up of resources, both synchronized and nonsynchronized, that can provide energy within 10 minutes. Primary reserve is PJM's implementation of the NERC 15-minute contingency reserve requirement.<sup>3</sup>

On April 1, 2018, PJM implemented five minute settlements. PJM determines the primary reserve requirement based on the most severe single contingency every five minutes. The market solution calculates the available tier 1 synchronized reserve every five minutes. In every five minute interval, the required synchronized reserve and nonsynchronized reserve are calculated and dispatched, and there are associated clearing prices (SRMCP and NSRMCP). Scheduled resources are credited based on their five minute assignment and clearing price.

### Market Structure

- **Supply.** Primary reserve is satisfied by both synchronized reserve (generation or demand response currently synchronized to the grid and available within 10 minutes), and nonsynchronized reserve (generation

currently off-line but available to start and provide energy within 10 minutes).

- **Demand.** The PJM primary reserve requirement is 150 percent of the most severe single contingency. In the first six months of 2018, the average primary reserve requirement was 2,257.1 MW in the RTO Zone and 2,234.1 MW in the MAD Subzone.

### Tier 1 Synchronized Reserve

Synchronized reserve is provided by generators or demand response resources synchronized to the grid and capable of increasing output or decreasing load within 10 minutes. Synchronized reserve consists of tier 1 and tier 2 synchronized reserves.

Tier 1 synchronized reserve is part of primary reserve and is the capability of online resources following economic dispatch to ramp up in 10 minutes from their current output in response to a synchronized reserve event. There is no formal market for tier 1 synchronized reserve.

- **Supply.** No offers are made for tier 1 synchronized reserves. The market solution estimates tier 1 synchronized reserve as available 10 minute ramp from the energy dispatch. In the first six months of 2018, there was an average hourly supply of 1,444.1 MW of tier 1 available in the RTO Zone. In the first six months of 2018, there was an average hourly supply of 600.2 MW of tier 1 synchronized reserve available within the MAD Subzone and an additional 851.4 MW of tier 1 available to the MAD Subzone from the RTO Zone.
- **Demand.** The synchronized reserve requirement is calculated each five minute interval as the most severe single contingency within both the RTO Zone and the MAD Subzone. The requirement can be met with tier 1 or tier 2 synchronized reserves.
- **Tier 1 Synchronized Reserve Event Response.** Tier 1 synchronized reserve is paid when a synchronized reserve event occurs and it responds. When a synchronized reserve event is called, all tier 1 response is paid the average

<sup>3</sup> See PJM, "Manual 10: Pre-Scheduling Operations," Rev. 36 (Dec. 22, 2017), p. 24.

of five minute LMPs during the event, rather than hourly integrated LMP, plus \$50 per MW. This is the Synchronized Energy Premium Price.

Of the Degree of Generator Performance (DGP) adjusted tier 1 synchronized reserve MW estimated at market clearing, 53.2 percent actually responded during the three synchronized reserve events with a duration of 10 minutes or longer in the first six months of 2018.

- **Issues.** The competitive offer for tier 1 synchronized reserves is zero, as there is no incremental cost associated with the ability to ramp up from the current economic dispatch point and the appropriate payment for responding to an event is the five-minute LMP plus \$50 per MWh. The tariff requires payment of the tier 2 synchronized reserve market clearing price to tier 1 resources whenever the nonsynchronized reserve market clearing price rises above zero. This requirement was unnecessary and inconsistent with efficient markets. This change had a significant impact on the cost of tier 1 synchronized reserves, resulting in a windfall payment of \$89,719,045 to tier 1 resources in 2014, \$34,397,441 in 2015, \$4,948,084 in 2016, \$2,197,514 in 2017, and \$2,832,294 in the first six months of 2018.

## Tier 2 Synchronized Reserve Market

Tier 2 synchronized reserve is part of primary reserve and is comprised of resources that are synchronized to the grid, that incur costs to be synchronized, that have an obligation to respond, that have penalties for failure to respond, and that must be dispatched in order to satisfy the synchronized reserve requirement.

When the synchronized reserve requirement cannot be met with tier 1 synchronized reserve, PJM uses a market to satisfy the balance of the requirement with tier 2 synchronized reserve. The Tier 2 Synchronized Reserve Market includes the PJM RTO Reserve Zone and a subzone, the Mid-Atlantic Dominion Reserve Subzone (MAD).

## Market Structure

- **Supply.** In the first six months of 2018, the supply of offered and eligible tier 2 synchronized reserve was 23,717.4 MW in the RTO Zone of which 6,527.1 MW was located in the MAD Subzone. 2,203.9 MW of DSR was available in the RTO Zone.
- **Demand.** The average hourly synchronized reserve requirement was 1,568.2 MW in the RTO Reserve Zone and 1,552.9 MW for the Mid-Atlantic Dominion Reserve Subzone. The hourly average required tier 2 synchronized reserve was 389.4 MW in the MAD Subzone and 550.0 MW in the RTO.
- **Market Concentration.** Both the Mid-Atlantic Dominion Subzone Tier 2 Synchronized Reserve Market and the RTO Synchronized Reserve Zone Market were characterized by structural market power in the first six months of 2018.

In the first six months of 2018, the average HHI for tier 2 synchronized reserve in the RTO Zone was 3358 which is classified as highly concentrated. The MMU calculates that 16.1 percent of hours would have failed a three pivotal supplier test.

## Market Conduct

- **Offers.** There is a must offer requirement for tier 2 synchronized reserve. All nonemergency generation capacity resources are required to submit a daily offer for tier 2 synchronized reserve, unless the unit type is exempt. Tier 2 synchronized reserve offers from generating units are subject to an offer cap of marginal cost plus \$7.50 per MW, plus opportunity cost which is calculated by PJM. PJM automatically enters an offer of \$0 for tier 2 synchronized reserve when an offer is not entered by the owner.

## Market Performance

- **Price.** The weighted average price for tier 2 synchronized reserve for all cleared hours/intervals in the Mid-Atlantic Dominion (MAD) Subzone

was \$6.06 per MW in the first six months of 2018, an increase of \$3.27 from the first six months of 2017.

The weighted average price for tier 2 synchronized reserve for all cleared hours/intervals in the RTO Synchronized Reserve Zone was \$6.40 per MW in the first six months of 2018, an increase of \$4.00 from the first six months of 2017.

## Nonsynchronized Reserve Market

Nonsynchronized reserve is part of primary reserve and includes the RTO Reserve Zone and the Mid-Atlantic Dominion Reserve Subzone (MAD). Nonsynchronized reserve is comprised of nonemergency energy resources not currently synchronized to the grid that can provide energy within 10 minutes. Nonsynchronized reserve is available to fill the primary reserve requirement above the synchronized reserve requirement. Generation owners do not submit supply offers for nonsynchronized reserve. PJM defines the demand curve for nonsynchronized reserve and PJM defines the supply curve based on nonemergency generation resources that are available to provide energy and can start in 10 minutes or less (based on offer parameters), and on the resource opportunity costs calculated by PJM.

## Market Structure

- Supply.** In the first six months of 2018, the average hourly supply of eligible nonsynchronized reserve was 2,497.9 MW in the RTO Zone.
- Demand.** Demand for nonsynchronized reserve equals the primary reserve requirement minus the tier 1 synchronized reserve estimate and minus the scheduled tier 2 synchronized reserve.<sup>4</sup> In the RTO Zone, the market cleared an hourly average of 495.5 MW of nonsynchronized reserve in the first six months of 2018.
- Market Concentration.** In the first six months of 2018, the weighted average HHI for cleared nonsynchronized reserve in the RTO Zone was 4289, which is highly concentrated. The MMU calculates that the three pivotal supplier test would have been failed in 91.7 percent of hours.

<sup>4</sup> See PJM, "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018), p. 81. "Because Synchronized Reserve may be utilized to meet the Primary Reserve requirement, there is no explicit requirement for non-synchronized reserves."

## Market Conduct

- Offers.** Generation owners do not submit supply offers. Nonemergency generation resources that are available to provide energy and can start in 10 minutes or less are considered available for nonsynchronized reserves by the market solution software. PJM calculates the associated offer prices based on PJM calculations of resource specific opportunity costs.

## Market Performance

- Price.** The nonsynchronized reserve price is determined by the opportunity cost of the marginal nonsynchronized reserve unit. The nonsynchronized reserve weighted average price for all hours in the RTO Reserve Zone was \$0.20 per MW in the first six months of 2018. The price cleared above \$0.00 in less than one percent of hours/intervals.

## Secondary Reserve

There is no NERC standard for secondary reserve. PJM defines secondary reserve as reserves (online or offline available for dispatch) that can be converted to energy in 30 minutes. PJM defines a secondary reserve requirement but does not have a goal to maintain this reserve requirement in real time.

PJM maintains a day-ahead, offer-based market for 30 minute day-ahead secondary reserve. The Day-Ahead Scheduling Reserve Market (DASR) has no performance obligations except that a unit which clears the DASR market may not be on an outage in real time.<sup>5</sup> If DASR units are on an outage in real time or cleared DASR MW are not available, the DASR payment is not made.

## Market Structure

- Supply.** The DASR Market is a must offer market. Any resources that do not make an offer have their offer set to \$0.00 per MW. DASR is calculated by the day-ahead market solution as the lesser of the 30 minute energy ramp rate or the economic maximum MW minus the day-ahead dispatch

<sup>5</sup> See PJM, "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018), p. 155 §11.2.7.

point for all online units. In the first six months of 2018, the average available hourly DASR was 38,626.4 MW.

- **Demand.** The DASR requirement for 2018 is 5.28 percent of peak load forecast, down from 5.52 percent in 2017. The average DASR MW purchased from the first six months of 2018 was 5,534.0 MW per hour, compared to 4,608.8 MW per hour in 2017.
- **Concentration.** In the first six months of 2018, the MMU calculates that the DASR Market would have failed the three pivotal supplier test in 11.7 percent of hours.

## Market Conduct

- **Withholding.** Economic withholding remains an issue in the DASR Market. The direct marginal cost of providing DASR is zero. PJM calculates the opportunity cost for each resource. All offers by resource owners greater than zero constitute economic withholding. In the first six months of 2018, a daily average of 38.6 percent of units offered above \$0.00. A daily average of 15.5 percent of units offered above \$5.
- **DR.** Demand resources are eligible to participate in the DASR Market. Some demand resources have entered offers for DASR. No demand resources cleared the DASR market in 2018.

## Market Performance

- **Price.** In the first six months of 2018, the weighted average DASR price for all hours when the DASRMCP was above \$0.00 was \$0.99.

## Regulation Market

The PJM Regulation Market is a real-time market. Regulation is provided by generation resources and demand response resources that qualify to follow one of two regulation signals, RegA or RegD. PJM jointly optimizes regulation with synchronized reserve and energy to provide all three products at least cost. The PJM regulation market design includes three clearing price components: capability; performance; and opportunity cost. The RegA signal

is designed for energy unlimited resources with physically constrained ramp ability. The RegD signal is designed for energy limited resources with fast ramp rates. In the Regulation Market RegD MW are converted to effective MW using a marginal rate of substitution (MRTS), called a marginal benefit function (MBF). Correctly implemented, the MBF would be the marginal rate of technical substitution (MRTS) between RegA and RegD, holding the level of regulation service constant. The current market design is critically flawed as it has not properly implemented the MBF as an MRTS between RegA and RegD resource MW and the MBF has not been consistently applied in the optimization, clearing and settlement of the Regulation Market.

## Market Structure

- **Supply.** In the first six months of 2018, the average hourly eligible supply of regulation for nonramp hours was 1,088.7 performance adjusted MW (850.7 effective MW). This was a decrease of 56.6 performance adjusted MW (an increase of 2.6 effective MW) from the first six months of 2017, when the average hourly eligible supply of regulation was 1,145.2 performance adjusted MW (848.1 effective MW). In the first six months of 2018, the average hourly eligible supply of regulation for ramp hours was 1,379.2 performance adjusted MW (1,168.0 effective MW). This was a decrease of 39.7 performance adjusted MW (an increase of 7.3 effective MW) from the first six months of 2017, when the average hourly eligible supply of regulation was 1,418.9 performance adjusted MW (1,160.7 effective MW).
- **Demand.** Prior to January 9, 2017, the hourly regulation demand was set to 525.0 effective MW for nonramp hours and 700.0 effective MW for ramp hours. Starting January 9, 2017, the hourly regulation demand was set to 525.0 effective MW for nonramp hours and 800.0 effective MW for ramp hours.
- **Supply and Demand.** The nonramp regulation requirement of 525.0 effective MW was provided by a combination of RegA and RegD resources equal to 486.4 hourly average performance adjusted actual MW in the first six months of 2018. This is a decrease of 10.6 performance adjusted

actual MW from the first six months of 2017, when the average hourly total regulation cleared performance adjusted actual MW for nonramp hours were 497.0 MW. The ramp regulation requirement of 800.0 effective MW was provided by a combination of RegA and RegD resources equal to 746.6 hourly average performance adjusted actual MW in the first six months of 2018. This is an increase of 32.3 performance adjusted actual MW from the first six months of 2017, where the average hourly regulation cleared MW for ramp hours were 714.3 performance adjusted actual MW.

The ratio of the average hourly eligible supply of regulation to average hourly regulation demand (performance adjusted cleared MW) for ramp hours was 1.85 in the first six months of 2018. This is a decrease of 7.2 percent from the first six months of 2017, when the ratio was 1.99. The ratio of the average hourly eligible supply of regulation to average hourly regulation demand (performance adjusted cleared MW) for nonramp hours was 2.24 in the first six months of 2018. This is a decrease of 2.7 percent from the first six months of 2017, when the ratio was 2.30.

- **Market Concentration.** In the first six months of 2018, the effective MW weighted average HHI of RegA resources was 2406 which is highly concentrated and the weighted average HHI of RegD resources was 1559 which is also highly concentrated.<sup>6</sup> The weighted average HHI of all resources was 1106, which is moderately concentrated. In the first six months of 2018, the three pivotal supplier test was failed in 84.7 percent of hours.

## Market Conduct

- **Offers.** Daily regulation offer prices are submitted for each unit by the unit owner. Owners are required to submit a cost-based offer and may submit a price-based offer. Offers include both a capability offer and a performance offer. Owners must specify which signal type the unit will be following, RegA or RegD.<sup>7</sup> In the first six months of 2018, there were

<sup>6</sup> HHI results are based on market shares of effective MW, defined as regulation capability MW adjusted by performance score and resource specific benefit factor, consistent with the way the regulation market is cleared.

<sup>7</sup> See the 2017 *State of the Market Report for PJM*, Vol. 2, Appendix F "Ancillary Services Markets."

193 resources following the RegA signal and 61 resources following the RegD signal.

## Market Performance

- **Price and Cost.** The weighted average clearing price for regulation was \$32.99 per MW of regulation in the first six months of 2018. This is an increase of \$17.91 per MW, or 118.8 percent, from the weighted average clearing price of \$15.08 per MW in the first six months of 2017. The weighted average cost of regulation in the first six months of 2018 was \$40.71 per MW of regulation. This is an increase of \$20.05 per MW, or 97.0 percent, from the weighted average cost of \$20.67 per MW in the first six months of 2017.
- **Prices.** RegD resources continue to be incorrectly compensated relative to RegA resources due to an inconsistent application of the marginal benefit factor in the optimization, assignment and settlement processes. If the Regulation Market were functioning efficiently, RegD and RegA resources would be paid the same price per effective MW. RegA resources are paid on the basis of dollars per effective MW of RegA. RegD resources are not paid in terms of dollars per effective MW of RegA because the marginal benefit factor is not used in settlements. When the marginal benefit factor is above 1.0, RegD resources are generally (depending on the mileage ratio) underpaid on a per effective MW basis. When the MBF is less than one, RegD resources are generally overpaid on a per effective MW basis.
- **Marginal Benefit Factor Function.** The marginal benefit factor (MBF) is intended to measure the operational substitutability of RegD resources for RegA resources. The marginal benefit factor function is incorrectly defined and applied in the PJM market clearing. Correctly defined, the MBF function represents the Marginal Rate of Technical Substitution (MRTS) between RegA and RegD. Correctly implemented, the MBF would be consistently applied in the Regulation Market clearing and settlement. The current incorrect and inconsistent implementation of the MBF function has resulted in the PJM Regulation Market over procuring RegD relative to RegA in most hours and in a consistently inefficient

market signal to participants regarding the value of RegD to the market in every hour. This over procurement can also degrade the ability of PJM to control ACE.

- **Changes to the Regulation Market.** The MMU and PJM developed a joint proposal to address the significant flaws in the regulation market design which was approved by the PJM Members Committee on July 27, 2017 and filed with the FERC on October 17, 2017. The proposal addresses issues with the inconsistent application of the marginal benefit factor throughout the optimization and settlement process in the PJM Regulation Market. On March 30, 2018, this joint proposal was rejected by the FERC.<sup>8</sup> The MMU and PJM have filed requests for rehearing.<sup>9</sup>

## Black Start Service

Black start service is required for the reliable restoration of the grid following a blackout. Black start service is the ability of a generating unit to start without an outside electrical supply, or is the demonstrated ability of a generating unit to automatically remain operating at reduced levels when disconnected from the grid (automatic load rejection or ALR).<sup>10</sup>

In the first six months of 2018, total black start charges were \$33.2 million, including \$33.1 million in revenue requirement charges and \$0.023 million in operating reserve charges. Black start revenue requirements consist of fixed black start service costs, variable black start service costs, training costs, fuel storage costs, and an incentive factor. Black start operating reserve charges are paid to units scheduled in the Day-Ahead Energy Market or committed in real time to provide black start service under the ALR option or for black start testing. Black start zonal charges for the first six months of 2018 ranged from \$0.05 per MW-day in the DLCO Zone (total charges were \$25,579) to \$4.37 per MW-day in the PENELEC Zone (total charges were \$2,287,099).

<sup>8</sup> 162 FERC ¶ 61,295.

<sup>9</sup> FERC Docket No. ER18-87-002.

<sup>10</sup> OATT Schedule 1 § 1.3BB.

## Reactive

Reactive service, reactive supply and voltage control are provided by generation and other sources of reactive power (measured in MVar). Reactive power helps maintain appropriate voltage levels on the transmission system and is essential to the flow of real power (measured in MW).

Reactive capability revenue requirements are based on FERC approved filings that permit recovery based on a cost of service approach.<sup>11</sup> Reactive service charges are paid to units that operate in real time outside of their normal range at the direction of PJM for the purpose of providing reactive service. Reactive service charges are paid for scheduling in the Day-Ahead Energy Market and committing units in real time that provide reactive service. In the first six months of 2018, total reactive charges were \$175.7 million, an 8.9 percent increase from \$161.3 million in the first six months of 2017. Reactive capability revenue requirement charges increased from \$152.0 million in the first six months of 2017 to \$165.0 million in the first six months of 2018 and reactive service charges increased from \$9.3 million in the first six months of 2017 to \$10.7 million in the first six months of 2018. Total reactive service charges in the first six months of 2018 ranged from \$0 in the RECO Zone, which has no generating units, to \$28.4 million in the ComEd Zone.

## Frequency Response

In response to a November 17, 2016 FERC NOPR, PJM formed the Primary Frequency Response Senior Task Force (PFRSTF) to review primary frequency response and propose changes to its tariff and operating manuals, including consideration of compensation mechanisms if needed.<sup>12</sup>

## Ancillary Services Costs per MWh of Load: January through June, 1999 through 2018

Table 10-4 shows PJM ancillary services costs for the first six months of 1999 through 2018, per MWh of load. The rates are calculated as the total charges for the specified ancillary service divided by the total PJM real-time load

<sup>11</sup> OATT Schedule 2.

<sup>12</sup> *Essential Reliability Services and the Evolving Bulk-Power System – Primary Frequency Response*, Notice of Proposed Rulemaking, 157 FERC ¶ 61,122 (2016) ("NOPR").

in MWh. The scheduling, system control, and dispatch category of costs is comprised of PJM scheduling, PJM system control and PJM dispatch; owner scheduling, owner system control and owner dispatch; other supporting facilities; black start services; direct assignment facilities; and ReliabilityFirst Corporation charges. The cost per MWh of load in Table 10-4 is a different metric than the cost of each ancillary service per MW of that service. The cost per MWh of load includes the effects both of price changes per MW of the ancillary service and changes in total load.

**Table 10-4 History of ancillary services costs per MWh of Load: January through June, 1999 through 2018<sup>13</sup>**

Year (Jan-Jun)	Regulation	Scheduling, Dispatch and System Control	Reactive	Synchronized Reserve	Total
1999	\$0.08	\$0.23	\$0.27	\$0.00	\$0.58
2000	\$0.26	\$0.32	\$0.33	\$0.00	\$0.91
2001	\$0.50	\$0.73	\$0.22	\$0.00	\$1.45
2002	\$0.31	\$0.81	\$0.19	\$0.00	\$1.31
2003	\$0.57	\$1.06	\$0.24	\$0.16	\$2.03
2004	\$0.53	\$1.07	\$0.26	\$0.16	\$2.02
2005	\$0.58	\$0.80	\$0.27	\$0.11	\$1.76
2006	\$0.48	\$0.74	\$0.29	\$0.08	\$1.59
2007	\$0.61	\$0.71	\$0.27	\$0.09	\$1.68
2008	\$0.73	\$0.52	\$0.34	\$0.08	\$1.67
2009	\$0.38	\$0.32	\$0.36	\$0.04	\$1.10
2010	\$0.34	\$0.36	\$0.37	\$0.06	\$1.13
2011	\$0.33	\$0.36	\$0.40	\$0.10	\$1.19
2012	\$0.20	\$0.43	\$0.47	\$0.03	\$1.13
2013	\$0.26	\$0.43	\$0.65	\$0.03	\$1.37
2014	\$0.46	\$0.43	\$0.42	\$0.20	\$1.51
2015	\$0.29	\$0.42	\$0.37	\$0.14	\$1.22
2016	\$0.11	\$0.43	\$0.39	\$0.05	\$0.98
2017	\$0.13	\$0.49	\$0.43	\$0.06	\$1.11
2018	\$0.21	\$0.39	\$0.38	\$0.07	\$1.05

<sup>13</sup> Note: The totals Table 10-4 account for after the fact billing adjustments made by PJM and may not match totals presented in past reports.

## Recommendations

- The MMU recommends that the Regulation Market be modified to incorporate a consistent application of the marginal benefit factor (MBF) throughout the optimization, assignment and settlement process. The MBF should be defined as the Marginal Rate of Technical Substitution (MRTS) between RegA and RegD. (Priority: High. First reported 2012. Status: Not adopted. FERC rejected, pending rehearing request before FERC.)
- The MMU recommends that the lost opportunity cost in the ancillary services markets be calculated using the schedule on which the unit was scheduled to run in the energy market. (Priority: High. First reported 2010. Status: Not adopted. FERC rejected, pending rehearing request before FERC.)
- The MMU recommends that the lost opportunity cost calculation used in the Regulation Market be based on the resource's dispatched energy offer schedule, not the lower of its price or cost offer schedule. (Priority: Medium. First reported 2010. Status: FERC rejected, pending rehearing request before FERC.)
- The MMU recommends that, to prevent gaming, there be a penalty enforced in the Regulation Market as a reduction in performance score and/or a forfeiture of revenues when resource owners elect to deassign assigned regulation resources within the hour. (Priority: Medium. First reported 2016. Status: Not adopted. FERC rejected, pending rehearing request before FERC.)
- The MMU recommends enhanced documentation of the implementation of the Regulation Market design. (Priority: Medium. First reported 2010. Status: FERC rejected, pending rehearing request before FERC.)
- The MMU recommends that all data necessary to perform the Regulation Market three pivotal supplier test be saved so that the test can be replicated. (Priority: Medium. First reported 2016. Status: Partially adopted. )
- The MMU recommends the use of a single five minute clearing price based on actual five minute LMP and lost opportunity cost to improve the performance of the Regulation Market. (Priority: Medium. First reported 2010. Status: Adopted in 2012.)

- The MMU recommends that PJM be required to save data elements necessary for verifying the performance of the Regulation Market. (Priority: Medium. First reported 2010. Status: Not adopted.)
- The MMU recommends that the rule requiring that tier 1 synchronized reserve resources are paid the tier 2 price when the nonsynchronized reserve price is above zero be eliminated immediately and that, under the current rule, tier 1 synchronized reserve resources not be paid the tier 2 price when they do not respond. (Priority: High. First reported 2013. Status: Not adopted.)
- The MMU recommends that the tier 2 synchronized reserve must offer requirement be enforced on a daily and hourly basis. The MMU recommends that PJM define a set of acceptable reasons why a unit can be made unavailable daily or hourly and require unit owners to select a reason in Markets Gateway whenever making a unit unavailable either daily or hourly or setting the offer MW to 0 MW. (Priority: Medium. First reported 2013. Status: Partially adopted.)
- The MMU recommends that PJM be more explicit and transparent about why tier 1 biasing is used in defining demand in the Tier 2 Synchronized Reserve Market. The MMU recommends that PJM define rules for estimating tier 1 MW, define rules for the use and amount of tier 1 biasing and identify the rule based reasons for each instance of biasing. (Priority: Medium. First reported 2012. Status: Not adopted.)
- The MMU recommends that the single clearing price for synchronized reserves be determined based on the actual five minute LMP and actual LOC and not the forecast LMP. (Priority: Low. First reported 2010. Status: Adopted, 2016.)
- The MMU recommends that no payments be made to tier 1 resources if they are deselected in the PJM market solution. The MMU also recommends that documentation of the Tier 1 synchronized reserve deselection process be published. (Priority: High. First reported 2014. Status: Adopted, 2014.)
- The MMU recommends that a reason code be attached to every hour in which PJM market operations adds additional DASR MW. (Priority: Medium. First reported 2015. Status: Not adopted.)
- The MMU recommends that PJM modify the DASR Market to ensure that all resources cleared incur a real-time performance obligation. (Priority: Low. First reported 2013. Status: Not adopted.)
- The MMU recommends that the three pivotal supplier test and market power mitigation be incorporated in the DASR Market. (Priority: Low. First reported 2009. Status: Not adopted.)
- The MMU recommends that separate payments for reactive capability be eliminated and the cost of reactive capability be recovered in the capacity market. (Priority: Medium. First reported 2016. Status: Not adopted.)
- The MMU recommends that for oil tanks which are shared with other resources only a proportionate share of the minimum tank suction level (MTSL) be allocated to black start service. The MMU further recommends that the PJM tariff be updated to clearly state how the MTS will be calculated for black start units sharing oil tanks. (Priority: Medium. First reported 2017. Status: Not adopted.)
- The MMU recommends that capability to operate under the proposed deadband (+/- 0.036 HZ) and droop (5 percent) settings be mandated as a condition of interconnection and that such capability be required of both new and existing resources. The MMU recommends that no additional compensation be provided as the current PJM market design provides adequate compensation. (Priority: Low. First reported 2017. Status: Not adopted.)

## Conclusion

The current PJM regulation market design that incorporates two signals using two resource types was a result of FERC Order No. 755 and subsequent orders that required a flawed design.<sup>14</sup>

The current design of the PJM Regulation Market is significantly flawed. The market design has failed to correctly incorporate the marginal rate of technical substitution (MRTS) in market clearing and settlement. The market design uses the marginal benefit factor (MBF) to incorrectly represent the MRTS and uses

<sup>14</sup> Frequency Regulation Compensation in the Organized Wholesale Power Markets, Order No. 755, 137 FERC ¶ 61,064 at PP 197–200 (2011).

a mileage ratio instead of the MBF in settlement. This failure to correctly and consistently incorporate the MRTS into the regulation market design has resulted in both underpayment and overpayment of RegD resources and in the over procurement of RegD resources in all hours. The market results continue to include the incorrect definition of opportunity cost. These issues have led to the MMU's conclusion that the regulation market design is flawed.

To address these flaws, the MMU and PJM developed a joint proposal which was approved by the PJM Members Committee on July 27, 2017 and filed with FERC on October 17, 2017.<sup>15</sup> The PJM/MMU joint proposal addresses issues with the inconsistent application of the marginal benefit factor throughout the optimization and settlement process in the PJM Regulation Market. The FERC rejected the joint proposal on March 30, 2018 as being noncompliant with Order No. 755.<sup>16</sup> The MMU and PJM have separately filed requests for rehearing.<sup>17</sup>

The structure of the Tier 2 Synchronized Reserve Market has been evaluated and the MMU has concluded that these markets are not structurally competitive as they are characterized by high levels of supplier concentration and inelastic demand. As a result, these markets are operated with market clearing prices and with offers based on the marginal cost of producing the product plus a margin. As a result of these requirements, the conduct of market participants within these market structures has been consistent with competition, and the market performance results have been competitive. However, compliance with calls to respond to actual synchronized reserve events remains less than 100 percent. For the six spinning events 10 minutes or longer in 2016, the average tier 2 synchronized reserve response was 85.5 percent of all scheduled MW. For the six spinning events 10 minutes or longer in 2017, the response was 87.6 percent of scheduled tier 2 MW. For the four spinning events longer than 10 minutes in the first six months of 2018, the response was 75.2 percent of scheduled tier 2 MW.

<sup>15</sup> 18 CFR § 385.211 (2017).

<sup>16</sup> 162 FERC ¶ 61,295 (2018).

<sup>17</sup> The MMU filed its request for rehearing on April 27, 2018, and PJM filed its request for rehearing on April 30, 2018.

The rule that requires payment of the tier 2 synchronized reserve price to tier 1 synchronized reserve resources when the nonsynchronized reserve price is greater than zero, is inefficient and results in a substantial windfall payment to the holders of tier 1 synchronized reserve resources. Tier 1 resources have no obligation to perform and pay no penalties if they do not perform, and tier 1 resources do not incur any costs when they are part of the tier 1 estimate in the market solution. Tier 1 resources are already paid for their response if they do respond. Tier 1 resources require no additional payment. If tier 1 resources wish to be paid as tier 2 resources, the rules provide the opportunity to make competitive offers in the tier 2 market and take on the associated obligations. Overpayment of tier 1 resources based on this rule added \$89.7 million to the cost of primary reserve in 2014, \$34.1 million in 2015, \$4.9 million in 2016, \$2.2 million in 2017, and \$2,832,294 in the first six months of 2018.

The benefits of markets are realized under these approaches to ancillary service markets. Even in the presence of structurally noncompetitive markets, there can be transparent, market clearing prices based on competitive offers that account explicitly and accurately for opportunity cost. This is consistent with the market design goal of ensuring competitive outcomes that provide appropriate incentives without reliance on the exercise of market power and with explicit mechanisms to prevent the exercise of market power.

The MMU concludes that the regulation market results were competitive, although the market design is flawed. The MMU concludes that the synchronized reserve market results were competitive. The MMU concludes that the DASR market results were competitive, although offers above the competitive level continue to affect prices.

## Primary Reserve

NERC Performance Standard BAL-002-2, Disturbance Control Performance, requires PJM to carry sufficient contingency reserve to recover from a sudden loss of load (disturbance) within 15 minutes. The NERC requirement is 100 percent compliance and status must be reported quarterly. PJM implements this contingency reserve requirement using primary reserves.<sup>18</sup>

<sup>18</sup> See PJM "Manual 10: Pre-Scheduling Operations," Rev. 36 (Dec. 22, 2017) at 22.

PJM maintains 10 minute reserves (primary reserve) to ensure reliability in the event of disturbances. PJM's primary reserves are made up of resources, both synchronized and nonsynchronized, that can provide energy within 10 minutes.

## Market Structure

### Demand

PJM requires that 150 percent of the largest contingency on the system be maintained as primary reserve. PJM can make temporary adjustments to the primary reserve requirement when grid maintenance or outages change the largest contingency or in cases of hot weather alerts or cold weather alerts.

On July 12, 2017, PJM adopted a dynamic reserve requirement set equal to 150 percent of the largest contingency, determined hourly, based on the forecasted dispatch.

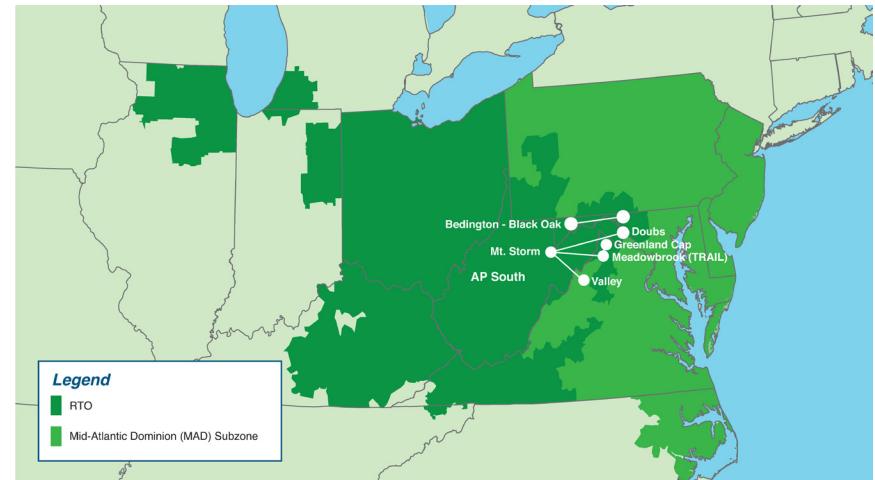
PJM can, for conservative operations, raise the primary and synchronized reserve requirement. Between January and June 2018, the average hourly primary reserve requirement for the RTO Zone was 2,257.1 MW. Between January and June 2018, the average hourly primary reserve requirement in the MAD Subzone was 2,234.1 MW. These averages include the hours when PJM raised the requirements as specified in Table 10-5.

**Table 10-5 Temporary adjustments to primary and synchronized reserve, January through June 2018**

From	To	Number of Hours	Amount of Adjustment
8-Jan-18	8-Jan-18	5	Primary reserve (450MW), Synchronized reserve (300MW)
28-Feb-18	3-Mar-18	55	Primary reserve (450MW), Synchronized reserve (300MW)
7-Mar-18	7-Mar-18	5	Primary reserve (450MW), Synchronized reserve (300MW)
15-Mar-18	15-Mar-18	18	Primary reserve (450MW), Synchronized reserve (300MW)
25-Apr-18	25-Apr-18	8	Primary reserve (950MW), Synchronized reserve (1,430MW)
14-Jun-18	14-Jun-18	4	Primary reserve (1,250MW), Synchronized reserve (850MW)
15-Jun-18	15-Jun-18	12	Primary reserve (2,050MW), Synchronized reserve (1,350MW)

Transmission constraints limit the deliverability of reserves within the RTO, requiring the definition of the Mid-Atlantic Dominion (MAD) Subzone (Figure 10-1).<sup>19</sup>

**Figure 10-1 PJM RTO Zone and MAD Subzone geography**



The MAD Subzone is generally defined dynamically by the most limiting constraint separating MAD from the PJM RTO Reserve Zone. However, PJM can override the dynamic determination. In the first six months of 2018, AP South was the most limiting interface in over 99 percent of cleared hours.

The NERC standard for primary reserves in a control area is equal to 150 percent of the control area's largest contingency. PJM requires that synchronized reserves equal at least 100 percent of the largest contingency. For the first six months of 2018, the hourly average synchronized reserve requirement in the RTO Zone was 1,568.2 MW. For the first six months of 2018, the hourly average synchronized reserve requirement in the MAD Subzone was 1,552.9 MW. Beginning April 1, 2018, the synchronized reserve requirement is

<sup>19</sup> Additional subzones may be defined by PJM to meet system reliability needs. PJM will notify stakeholders in such an event. See PJM Manual 11: Energy & Ancillary Services Market Operations, Rev. 97 (July 26, 2018) at 75.

calculated every five minutes. Prior to April 1, 2018 the synchronized reserve requirement was calculated hourly.

## Supply

The demand for primary reserve is satisfied by tier 1 synchronized reserves, tier 2 synchronized reserves and nonsynchronized reserves, subject to the requirement that synchronized reserves equal 100 percent of the largest contingency. After the hourly synchronized reserve requirement is satisfied, the remainder of primary reserves can come from the least expensive combination of synchronized and nonsynchronized reserves.

Estimated tier 1 is credited against PJM's primary reserve requirement as well as PJM's synchronized reserve requirement. In the MAD Subzone, an average of 1,451.6 MW of tier 1 was identified by the ASO market solution as available hour ahead in the first six months of 2018 (Table 10-7).<sup>20</sup> Of that 1,451.6 MW, an average of 851.4 MW was available from outside the MAD Subzone. Tier 1 synchronized reserve fully satisfied the MAD Subzone synchronized reserve requirement or reduced the need for tier 2 synchronized reserve to zero-cost self scheduled in 39.0 percent of hours in the first six months of 2018. In the RTO Zone, an average of 1,444.1 MW of tier 1 was available (Table 10-7).

Regardless of online/offline state, all nonemergency generation capacity resources must submit a daily offer for tier 2 synchronized reserve in Markets Gateway prior to the offer submission deadline (14:15 the day prior to the operating day). Resources listed as available for tier 2 synchronized reserve without a synchronized reserve offer will have their offer price automatically set to \$0.00. Offer MW and other non-cost offer parameters can be changed during the operating day. Prior to November 1, 2017, owners were permitted to make resources unavailable for tier 2 synchronized reserve daily or hourly, but only if they were physically unavailable. After November 1, 2017, owners who opt in for intraday updates may change their offer price up to 65 minutes before the hour. Certain unit types including nuclear, wind, solar, and energy

<sup>20</sup> ASO, Ancillary Services Optimizer. This is the hour-ahead market software that optimizes ancillary services with energy. ASO schedules hourly the Tier 2 Synchronized Reserve, Regulation, and Nonsynchronized Reserves.

storage resources, are expected to have zero MW tier 2 synchronized reserve offer quantities.<sup>21</sup>

After tier 1 is estimated, the remainder of the synchronized reserve requirement is met by tier 2. In the RTO Zone, there were 25,714.1 MW of tier 2 synchronized reserve offered daily. Of this, 6,772.6 MW were located in the MAD Subzone (Figure 10-10) and available to meet the average tier 2 hourly demand of 307.9 MW (Table 10-6).

In the MAD Subzone, there was an average of 2,239.4 MW of eligible nonsynchronized reserve supply available to meet the average hourly demand for primary reserve above the synchronized reserve requirement. (Table 10-7) In the RTO Zone, an hourly average of 2,503.6 MW supply was available to meet the average hourly demand of 495.7 MW (Table 10-6).

Table 10-6 provides the average hourly reserves, by type, used to satisfy the primary reserve requirement in the MAD Subzone from January 1, 2017, through June 30, 2018.

**Table 10-6 Average monthly reserves used to satisfy the primary reserve requirement, MAD Subzone: January 2017 through June 2018**

Year	Month	Tier 1 Total MW	Tier 2 Synchronized Reserve MW	Nonsynchronized Reserve MW	Total Primary Reserve MW
2017	Jan	981.6	356.1	361.1	1,698.9
2017	Feb	1,111.6	233.2	377.7	1,722.5
2017	Mar	767.4	453.3	399.3	1,620.0
2017	Apr	896.9	362.4	435.4	1,694.7
2017	May	1,164.6	376.8	440.8	1,982.2
2017	Jun	1,373.0	379.6	459.9	2,212.5
2017	Jul	1,391.9	353.3	448.2	2,193.4
2017	Aug	1,438.3	226.9	451.8	2,117.0
2017	Sep	1,419.2	339.7	442.1	2,201.0
2017	Oct	1,364.2	348.1	460.4	2,172.7
2017	Nov	1,392.1	245.9	428.0	2,066.0
2017	Dec	1,411.5	160.0	478.9	2,050.4
2017		1,226.0	319.6	432.0	1,977.6
2018	Jan	1,510.0	273.2	466.0	2,249.2
2018	Feb	1,541.5	247.0	475.7	2,264.2
2018	Mar	1,465.7	333.4	470.3	2,269.4
2018	Apr	1,373.3	421.3	437.5	2,232.1
2018	May	1,334.7	412.9	456.0	2,203.6
2018	Jun	1,491.0	152.5	574.6	2,218.1
2018		1,452.7	306.7	480.0	2,239.4

Table 10-7 provides the average monthly reserves, by type, used to satisfy the primary reserve requirement in the RTO Zone for January 2017 through June 2018.

**Table 10-7 Average monthly reserves used to satisfy the primary reserve requirement, RTO Zone: January 2017 through June 2018**

Year	Month	Tier 1 Total MW	Tier 2 Synchronized Reserve MW	Nonsynchronized Reserve MW	Total Primary Reserve MW
2017	Jan	1,020.4	730.6	372.3	2,308.2
2017	Feb	1,172.0	508.3	395.1	2,253.2
2017	Mar	654.2	693.1	420.9	2,204.0
2017	Apr	805.1	623.0	452.2	2,216.5
2017	May	924.1	560.7	454.0	2,257.5
2017	Jun	1,413.5	568.8	474.9	2,533.0
2017	Jul	1,540.1	667.6	459.5	2,675.7
2017	Aug	1,512.8	517.0	466.9	2,589.9
2017	Sep	1,368.9	496.6	453.2	2,442.3
2017	Oct	1,104.3	528.5	477.3	2,110.1
2017	Nov	1,173.6	465.6	447.3	2,086.5
2017	Dec	1,308.4	417.8	497.9	2,224.1
2017		1,166.4	564.8	447.6	2,325.1
2018	Jan	1,536.3	502.1	479.9	2,518.3
2018	Feb	1,770.9	358.2	492.3	2,621.4
2018	Mar	1,465.6	513.2	491.0	2,469.8
2018	Apr	881.4	926.8	455.9	2,264.1
2018	May	1,085.5	761.3	470.5	2,317.3
2018	Jun	1,955.1	290.5	584.9	2,830.5
2018		1,449.1	558.7	495.7	2,503.6

## Supply and Demand

The market solution software relevant to reserves consists of: the Ancillary Services Optimizer (ASO) solving hourly; the intermediate term security constrained economic dispatch market solution (IT-SCED); and the real-time (short term) security constrained economic dispatch market solution (RT-SCED).

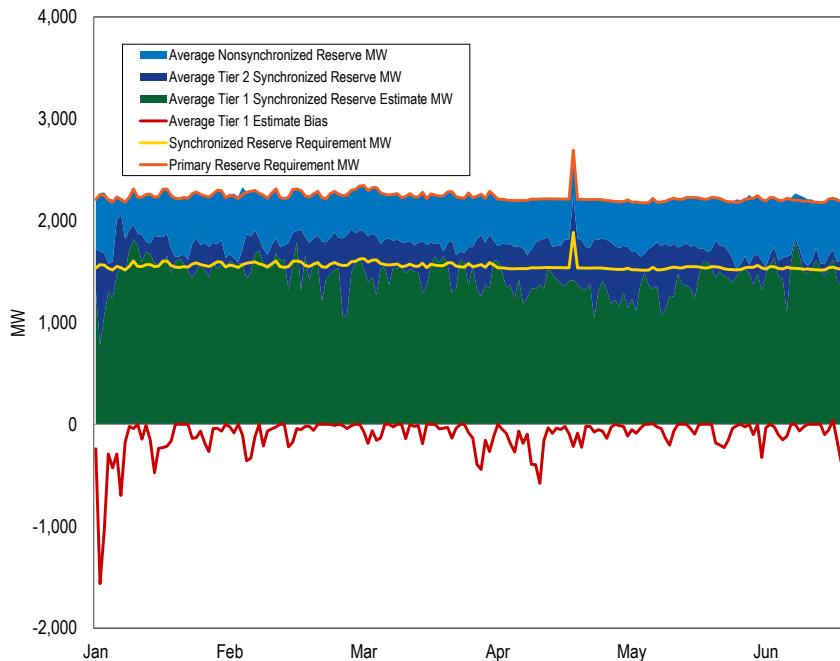
The ASO market solution determines the actual primary reserves required each hour as one hundred and fifty percent of the largest contingency based on generation and transmission resources. Of this, synchronized reserves must be one hundred percent of the largest contingency. The ASO first assigns self-scheduled synchronized reserves and then estimates the amount of tier 1 synchronized reserves available. The remainder of the requirement up to the synchronized reserve required is filled by a market solution of tier 2

synchronized reserves. Above that requirement, the ASO and RT-SCED jointly optimize energy, synchronized reserves, and nonsynchronized reserves based on forecast system conditions to determine the most economic set of resources to commit for primary reserve in the upcoming operating hour. Figure 10-2 and Figure 10-3 show the components of primary reserve in the solution.

IT-SCED runs at 15 minute intervals and jointly optimizes energy and reserves given the ASO's inflexible unit commitments. IT-SCED estimates available tier 1 synchronized reserve and can commit additional reserves (flexibly or inflexibly) if needed. RT-SCED runs at five minute intervals and produces load forecasts up to 20 minutes ahead. The RT-SCED estimates the available tier 1, provides a real-time ancillary services solution and can commit additional tier 2 resources (flexibly or inflexibly) if needed.

Figure 10-2 illustrates how the ASO satisfies the primary reserve requirement (orange line) for the Mid-Atlantic Dominion Subzone. For the Mid-Atlantic Dominion Reserve Zone primary reserve solution the ASO must first satisfy the synchronized reserve requirement (yellow line) which is calculated hourly in the MAD Subzone. The ASO first estimates how much tier 1 synchronized reserve (green area) is available. If there is enough tier 1 MW available to satisfy the synchronized reserve requirement, then ASO jointly optimizes synchronized reserve and nonsynchronized reserve to assign the remaining primary reserve up to the primary reserve requirement. If there is not enough tier 1 synchronized reserve then the remaining synchronized reserve requirement up to the synchronized reserve is filled with tier 2 synchronized reserve (dark blue area). After synchronized reserve is assigned, the primary reserve requirement is filled by jointly optimizing synchronized reserve and nonsynchronized reserve (light blue area). Since nonsynchronized reserve is priced lower than or equal to synchronized reserve, almost all primary reserve above the synchronized reserve requirement is filled by nonsynchronized reserve.

**Figure 10-2 Mid-Atlantic Dominion subzone primary reserve MW by source (Daily Averages): January through June, 2018**



The solution method is the same for the RTO Reserve Zone.<sup>22</sup> Figure 10-3 shows how the hour ahead ASO satisfies the primary reserve requirement for the RTO Zone.

<sup>22</sup> Although tier 1 has a price of zero, changes made with shortage pricing on November 1, 2012, have given tier 1 a very high cost in some hours. This high cost raises questions about the economics of the solution method used by the ASO, IT-SCED, and RT-SCED market solutions which assume zero cost.

**Figure 10-3 RTO reserve zone primary reserve MW by source (Daily Averages): January through June, 2018**

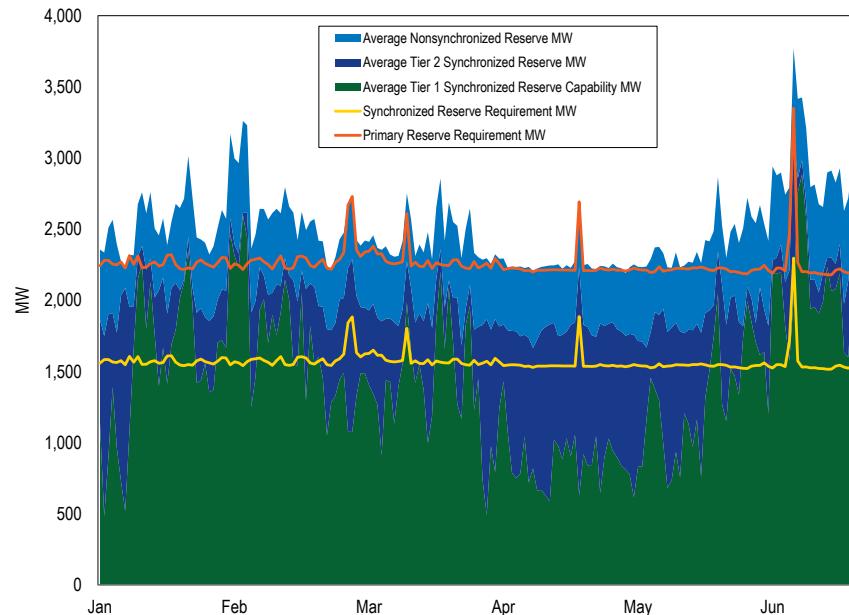
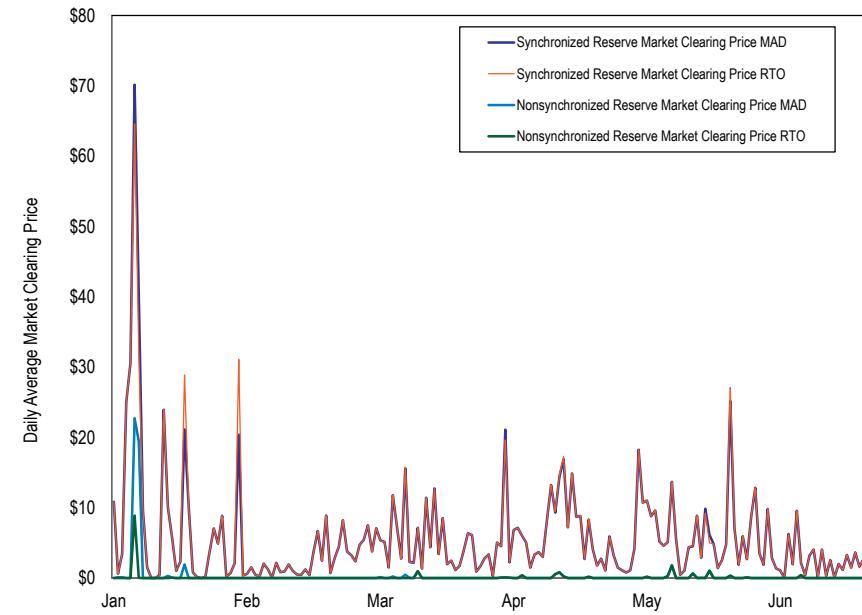


Figure 10-2 and Figure 10-3 show that tier 1 synchronized reserve remains the major contributor to satisfying the synchronized reserve requirements both in the RTO Zone and the Mid-Atlantic Dominion (MAD) Subzone.

## Price and Cost

Figure 10-4 shows daily weighted average synchronized and nonsynchronized market clearing prices in the first six months of 2018.

**Figure 10-4 Daily average market clearing prices (\$/MW) for synchronized reserve and nonsynchronized reserve: January through June, 2018**



PJM's primary reserves are made up of three components, tier 1 synchronized reserve, tier 2 synchronized reserve, and nonsynchronized reserve, each with its own price and cost determinants and interdependent scheduling algorithms. The overall price and cost for meeting the BAL-002-2 primary reserve requirement is calculated by combining the three components. Each of these three components is shown in Table 10-8. The "Cost per MW" column is the total credits divided by the total MW of reserves.

On a combined basis, the ratio of price to cost for all primary reserve during the first six months of 2018 is low at 36.2 percent. This is partly a result of the unnecessary payment of the tier 2 price to tier 1 resources, and partly a result of the poor price to cost ratio of nonsynchronized reserves. While tier 1 has zero actual incremental cost, estimated tier 1 is paid the tier 2 clearing price

in any hour where nonsynchronized reserves clear at a non-zero price. Table 10-8 shows that the cost of tier 1 reserves is \$46.70 per MW when the price of nonsynchronized reserve is greater than zero and over four times the cost of tier 2 reserves which is \$11.43 per MW.

**Table 10-8 Primary reserve requirement components, RTO Reserve Zone: January through June 2018**

Product	MW Share of Primary Reserve Requirement			Price Per MW Reserve	Cost Per MW Reserve
		MW	Credits Paid		
Tier 1 Synchronized Reserve Response	NA	7,925	\$1,232,327	NA	\$155.50
Tier 1 Synchronized Reserve Estimated	0.8%	60,647	\$2,832,294	\$0.00	\$46.70
Tier 2 Synchronized Reserve Scheduled	25.2%	1,847,593	\$21,108,941	\$6.40	\$11.43
Non Synchronized Reserve Scheduled	73.9%	5,422,185	\$10,562,878	\$0.20	\$1.95
Primary Reserve (total of above)	100.0%	7,338,350	\$35,736,440	\$1.76	\$4.87

## Tier 1 Synchronized Reserve

Tier 1 synchronized reserve is a component of primary reserve comprised of all online resources following economic dispatch and able to ramp up from their current output in response to a synchronized reserve event. The tier 1 synchronized reserve for a unit is measured as the lesser of the available 10 minute ramp or the difference between the economic dispatch point and the synchronized reserve maximum output. By default the synchronized reserve maximum for a resource is equal to its economic maximum. Resource owners may request a lower synchronized reserve maximum if a physical limitation exists.<sup>23</sup> Tier 1 resources are identified by the market solution. The sum of their 10 minute availability equals available tier 1 synchronized reserve. Tier 1 synchronized reserve is the first element of primary reserve identified by the market software and has an incremental cost of zero. Tier 1 synchronized reserve is paid compensation under two circumstances. Tier 1 reserves are paid when they respond to a synchronized reserve event. Tier 1 reserves are paid the synchronized reserve market clearing price whenever the nonsynchronized reserve market clearing price is above \$0.

23 See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 75.

While PJM relies on tier 1 resources to respond to a synchronized reserve event, tier 1 resources are not obligated to respond during an event. Tier 1 resources are credited if they do respond but are not penalized if they do not.

## Market Structure

### Supply

All generating resources operating on the PJM system with the exception of those assigned to tier 2 synchronized reserve are available for tier 1 synchronized reserve and any response to a spinning event will be credited at the Synchronized Energy Premium Price.

Beginning January 2015, DGP (Degree of Generator Performance) was introduced as a metric to improve the accuracy of the tier 1 MW estimate used by the market solution. DGP is calculated for all online resources for each market solution. DGP measures how closely the unit has been following economic dispatch for the past 30 minutes.<sup>24</sup> The available tier 1 MW estimated by the market solution for each resource is based upon its economic dispatch, and energy schedule ramp rate or submitted synchronized reserve ramp rate, adjusted by its DGP. PJM communicates to generation operators whose tier 1 MW is part of the market solution the latest estimate of units' tier 1 MW and units' current DGP.<sup>25</sup>

In the first six months of 2018, PJM estimated tier 1 MW for an average of 134 units as part of the market solution each hour for which the average MW weighted DGP was 90.8 percent.

The supply of tier 1 synchronized reserve available to the market solution is adjusted by eliminating tier 1 MW from units that cannot reliably provide synchronized reserve. These units are nuclear, wind, solar, landfill gas, energy storage, and hydro units.<sup>26</sup> These units will be credited the synchronized energy premium price, like any other responding unit, if they respond to a

24 See PJM "Manual 12: Balancing Operations," Rev. 38 (April 20, 2018) at 78.

25 PJM. Ancillary Services, "Communication of Synchronized Reserve Quantities to Resource Owners," <<http://www.pjm.com/~/media/markets-ops/ancillary/communication-of-synchronized-reserve-quantities-to-resource-ownersashx>> (May 6, 2015).

26 See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 92 (Nov. 1, 2017) at 72.

spinning event. These units will not, however, be paid as tier 1 resources when the nonsynchronized reserve market clearing price goes above \$0.

In the first six months of 2018, in the RTO Reserve Zone, the average hourly estimated tier 1 synchronized reserve was 1,449.1 MW (Table 10-9). In 40.1 percent of hours, the estimated tier 1 synchronized reserve was greater than the synchronized reserve requirement, meaning that the synchronized reserve requirement was met entirely by tier 1 synchronized reserve.

In the first six months of 2018, in the MAD Reserve Subzone, the average hourly estimated tier 1 synchronized reserve was 601.3 MW in the MAD Subzone and 851.4 MW were available from the RTO (Table 10-9). In 39.0 percent of hours, the estimated tier 1 synchronized reserve available plus self scheduled tier 2 in MAD was greater than the synchronized reserve requirement, meaning that the synchronized reserve requirement was met at zero cost.

**Table 10-9 Monthly average market solution tier 1 synchronized reserve (MW) identified hourly: January 2017 through June 2018**

Year	Month	Average Hourly Tier 1 Local To MAD	Tier 1 Synchronized Reserve From RTO Zone	Average Hourly Tier 1 Used in MAD	Average Hourly Tier 1 Used in RTO Zone
2017	Jan	529.3	452.3	981.6	1,020.4
2017	Feb	526.1	585.5	1,111.6	1,172.0
2017	Mar	292.6	474.8	767.4	654.2
2017	Apr	288.2	608.8	896.9	805.1
2017	May	386.5	778.1	1,164.6	924.1
2017	Jun	559.5	813.5	1,373.0	1,413.5
2017	Jul	693.8	698.1	1,391.9	1,540.1
2017	Aug	583.1	855.2	1,438.3	1,512.8
2017	Sep	564.7	854.5	1,419.2	1,368.9
2017	Oct	465.7	898.4	1,364.2	1,104.3
2017	Nov	469.7	922.4	1,392.1	1,173.6
2017	Dec	539.8	871.7	1,411.5	1,308.4
2017		491.6	734.4	1,226.0	1,166.4
2018	Jan	674.2	835.9	1,510.0	1,536.3
2018	Feb	720.2	821.2	1,541.5	1,770.9
2018	Mar	708.5	757.2	1,465.7	1,465.6
2018	Apr	333.2	1,040.2	1,373.4	881.4
2018	May	430.9	903.9	1,334.7	1,085.5
2018	Jun	741.0	750.0	1,491.0	1,955.1
2018		601.3	851.4	1,452.7	1,449.1

## Demand

There is no required amount of tier 1 synchronized reserve.

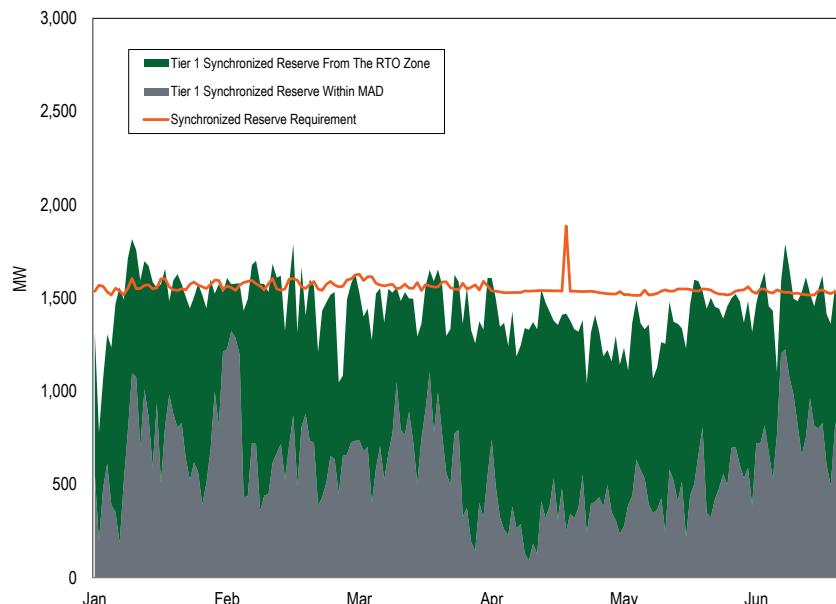
The ancillary services market solution treats the cost of estimated tier 1 synchronized reserve as \$0, even when the nonsynchronized reserve market clearing price is above \$0. As a result, the optimization cannot minimize the total cost of primary reserves.

## Supply and Demand

When solving for the synchronized reserve requirement the market solution first subtracts the amount of self scheduled synchronized reserve from the requirement and then estimates the amount of tier 1.

In the MAD Subzone, the market solution takes all tier 1 MW estimated to be available within the MAD Subzone (gray area of Figure 10-5). It then adds the tier 1 MW estimated to be available within the MAD Subzone from the RTO Zone (green area of Figure 10-5) up to the synchronized reserve requirement. If the total tier 1 synchronized reserve is less than the synchronized reserve requirement, the remainder of the synchronized reserve requirement is filled with tier 2 synchronized reserve (white area below the synchronized reserve required line in Figure 10-5).

**Figure 10-5 Daily average tier 1 synchronized reserve supply (MW) in the MAD Subzone: January through June, 2018**



Average demand for synchronized reserve in the RTO Zone in the first six months of 2018 was 1,568.2 MW. These averages include temporary increases to the requirement by PJM (Table 10-5).

## Tier 1 Synchronized Reserve Event Response

Tier 1 synchronized reserve is awarded credits when a synchronized reserve event occurs and it responds. These synchronized reserve event response credits for tier 1 response are independent of the tier 1 estimated, independent of the synchronized reserve market clearing price, and independent of the nonsynchronized reserve market clearing price. Credits are awarded to tier 1 synchronized reserve resources equal to the increase in MW output (or decrease in MW consumption for demand resources) for each five minute

interval times the five minute LMP plus \$50 per MW. During a synchronized reserve event, tier 1 credits are awarded to all units that increase their output during the event regardless of their estimated tier 1 MW, or tier 1 deselection status at market clearing time, unless the units have cleared the tier 2 market.

In the first six months of 2018, tier 1 synchronized reserve event response credits of \$1,232,327 were paid for an average response of 750 MWh of tier 1 response at an average cost per MWh of \$29.56, over 7 spinning event hours (Table 10-10).

**Table 10-10 Tier 1 synchronized reserve event response costs: January 2017 through June 2018**

Year	Month	Total Synchronized Reserve Event Response Hour Count	Total Credited Tier 1 Synchronized Reserve Event Response MWh	Total Tier 1 Event Response Credits	Tier 1 Synchronized Reserve Event Response Cost Per MWh
2017	Jan	6	1,252.0	\$60,319	\$48.18
2017	Feb	3	627.4	\$56,103	\$89.42
2017	Mar	2	769.2	\$56,352	\$73.26
2017	Apr	2	307.8	\$17,559	\$57.05
2017	May	1	388.7	\$20,940	\$53.87
2017	Jun	2	611.9	\$28,681	\$46.87
2017	Jul	0	0.0	\$0	\$0.00
2017	Aug	0	0.0	\$0	\$0.00
2017	Sep	3	1,042.8	\$231,178	\$221.69
2017	Oct	0	0.0	\$0	\$0.00
2017	Nov	0	0.0	\$0	\$0.00
2017	Dec	0	0.0	\$0	\$0.00
2017		19	4,999.8	\$471,132	\$94.23
2018	Jan	3	6,081.6	\$1,146,858	\$188.58
2018	Feb	0	0.0	\$0	\$0.00
2018	Mar	0	0.0	\$0	\$0.00
2018	Apr	1	1,149.4	\$14,368	\$12.50
2018	May	0	0.0	\$0	\$0.00
2018	Jun	3	2,437.7	\$71,101	\$29.17
2018		7	9,668.7	\$1,232,326	\$127.46

## Paying Tier 1 the Tier 2 Price

Tier 1 synchronized reserve has zero marginal cost and the corresponding price for tier 1 synchronized reserves is also zero. However, the PJM rules artificially create a marginal cost of tier 1 when the price of nonsynchronized reserve is greater than zero and tier 1 is paid the tier 2 price. The PJM market solutions do not include that marginal cost and therefore do not solve for the efficient level of tier 1, tier 2 and nonsynchronized reserve in those cases. When called to respond to a spinning event tier 1 is compensated at the Synchronized Energy Premium Price (Table 10-13). However, the shortage pricing tariff changes (October 1, 2012) modified the pricing of tier 1 so that tier 1 synchronized reserve is paid the tier 2 synchronized reserve market clearing price whenever the nonsynchronized reserve market clearing price rises above zero. The rationale for this change was and is unclear, but it has had a significant impact on the cost of tier 1 synchronized reserves (Table 10-11). The nonsynchronized reserve market clearing price was above \$0.00 in 41 hours in the first three months of 2018. For those 41 hours, tier 1 synchronized reserve resources were paid a weighted average synchronized reserve market clearing price of \$52.53 per MWh and earned \$2,571,604 in credits. For April through June, 2018, the nonsynchronized reserve market clearing price was above zero in 171 intervals. For those 171 intervals tier 1 synchronized reserve resources were paid a weighted average synchronized reserve market clearing price of \$19.69 per MWh and earned \$260,691.

**Table 10-11 Price of tier 1 synchronized reserve attributable to a nonsynchronized reserve price above zero: January 2017 through June 2018**

Year	Month	Total Hours	Weighted	Total Tier 1	Total Tier
		When NSRMCP>\$0	Average SRMCP for Hours When NSRMCP>\$0	MWh Credited for Hours When NSRMCP>\$0	1 Credits Paid When NSRMCP>\$0
2017	Jan	17	\$11.38	19,441	\$221,157 1,143.6
2017	Feb	1	\$12.35	1,293	\$15,971 1,293.2
2017	Mar	14	\$14.27	13,389	\$191,084 956.4
2017	Apr	16	\$9.82	11,680	\$114,662 730.0
2017	May	19	\$10.61	20,242	\$214,816 1,065.3
2017	Jun	8	\$4.96	7,563	\$37,542 945.4
2017	Jul	7	\$29.58	6,631	\$196,128 947.2
2017	Aug	4	\$14.04	3,926	\$55,108 981.5
2017	Sep	26	\$45.11	21,030	\$948,664 808.9
2017	Oct	9	\$7.65	6,343	\$48,539 704.8
2017	Nov	26	\$6.35	24,218	\$153,842 931.4
2017	Dec	2	\$0.26	1,274	\$295 637.0
2017		149	\$13.87	137,030	\$2,197,809 928.7
2018	Jan	31	\$61.34	39,047	\$2,394,953 1,259.6
2018	Feb	0	NA	NA	NA
2018	Mar	10	\$17.83	9,906	\$176,651 990.6
2018	Apr	18	\$18.91	2,584	\$48,877 143.6
2018	May	16	\$34.41	5,565	\$191,459 347.8
2018	Jun	6	\$5.74	3,545	\$20,354 590.9
2018		81	\$27.65	60,647	\$2,832,294 666.5

The additional payments to tier 1 synchronized reserves under the shortage pricing rule are a windfall. The additional payment does not create an incentive to provide more tier 1 synchronized reserves. The additional payment is not a payment for performance; all estimated tier 1 receives the higher payment regardless of whether they provide any response during any spinning event. Tier 1 resources are not obligated to respond to synchronized reserve events. In the first six months of 2018, 53.2 percent of the DGP adjusted market solution's estimated tier 1 resources MW actually responded during synchronized reserve events of 10 minutes or longer. Thus, 46.8 percent of DGP adjusted tier 1 estimated MW did not respond during spinning events. However, all resources that were included in the Tier 1 estimates were paid the Tier 2 price for their full estimated MW when the nonsynchronized reserve (NSR) price was greater than zero. Unlike tier 1 resources, tier 2 synchronized

reserve resources are paid the market clearing price for tier 2 because they stand ready to respond and incur costs to do so, have an obligation to perform and pay penalties for nonperformance.

When the next MW of nonsynchronized reserve required to satisfy the primary reserve requirement increases in price from \$0.00 per MW to \$0.01 per MW, the cost of all tier 1 MW increases significantly.

In the first six months of 2018, tier 1 synchronized reserve was paid \$1,232,327 for responding to synchronized reserve events. During the same time period, tier 1 synchronized reserve was paid a windfall of \$2,832,294 simply because the NSRMCP was greater than \$0.00 in 41 hours before Apr 1, 2018 and 171 intervals (contained within 40 hours) after April 1, 2018 (Table 10-12).

**Table 10-12 Excess payments for tier 1 synchronized reserve: January 2017 through June 2018**

Year	Month	Synchronized Reserve Events			Hours/Intervals When NSRMCP>\$0		
		Total MWh	Total Credits	Average MWh Per Event	Total MWh	Total Credits	Average MW Per Hour
2017	Jan	1,252	\$60,319	208	19,441	\$221,157	1,143.6
2017	Feb	627	\$56,103	209	1,293	\$15,971	1,293.2
2017	Mar	769	\$56,352	385	13,389	\$191,084	956.4
2017	Apr	308	\$17,559	149	11,680	\$114,662	730.0
2017	May	389	\$20,940	406	20,242	\$214,816	1,065.4
2017	Jun	612	\$28,681	312	7,563	\$37,542	945.4
2017	Jul	0	\$0	NA	6,631	\$196,128	947.2
2017	Aug	0	\$0	NA	3,926	\$55,108	981.5
2017	Sep	1,043	\$231,178	368	21,030	\$948,664	808.9
2017	Oct	0	\$0	NA	6,343	\$48,539	704.8
2017	Nov	0	\$0	NA	24,218	\$153,842	931.4
2017	Dec	0	\$0	NA	1,274	\$295	637.0
2017		5,000	\$471,132	291	137,030	\$2,197,809	928.7
2018	Jan	3	\$1,146,858	6,082	39,047	\$2,394,953	1,259.6
2018	Feb	0	\$0	NA	0	NA	NA
2018	Mar	0	\$0	NA	9,906	\$176,651	990.6
2018	Apr	1	\$14,368	591	2,584	\$48,877	546.8
2018	May	0	\$0	NA	5,565	\$191,459	931.6
2018	Jun	3	\$71,101	1,252	3,545	\$20,354	1,959.9
2018		7	\$1,232,327	2,641	60,648	\$2,832,294	1,137.7

The MMU recommends that the rule requiring the payment of tier 1 synchronized reserve resources when the nonsynchronized reserve price is above zero be eliminated immediately.<sup>27</sup> Tier 1 should be compensated only for a response to synchronized reserve events, as it was before the shortage pricing changes. This compensation requires that when a synchronized reserve event is called, all tier 1 response is paid the average of five-minute LMPs during the event, rather than hourly integrated LMP, plus \$50/MW, termed the Synchronized Energy Premium Price.

PJM's current tier 1 compensation rules are presented in Table 10-13.

**Table 10-13 Tier 1 compensation as currently implemented by PJM**

Tier 1 Compensation by Type of Interval as Currently Implemented by PJM		
Interval Parameters	No Synchronized Reserve Event	Synchronized Reserve Event
NSRMCP=\$0	T1 credits = \$0	T1 credits = Synchronized Energy Premium Price * actual response MWi
NSRMCP>\$0	T1 credits = T2 SRMCP * estimated tier 1 MW	T1 credits = T2 SRMCP * min(calculated tier 1 MW, actual response MWi)

The MMU's recommended compensation rules for tier 1 MW are in Table 10-14.

**Table 10-14 Tier 1 compensation as recommended by MMU**

Tier 1 Compensation by Type of Hour as Recommended by MMU		
Interval Parameters	No Synchronized Reserve Event	Synchronized Reserve Event
NSRMCP=\$0	T1 credits = \$0	T1 credits = Synchronized Energy Premium Price * actual response MWi
NSRMCP>\$0	T1 credits = \$0	T1 credits = Synchronized Energy Premium Price * actual response MWi

## Tier 1 Estimate Bias

PJM's market solution software allows the dispatcher to bias the tier 2 synchronized reserve solution by forcing the software to assume a different tier 1 MW value than it actually estimates. PJM no longer allows dispatchers to use tier 1 biasing in the intermediate and real-time SCED solutions, but

<sup>27</sup> This recommendation was presented as a proposal, "Tier 1 Compensation," to the Markets and Reliability Committee Meeting, October 22, 2015. The MMU proposal and a PJM counterproposal were both rejected.

tier 1 biasing is used in the hour ahead reserve market solution, ASO. Biasing means manually modifying (decreasing or increasing) the tier 1 synchronized reserve estimate of the market solution. This forces the market clearing engine to clear more or less tier 2 synchronized reserve and nonsynchronized reserve to satisfy the synchronized reserve and primary reserve requirements than would have cleared under the market solution. Negative biasing is the primary form of biasing actually used although sometimes the solution is biased positively (Table 10-15).

**Table 10-15 RTO zone ASO tier 1 estimate biasing: January 2017 through June 2018**

Year	Month	Number of Hours Biased Negatively	Average Negative Bias (MW)	Number of Hours Biased Positively	Average Positive Bias (MW)
2017	Jan	332	(987.7)	4	362.5
2017	Feb	194	(719.7)	0	NA
2017	Mar	354	(760.5)	3	200.0
2017	Apr	227	(697.1)	0	NA
2017	May	301	(1,000.3)	13	207.7
2017	Jun	253	(873.5)	0	NA
2017	Jul	244	(938.1)	0	NA
2017	Aug	179	(805.3)	2	1,250.0
2017	Sep	144	(682.6)	0	NA
2017	Oct	234	(807.7)	0	NA
2017	Nov	240	(739.7)	0	NA
2017	Dec	273	(920.0)	0	NA
2017		2,975	(827.7)	22	256.7
2018	Jan	209	(841.9)	0	NA
2018	Feb	85	(558.9)	0	NA
2018	Mar	72	(477.8)	0	NA
2018	Apr	233	(509.3)	0	NA
2018	May	113	(395.8)	4	237.5
2018	Jun	96	(534.2)	3	733.3
2018		808	(553.0)	7	485.4

Tier 1 biasing is not mentioned in the PJM manuals and does not appear to be defined in any public document. PJM dispatchers use tier 1 biasing to compensate for uncertainty in short-term load forecasting and uncertainty about expected generator performance, which result in uncertainty about the accuracy of the market solution's tier 1 estimate. The purpose of tier 1 estimate biasing is to modify the demand for tier 2 and therefore the market

results both for tier 2 synchronized reserve and for nonsynchronized reserve. Biasing the tier 1 estimate forces the market solution to clear more or less tier 2 and thus affects the price for tier 2 reserves. The MMU recommends that PJM be more explicit and transparent about why tier 1 biasing is used in defining demand in the Tier 2 Synchronized Reserve Market. The MMU recommends that PJM define rules for estimating tier 1 MW, define rules for the use and amount of tier 1 biasing and identify the rule based reasons for each instance of biasing.

## Tier 2 Synchronized Reserve Market

Synchronized reserve is provided by generators or demand response resources synchronized to the grid and capable of increasing output or decreasing load within 10 minutes. Synchronized reserve consists of tier 1 and tier 2 synchronized reserves. When the synchronized reserve requirement cannot be met by tier 1 synchronized reserve, PJM clears a market to satisfy the requirement with tier 2 synchronized reserve. Tier 2 synchronized reserve is provided by online resources, either synchronized to the grid but not producing energy, or dispatched to provide synchronized reserve at an operating point below their economic dispatch point. Tier 2 synchronized reserve is also provided by demand resources that have offered to reduce load in the event of an synchronized reserve event. Tier 2 synchronized reserves are committed to be available in the event of a synchronized reserve event. Tier 2 resources have a must offer requirement. Tier 2 resources are scheduled by the ASO 60 minutes before the operating hour, are committed to provide synchronized reserve for the entire hour, and are paid the higher of the SRMCP or their offer price plus lost opportunity cost (LOC). Demand response resources are paid the clearing price (SRMCP).

Tier 2 synchronized reserve resources committed for a full hour by the hour ahead market solution are defined to be inflexible resources. Inflexible resources cannot be released for energy during the operating hour. Tier 2 synchronized reserve resources may also be inflexible because of asserted physical limitations. Such resources include synchronous condensers

operating solely for the purpose of providing synchronized reserves and demand resources. Demand side resources are also considered to be inflexible.

During the operating hour, the IT-SCED and the RT-SCED market solutions software can dispatch additional resources flexibly. A flexible commitment is one in which the IT-SCED or RT-SCED redispatches online tier 1 generating resources as tier 2 synchronized reserve to meet the synchronized and primary reserve requirements within the operational hour. Resources that are redispatched as tier 2 within the hour are required to maintain their available ramp and are paid the SRMCP plus any lost opportunity costs or energy use costs that exceed the SRMCP.

## Market Structure

### Supply

PJM has a must offer tier 2 synchronized reserve requirement. All nonemergency generating resources are required to submit tier 2 synchronized reserve offers. All online, nonemergency generating resources are deemed available to provide both tier 1 and tier 2 synchronized reserve although certain unit types are exempt. If PJM issues a primary reserve warning, voltage reduction warning, or manual load dump warning, all offline emergency generation capacity resources available to provide energy must submit an offer for tier 2 synchronized reserve.<sup>28</sup>

In the first six months of 2018, the Mid Atlantic Dominion (MAD) Reserve Subzone averaged 6,772.6 MW of tier 2 synchronized reserve offers, and the RTO Reserve Zone averaged 25,714.1 MW of tier 2 synchronized reserve offers (Figure 10-10).

The supply of tier 2 synchronized reserve in the first six months of 2018 was sufficient to cover the ASO hourly requirement net of tier 1 in both the RTO Reserve Zone and the MAD Reserve Subzone. While the hourly market solution showed a one hour shortage event on May 7, 2018 in hour 2, this was not treated as an actual reserve shortage event because it was triggered

<sup>28</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 84.

by PJM operators using a 1,200 MW tier 1 bias setting, not an actual shortage of reserves.

The largest portion of cleared tier 2 synchronized reserve in the first six months of 2018 was from CTs, 50.9 percent (Figure 10-6). Although demand resources are limited to 33 percent of the total synchronized reserve requirement, the amount of tier 2 synchronized reserve required in any hour is often much less than the full synchronized reserve requirement because so much of it is met with tier 1 synchronized reserve. This means that in many hours demand resources make up considerably more than 33 percent of the cleared Tier 2 MW. DR MW were 27.9 percent of cleared Tier 2 Synchronized Reserve Market in the first six months of 2018.

**Figure 10-6 Cleared tier 2 synchronized reserve average hourly MW per hour by unit type, RTO Zone: January 2016 through June 2018**

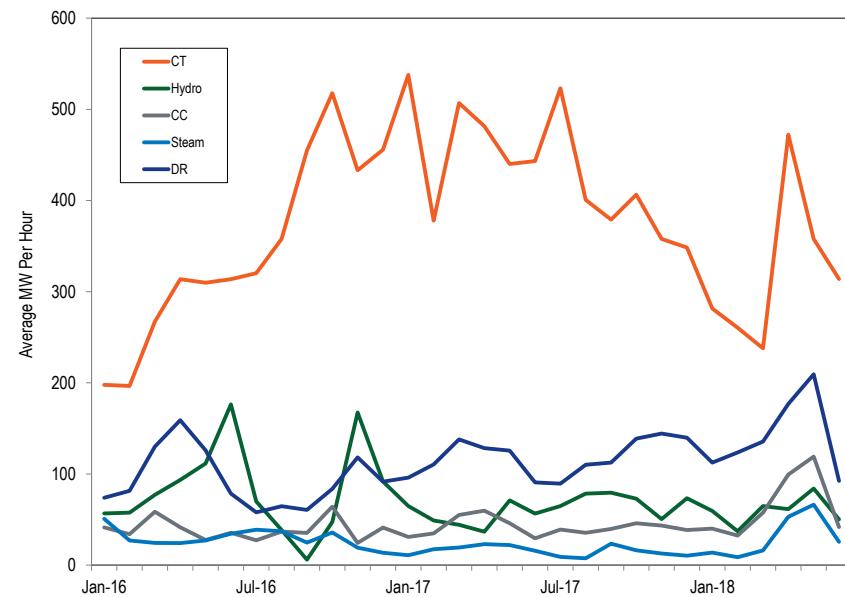
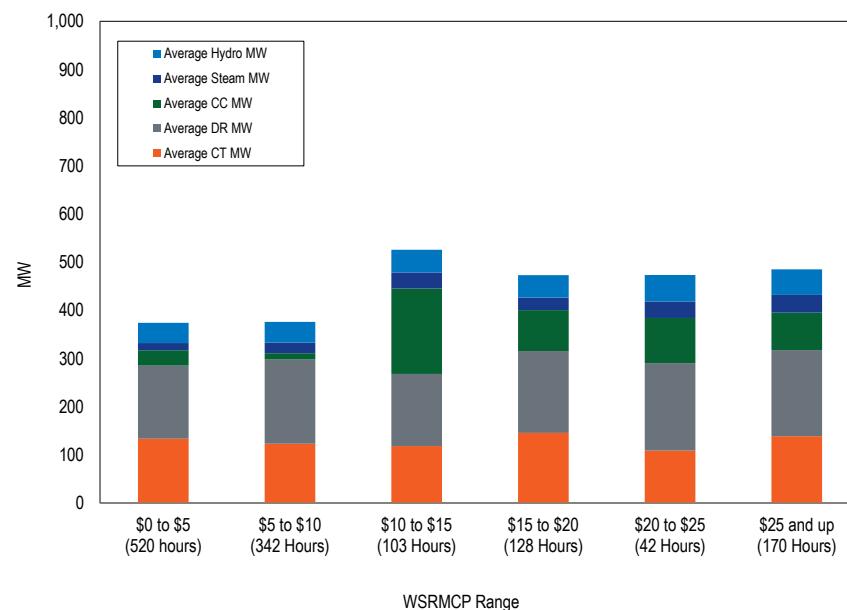


Figure 10-7 provides the average hourly cleared tier 2 MW by unit type by tier 2 clearing price range (SRMCP).

**Figure 10-7 Average hourly tier 2 MW by unit type by weighted SRMCP range: January through June, 2018**



## Demand

Until July 12, 2017 the default synchronized reserve requirement was set to 1,450 MW in both the Mid-Atlantic Dominion Subzone and the RTO Zone (Table 10-16). On July 12, 2017, PJM adopted a dynamic reserve requirement set equal to 150 percent of the largest contingency, determined hourly, based on the forecasted dispatch. There are two circumstances in which PJM may alter the synchronized reserve requirement from its 150 percent of the largest contingency value. When PJM operators anticipate periods of heavy load, they may bring on additional units to account for increased operational uncertainty in meeting load. When a Hot Weather Alert, Cold Weather Alert

or an escalating emergency procedure (as defined in Manual 11 § 4.2.2 Synchronized Reserve Requirement Determination) has been issued for the operating day, operators may increase the synchronized reserve requirement up to the full amount of the additional MW brought on line.<sup>29</sup>

**Table 10-16 Default Tier 2 Synchronized Reserve Markets required MW, RTO Zone and Mid-Atlantic Dominion Subzone**

Mid-Atlantic Dominion Subzone			RTO Synchronized Reserve Zone		
From Date	To Date	Required MW	From Date	To Date	Required MW
May 10, 2008	May 8, 2010	1,150	May 10, 2008	Jan 1, 2009	1,305
May 8, 2010	Jul 13, 2010	1,200	Jan 1, 2009	Mar 15, 2010	1,320
July 13, 2010	Jan 1, 2015	1,300	Mar 15, 2010	Nov 12, 2012	1,350
Jan 1, 2015	Jan 8, 2015	1,342	Nov 12, 2012	Jan 8, 2015	1,375
Jan 8, 2015	Jul 11, 2017	1,450	Jan 8, 2015	Jul 11, 2017	1,450
Jul 12, 2017	Calculated Hourly	Calculated Hourly	Jul 12, 2017	Calculated Hourly	Calculated Hourly

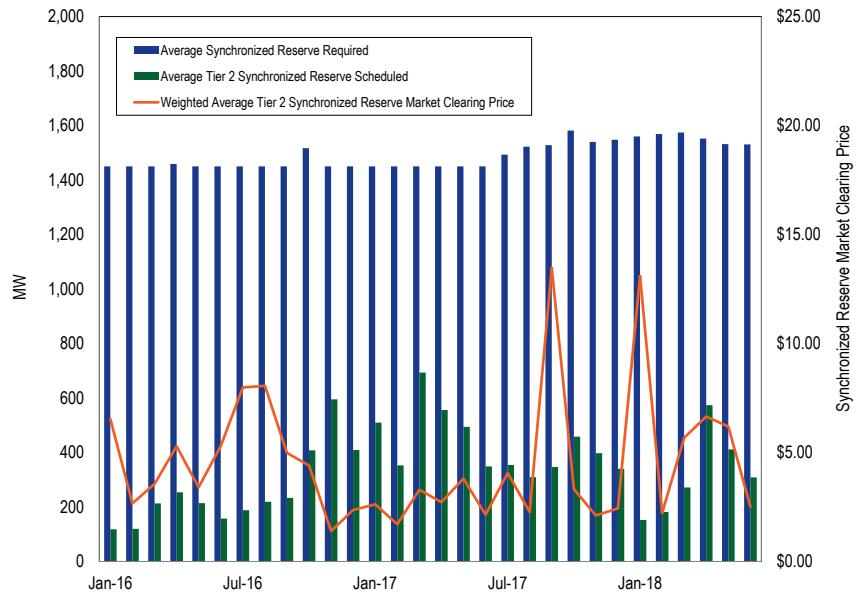
In the first six months of 2018, the average hourly synchronized reserve requirement in the RTO Zone was 1,568.2 MW and the average hourly synchronized reserve requirement in the MAD Subzone was 1,552.9 MW. These averages include temporary increases to the synchronized reserve requirement as specified in Table 10-5.

The RTO Reserve Zone purchased an hourly average of 550.0 MW of tier 2 synchronized reserves the first six months of 2018. Of this, an average of 389.4 MW cleared within the MAD Subzone.

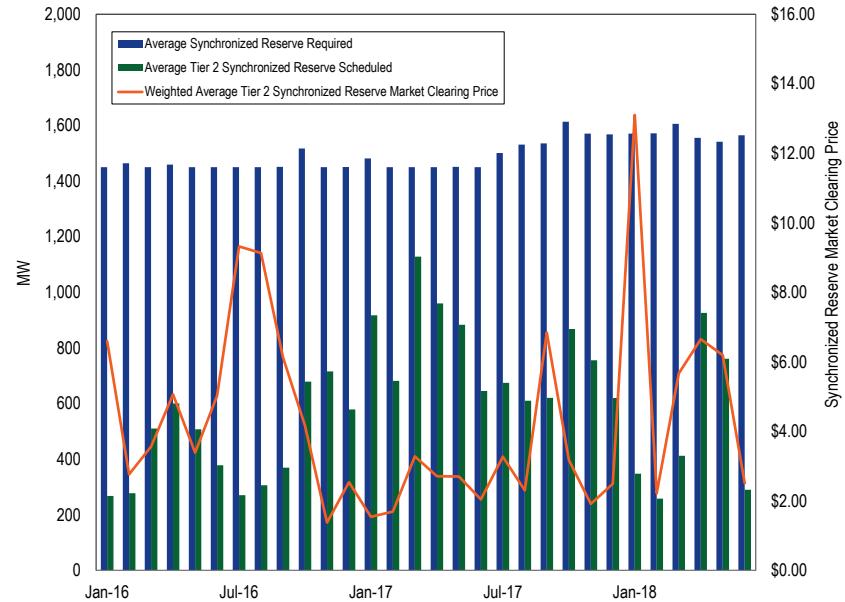
Figure 10-8 and Figure 10-9 show the average monthly synchronized reserve required and the average monthly tier 2 synchronized reserve MW scheduled (PJM scheduled plus self scheduled) from January 2016 through June 2018, for the RTO Reserve Zone and MAD Reserve Subzone. There were no intervals of shortage in the first six months of 2018. There were seven spinning events in the first six months of 2018. None of these were due to a low ACE event.

<sup>29</sup> PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 88.

**Figure 10-8 MAD hourly average tier 2 synchronized reserve scheduled MW: January 2016 through June 2018**



**Figure 10-9 RTO hourly average tier 2 synchronized reserve scheduled MW: January 2016 through June 2018**



## Market Concentration

The HHI for tier 2 synchronized reserve for cleared hours in the Mid-Atlantic Dominion Subzone Tier 2 Synchronized Reserve Market the first three months of 2018 was 6626, which is defined as highly concentrated. The largest hourly market share was 100 percent and 98.8 percent of all cleared hours had a maximum market share greater than or equal to 40 percent.

The average hourly HHI for tier 2 synchronized reserve for cleared hours of the RTO Zone Tier 2 Synchronized Reserve Market in the first three months of 2018 was 5438, which is defined as highly concentrated. The interval average HHI for April through June was 3116 which is defined as highly concentrated. The largest hourly market share was 100 percent and 80.5 percent of cleared hours had a maximum market share greater than or equal to 40 percent in the

first three months. From April through June 2018, 35.6 percent of intervals had a maximum market share greater than 40 percent.

In the MAD Subzone, flexible synchronized reserve was 7.3 percent of all tier 2 synchronized reserve January through June 2018. In the RTO Zone, flexible synchronized reserve assigned was 20.6 percent of all tier 2 synchronized reserve during the same period.

The MMU calculates that 50.1 percent of hours would have failed the three pivotal supplier test in the MAD Subzone in the first six months of 2018 for all cleared hours of the inflexible Synchronized Reserve Market (excluding self scheduled synchronized reserve) in the hour ahead market (Table 10-17) and 14.0 percent of hours would have failed the three pivotal supplier test in the RTO Zone during the same time period.

**Table 10-17 Three pivotal supplier test results for the RTO Zone and MAD Subzone: January 2017 through June 2018**

Year	Month	Mid Atlantic Dominion Reserve Subzone Pivotal Supplier Hours	RTO Reserve Zone Pivotal Supplier Hours
2017	Jan	79.3%	67.0%
2017	Feb	73.8%	57.6%
2017	Mar	72.6%	38.3%
2017	Apr	75.0%	51.0%
2017	May	70.9%	69.8%
2017	Jun	62.6%	84.9%
2017	Jul	57.3%	69.5%
2017	Aug	34.8%	71.0%
2017	Sep	53.7%	66.4%
2017	Oct	72.8%	38.5%
2017	Nov	71.2%	47.4%
2017	Dec	75.9%	45.1%
2017		66.7%	58.9%
2018	Jan	65.5%	19.5%
2018	Feb	31.4%	0.0%
2018	Mar	41.2%	18.0%
2018	Apr	52.6%	19.4%
2018	May	58.5%	15.2%
2018	Jun	51.2%	12.0%
2018		50.1%	14.0%

The market structure results indicate that the RTO Zone and Mid-Atlantic Dominion Subzone Tier 2 Synchronized Reserve Markets are not structurally competitive.

## Market Behavior

### Offers

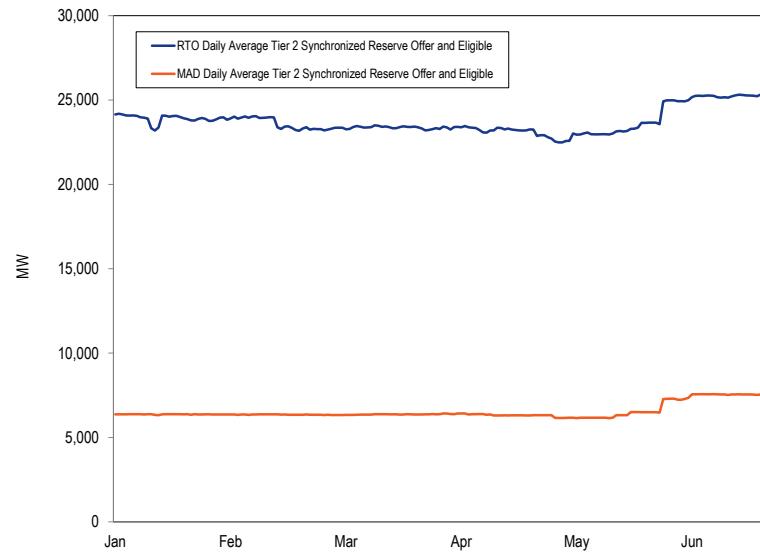
Daily cost-based offers are submitted for each unit by the unit owner. For generators the offer must include tier 1 synchronized reserve ramp rate, a tier 1 synchronized reserve maximum, self scheduled status, synchronized reserve availability, synchronized reserve offer quantity (MW), tier 2 synchronized reserve offer price, energy use for tier 2 condensing resources (MW), condense to gen cost, shutdown costs, condense startup cost, condense hourly cost, condense notification time, spin as a condenser status, and condense available status. The synchronized reserve offer price made by the unit owner is subject to an offer cap of marginal cost plus \$7.50 per MW. All suppliers are paid the higher of the market clearing price or their offer plus their unit specific opportunity cost. The offer quantity is limited to the economic maximum. PJM monitors this offer by checking to ensure that all offers are greater than or equal to 90 percent of the resource's ramp rate times 10 minutes. A resource that is unable to participate in the synchronized reserve market during a given hour may set its hourly offer to 0 MW. Certain defined resource types are not required to offer tier 2 because they cannot reliably provide synchronized reserve. These include: nuclear, wind, solar, landfill gas and energy storage resources.<sup>30</sup>

Figure 10-10 shows the daily average of hourly offered tier 2 synchronized reserve MW for both the RTO Synchronized Reserve Zone and the Mid-Atlantic Dominion Synchronized Reserve Subzone. In the first six months of 2018, the ratio of eligible tier 2 synchronized reserve to synchronized reserve required in the Mid-Atlantic Dominion Subzone was 4.1 averaged over all hours. For the RTO Synchronized Reserve Zone the ratio was 14.8.

<sup>30</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 72.

PJM has a tier 2 synchronized reserve must offer requirement for all generation that is online, nonemergency, and physically able to operate with an output less than dictated by economic dispatch. Tier 2 synchronized reserve offers are made on a daily basis with hourly updates permitted. Daily offers can be changed as a result of maintenance status or physical limitations only and are required regardless of online/offline state.<sup>31</sup> The Tier 2 Synchronized Reserve Market is not actually cleared based on daily offers but based on hourly updates to the daily offers. As a result of hourly updates the actual amount of eligible tier 2 MW can change significantly every hour (Figure 10-10). Changes to the hourly offer status are only permitted when resources are physically unable to provide tier 2. Changes to hourly eligibility levels are the result of online status, minimum/maximum runtimes, minimum notification times, maintenance status and grid conditions including constraints. However, resource operators can make their units unavailable for an hour or block of hours without having to provide a reason.

**Figure 10-10 Tier 2 synchronized reserve hourly offer and eligible volume (MW): January through June, 2018**



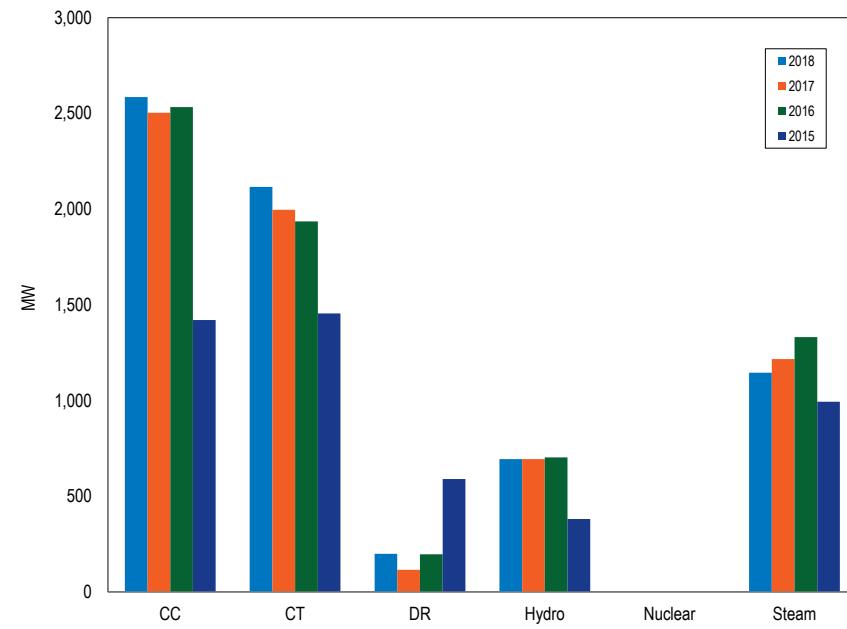
<sup>31</sup> See *id.* ("Regardless of online/offline state, all non-emergency generation capacity resources must submit a daily offer for Tier 2 Synchronized Reserve in eMKT...").

As of the end of June 2018 all nonemergency resources capable of reliably producing synchronized reserve have tier 2 synchronized reserve offers in compliance with the PJM Tariff. There remain a large number of hours when many units make themselves unavailable for tier 2 synchronized reserve.

The MMU recommends that the tier 2 synchronized reserve must offer requirement be enforced. The MMU recommends that PJM define a set of acceptable reasons why a unit can be made unavailable daily or hourly and require unit owners to select a reason in Markets Gateway whenever making a unit unavailable either daily or hourly or setting the offer MW to 0 MW.<sup>32</sup>

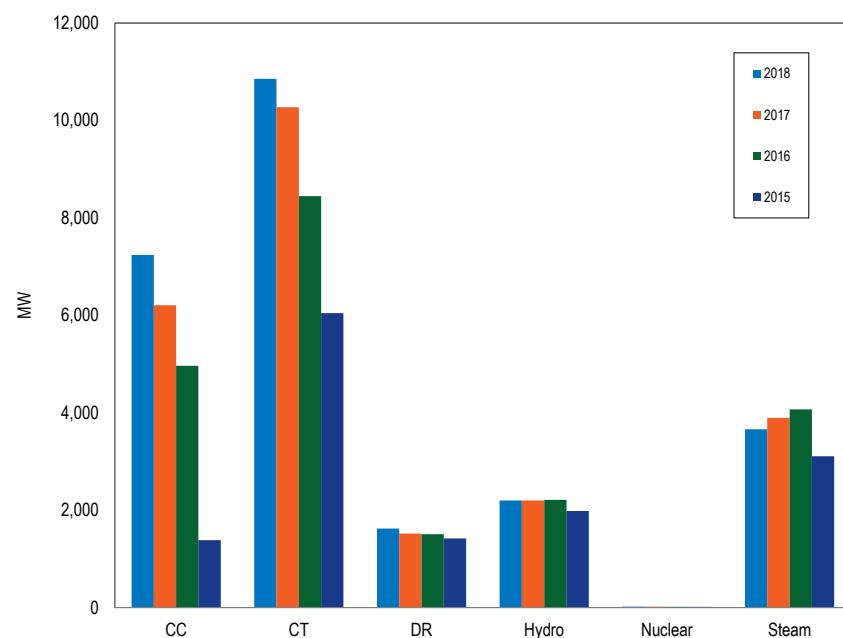
Figure 10-11 shows average offer MW volume by market and unit type for the MAD Subzone and Figure 10-12 shows average offer MW volume by market and unit type for the RTO Zone.

**Figure 10-11 MAD average daily tier 2 synchronized reserve offer by unit type (MW): January 2016 through June 2018**



<sup>32</sup> PJM has adopted a new business rule in the third quarter of 2017 to enforce compliance with the tier 2 must-offer requirement. PJM enters a zero dollar offer price for all units with a must offer obligation for tier 2 synchronized reserves.

**Figure 10-12 RTO Zone average daily tier 2 synchronized reserve offer by unit type (MW): January 2016 through June 2018**



92.3 percent of the five minute intervals. In the remaining hours and intervals there was enough tier 1 synchronized reserve or self-scheduled tier 2 reserve to cover the full requirement. For the first six months of 2018 the MAD tier 2 market cleared an average of 326.3 MW at a weighted average clearing price of \$6.06 compared to \$2.79 in 2017 (Table 10-18).

In the first six months of 2018, the Tier 2 Synchronized Reserve Market for the RTO Zone cleared an average of 499.4 MW at a weighted average price of \$6.40 compared to \$4.40 in 2017 (Table 10-19).

In 98.3 percent of cleared hours, the synchronized reserve market clearing price was the same for both the MAD Subzone and the RTO Zone. In the 1.7 percent of hours when the price diverged, the average clearing price was \$21.74 in the MAD Subzone, and \$10.50 in the RTO Zone.

Supply, performance, and demand are reflected in the price of synchronized reserve. (Figure 10-8 and Figure 10-9).

## Market Performance

### Price

The price of tier 2 synchronized reserve is calculated in real time every five minutes for the RTO Reserve Zone and the MAD Subzone. In hours where total tier 1 MW synchronized reserve MW is less than the synchronized reserve requirement, PJM must clear a Tier 2 Synchronized Reserve Market for synchronized reserves.

In the first three months of 2018, a Tier 2 Synchronized Reserve Market was cleared for the MAD Subzone in 97.3 percent of all hours. From April through June, 2018, the Tier 2 Synchronized Reserve Market was cleared in

**Table 10-18 MAD Subzone, average SRMCP and average scheduled, tier 1 estimated and demand response MW: January 2017 through June 2018**

Year	Month	Weighted Average	Average Tier	Average Hourly Tier 1	Average Hourly Demand Response Cleared (MW)
		Synchronized Reserve Market Clearing Price	2 Generation Synchronized Reserve Purchased (MW)	Synchronized Reserve Estimated Hour Ahead (MW)	
2017	Jan	\$2.25	356.1	981.6	96.0
2017	Feb	\$1.75	233.2	1,111.6	110.5
2017	Mar	\$2.87	453.3	767.4	140.5
2017	Apr	\$2.80	362.4	896.9	128.4
2017	May	\$3.26	376.8	1,164.6	126.2
2017	Jun	\$2.12	379.6	1,373.0	91.3
2017	Jul	\$3.24	353.3	1,391.9	89.4
2017	Aug	\$2.05	226.9	1,438.3	110.2
2017	Sep	\$11.56	339.7	1,419.2	113.1
2017	Oct	\$2.98	348.1	1,364.2	138.8
2017	Nov	\$2.08	245.9	1,392.1	144.3
2017	Dec	\$2.38	160.0	1,411.5	139.8
2017		\$3.28	319.6	1,226.0	119.0
2018	Jan	\$13.10	211.7	1,510.0	125.6
2018	Feb	\$2.22	181.4	1,541.5	180.6
2018	Mar	\$5.67	271.5	1,465.7	156.0
2018	Apr	\$6.65	573.6	1,373.3	189.4
2018	May	\$6.19	411.1	1,334.7	239.4
2018	Jun	\$2.51	308.5	1,491.0	159.1
2018		\$6.06	326.3	1,452.7	175.0

**Table 10-19 RTO zone average SRMCP and average scheduled, tier 1 estimated and demand response MW: January 2017 through June 2018**

Year	Month	Weighted Average	Average Tier	Average Hourly Tier 1	Average Hourly Demand Response Cleared (MW)
		Synchronized Reserve Market Clearing Price	2 Generation Synchronized Reserve Purchased (MW)	Synchronized Reserve Estimated Hour Ahead (MW)	
2017	Jan	\$2.16	730.6	1,020.4	96.0
2017	Feb	\$1.89	508.3	1,172.0	110.5
2017	Mar	\$3.81	693.1	654.2	140.5
2017	Apr	\$2.89	623.0	805.1	128.4
2017	May	\$3.48	560.7	924.1	126.2
2017	Jun	\$2.24	568.8	1,413.5	91.3
2017	Jul	\$4.15	667.6	1,540.1	89.4
2017	Aug	\$2.72	517.0	1,512.8	110.2
2017	Sep	\$12.60	496.6	1,368.9	113.1
2017	Oct	\$3.55	528.5	1,104.3	138.8
2017	Nov	\$2.30	465.6	1,173.6	144.3
2017	Dec	\$3.00	417.8	1,308.4	139.8
2017		\$3.73	564.8	1,166.5	119.0
2018	Jan	\$14.42	348.3	1,536.3	117.4
2018	Feb	\$2.50	257.6	1,770.9	123.6
2018	Mar	\$5.97	412.0	1,465.6	137.6
2018	Apr	\$6.76	926.8	881.4	190.1
2018	May	\$6.27	761.3	1,085.5	235.9
2018	Jun	\$2.48	290.5	1,955.1	147.4
2018		\$6.40	499.4	1,449.1	158.7

## Cost

As a result of changing grid conditions, load forecasts, and unexpected generator performance, prices do not always cover the full cost including the final LOC for each resource. Because price formation occurs within the hour (on a five minute basis integrated over the hour) but the synchronized reserve commitment occurs prior to the hour, the realized within hour price can be zero even when some tier 2 synchronized reserve is cleared. All resources cleared in the market are guaranteed to be made whole and are paid if the SRMCP does not compensate them for their offer plus LOC.

The full cost of tier 2 synchronized reserve including payments for the clearing price and out of market costs is calculated and compared to the price. The closer the price to cost ratio is to one hundred percent, the more the market price reflects the full cost of tier 2 synchronized reserve. A price to cost ratio close to one hundred percent is an indicator of an efficient synchronized reserve market design.

In the first six months of 2018, the price to cost (including self scheduled) ratio of the RTO Zone Tier 2 Synchronized Reserve Market averaged 55.6 percent (Table 10-20); the price to cost ratio of the MAD Subzone averaged 57.0 percent.

**Table 10-20 RTO Zone, MAD Subzone tier 2 synchronized reserve MW, credits, price, and cost: January 2017 through June 2018**

Zone	Year	Month	Tier 2		Weighted Average Synchronized Reserve Market Clearing price	Tier 2 Synchronized Reserve Cost	Price/Cost Ratio
			Credited MW	Tier 2 Credits			
MAD Subzone	2017	Jan	242,160	\$1,821,697	\$2.25	\$7.52	29.9%
MAD Subzone	2017	Feb	137,103	\$1,354,202	\$1.75	\$9.88	17.7%
MAD Subzone	2017	Mar	328,192	\$2,611,457	\$2.87	\$7.96	36.1%
MAD Subzone	2017	Apr	229,057	\$1,780,751	\$2.80	\$7.77	36.0%
MAD Subzone	2017	May	231,704	\$1,960,763	\$3.26	\$8.46	38.5%
MAD Subzone	2017	Jun	170,078	\$1,586,215	\$2.12	\$9.33	22.7%
MAD Subzone	2017	Jul	193,231	\$2,367,906	\$3.24	\$12.25	26.4%
MAD Subzone	2017	Aug	157,259	\$1,269,006	\$2.05	\$8.07	25.4%
MAD Subzone	2017	Sep	172,568	\$3,631,598	\$11.56	\$21.04	54.9%
MAD Subzone	2017	Oct	217,186	\$2,703,322	\$2.98	\$12.45	23.9%
MAD Subzone	2017	Nov	157,391	\$1,350,024	\$2.08	\$8.58	24.3%
MAD Subzone	2017	Dec	138,151	\$1,296,784	\$2.25	\$9.39	24.0%
MAD Subzone	2017		2,374,080	\$23,733,724	\$3.27	\$10.23	32.0%
MAD Subzone	2018	Jan	246,978	\$3,908,791	\$13.10	\$24.89	52.6%
MAD Subzone	2018	Feb	121,873	\$537,031	\$2.22	\$4.41	50.4%
MAD Subzone	2018	Mar	201,995	\$1,548,772	\$5.67	\$7.67	74.0%
MAD Subzone	2018	Apr	505,510	\$4,372,919	\$6.65	\$8.65	76.9%
MAD Subzone	2018	May	423,498	\$4,504,307	\$6.19	\$10.64	58.2%
MAD Subzone	2018	Jun	180,908	\$1,368,006	\$2.51	\$7.56	33.2%
MAD Subzone	2018		1,680,762	\$16,239,825	\$6.06	\$10.64	57.0%
RTO Zone	2017	Jan	464,500	\$3,282,394	\$2.16	\$7.07	30.5%
RTO Zone	2017	Feb	316,299	\$2,014,318	\$1.89	\$6.37	29.7%
RTO Zone	2017	Mar	488,009	\$4,297,595	\$3.81	\$8.81	43.2%
RTO Zone	2017	Apr	438,444	\$3,567,451	\$2.89	\$8.14	35.6%
RTO Zone	2017	May	418,051	\$3,302,941	\$3.48	\$7.90	44.1%
RTO Zone	2017	Jun	284,845	\$2,233,462	\$2.24	\$7.84	28.6%
RTO Zone	2017	Jul	306,615	\$3,518,497	\$4.15	\$11.48	36.1%
RTO Zone	2017	Aug	268,260	\$1,935,732	\$2.72	\$7.22	37.7%
RTO Zone	2017	Sep	296,111	\$4,972,581	\$12.60	\$16.79	75.0%
RTO Zone	2017	Oct	401,595	\$3,878,155	\$3.55	\$9.66	36.8%
RTO Zone	2017	Nov	343,474	\$2,389,690	\$2.30	\$6.96	33.1%
RTO Zone	2017	Dec	341,179	\$2,858,839	\$2.77	\$8.39	33.1%
RTO Zone	2017		4,367,382	\$38,251,656	\$3.71	\$8.88	41.8%
RTO Zone	2018	Jan	258,690	\$7,321,268	\$14.42	\$28.30	51.0%
RTO Zone	2018	Feb	173,079	\$895,023	\$2.50	\$5.17	48.3%
RTO Zone	2018	Mar	304,643	\$2,770,039	\$5.97	\$9.04	66.0%
RTO Zone	2018	Apr	506,648	\$4,115,343	\$6.76	\$8.12	83.3%
RTO Zone	2018	May	423,675	\$4,678,415	\$6.27	\$11.04	56.8%
RTO Zone	2018	Jun	180,858	\$1,328,853	\$2.48	\$7.35	33.7%
RTO Zone	2018		1,847,593	\$21,108,941	\$6.40	\$11.50	55.6%

## Compliance

The MMU has identified and quantified the actual performance of scheduled tier 2 synchronized reserve resources when called on to deliver during synchronized reserve events since 2011.<sup>33</sup> When synchronized reserve resources self schedule or clear the Tier 2 Synchronized Reserve Market they are obligated to provide their full scheduled tier 2 MW during a synchronized reserve event. Actual synchronized reserve event response is determined by final output minus initial output where final output is the largest output between 9 and 11 minutes after start of the event, and initial output is the lowest output between one minute before the event and one minute after the event.<sup>34</sup> Tier 2 resources are obligated to sustain their final output for the shorter of the length of the event or 30 minutes. Penalties can be assessed for failure of a scheduled tier 2 resource to perform during any synchronized reserve event lasting 10 minutes or longer.

The MMU has reported the wide range of synchronized reserve event response levels and recommended that PJM take action to increase compliance rates. In 2015, there were 21 spinning events of which seven were 10 minutes or longer. In 2016, there were 16 spinning events of which six were 10 minutes or longer. In 2017, there were 16 spinning events, six of which were 10 minutes or longer. In the first six months of 2018, there were 6 spinning events, only three were 10 minutes or longer.

Tier 1 resource owners are paid for the actual amount of synchronized reserve they provide in response to a synchronized reserve event.<sup>35</sup> Tier 2 resource owners are paid for being available and responding but are not paid based on the actual response to a synchronized reserve event. Tier 1 resource owners do not have an obligation to respond and are not penalized for a failure to respond. Tier 2 resource owners are penalized for a failure to respond.

A tier 2 resource is penalized for the amount of MW it falls short of its scheduled MW for the entire hour, not just for the portion of the hour covered

<sup>33</sup> See 2011 *State of the Market Report for PJM*, Vol. 2, Section 9, "Ancillary Services," at 250.

<sup>34</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) § 4.2.11 Verification at 97.

<sup>35</sup> See *id.* at 98.

by the synchronized reserve event.<sup>36</sup> The penalty period is calculated as the lesser of the average number of days between spinning events over the past two years or the number of days since the resource last failed to respond fully. For 2018, PJM uses the average number of days between spinning events from November 2016 through October 2017 which is 19 days.<sup>37</sup> Resource owners are permitted to aggregate the response of multiple units to offset an under response from one unit with an overresponse from a different unit to reduce an under response penalty.

There were six synchronized reserve events of 10 minutes or longer in 2017. For those six events, 12.4 percent of all scheduled tier 2 synchronized reserve MW were not delivered and were penalized (Table 10-21). In the first 6 months of 2018, there have been 3 synchronized reserve events of 10 minutes or longer. Tier 2 synchronized reserve response rate was 75.2 percent.

**Table 10-21 Synchronized reserve events 10 minutes or longer, tier 2 response compliance, RTO Reserve Zone: January 2017 through June 2018**

Spin Event (Day, Time)	Duration (Minutes)	Tier 1 Estimate (MW Adj by DGP)	Tier 1 Response (MW)	Tier 2 Scheduled (MW)	Tier 2 Response (MW)	Tier 2 Penalty (MW)	Tier 2 Response Percent	Tier 1 Response Percent	Tier 2 Response Percent
Mar 23, 2017 06:48	24	926.8	549.6	742.8	559.1	183.7	59.3%	75.3%	
Apr 8, 2017 11:53	10	1,222.6	827.2	879.3	828.7	50.6	67.7%	94.2%	
May 8, 2017 04:18	10	1,325.6	976.3	335.1	298.5	36.6	73.6%	89.1%	
Jun 8, 2017 03:39	10	974.4	726.7	575.7	522.4	53.3	74.6%	90.7%	
Sep 4, 2017 20:03	15	476.3	68.1	601.0	563.8	37.2	14.3%	93.8%	
Sep 21, 2017 14:15	16	305.8	217.4	1,253.9	1,037.3	216.6	71.1%	82.7%	
2017 Average	14	871.9	560.9	731.3	635.0	96.3	60.1%	87.6%	
Jan 3, 2018 03:00	13	1,896.7	509.9	162.1	107.1	55.0	26.9%	66.1%	
Apr 12, 2018 17:28	10	1,063.3	591.2	464.6	372.5	92.1	55.6%	80.2%	
Jun 30, 2018 09:46	11	2,710.1	2,086.2	71.6	56.8	14.8	77.0%	79.3%	
2018 Average	11	1,890.0	1,062.4	232.8	178.8	54.0	53.2%	75.2%	

<sup>36</sup> See PJM, "Manual 28: Operating Agreement Accounting," Rev. 80 (June 1, 2018) at 47. See also PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 July 26, 2018) § 4.2.12 Non-Performance at 99.

<sup>37</sup> "2016 Third Quarter Synchronized Reserve Performance & 2017 Synchronized Reserve Penalty Days," presentation to the Operating Committee, December 13, 2016. <<http://www.pjm.com/-/media/committees-groups/committees/oc/20161213/20161213-item-16-2016-third-quarter-synchronized-reserve-performance-with-2017-penalty-days.ashx>>.

## History of Synchronized Reserve Events

Synchronized reserve is designed to provide relief for disturbances.<sup>38</sup> <sup>39</sup> A disturbance is defined as loss of 1,000 MW of generation and/or transmission resources within 60 seconds. In the absence of a disturbance, PJM dispatchers have used synchronized reserve as a source of energy to provide relief from low ACE. There were five low ACE events in 2017, on January 12, 2017 for 8 minutes, February 13, 2017 for 7 minutes, March 23, 2017 for 24 minutes, June 20, 2017 for 9 minutes, and September 21, 2017 for 16 minutes. There were no low ACE synchronized reserve events in the first six months of 2018.

The risk of using synchronized reserves for energy or any other non-disturbance reason is that it reduces the amount of synchronized reserve available for a disturbance. Disturbances are unpredictable. Synchronized reserve has a requirement to sustain its output for only up to 30 minutes. When the need is for reserve extending past 30 minutes secondary reserve is the appropriate source of the response. The use of synchronized reserve is an expensive solution during an hour when the hour ahead market solution and reserve dispatch indicated no shortage of primary reserve. PJM's primary reserve levels have been sufficient to recover from disturbances and should remain available in the absence of disturbance.

From January 1, 2010, through June 30, 2018, PJM experienced 217 synchronized reserve events (Table 10-22), approximately 2.1 events per month. During this period, synchronized reserve events had an average duration of 12.1 minutes.

<sup>38</sup> 2013 State of the Market Report for PJM, Appendix F – PJM's DCS Performance, at 451–452.

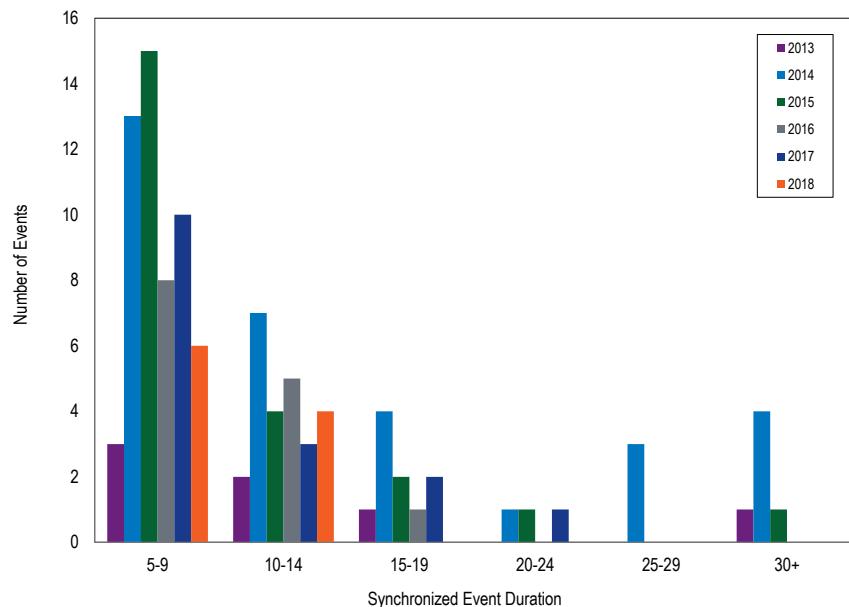
<sup>39</sup> See PJM "Manual 12: Balancing Operations," Rev. 38 (April 20, 2018) § 4.1.2 Loading Reserves at 40.

**Table 10-22 Synchronized reserve events: January 2010 through June 2018**

Table 10-22 Synchronized reserve events: January 2010 through June 2018 (continued)

Effective Time	Region	Duration (Minutes)	Effective Time	Region	Duration (Minutes)	Effective Time	Region	Duration (Minutes)	Effective Time	Region	Duration (Minutes)	Effective Time	Region	Duration (Minutes)
JAN-06-2014 22:01	RTO	68	JAN-07-2015 22:36	RTO	8	JAN-18-2016 17:58	RTO	12	JAN-08-2017 03:21	RTO	7	JAN-01-2018 02:41	RTO	7
JAN-07-2014 02:20	RTO	25	FEB-24-2015 02:51	RTO	5	FEB-08-2016 15:05	RTO	10	JAN-09-2017 19:24	RTO	9	JAN-03-2018 03:00	RTO	13
JAN-07-2014 04:18	RTO	34	FEB-26-2015 15:20	RTO	6	FEB-28-2016 18:29	RTO	8	JAN-10-2017 13:05	MAD	9	JAN-07-2018 14:15	RTO	9
JAN-07-2014 11:27	RTO	11	MAR-03-2015 17:02	RTO	11	APR-14-2016 20:09	RTO	10	JAN-15-2017 20:13	RTO	8	APR-12-2018 13:28	RTO	10
JAN-07-2014 13:20	RTO	41	MAR-16-2015 10:25	RTO	24	MAY-11-2016 15:55	RTO	6	JAN-23-2017 09:08	RTO	7	JUN-04-2018 10:22	RTO	6
JAN-10-2014 16:46	RTO	12	MAR-17-2015 23:34	RTO	17	JUN-01-2016 09:01	RTO	5	FEB-13-2017 18:30	RTO	7	JUN-29-2018 15:21	RTO	9
JAN-21-2014 18:52	RTO	6	MAR-23-2015 23:44	RTO	15	JUL-06-2016 00:40	RTO	5	FEB-14-2017 00:11	RTO	6	JUN-30-2018 09:46	RTO	11
JAN-22-2014 02:26	RTO	7	APR-06-2015 14:23	RTO	8	JUL-28-2016 13:28	RTO	15	FEB-15-2017 06:37	RTO	6			
JAN-22-2014 22:54	RTO	8	APR-07-2015 17:11	RTO	31	AUG-31-2016 19:29	RTO	8	MAR-23-2017 06:48	RTO	24			
JAN-25-2014 05:22	RTO	10	APR-15-2015 08:14	RTO	8	SEP-09-2016 19:11	RTO	6	APR-08-2017 11:53	RTO	10			
JAN-26-2014 17:11	RTO	6	APR-25-2015 03:21	RTO	9	SEP-11-2016 19:30	RTO	9	MAY-08-2017 04:18	RTO	10			
JAN-31-2014 15:05	RTO	13	JUL-30-2015 14:04	RTO	10	OCT-12-2016 08:21	RTO	5	JUN-08-2017 03:39	RTO	10			
FEB-02-2014 14:03	Dominion	8	AUG-05-2015 19:47	RTO	7	OCT-12-2016 14:40	RTO	7	JUN-20-2017 05:38	RTO	9			
FEB-08-2014 06:05	Dominion	18	AUG-19-2015 16:47	RTO	9	NOV-04-2016 17:13	RTO	11	SEP-04-2017 20:18	MAD	15			
FEB-22-2014 23:05	RTO	7	SEP-05-2015 01:16	RTO	7	DEC-03-2016 00:11	RTO	7	SEP-07-2017 09:16	RTO	9			
MAR-01-2014 05:18	RTO	26	SEP-10-2015 10:12	RTO	8	DEC-31-2016 05:10	RTO	12	SEP-21-2017 14:15	RTO	16			
MAR-05-2014 21:25	RTO	8	SEP-29-2015 00:58	Mid-Atlantic	11									
MAR-13-2014 20:39	RTO	8	NOV-12-2015 16:42	RTO	8									
MAR-27-2014 10:37	RTO	56	NOV-21-2015 17:17	RTO	8									
APR-14-2014 01:16	RTO	10	DEC-04-2015 22:41	RTO	7									
APR-25-2014 17:33	RTO	6	DEC-24-2015 17:42	RTO	8									
MAY-01-2014 14:18	RTO	13												
MAY-03-2014 17:11	RTO	13												
MAY-14-2014 01:36	RTO	5												
JUL-08-2014 03:07	RTO	9												
JUL-25-2014 19:19	RTO	7												
SEP-06-2014 13:32	RTO	18												
SEP-20-2014 23:42	RTO	14												
SEP-29-2014 10:08	RTO	15												
OCT-20-2014 06:35	RTO	15												
OCT-23-2014 11:03	RTO	27												
NOV-01-2014 06:50	RTO	9												
NOV-08-2014 02:08	RTO	8												
NOV-22-2014 05:27	RTO	21												
NOV-22-2014 08:19	RTO	10												
DEC-10-2014 18:58	RTO	8												
DEC-31-2014 21:42	RTO	12												

**Figure 10-13 Synchronized reserve events duration distribution curve: January 2013 through June 2018**



## Nonsynchronized Reserve Market

Nonsynchronized reserve consists of MW available within 10 minutes but not synchronized to the grid. Startup time for nonsynchronized reserve resources is not subject to testing and is based on parameters in offers submitted by resource owners. There is no defined requirement for nonsynchronized reserves. It is available to meet the primary reserve requirement. Generation resources that have designated their entire output as emergency are not eligible to provide nonsynchronized reserves. Generation resources that are not available to provide energy are not eligible to provide nonsynchronized reserves.

The market mechanism for nonsynchronized reserve does not include any direct participation by market participants. PJM defines the demand curve

for nonsynchronized reserve and PJM defines the supply curve based on nonemergency generation resources that are available to provide energy and can start in 10 minutes or less and on the associated resource opportunity costs calculated by PJM. Generation owners do not submit supply offers. Since nonsynchronized reserve is a lower quality product, its clearing price is always less than or equal to the synchronized reserve market clearing price. In most hours, the nonsynchronized reserve clearing price is zero.

## Market Structure

### Demand

Prior to July 12, 2017, PJM specified that 2,175 MW of primary reserve must be available in the Mid-Atlantic Dominion Reserve Subzone, of which 1,450 MW must be synchronized reserve (Figure 10-2), and that 2,175 MW of primary reserve must be available in the RTO Reserve Zone of which 1,450 MW must be synchronized reserve (Figure 10-3). As of July 12, 2017, the largest contingency is calculated dynamically in every synchronized and nonsynchronized reserve market solution and the primary requirement is set equal to 150 percent of the largest expected contingency within the upcoming hour. The balance of primary reserve can be made up by the most economic combination of synchronized and nonsynchronized reserve. PJM market operations increased the required amount of primary reserve in the RTO Reserve Zone by 450 MW for five hours on January 8, by 450 MW for 55 hours on February 28, by 450 MW for five hours on March 7, by 450 MW for 18 hours on March 15, by 1,400 MW for eight hours on April 25, by 1,400 MW for eight hours on June 14, and by 2,000 MW for 12 hours on June 16.

The average hourly demand for primary reserve in the first six months of 2018 was 2,257.1 MW.

### Supply

Figure 10-2 shows that most of the primary reserve requirement (orange line) in excess of the synchronized reserve requirement (yellow line) is satisfied by nonsynchronized reserve (light blue area).

There are no offers for nonsynchronized reserve. The hour ahead market solution considers the MW supply of nonsynchronized reserve to be all generation resources currently not synchronized to the grid but available and capable of providing energy within 10 minutes. Generators that have set themselves as unavailable or have set their output to be emergency only will not be considered. The market solution considers the offered MW to be the lesser of the economic maximum or the ramp rate times 10 minutes minus the startup and notification time. The offer price of nonsynchronized is the unit's opportunity cost of providing reserves.

The market solution optimizes synchronized reserve, nonsynchronized reserve, and energy to satisfy the primary reserve requirement at the lowest cost. Nonsynchronized reserve resources are scheduled economically based on LOC until the Primary Reserve requirement is filled. The nonsynchronized reserve market clearing price is determined at the end of the hour based on the LOC of the marginal unit. When a unit clears the nonsynchronized reserve market and is scheduled, it is committed to remain offline for the hour and available to provide 10 minute reserves.

Resources that generally qualify as nonsynchronized reserve include run of river hydro, pumped hydro, combustion turbines that can start in 10 minutes or less, combined cycles and diesels.<sup>40</sup> In the first six months of 2018, an average of 4,95.5 MW of nonsynchronized reserve was scheduled hourly out of 2,497.9 eligible MW as part of the primary reserve requirement in the RTO Zone.

In the first six months of 2018, CTs provided 61.0 percent of scheduled nonsynchronized reserve and hydro provided 38.0 percent. The remaining one percent of cleared nonsynchronized reserve was provided by diesel resources.

## Market Concentration

The supply of nonsynchronized reserves in the Mid-Atlantic Dominion Subzone and the RTO Zone was highly concentrated in the first six months of 2018.

<sup>40</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 92 (Nov. 1, 2017) at 101.

**Table 10-23 Nonsynchronized reserve market HHIs: January 2017 through June 2018**

Year	Month	MAD HHI	RTO HHI
2017	Jan	5538	5525
2017	Feb	5404	5402
2017	Mar	5679	5653
2017	Apr	4858	4847
2017	May	4213	4209
2017	Jun	3922	3922
2017	Jul	4106	4105
2017	Aug	4084	4084
2017	Sep	3806	3802
2017	Oct	3391	3391
2017	Nov	3125	3123
2017	Dec	2841	2841
		4247	4242
2018	Jan	3658	3651
2018	Feb	4063	4063
2018	Mar	4188	4188
2018	Apr	5914	4274
2018	May	4999	4409
2018	Jun	5149	5149
		4662	4289

**Table 10-24 Nonsynchronized reserve market pivotal supplier test: January 2017 through June 2018**

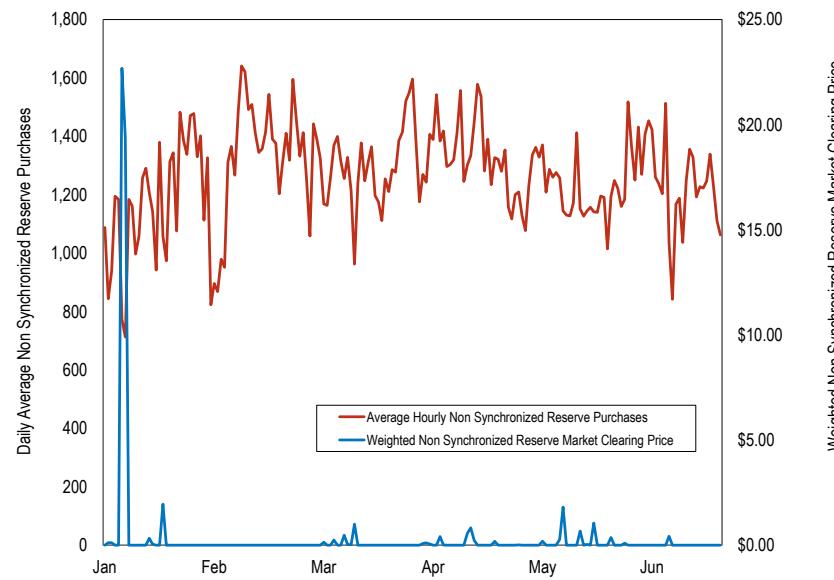
Year	Month	Non Synchronized Reserve Pivotal Supplier Hours
2017	Jan	32.2%
2017	Feb	31.1%
2017	Mar	38.1%
2017	Apr	38.1%
2017	May	52.3%
2017	Jun	60.4%
2017	Jul	55.9%
2017	Aug	57.1%
2017	Sep	70.8%
2017	Oct	82.1%
2017	Nov	57.1%
2017	Dec	92.5%
2017	Average	55.6%
2018	Jan	87.2%
2018	Feb	88.0%
2018	Mar	93.5%
2018	Apr	82.2%
2018	May	100.0%
2018	Jun	99.0%
2018		91.7%

## Price

The price of nonsynchronized reserve is calculated in real time every five minutes for the RTO Reserve Zone and the Mid-Atlantic Dominion Reserve Subzone.

Figure 10-14 shows the daily average nonsynchronized reserve market clearing price and average scheduled MW for the RTO Zone. In January through June 2018, the average nonsynchronized market clearing price was \$0.30 per MW. The hourly average nonsynchronized reserve purchased was 1,265.0 MW. From January through March, the market cleared at a price greater than \$0 in 41 hours. From April through June, the market cleared at a NSRMCP greater than \$0 in 171 intervals. The maximum hourly clearing price was \$404.60 per MW on January 7, 2018.

**Figure 10-14 Daily average RTO Zone nonsynchronized reserve market clearing price and MW purchased: January through June, 2018**



## Price and Cost

As a result of changing grid conditions, load forecasts, and unexpected generator performance, prices sometimes do not cover the full LOC of each resource. All resources cleared in the market are guaranteed to be made whole and are paid uplift credits if the NSRMCP does not fully compensate them. When real-time LMP rises above the generator's cost at economic minimum, then an LOC is paid.<sup>41</sup>

The full cost of nonsynchronized reserve including payments for the clearing price and uplift costs is calculated and compared to the price (Table 10-25). The closer the price to cost ratio comes to one, the more the market price reflects the full cost of nonsynchronized reserve.

<sup>41</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 103.

In the first six months of 2018, the price to cost ratio for the RTO Zone was 10.1 percent.

Resources that are not synchronized to the grid are generally off because it is not economic for them to produce energy. A resource scheduled for nonsynchronized reserve is obligated to remain unsynchronized even if its LMP changes and it becomes economic to start. In that case, the unit has a positive LOC.

Both nonsynchronized reserve markets cleared at a price above \$0 in less than one percent of hours.

**Table 10-25 RTO zone nonsynchronized reserve MW, charges, price, and cost: January 2017 through June 2018**

Market	Year	Month	Total	Weighted			Price/Cost Ratio
			Nonsynchronized Reserve MW	Nonsynchronized Reserve Charges	Nonsynchronized Reserve Market Price	Nonsynchronized Reserve Cost	
RTO Zone	2017	Jan	585,294	\$384,707	\$0.15	\$0.66	23.0%
RTO Zone	2017	Feb	599,301	\$171,893	\$0.00	\$0.29	1.2%
RTO Zone	2017	Mar	548,021	\$382,743	\$0.14	\$0.70	20.2%
RTO Zone	2017	Apr	653,581	\$357,047	\$0.13	\$0.55	24.4%
RTO Zone	2017	May	796,190	\$508,149	\$0.16	\$0.64	25.4%
RTO Zone	2017	Jun	841,672	\$351,251	\$0.03	\$0.42	7.4%
RTO Zone	2017	Jul	745,694	\$876,884	\$0.13	\$1.18	11.1%
RTO Zone	2017	Aug	874,602	\$548,271	\$0.01	\$0.63	1.4%
RTO Zone	2017	Sep	867,103	\$1,229,492	\$0.73	\$1.42	51.6%
RTO Zone	2017	Oct	929,944	\$713,508	\$0.02	\$0.77	2.5%
RTO Zone	2017	Nov	850,863	\$727,515	\$0.05	\$0.86	5.5%
RTO Zone	2017	Dec	936,590	\$772,028	\$0.00	\$0.82	0.1%
RTO Zone	2017	Total	9,228,856	\$7,023,487	\$0.13	\$0.76	17.1%
RTO Zone	2018	Jan	873,930	\$4,616,906	\$0.94	\$5.28	17.7%
RTO Zone	2018	Feb	886,683	\$249,232	\$0.00	\$0.28	0.0%
RTO Zone	2018	Mar	954,515	\$1,693,691	\$0.05	\$1.77	3.0%
RTO Zone	2018	Apr	968,046	\$1,269,953	\$0.08	\$0.76	10.7%
RTO Zone	2018	May	898,840	\$1,801,182	\$0.14	\$0.50	27.5%
RTO Zone	2018	Jun	840,171	\$931,913	\$0.01	\$0.90	1.5%
RTO Zone	2018	Total	5,422,185	\$10,562,878	\$0.20	\$1.58	10.1%

## Secondary Reserve

There is no NERC standard for secondary reserve. PJM defines secondary reserve as reserves (online or offline available for dispatch) that can be converted to energy in 30 minutes. PJM defines a secondary reserve requirement but does not have a goal to maintain this reserve requirement in real time.

PJM maintains a day-ahead, offer based market for 30 minute day-ahead secondary reserve. The Day-Ahead Scheduling Reserve Market (DASR) has no performance obligations except that a unit which clears the DASR market is required to be available for dispatch in real time.<sup>42</sup>

## Market Structure

### Supply

DASR is offered by both generation and demand resources. DASR offers consist of price only. DASR MW are calculated by the market clearing engine. DASR MW are the lesser of the energy ramp rate per minute for online units times 30 minutes, or the economic maximum MW minus the day-ahead dispatch point. For offline resources capable of being online in 30 minutes, the DASR quantity is the economic maximum. In the first six months of 2018, the average available hourly DASR was 38,626.4 MW, an 8.2 percent increase from 2017. The DASR hourly MW purchased averaged 5,534.0 MW.

PJM excludes resources that cannot reliably provide reserves in real time from participating in the DASR Market. Such resources include nuclear, run of river hydro, self scheduled pumped hydro, wind, solar, and energy storage resources.<sup>43</sup> The intent of this proposal is to limit cleared DASR resources to those resources actually capable of providing reserves in the real-time market. Owners of excluded resources may request an exemption from their default noneligibility.

<sup>42</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 155.

<sup>43</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 152.

Of the 5,534.0 MW average hourly DASR cleared in the first six months of 2018, 73.5 percent was from CTs, 6.8 percent was from steam, 14.2 percent was from hydro, and 5.0 percent was CCs. Load response resources which are registered in PJM's Economic Load Response and are dispatchable by PJM are eligible to provide DASR. In 2018, eight demand resources offered into the DASR Market.

## Demand

Secondary reserve (30 minute reserve) requirements are determined by PJM for each reliability region. In the *ReliabilityFirst* (RFC) region, secondary reserve requirements are calculated based on historical under-forecasted load rates and generator forced outage rates.<sup>44</sup> The RFC and Dominion secondary reserve requirements are added together to form a single RTO DASR requirement defined as the sum of a percent of the load forecast error and forced outage rate times the daily peak load forecast. For 2018, the DASR requirement is set to 5.29 percent of daily peak load forecast. This is down from 5.52 for 2017. The DASR requirement is applicable for all hours of the operating day.

Effective March 1, 2015, the DASR requirement can be increased by PJM dispatch under conditions of "hot weather or cold weather alert or max emergency generation alert or other escalating emergency."<sup>45</sup> The amount of additional DASR MW that may be required is the Adjusted Fixed Demand (AFD) determined by a Seasonal Conditional Demand (SCD) factor.<sup>46</sup> The SCD factor is calculated separately for the winter (November through March) and summer (April through October) seasons. The SCD factor is calculated every year based on the top 10 peak load days from the prior year. For November 2017 through October 2018, the SCD values are 3.89 percent for winter and 3.29 percent for summer. For November 2017 through March of 2018 the value is 3.89 percent. PJM Dispatch may also schedule additional Day-Ahead Scheduling Reserves as deemed necessary for conservative operations.<sup>47</sup> PJM has defined the reasons for conservative operations to include, potential fuel

<sup>44</sup> See PJM "Manual 13: Emergency Operations," Rev. 65 (Jan. 1, 2018) at 12.

<sup>45</sup> PJM, "Energy and Reserve Pricing & Interchange Volatility Final Proposal Report," <http://www.pjm.com/~/media/committees-groups/committees/mrc/20141030/20141030-item-04-erpiv-final-proposal-report.ashx>.

<sup>46</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 166 at 11.2.1 Day-Ahead Scheduling Reserve Market Requirement.

<sup>47</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 167.

delivery issues, forest/brush fires, extreme weather events, environmental alerts, solar disturbances, unknown grid operating state, physical or cyber attacks.<sup>48</sup> The result is substantial discretion for PJM to increase the demand for DASR under a variety of circumstances. PJM invoked adjusted fixed demand on 12 days during the first six months of 2018. The 30 hours with highest DASR market clearing price were during days when adjusted fixed demand was invoked.

The MMU recommends that PJM modify the DASR Market to ensure that all resources cleared incur a real-time performance obligation.

## Market Concentration

DASR market three pivotal supplier test results are provided in Table 10-26.

**Table 10-26 DASR market three pivotal supplier test results and number of hours with DASRMCP above \$0: January 2017 through June 2018**

Year	Month	Number of Hours When DASRMCP > \$0	Percent of Hours Pivotal
2017	Jan	93	16.1%
2017	Feb	49	2.0%
2017	Mar	359	2.5%
2017	Apr	402	9.5%
2017	May	250	44.0%
2017	Jun	242	37.8%
2017	Jul	341	36.8%
2017	Aug	165	8.3%
2017	Sep	179	12.8%
2017	Oct	154	0.7%
2017	Nov	92	3.2%
2017	Dec	72	17.1%
2017	Average	200	15.9%
2018	Jan	197	7.6%
2018	Feb	14	42.9%
2018	Mar	66	0.0%
2018	Apr	189	0.5%
2018	May	337	5.6%
2018	Jun	102	11.8%
2018	Average	151	11.4%

<sup>48</sup> See PJM "Manual 13: Emergency Operations," Rev. 64, (June 1, 2017) at 58.

## Market Conduct

PJM rules allow any unit with reserve capability that can be converted into energy within 30 minutes to offer into the DASR Market.<sup>49</sup> Units that do not offer have their offers set to \$0.00 per MW during the day-ahead market clearing process.

Economic withholding remains an issue in the DASR Market. The marginal cost of providing DASR is zero. All offers greater than zero constitute economic withholding. In the first six months of 2018, 38.6 percent of generation units offered DASR at a daily price above \$0.00, compared to 39.6 percent in 2017. In the first six months of 2018, 15.5 percent of daily offers were above \$5.00 per MW.

## Market Performance

In the first six months of 2018, the DASR Market cleared at a price above \$0 in 20.9 percent of hours. The weighted average DASR price for all hours when the DASRMCP was above \$0.00 was \$.99. In 2017, the weighted average DASR price for all hours when the DASRMCP was above \$0.00 was \$2.18. In the first six months of 2018 the average cleared MW in all hours was 5,256.0 MW. The average cleared MW in all hours when the DASRMCP was above \$0.00 was 6,257.7 MW. The highest DASR price was \$50.00 on January 2, 2018 and May 29, 2018.

The introduction of Adjusted Fixed Demand (AFD) on March 1, 2015, created a bifurcated market (Table 10-28). In 2015, PJM added AFD to the normal 5.93 percent of forecast load in 367 hours. In 2016, PJM added AFD to the normal 5.7 percent of forecast load in 522 hours. In 2017, PJM added AFD to the normal 5.52 percent of forecast load in 336 hours. In the first six months of 2018 PJM added AFD to the normal 5.29 percent in 286 hours. The difference in market clearing price, MW cleared, obligation incurred, and charges to PJM load are substantial (Table 10-27).

**Table 10-27 Impact of Adjusted Fixed Demand on DASR prices and demand: January through June 2018**

Metric	Year	Number Hours	Weighted Day-Ahead Scheduling Reserve Market Clearing Price (DASRMCP)	Average Hourly Total DASR MW
All Hours	Jan-Jun 2018	4,343	\$0.68	5,256.6
All Hours when DASRMCP > \$0	Jan-Jun 2018	907	\$2.73	6,257.7
All Hours when AFD is used	Jan-Jun 2018	286	\$5.16	9,487.7

While the new rules allow PJM dispatch substantial discretion to add to DASR demand for a variety of reasons, the rationale for each specific increase is not always clear. The MMU recommends that PJM Market Operations attach a reason code to every hour in which PJM dispatch adds additional DASR MW above the default DASR hourly requirement. The addition of such a code would make the reason explicit, increase transparency and facilitate analysis of the use of PJM's ability to add DASR MW.

<sup>49</sup> See PJM "Manual 11: Energy & Ancillary Services Market Operations," Rev. 97(July 26, 2018) at 152.

**Table 10-28 DASR Market, regular hours vs. adjusted fixed demand hours: January 2017 through June 2018**

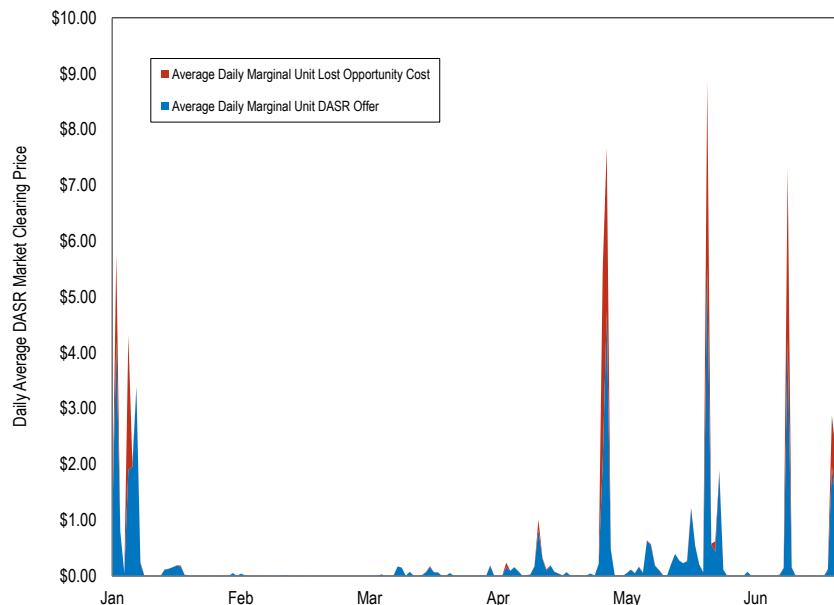
Year	Month	Number of Hours DASRMCP>\$0		Weighted DASRMCP		Average PJM Load MW		Hourly Average Cleared DASR MW		Average Hourly DASR Credits	
		Normal Hour	AFD Hour	Normal Hour	AFD Hour	Normal Hour	AFD Hour	Normal Hour	AFD Hour	Normal Hour	AFD Hour
2017	Jan	93	0	\$0.02		106,095		4,386		\$91	
2017	Feb	49	0	\$0.02		96,628		4,444		\$92	
2017	Mar	359	0	\$0.08		91,182		4,092		\$329	
2017	Apr	402	0	\$0.04		80,834		3,828		\$159	
2017	May	250	48	\$0.07	\$18.13	85,581	98,184	4,004	10,727	\$280	\$194,491
2017	Jun	242	73	\$0.18	\$6.63	108,482	116,172	5,099	11,713	\$907	\$77,542
2017	Jul	341	115	\$0.29	\$6.41	114,832	117,568	5,288	10,669	\$1,551	\$68,397
2017	Aug	165	12	\$0.42	\$1.23	114,916	125,601	5,515	10,585	\$2,318	\$12,980
2017	Sep	179	22	\$1.17	\$40.30	105,850	104,097	5,111	11,652	\$5,960	\$466,893
2017	Oct	154	0	\$0.33		89,402		4,404		\$1,446	
2017	Nov	92	0	\$0.20		91,098		4,950		\$972	
2017	Dec	72	0	\$0.27		110,878		5,675		\$1,542	
		2,398	270	\$0.26	\$14.54	100,489	112,324	4,641	11,317	\$1,298	\$164,060
<hr/>											
2018	Jan	77	120	\$0.36	\$3.57	116,727	119,404	5,620	9,178	\$2,026	\$32,770
2018	Feb	14	0	\$0.13	NA	109,398	NA	5,568	NA	\$745	NA
2018	Mar	66	0	\$0.32	NA	100,431	NA	5,145	NA	\$1,660	NA
2018	Apr	190	0	\$0.37	NA	85,912	NA	4,528	NA	\$1,686	NA
2018	May	267	72	\$0.58	\$9.00	93,965	91,483	4,907	10,896	\$2,847	\$98,059
2018	Jun	46	55	\$0.26	\$6.05	115,317	119,136	5,729	9,243	\$1,484	\$55,967
		660	247	\$0.34	\$6.21	103,625	110,008	5,250	9,772	\$1,741	\$62,265

The implementation of AFD in 270 hours of 2017 and 247 hours of the first six months of 2018 significantly increased the cost of DASR as a result of increases in DASR MW cleared and corresponding increases in the DASR clearing prices (Table 10-29).

**Table 10-29 DASR Market all hours of DASR market clearing price greater than \$0: January 2017 through June 2018**

Year	Month	Number of Hours DASRMCP > \$0	Weighted DASR Market Clearing Price	Average Hourly RT Load MW	Total PJM Cleared DASR MW	Total PJM Cleared Additional DASR MW	Total Charges
2017	Jan	93	\$0.02	106,095	407,922	0	\$8,426
2017	Feb	49	\$0.02	96,628	217,737	0	\$4,487
2017	Mar	359	\$0.08	91,182	1,468,921	0	\$117,995
2017	Apr	402	\$0.04	80,834	1,539,010	0	\$63,852
2017	May	250	\$6.76	87,849	1,303,480	246,420	\$8,809,449
2017	Jun	242	\$3.20	110,611	1,677,956	383,822	\$5,365,628
2017	Jul	341	\$3.39	115,755	2,422,053	516,238	\$8,216,211
2017	Aug	165	\$0.53	115,693	970,853	49,896	\$510,353
2017	Sep	179	\$10.59	105,635	1,058,754	136,480	\$11,207,356
2017	Oct	154	\$0.33	89,402	678,175	0	\$222,717
2017	Nov	92	\$0.20	91,098	455,371	0	\$89,460
2017	Dec	72	\$0.27	110,878	408,569	0	\$111,029
2017	Average	200	\$2.12	100,138	1,050,733	148,095	\$2,893,914
2017	Total	2,398			12,608,800	1,332,856	\$34,726,963
2018	Jan	197	\$2.67	118,358	3,869,914	482,643	\$4,088,381
2018	Feb	14	\$0.13	109,398	3,404,236	0	\$10,436
2018	Mar	66	\$0.32	100,431	3,650,839	0	\$109,563
2018	Apr	190	\$0.10	85,912	3,247,134	0	\$320,330
2018	May	339	\$1.96	93,965	3,586,629	388,391	\$3,741,451
2018	Jun	101	\$0.75	115,317	3,954,451	595,215	\$2,316,276
2018	Average	151	\$0.99	103,897	3,618,867	244,375	\$1,764,406
2018	Total	907			21,713,203	1,466,249	\$10,586,437

**Figure 10-15 Daily average components of DASR clearing price (\$/MW), marginal unit offer and LOC: January through June 2018**



When the DASR requirement is increased by PJM dispatch, the reserve requirement frequently cannot be met without redispatching online resources which significantly affects the price by creating an LOC, (Figure 10-15). DASR prices had several severe peaks in January. Cold weather from December 28, 2017, through January 7, 2018, forced PJM dispatch to invoke 120 hours of Seasonal Conditional Demand resulting in relatively high prices. The May 29, 2018 high price occurred during a hot weather alert and on the same day as the Twin Branch load shed event in AEP. The highest prices were \$50.00 on January 8, 2018, and May 29, 2018.

## Regulation Market

Regulation matches generation with very short term changes in load by moving the output of selected resources up and down via an automatic control signal. Regulation is provided by generators with a short-term response capability (less than five minutes) or by demand response (DR). The PJM Regulation Market is operated as a single real-time market.

## Market Design

PJM's regulation market design is a result of Order No. 755.<sup>50</sup> The objective of PJM's regulation market design is to minimize the cost to provide regulation using two resource types in a single market.

The regulation market includes resources following two signals: RegA and RegD. Resources responding to either signal help control ACE (area control error). RegA is PJM's slow-oscillation regulation signal and is designed for resources with the ability to sustain energy output for long periods of time, with slower ramp rates. RegD is PJM's fast-oscillation regulation signal and is designed for resources with limited ability to sustain energy output and with faster ramp rates. Resources must qualify to follow one or both of the RegA and RegD signals, but will be assigned by the market clearing engine to follow only one signal in a given market hour.

The PJM regulation market design includes three clearing price components: capability (\$/MW, based on the MW being offered); performance (\$/mile, based on the total MW movement requested by the control signal, known as mileage); and lost opportunity cost (\$/MW of lost revenue from the energy market as a result of providing regulation). The MBF and performance score translate a RegD resource's capability (actual) MW into marginal effective MW and offers into \$/effective MW.

The regulation market solution is intended to meet the regulation requirement with the least cost combination of RegA and RegD. When solving for the least cost combination of RegA and RegD MW to meet the regulation requirement, the Regulation Market will substitute RegD MW for RegA MW when RegD

<sup>50</sup> Frequency Regulation Compensation in the Organized Wholesale Power Markets, Order No. 755, 137 FERC ¶ 61,064 at P 2 (2011).

is cheaper. Performance adjusted RegA MW are used as the common unit of measure, called effective MW, of regulation service. All resource MW (RegA and RegD) are converted into effective MW. RegA MW are converted into effective MW by multiplying the RegA MW offered by their performance score. RegD MW are converted into effective MW by multiplying the RegD offered by their performance score and by the marginal benefit function (MBF). The regulation requirement is defined as the total effective MW required to provide a defined amount of area control error (ACE) control.

The Regulation Market converts performance adjusted RegD MW into effective MW using the marginal benefit function (MBF) in the PJM design. The MBF is used to convert incremental additions of RegD MW into incremental effective MW. The total effective MW for a given amount of RegD MW equal the area under the MBF curve (the sum of the incremental effective MW contributions). RegA and RegD resources should be paid the same price per marginal effective MW.

The MBF function describing the engineering substitutability between RegA and RegD must be correctly defined and consistently applied throughout the market design, from optimization to settlement. The MBF should be equal to the marginal rate of technical substitution (MRTS) between RegA and RegD, holding the level of regulation service constant. The MRTS is the marginal measure of substitutability of RegD resources for RegA resources in satisfying a defined regulation requirement at feasible combinations of RegA and RegD MW. Consistently applying the MBF from optimization to settlement is the only way to ensure that the rate of substitution between RegA and RegD in providing a defined level of regulation is reflected in the relative value of RegA and RegD resources. While resources following RegA and RegD can both provide regulation service in PJM's Regulation Market, PJM's joint optimization is intended to determine and assign the optimal mix of RegA and RegD MW to meet the hourly regulation requirement. The optimal mix is a function of the relative effectiveness and cost of available RegA and RegD resources.

At any valid combination of RegA and RegD, regulation offers are converted to dollars per effective MW using the RegD offer and the MBF associated with that combination of RegA and RegD. The marginal contribution of a RegD MW to effective MW is equal to the MRTS associated with that RegA/RegD combination.

For example, a 1.0 MW RegD resource with a total offer price of \$2/MW with a MBF of 0.5 and a performance score of 100 percent would be calculated as offering 0.5 effective MW (0.5 MBF times 1.00 performance score times 1 MW). The total offer price would be \$4 per effective MW (\$2/MW offer divided by the 0.5 effective MW).

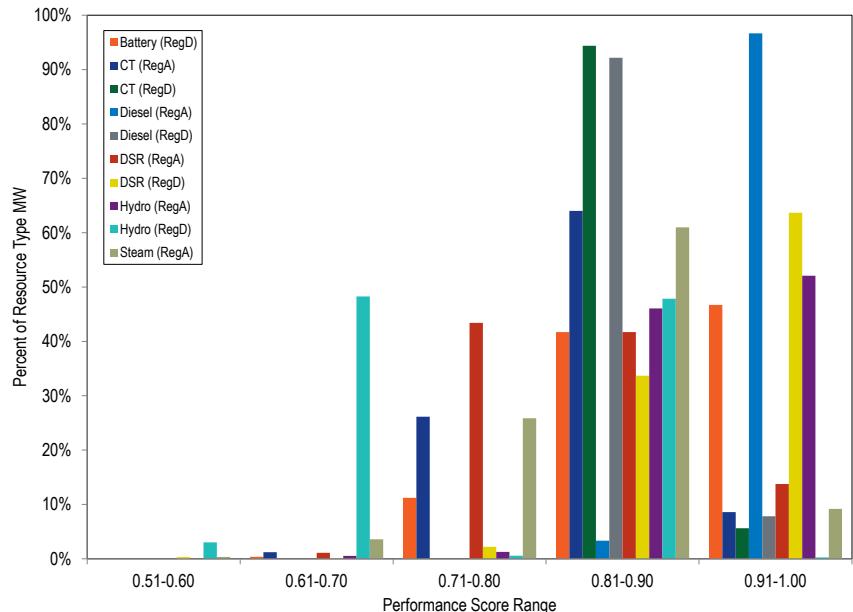
Regulation performance scores (0.0 to 1.0) measure the response of a regulating resource to its assigned regulation signal (RegA or RegD) every 10 seconds by measuring: delay, the time delay of the regulation response to a change in the regulation signal; correlation, the correlation between the regulating resource output and the regulation signal; and precision, the difference between the regulation response and the regulation requested.<sup>51</sup> Performance scores are reported on an hourly basis for each resource.

Figure 10-16 and Figure 10-17 show the average performance score by resource type and the signal followed in the first six months of 2018. In these figures, the MW used are actual MW and the performance score is the hourly performance score of the regulation resource.<sup>52</sup> Each category (color bar) is based on the percentage of the full performance score distribution for each resource (or signal) type. As Figure 10-17 shows, 44.2 percent of RegD resources had average performance scores within the 0.91-1.00 range, and 18.8 percent of RegA resources had average performance scores within that range, in the first six months of 2018. These scores are lower than the scores for both product types in the first six months of 2017, where 51.5 percent of RegD resources had average performance scores within the 0.91-1.00 range, and 23.9 percent of RegA resources had average performance scores within that range.

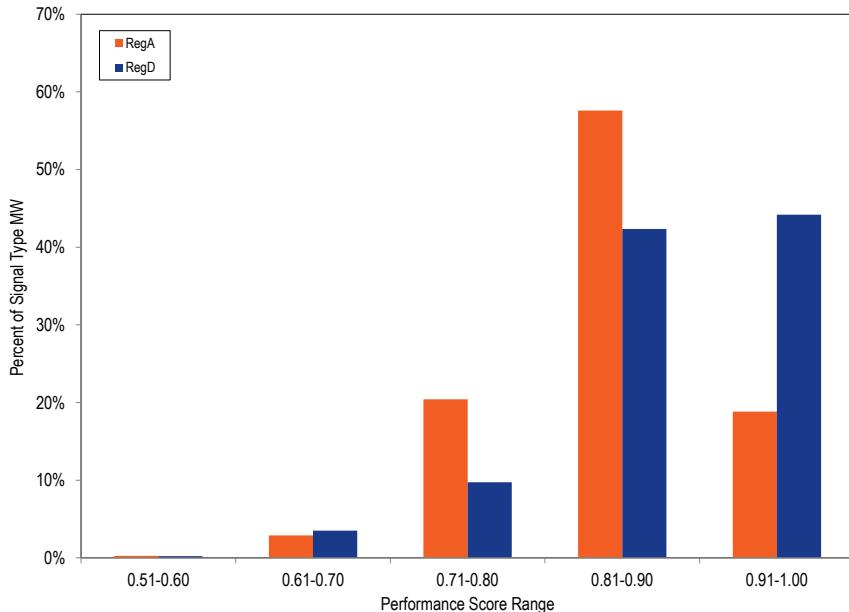
<sup>51</sup> PJM "Manual 12: Balancing Operations," Rev. 38 (April 30, 2018) at 4.5.6, p 54.

<sup>52</sup> Except where explicitly referred to as effective MW or effective regulation MW, MW means actual MW unadjusted for either MBF or performance factor.

**Figure 10-16 Hourly average performance score by unit type: January through June, 2018**



**Figure 10-17 Hourly average performance score by regulation signal type: January through June, 2018**



Each cleared resource in a class (RegA or RegD) is allocated a portion of the class signal (RegA or RegD). This portion of the class signal is based on the cleared regulation MW of the resource relative to the cleared MW cleared for that class. This signal is called the Total Regulation Signal (TREG) for the resource. A resource with 10 MW of capability will be provided a TREG signal asking for a positive or negative regulation movement between negative and positive 10 MW around its regulation set point.

Resources are paid Regulation Market Clearing Price (RMCP) credits and lost opportunity cost credits. If a resource's lost opportunity costs for an hour are greater than its RMCP credits, that resource receives lost opportunity cost credits equal to the difference. PJM posts clearing prices for the Regulation Market (RMCCP, RMPCP and RMCP) in dollars per effective MW. The

regulation market clearing price (RMCP in \$/effective MW) for the hour is the simple average of the 12 five minute RMCPs within the hour. The RMCP is set in each five minute interval based on the marginal offer in each interval. The performance clearing price (RMPCP in \$/effective MW) is based on the marginal performance offer (RMPCP) for the hour. The capability clearing price (RMCCP in \$/effective MW) is equal to the difference between the RMCP for the hour and the RMPCP for the hour. This is done so the total of RMPCP plus RMCCP equals the total clearing price (RMCP) but the RMPCP is maximized.

Market solution software relevant to regulation consists of the Ancillary Services Optimizer (ASO) solving hourly; the intermediate term security constrained economic dispatch market solution (IT-SCED) solving every 15 minutes; and the real-time security constrained economic dispatch market solution (RT-SCED) solving every five minutes. The market clearing price is determined by pricing software (LPC) that looks at the units cleared in the RT-SCED 15 minutes ahead of the pricing interval. The marginal price as identified by the LPC for each of these intervals is then averaged over the hour for an hourly regulation market clearing price.

## Market Design Issues

PJM's current regulation market design is severely flawed and does not follow the appropriate basic design logic. The market results do not represent the least cost solution for the defined level of regulation service.

To address the identified market flaws, the MMU and PJM developed a joint proposal which was approved by the PJM Members Committee on July 27, 2017 and filed with the FERC on October 17, 2017. The PJM/MMU joint proposal addresses issues with the inconsistent application of the marginal benefit factor throughout the optimization and settlement process in the PJM Regulation Market. On March 30, 2018, FERC rejected the proposal finding it inconsistent with Order No. 755.<sup>53</sup> Both PJM and the MMU have filed requests for rehearing.<sup>54</sup>

<sup>53</sup> 162 FERC ¶ 61,295 (2018).

<sup>54</sup> See FERC Docket No. ER18-87-002.

The MBF related issues with the Regulation Market have been raised in the PJM stakeholder process. In 2015, PJM stakeholders approved an interim, partial solution to the RegD over procurement problem which was implemented on December 14, 2015. The interim solution was designed to reduce the relative value of RegD MW in all hours and to cap purchases of RegD MW during critical performance hours. But the interim solution did not address the fundamental issues in the optimization or the lack of consistency in the application of the MBF.

Additional changes were implemented on January 9, 2017. These modifications included changing the definition of off peak and on peak hours, adjusting the currently independent RegA and RegD signals to be interdependent, and changing the 15 minute neutrality requirement of the RegD signal to a 30 minute neutrality requirement.

The January design changes appear to have been intended to make RegD more valuable. That is not a reasonable design goal. The design goal should be to determine the least cost way to provide needed regulation. The RegA signal is now slower than it was previously, which may make RegA following resources less useful as ACE control. RegA is now explicitly used to support the conditional energy neutrality of RegD. The RegD signal is now the difference between ACE and RegA. RegA is required to offset RegD when RegD moves in the opposite direction of that required by ACE control in order to permit RegD to recharge. These changes in the signal design will allow PJM to accommodate more RegD in its market solutions. The new signal design is not making the most efficient use of RegA and RegD resources. The explicit reliance on RegA to offset issues with RegD is a significant conceptual change to the design that is inconsistent with the long term design goal for regulation. PJM increased the regulation requirement as part of these changes.

The January 9, 2017, design changes replaced off peak and on peak hours with nonramp and ramp hours with definitions that vary by season. The regulation requirement for ramp hours was increased from 700 MW to 800 MW (Table 10-30). These market changes still do not address the fundamental issues in the optimization or the lack of consistency in the application of the MBF.

**Table 10-30 Seasonal regulation requirement definitions<sup>55</sup>**

Season	Dates	Nonramp Hours	Ramp Hours
Winter	Dec 1 - Feb 28(29)	00:00 - 03:59	04:00 - 08:59
		09:00 - 15:59	16:00 - 23:59
		00:00 - 04:59	05:00 - 07:59
Spring	Mar 1 - May 31	08:00 - 16:59	17:00 - 23:59
Summer	Jun 1 - Aug 31	00:00 - 04:59	05:00 - 13:59
		14:00 - 17:59	18:00 - 23:59
Fall	Sep 1 - Nov 30	00:00 - 04:59	05:00 - 07:59
		08:00 - 16:59	17:00 - 23:59

## Performance Scores

Performance scores, by class and unit, are not an indicator of how well resources contribute to ACE control. Performance scores are an indicator only of how well the resources follow their TREG signal. High performance scores with poor signal design are not a meaningful measure of performance. For example, if ACE indicates the need for more regulation but RegD resources have provided all their available energy, the RegD regulation signal will be in the opposite direction of what is needed to control ACE. So, despite moving in the wrong direction for ACE control, RegD resources would get a good performance score for following the RegD signal and will be paid for moving in the wrong direction.

The RegD signal prior to January 9, 2017, is an example of a signal that resulted in high performance scores, but due to 15 minute energy neutrality built into the signal, ran counter to ACE control at times. Energy neutrality means that energy produced equals energy used within a defined timeframe. With 15 minute energy neutrality, if a battery were following the regulation signal to provide MWh for 7.5 minutes, it would have to consume the same amount of MWh for the next 7.5 minutes. When neutrality correction of the RegD signal is triggered, it overrides ACE control in favor of achieving zero net energy over the 15 minute period. When this occurs, the RegD signal runs counter to the control of ACE and hurts rather than helps ACE. In that situation, the control of ACE, which must also offset the negative impacts of RegD, depends entirely on RegA resources following the RegA signal. High

<sup>55</sup> See PJM, "Regulation Requirement Definition," <<http://www.pjm.com/~/media/markets-ops/ancillary/regulation-requirement-definition.ashx>>.

performance scores under the signal design prior to January 9, 2017, was not an indication of good ACE control.

The January 9, 2017, design changes did not address the fundamental issues with the definition of performance or the nature of payments for performance in the regulation market design. The regulation signal should not be designed to favor a particular technology. The signal should be designed to result in the lowest cost of regulation to the market. Only with a performance score based on full substitutability among resource types should payments be based on following the signal. The MRTS must be redesigned to reflect the actual capabilities of technologies to provide regulation. The PJM regulation market design remains fundamentally flawed.

In addition, the absence of a performance penalty, imposed as a reduction in performance score and/or as a forfeiture of revenues, for deselection initiated by the resource owner within the hour, creates a possible gaming opportunity for resources which may overstate their capability to follow the regulation signal. The MMU recommends that there be a penalty enforced as a reduction in performance score and/or a forfeiture of revenues when resource owners elect to deassign assigned regulation resources within the hour, to prevent gaming.

## Regulation Signal

With any signal design for substitutable resources, the MBF function should be determined by the ability of RegA and RegD resources to follow the signal, including conditions under which neutrality cannot be maintained by RegD resources. The ability of energy limited RegD to provide ACE control depends on the availability of excess RegA capability to support RegD under the conditional neutrality design. When RegD resources are largely energy limited resources, a correctly calculated MBF would exhibit a rapid decrease in the MBF value for every MW of RegD added. This means that only a small amount of energy limited RegD is economic. The current and proposed signals and corresponding MBF functions do not reflect these principles or the actual substitutability of resource types.

## MBF Issues

The MBF function, as implemented in the PJM Regulation Market, is not equal to the MRTS between RegA and RegD. The MBF is not consistently applied throughout the market design, from optimization to settlement, and market clearing does not confirm that the resulting combinations of RegA and RegD are realistic and can meet the defined regulation demand. The calculation of total regulation cleared using the MBF is incorrect.<sup>56</sup>

The result has been that the PJM Regulation Market has over procured RegD relative to RegA in most hours, has provided a consistently inefficient market signal to participants regarding the value of RegD in every hour, and has overpaid for RegD. In 2015, this over procurement began to degrade the ability of PJM to control ACE in some hours while at the same time increasing the cost of regulation. When the price paid for RegD is above the level defined by an accurate MBF function, there is an artificial incentive for inefficient entry of RegD resources.

The PJM/MMU joint proposal, filed with FERC on October 17, 2017, addresses issues with the inconsistent application of the marginal benefit factor throughout the optimization and settlement process in the PJM Regulation Market.<sup>57</sup>

### Marginal Benefit Factor Not Correctly Defined

The MBF used in the PJM Regulation Market did not accurately reflect the MRTS between RegA and RegD resources under the old market design and it does not accurately reflect the MRTS between RegA and RegD resources under the modified design. The MBF function is incorrectly defined and improperly implemented in the current PJM Regulation Market.

The MBF should be the marginal rate of technical substitution between RegA and RegD MW at different, feasible combinations of RegA and RegD that can be used to provide a defined level of regulation service. The objective of the market design is to find, given the relative costs of RegA and RegD MW, the least cost feasible combination of RegA and RegD MW. If the MBF function

is incorrectly defined, or improperly implemented in the market clearing and settlement, the resulting combinations of RegA and RegD will not represent the least cost solution and may not be a feasible way to reach the target level of regulation.

The MBF is not included in PJM's settlement process. This is a design flaw that results in incorrect payments for regulation. The issue results from two FERC orders. From October 1, 2012, through October 31, 2013, PJM implemented a FERC order that required the MBF to be fixed at 1.0 for settlement calculations only. On October 2, 2013, FERC directed PJM to eliminate the use of the MBF entirely from settlement calculations of the capability and performance credits and replace it with the RegD to RegA mileage ratio in the performance credit paid to RegD resources, effective retroactively to October 1, 2012.<sup>58</sup> That rule continues in effect. The result of the current FERC order is that the MBF is used in market clearing to determine the relative value of an additional MW of RegD, but the MBF is not used in the settlement for RegD.

If the MBF were consistently applied, every resource would receive the same clearing price per marginal effective MW. But the MBF is not consistently applied and resources do not receive the same clearing price per marginal effective MW.

While prices are set on the basis of dollars per effective MW, only RegA resources receive payments based on this price per effective MW.<sup>59</sup> RegA resources are paid the RMCCP times MW times the performance factor times the MBF, plus the RMPCP times MW times the performance factor times the MBF. (The RegA MBF is 1.0.) RegD resources do not receive payments based on this price per effective MW. RegD resources are paid the RMCCP times MW times the performance factor, plus the RMPCP times MW times the performance factor times the mileage ratio.<sup>60</sup> As a result, the current market design does not send the correct price signal to the RegD resources.

<sup>56</sup> 145 FERC ¶ 61,011 (2013).

<sup>57</sup> This is due to the fact that RegA resources performance adjusted MW are their effective MW as the MRTS of RegA resources is always equal to one, as effective MW are defined in terms of RegA performance adjusted MW.

<sup>60</sup> Performance adjusted RegD MW are converted to effective MW by multiplying the performance adjusted MW by the market clearing MRTS.

<sup>56</sup> The MBF, as used in this report, refers to PJM's incorrectly calculated MBF and not the MBF equivalent to the MRTS.  
<sup>57</sup> 18 CFR § 385.211 (2017)

Figure 10-18 compares the daily average MBF and the mileage ratio for excursion and nonexcursion hours. Excursion hours (hours ending 7:00, 8:00, 18:00-21:00) were hours in which PJM had decided that more RegA was needed and PJM would not clear any RegD with an MBF less than 1.0.<sup>61</sup> Excursion hours were discontinued by PJM as of July 31, 2017. The shift in both the MBF values and the mileage ratio (Figure 10-18) resulted from the design changes implemented on January 9, 2017.

The change in design decreased RegA mileage (the change in MW output in response to regulation signal per MW of capability), increased the proportion of cleared RegD resources' capability that was called by the RegD signal (increased REG for a given MW) to better match offered capability, increased the mileage required of RegD resources and changed the energy neutrality component of the signal from a strict 15 minute neutrality to a conditional 30 minute neutrality. The changes in signal design increased the mileage ratio (the ratio of RegD mileage to RegA mileage). In addition, to adapt to the 30 minute neutrality requirement, RegD resources decreased their offered capability to maintain their performance. The reduction in offered capability reduced the amount of RegD MW clearing and increased the amount of RegA MW clearing, meaning a higher MBF in every hour.

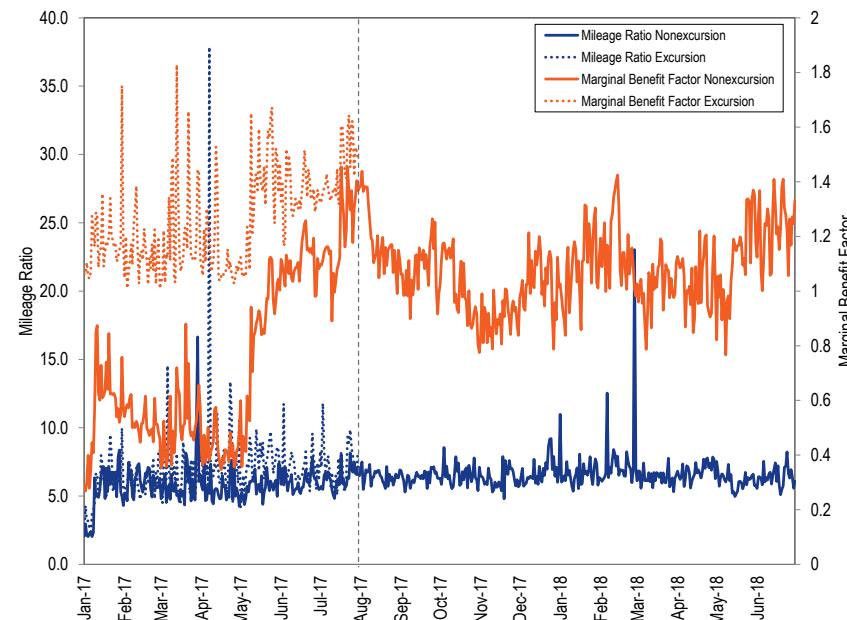
The weighted average mileage ratio during nonexcursion hours increased from 5.76 in the first six months of 2017, to 6.68 in the first six months of 2018 (an increase of 15.9 percent). The high mileage ratio values are the result of the mechanics of the mileage ratio calculation. The extreme mileage ratios result when the RegA signal is fixed at a single value ("pegged") to control ACE and the RegD signal is not. If RegA is held at a constant MW output, mileage is zero for RegA. The result of a fixed RegA signal is that RegA mileage is very small and therefore the mileage ratio is very large.

These results are an example of why it is not appropriate to use the mileage ratio, rather than the MBF, to measure the relative value of RegA and RegD resources. In these events, RegA resources are providing ACE control by providing a fixed level of MW output which means zero mileage, while RegD

<sup>61</sup> See "PJM Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 27, 2018) at 3.2.9, p 70.

resources alternate between helping and hurting ACE control, both of which result in positive mileage.

**Figure 10-18 Daily average MBF and mileage ratio during excursion and nonexcursion hours: January 2017 through June 2018<sup>62</sup>**



The increase in the average mileage ratio caused by the signal design changes introduced on January 9, 2017, caused a large increase in payments to RegD resources on a performance adjusted MW basis.

Table 10-31 shows RegD resource payments on a performance adjusted MW basis and RegA resource payments on a performance adjusted MW basis by month, from January 1, 2017, through June 30, 2018. In the first six months of 2017, RegD resources earned 74.6 percent more per performance adjusted

<sup>62</sup> Excursion hours were discontinued as of 00:00 on July 31, 2017.

MW than RegA resources. In the first six months of 2018, RegD resources earned 22.5 percent more per performance adjusted MW than RegA resources.

**Table 10-31 Average monthly price paid per performance adjusted MW of RegD and RegA: January 2017 through June 2018**

		Settlement Payments		
Year	Month	RegD (\$/Performance Adjusted MW)	RegA (\$/Performance Adjusted MW)	Percent Performance Adjusted RegD/RegA Under/Over Payment
2017	Jan	\$17.07	\$13.62	25.4%
	Feb	\$16.58	\$10.64	55.8%
	Mar	\$26.76	\$15.06	77.7%
	Apr	\$32.60	\$15.58	109.2%
	May	\$28.45	\$17.89	59.0%
	Jun	\$28.88	\$13.23	118.2%
	Jul	\$28.49	\$15.00	89.9%
	Aug	\$32.06	\$13.24	142.1%
	Sep	\$37.89	\$21.33	77.6%
	Oct	\$32.37	\$16.11	100.9%
	Nov	\$26.81	\$15.62	71.7%
	Dec	\$36.00	\$25.13	43.3%
Average		\$28.73	\$16.08	78.7%
2018	Jan	\$86.14	\$78.36	9.9%
	Feb	\$21.92	\$12.22	79.3%
	Mar	\$27.46	\$21.76	26.2%
	Apr	\$33.75	\$26.41	27.8%
	May	\$36.74	\$29.36	25.1%
	Jun	\$24.05	\$18.06	33.2%
Average		\$38.71	\$31.60	22.5%

The current settlement process does not result in paying RegA and RegD resources the same price per effective MW. RegA resources are paid on the basis of dollars per effective MW of RegA. RegD resources are not paid in terms of dollars per effective MW of RegA because the MBF is not used in settlements. Instead of being paid based on the MBF ( $(RMCCP + RMPCP) * MBF$ ), RegD resources are currently paid based on the mileage ratio ( $(RMCCP + (RMPCP * \text{mileage ratio}))$ ). Because the RMCCP component makes up the majority of the overall clearing price, when the MBF is above one, RegD resources can be underpaid on a per effective MW basis by the current payment method, unless offset by a high mileage ratio. When the MBF is less than one, RegD resources are overpaid on a per effective MW basis. The average MBF was

less than 1.0 in 2017 (0.96), resulting in an average overpayment of RegD resources. In the first six months of 2018, the average MBF was equal to 1.1, however, RegD resources were still overpaid on average versus if they had been paid on a per effective MW basis.

The effect of using the mileage ratio instead of the MBF to convert RegD MW into effective MW for purposes of settlement is illustrated in Table 10-32. Table 10-32 compares the monthly average payment to RegD per effective MW under the current settlement process to the monthly average payment RegD resources should have received using the MBF to convert RegD MW to effective MW. This also shows that using the MBF would result in RegA and RegD resources being paid exactly the same on a per effective MW basis. The MBF averaged less than one in the first six months of 2017 (0.83), while the average daily mileage ratio was 6.13, resulting in RegD resources being paid \$50.5 million (85.0 percent) more than they would have been if the MBF were correctly implemented. In the first six months of 2018, the MBF averaged 1.1, while the average daily mileage ratio was 6.68, resulting in RegD resources being paid \$0.42 million (1.7 percent) less than they would have been if the MBF were correctly implemented.

**Table 10-32 Average monthly price paid per effective MW of RegD and RegA under mileage and MBF based settlement: January 2017 through June 2018**

RegD Settlement Payments						
Year	Month	Mileage Based RegD (\$/Effective MW)	Marginal Rate of Technical Substitution Based RegD (\$/Effective MW)	RegA (\$/Effective MW)	Percent RegD Under/Over Payment	Total RegD Under/Over Payment (\$)
2017	Jan	\$80.44	\$13.62	\$13.62	490.7%	\$6,674,174
	Feb	\$293.97	\$10.64	\$10.64	2,662.3%	\$23,955,220
	Mar	\$80.90	\$15.06	\$15.06	437.2%	\$5,885,287
	Apr	\$79.84	\$15.58	\$15.58	412.4%	\$5,761,398
	May	\$34.79	\$17.89	\$17.89	94.4%	\$1,985,119
	Jun	\$24.18	\$13.23	\$13.23	82.7%	\$1,481,005
	Jul	\$22.16	\$15.00	\$15.00	47.7%	\$1,021,794
	Aug	\$26.53	\$13.24	\$13.24	100.4%	\$1,874,341
	Sep	\$35.67	\$21.33	\$21.33	67.2%	\$1,719,466
	Oct	\$33.29	\$16.11	\$16.11	106.7%	\$2,119,188
	Nov	\$27.43	\$15.62	\$15.62	75.6%	\$1,367,771
	Dec	\$30.24	\$25.13	\$25.13	20.3%	\$693,153
Yearly		\$62.44	\$16.08	\$16.08	288.3%	\$64,657,186
2018	Jan	\$70.22	\$78.36	\$78.36	(10.4%)	(\$1,127,265)
	Feb	\$16.69	\$12.22	\$12.22	36.5%	\$560,643
	Mar	\$21.85	\$21.76	\$21.76	0.4%	\$11,868
	Apr	\$28.52	\$28.08	\$26.41	1.6%	\$56,125
	May	\$32.51	\$31.22	\$29.36	4.1%	\$166,582
	Jun	\$21.11	\$15.48	\$18.06	36.3%	\$736,671
Year to Date		\$32.14	\$31.60	\$31.60	1.7%	\$421,669

Figure 10-19 shows, for the first six months of 2018, the maximum, minimum and average MBF, by month, for excursion and nonexcursion hours. The average MBF in the first six months of 2018 was 1.1. The average MBF in the first six months of 2017 was 0.83.

**Figure 10-19 Maximum, minimum, and average PJM calculated MBF by month: January through June, 2018<sup>63</sup>**

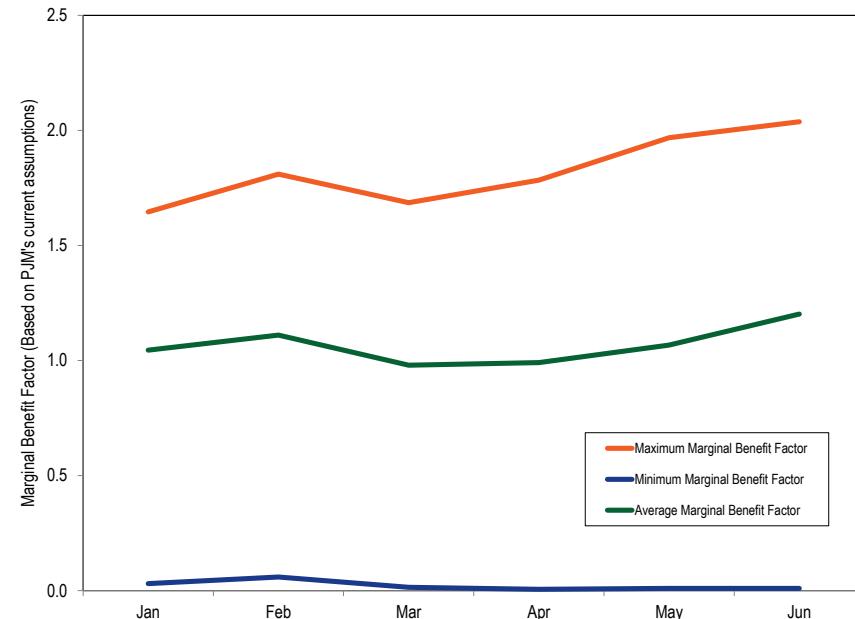


Table 10-33 shows performance adjusted and effective MW that were eligible and cleared during the first six months of 2017 and 2018.

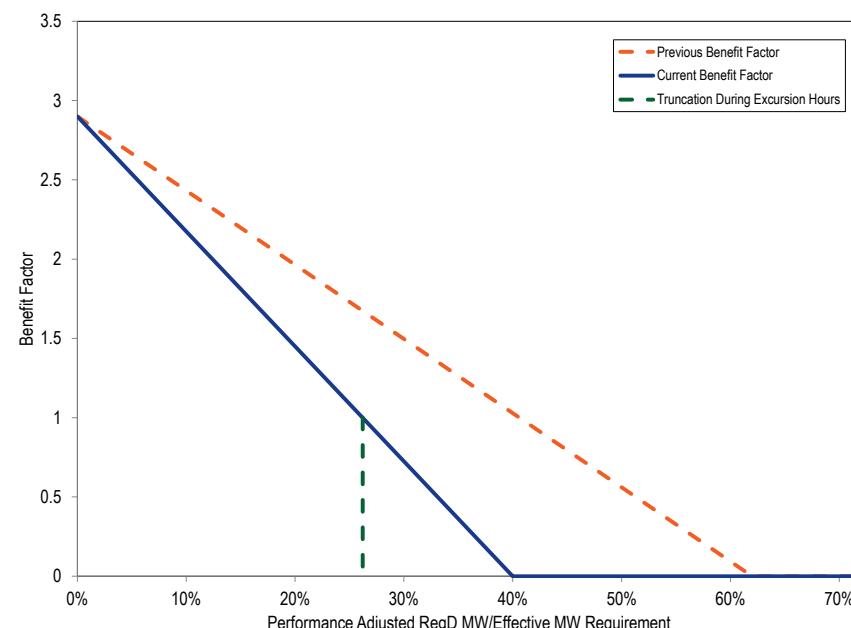
**Table 10-33 Performance adjusted and effective RegD MW eligible and cleared: January through June, 2017 and 2018**

	Performance Adjusted RegD MW		
	2017 (Jan-Jun)	2018 (Jan-Jun)	Change
Actual Eligible	347.3	269.3	(22.5%)
Effective Eligible	321.6	289.6	(9.9%)
Actual Cleared	203.2	163.1	(19.8%)
Effective Cleared	317.6	277.0	(12.8%)

<sup>63</sup> Excursion hours were discontinued as of 00:00 on July 31, 2017.

Figure 10-20 shows the MBF curve before and after the December 14, 2015, modification. Figure 10-20 shows the change in RegA for a change in RegD (MBF of RegD on the y-axis) for given ratio of RegD MW as a percentage of the effective MW requirement (Percentage RegD on the x-axis). The objective of the modification of the MBF was to reduce the operational issues caused by the over procurement of RegD. The modification to the MBF curve reduced the amount of RegD procured, but did not correct for identified issues with the definition of the MBF that are causing the over procurement to occur.

**Figure 10-20 MBF curve before and after December 14, 2015, revisions by PJM**



The MMU recommends that the Regulation Market be modified to incorporate a consistent and correct application of the MBF throughout the optimization, assignment and settlement process.<sup>64</sup>

<sup>64</sup> See "Regulation Market Review," Operating Committee meeting (May 5, 2015) <<http://www.pjm.com/~media/committees-groups/committees/oc/20150505/20150505-item-17-regulation-market-review.ashx>>.

## MBF Creates Results in Market Solutions that are not Feasible

An additional significant problem that results from using the incorrect MBF is that the market clearing is done without confirming that the resulting combinations of RegA and RegD are feasible and can meet the defined demand for regulation. This guarantees that an increasing proportion of RegD MW in the market incorrectly appears as a cheap feasible source of incremental effective regulation MW even when there are not enough RegA MW clearing the market to support this market solution.

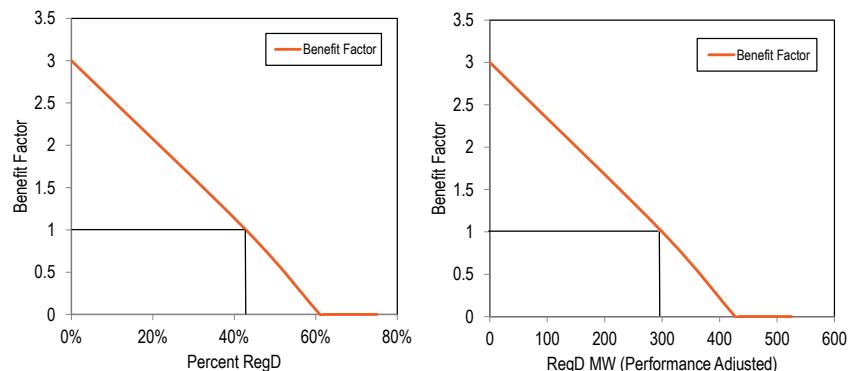
The problem is illustrated in Table 10-34, for both the MBF curve used prior to December 14, 2015, and the current MBF curve. In Table 10-34, the contribution to the total regulation requirement of 800.0 MW for a ramp hour is given on both a performance adjusted RegD MW basis and effective RegD MW basis. For example, if the market cleared 320.0 MW of performance adjusted RegD (40 percent of the 800.0 performance adjusted MW needed) at a price of zero, the market would calculate that as 464.0 effective MW of RegD (area under curve) consistent with the MBF of 0.00, and determine it would need 336.0 MW of RegA to meet the 800.0 MW requirement using the current MBF curve. The resulting proportion of actual RegD MW to total regulation cleared would be 48.8 percent for the current MBF curve (320.0 actual RegD MW/(320.0 actual RegD MW + 336.0 actual RegA)), rather than the 40.0 percent defined by the MBF function. Although there is a smaller difference between the proportion of RegD cleared under the current MBF curve and the correct amount than under the prior MBF curve (48.8 percent versus 65.1 percent), the error is not eliminated. The result should be to maintain the desired proportions of RegA and RegD regardless of the amount of RegD cleared. To do this, the MBF must be defined as the relationship between RegA MW and RegD MW, rather than the percent of RegD.

**Table 10-34 MBF assumed RegD proportions versus market solution realized RegD proportions<sup>65</sup>**

RegD Percent of 800 MW	RegD MW (Performance Adjusted)	MBF (Previous)	MBF (Current)	Effective MW from RegD MW (Previous)	Effective MW from RegD MW (Current)	Residual A (800 MW Target, Previous)	Residual A (800 MW Target, Current)	RegD/(RegA+RegD, Previous)	RegD/(RegA+RegD, Current)
5.0%	40.0	2.67	2.54	111.3	108.8	688.7	691.3	5.5%	5.5%
10.0%	80.0	2.43	2.18	213.3	203.0	586.7	597.0	12.0%	11.8%
15.0%	120.0	2.20	1.81	305.9	282.8	494.1	517.3	19.5%	18.8%
20.0%	160.0	1.96	1.45	389.2	348.0	410.8	452.0	28.0%	26.1%
25.0%	200.0	1.73	1.09	463.1	398.8	336.9	401.3	37.2%	33.3%
30.0%	240.0	1.50	0.73	527.6	435.0	272.4	365.0	46.8%	39.7%
35.0%	280.0	1.26	0.36	582.8	456.8	217.2	343.3	56.3%	44.9%
40.0%	320.0	1.03	0.00	628.6	464.0	171.4	336.0	65.1%	48.8%
45.0%	360.0	0.80	-	665.1	-	134.9	-	72.7%	-
50.0%	400.0	0.56	-	692.3	-	107.7	-	78.8%	-
55.0%	440.0	0.33	-	710.0	-	90.0	-	83.0%	-
60.0%	480.0	0.09	-	718.5	-	81.5	-	85.5%	-

An example illustrates the issue. Figure 10-21 shows the same MBF curve, in terms of RegD percent (left diagram) and RegD MW (right diagram) in a scenario where 700 MW of effective MW are needed and the market clears 300 MW of RegD (actual MW), all priced at \$0.00, and 400 MW of RegA. Figure 10-21 shows that the 300 MW of cleared RegD are 42.9 percent of total cleared actual MW and that the MBF is 1.0.

**Figure 10-21 Example MBF functions with percent RegD and RegD MW**



<sup>65</sup> This example assumes that the calculation of effective MW from RegD was calculated correctly as the area under the MBF curve.

## The Market Buys Too Much RegD

In 2015, the MMU determined that the PJM market design was buying too much RegD because the regulation market solution understates the amount of effective MW provided by RegD. PJM calculates the total effective MW of a unit as the simple product of the MW and the MBF, rather than the area under the MBF curve. The result is that 100 MW of RegD provided by a single resource (one 100 MW unit) will appear to provide

fewer effective MW than 100 MW of RegD provided by two 50 MW units although they provide exactly the same total effective MW. This is the unit block issue.

The understatement of RegD was amplified by the treatment, in the market solution, of all RegD resources with the same price as a single resource for purposes of assigning a benefit factor and calculating total effective MW. All of the MW associated with multiple units with the same price were assigned the MBF of the last MW of the last unit of that block of resources. PJM calculates the total effective MW as the product of the MW and the marginal MBF, rather than the area under the MBF curve. This resulted in understating total effective MW from RegD resources cleared. This price block issue was solved by the modification of December 14, 2015.

The unit block issue was not addressed by the modification made on December 14, 2015. A complete correction of the effective MW calculation requires the use of the area under the curve.

Using PJM's unit block method, all RegD resources are assigned the lowest MBF associated with the last RegD MW purchased. In this example (Figure 10-22), all 300 MW have an MBF of 1.0. PJM calculates total effective MW from

RegD resources to be 300 ( $300 \text{ MW} \times 1.0 = 300 \text{ effective MW}$ ). In Figure 10-22, PJM's price block/unit block calculation of total effective MW from RegD is represented by the area of the blue rectangle which is 300 effective MW.

The marginal benefit curve represents a marginal rate of substitution between RegD and RegA MW, and the area under the curve, at any RegD amount, represents the total effective MW supplied by RegD at that point. RegD is providing effective MW equal to the area of the green triangle plus the blue rectangle in Figure 10-22. This equals 600 effective MW from RegD resources, not 300 effective MW. The actual total effective MW cleared in the market is 300 more effective MW than needed to meet the regulation requirement.

**Figure 10-22 Illustration of correct method for calculating effective MW**

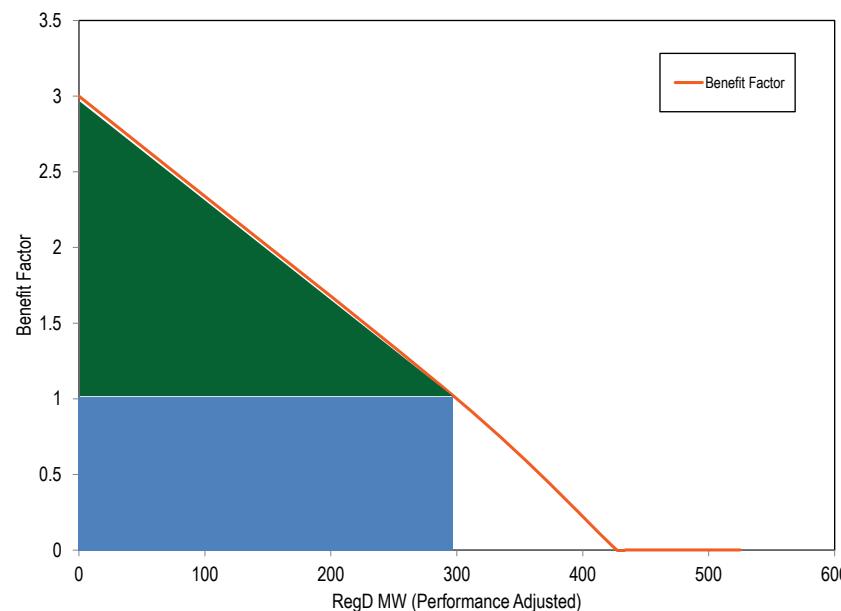
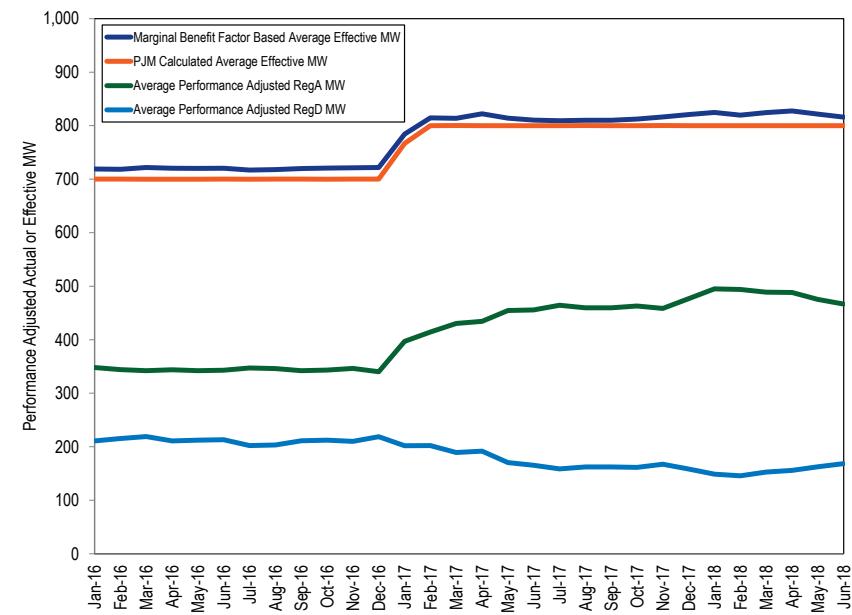


Figure 10-23 shows the average monthly peak and ramp total effective MW as calculated by PJM's MBF and as calculated by a correctly applied MBF for January 1, 2016, through March 31, 2017. The figure also shows the monthly average performance adjusted RegA MW and RegD MW cleared in the Regulation Market for the period.

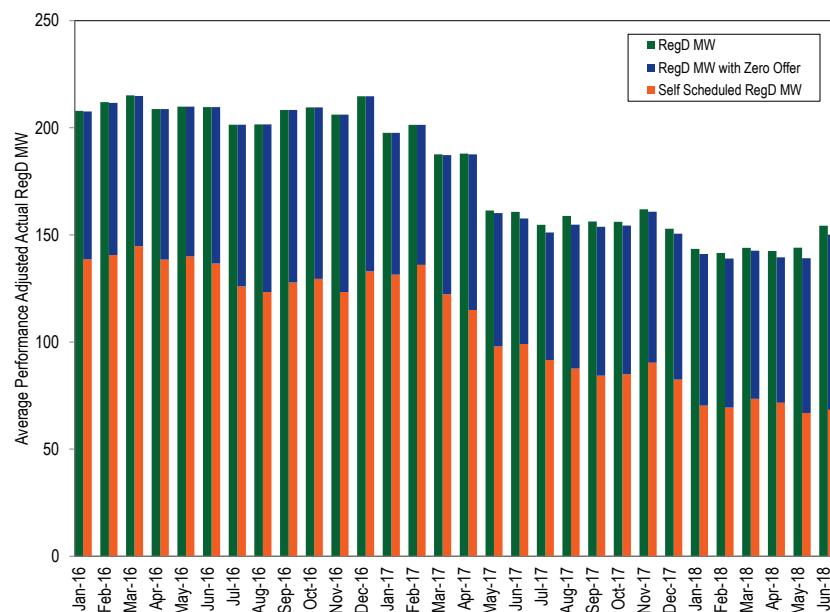
RegD MW during ramp hours increased from 165.3 MW in June 2017, to 168.4 MW (an increase of 1.9 percent) in June 2018. The average cleared performance adjusted RegA MW during ramp hours increased from 455.7 MW in June 2017, to 466.6 MW (an increase of 2.4 percent) during ramp hours in June 2018.

**Figure 10-23 PJM and MBF based effective MW and RegA and RegD performance adjusted MW: January 2016 through June 2018**



The excess procurement of RegD combined with the overpayment of RegD resulted in an increase in the level of \$0.00 offers from RegD resources. RegD MW providers are ensured that \$0.00 offers will be cleared and will be paid a price determined by the offers of RegA resources. Figure 10-24 shows, by month, the proportion of cleared RegD MW with an effective price of \$0.00 from January 1, 2016, through June 30, 2018. The figure shows that all RegD MW clearing the market in the period between January 1, 2016, and April 30, 2017, had an effective offer of \$0.00. From May 1, 2017, through June 30, 2018, an average of 98.2 percent of cleared RegD MW had an effective cost of \$0.00. The total level of RegD clearing the market leveled off beginning in January 2016 because the market cleared the maximum allowed RegD MW. The total level of RegD cleared in the market decreased 20.7 percent in the first six months of 2018 compared to the first six months of 2017. This was caused by a continued reduction in the total amount of actual RegD MW being offered due to the January 9, 2017, market changes.

**Figure 10-24 Average cleared RegD MW and average cleared RegD with an effective price of \$0.00 by month: January 2016 through June 2018**

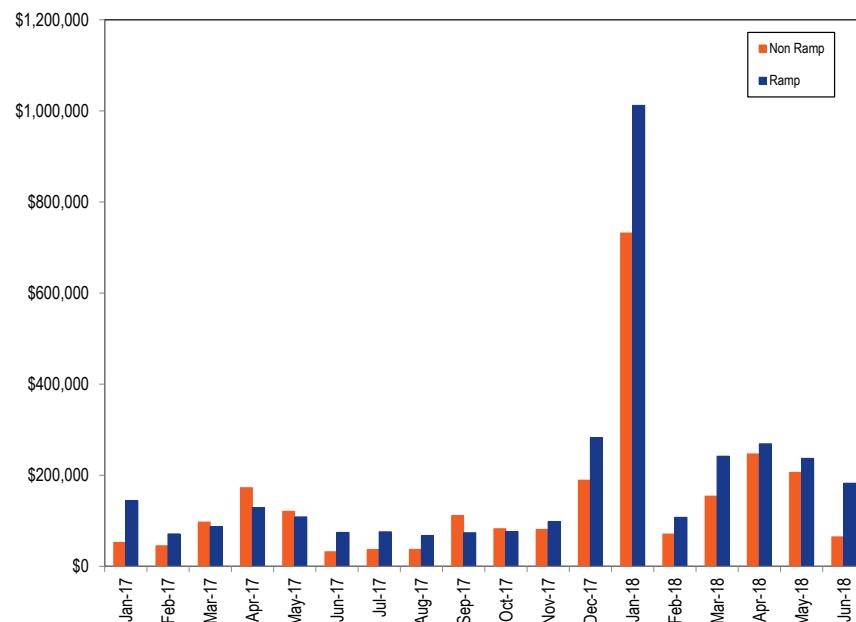


## The Cost of Buying Too Much Regulation

Figure 10-25 shows the estimated cost of the excess effective MW cleared by month, peak and off peak, from January 1, 2017, through June 30, 2018, caused by PJM's calculation of effective MW from RegD resources using mileage rather than MBF. To determine this excess cost, the total effective MW of RegD are calculated using the full area under the PJM MBF curve, and the difference between that value and the value used by PJM is multiplied by the price in each hour. The calculation of excess cost shown in Figure 10-25 that is caused by purchasing too much RegD is conservatively underestimated because it does not incorporate how the market clearing price and settlement would have been affected by replacing the current optimization and settlement process with a correct and consistent utilization of the MBF. Specifically, the calculation only reflects differences in RegA and RegD proportions due to incorrect versus correct application of the MBF, holding the actual market price and the mileage ratio based settlement constant and ignoring the actual MRTS.

In the first six months of 2018, the estimated total cost of excess effective RegD MW during ramp and nonramp hours was \$2.10 million and \$1.47 million. In the first six months of 2017, the estimated total cost of excess RegD MW during on peak and off peak hours was \$0.62 million and \$0.52 million. The increase in the cost of excess RegD MW during January 2018 was due to an almost \$70 increase in the average clearing price of regulation in that month. The implementation of the partial solution to the effective MW calculation and the changes in the MBF curve in December of 2015 reduced, but did not eliminate, the excess effective MW clearing in the regulation market.

**Figure 10-25 Cost of excess effective MW cleared by month, peak and off peak: January 2017 through June 2018<sup>66</sup>**



## Market Structure

### Supply

Table 10-35 shows capability MW (performance adjusted), average daily offer MW (performance adjusted), average hourly eligible MW (performance adjusted and effective), and average hourly cleared MW (performance adjusted and effective) for all hours in the first six months of 2018.<sup>67</sup> Total MW are adjusted by the historic 100-hour moving average performance score to get performance adjusted MW, and additionally by the resource specific benefit factor to get effective MW. A resource can choose to follow either signal.

<sup>66</sup> Prior to January 9, 2017, on peak hours were defined between 05:00-23:59, off peak hours were defined as 00:00-04:59. After January 9, 2017, ramp and nonramp hours are defined seasonally. Please see Table 10-30 for a list of what hours are considered ramp and nonramp.

<sup>67</sup> Unless otherwise noted, analysis provided in this section uses PJM market data based on PJM's internal calculations of effective MW values, based on PJM's currently incorrect MBF curve. The MMU is working with PJM to correct the MBF curve.

For that reason, the sum of each signal type's capability can exceed the full regulation capability. Offered MW are calculated based on the daily offers from units that are offered as available for the day. Eligible MW are calculated from the hourly offers from units with daily offers and units that are offered as unavailable for the day, but still offer MW into some hours. Units with daily offers are permitted to offer above or below their daily offer from hour to hour. As a result of these hourly MW adjustments, the average hourly Eligible MW can be higher than the Offered MW.

In the first six months of 2018, the average hourly eligible supply of regulation for nonramp hours was 1,088.7 performance adjusted MW (850.7 effective MW). This was a decrease of 56.6 performance adjusted MW (an increase of 2.6 effective MW) from the first six months of 2017, when the average hourly eligible supply of regulation was 1,145.2 performance adjusted MW (848.1 effective MW). In the first six months of 2018, the average hourly eligible supply of regulation for ramp hours was 1,379.2 performance adjusted MW (1,168.0 effective MW). This was a decrease of 39.7 performance adjusted MW (an increase of 7.3 effective MW) from the first six months of 2017, when the average hourly eligible supply of regulation was 1,418.9 performance adjusted MW (1,160.7 effective MW).

The ratio of the average hourly eligible supply of regulation to average hourly regulation demand (performance adjusted cleared MW) for ramp hours was 1.85 in the first six months of 2018. This is a decrease of 7.2 percent from the first six months of 2017, when the ratio was 1.99. The ratio of the average hourly eligible supply of regulation to average hourly regulation demand (performance adjusted cleared MW) for nonramp hours was 2.23 in the first six months of 2018. This is a decrease of 2.7 percent from the first six months of 2017, when the ratio was 2.30.

**Table 10-35 PJM regulation capability, daily offer and hourly eligible: January through June, 2018<sup>68 69</sup>**

	By Resource Type			By Signal Type	
	All Regulation	Generating Resources	Demand Resources	RegA Following Resources	RegD Following Resources
Capability MW	Daily	10,383.4	10,354.0	29.4	10,065.9
Offered MW	Daily	6,199.3	6,178.2	21.1	5,844.7
Actual Eligible MW	Ramp	1,379.2	1,361.2	18.0	1,092.2
	Nonramp	1,088.7	1,071.9	16.8	836.5
Effective Eligible MW	Ramp	1,168.0	1,140.7	27.3	832.6
	Nonramp	850.7	828.0	22.8	605.4
Actual Cleared MW	Ramp	746.8	735.0	11.8	570.5
	Nonramp	486.5	476.0	10.5	336.2
Effective Cleared MW	Ramp	800.0	774.9	25.1	484.2
	Nonramp	525.1	503.9	21.1	285.6
					239.5

**Table 10-36 PJM regulation by source: January through June, 2017 and 2018<sup>70</sup>**

Source	2017 (Jan-Jun)				2018 (Jan-Jun)			
	Number of Units	Performance		Total Regulation Credits	Number of Units	Performance		Total Regulation Credits
		Adjusted Settlement (MW)	Percent of Settled Regulation			Adjusted Settlement (MW)	Percent of Settled Regulation	
Battery	22	1,440,596.4	47.7%	\$18,388,068	20	873,994.6	32.6%	\$21,171,150
Coal	42	169,461.4	5.6%	\$3,613,215	33	202,136.8	7.5%	\$13,128,966
Hydro	27	463,775.0	15.4%	\$8,657,765	28	434,948.3	16.2%	\$16,424,862
Natural Gas	156	883,054.2	29.2%	\$15,078,388	139	1,098,221.1	41.0%	\$39,424,267
DR	29	62,363.9	2.1%	\$806,358	26	70,142.8	2.6%	\$1,624,390
Total	276	3,019,250.9	100.0%	\$46,543,795	246	2,679,443.5	100.0%	\$91,773,635

Table 10-36 provides the settled regulation MW by source unit type, the total settled regulation MW provided by all resources, and the percent of settled regulation provided by unit type. In Table 10-36 the MW have been adjusted by the performance score since this adjustment forms the basis of payment for units providing regulation. Total regulation performance adjusted capability MW decreased 11.3 percent from 3,019,250.9 MW in the first six months of 2017 to 2,679,443.5 MW in the first six months of 2018. The average proportion of regulation provided by natural gas units had the largest increase (11.7 percent), providing 29.2 percent of regulation in the first six months of

<sup>68</sup> Average Daily Offer MW excludes units that have offers but are unavailable for the day.

<sup>69</sup> Total offer capability is defined as the sum of the maximum daily offer volume for each offering unit during the period, without regard to the actual availability of the resource or to the day on which the maximum was offered.

<sup>70</sup> Biomass data have been added to the natural gas category for confidentiality purposes.

2017 and 41.0 percent of regulation in the first six months of 2018. Battery units had the largest decrease in average proportion of regulation provided (15.1 percent), decreasing from 47.7 percent in the first six months of 2017, to 32.6 percent in the first six months of 2018. The total regulation credits in the first six months of 2018 were \$91,773,635, up 97.2 percent from \$46,543,795 in the first six months of 2017.

Significant flaws in the regulation market design have led to a significant over procurement of RegD MW primarily in the form of storage capacity. The incorrect market signals have led to more storage projects entering PJM's interconnection queue, despite clear evidence that the market design is flawed and despite operational evidence that the RegD market is saturated (Table 10-37).

**Table 10-37 Active battery storage projects in the PJM queue system by submitted year: 2012 to 2018**

Year	Number of Storage Projects	Total Capacity (MW)
2012	1	4.5
2013	0	0.0
2014	6	108.4
2015	31	146.1
2016	4	41.7
2017	4	3.5
2018	13	464.8
Total	59	768.9

The supply of regulation can be affected by regulating units retiring from service. If all units that are requesting retirement through the end of the first six months of 2018 retire, the supply of regulation in PJM will be reduced by less than one percent.

Although the MBF for RegA resources is 1.0, the effective MW of RegA resources were lower than the offered MW in the first six months of 2018, because the average performance score was less than 1.00. For the first six months of 2018, the MW weighted average RegA performance score was 0.85 and there were 193 resources following the RegA signal.

For RegD resources, the total effective MW do not equal performance adjusted MW because the MBF for RegD resources can range from 0.0 to 2.9. In the first six months of 2018, the MBF for cleared RegD resources ranged from 0.006 to 2.038 with an average over all hours of 1.066. In the first six months of 2018, the MW weighted average RegD resource performance score was 0.89 and there were 61 resources following the RegD signal.

## Demand

The demand for regulation does not change with price. The regulation requirement is set by PJM to meet NERC control standards, based on reliability objectives, which means that a significant amount of judgment is exercised by PJM in determining the actual demand. Prior to October 1, 2012, the regulation requirement was 1.0 percent of the forecast peak load for on peak hours and 1.0 percent of the forecast valley load for off peak hours. Between October 1, 2012, and December 31, 2012, PJM changed the regulation requirement several times. It had been scheduled to be reduced from 1.0 percent of peak load forecast to 0.9 percent on October 1, 2012, but instead it was changed from 1.0 percent of peak load forecast to 0.78 percent of peak load forecast. It was further reduced to 0.74 percent of peak load forecast on November 22, 2012 and reduced again to 0.70 percent of peak load forecast on December 18, 2012. On December 14, 2013, it was reduced to 700 effective MW during peak hours and 525 effective MW during off peak hours. The regulation requirement remained 700 effective MW during peak hours and 525 effective

MW during off peak hours until January 9, 2017. A change to the regulation requirement was approved by the RMISTF in 2016, with an implementation date of January 9, 2017. The regulation requirement was increased from 700 effective MW to 800 effective MW during ramp hours (See Table 10-30).

Table 10-38 shows the average hourly required regulation by month and the ratio of supply to demand for both actual and effective MW, for ramp and nonramp hours. The average hourly required regulation by month is an average of the ramp and nonramp hours in the month.

The nonramp regulation requirement of 525.0 effective MW was provided by a combination of RegA and RegD resources equal to 486.4 hourly average performance adjusted actual MW in the first six months of 2018. This is a decrease of 10.6 performance adjusted actual MW from the first six months of 2017, when the average hourly total regulation cleared performance adjusted actual MW for nonramp hours were 497.0 performance adjusted actual MW. The ramp regulation requirement of 800.0 effective MW was provided by a combination of RegA and RegD resources equal to 746.6 hourly average performance adjusted actual MW in the first six months of 2018. This is an increase of 32.3 performance adjusted actual MW from the first six months of 2017, where the average hourly regulation cleared MW for ramp hours were 714.3 performance adjusted actual MW.

**Table 10-38 Required regulation and ratio of supply to requirement: January through June, 2017 and 2018<sup>71</sup>**

Hours	Month	Average Required Regulation (MW)		Average Required Regulation (Effective MW)		Ratio of Supply MW to MW Requirement		Ratio of Supply Effective MW to Effective MW Requirement	
		2017	2018	2017	2018	2017	2018	2017	2018
Ramp	Jan	690.8	756.8	766.8	800.0	2.10	1.88	1.48	1.49
	Feb	705.8	738.7	800.1	799.9	2.11	1.90	1.52	1.48
	Mar	714.7	742.9	800.1	800.0	1.96	1.86	1.41	1.43
	Apr	730.6	747.4	800.0	799.9	1.86	1.76	1.41	1.39
	May	723.6	747.2	800.0	800.1	1.88	1.76	1.44	1.42
	Jun	719.9	746.4	800.0	800.0	1.98	1.88	1.49	1.51
Nonramp	Jan	503.6	497.6	525.1	525.1	2.45	2.27	1.65	1.71
	Feb	508.3	482.0	525.0	525.2	2.47	2.37	1.75	1.70
	Mar	499.9	486.6	525.0	525.2	2.22	2.35	1.52	1.67
	Apr	519.0	488.1	525.0	525.0	2.20	2.03	1.60	1.47
	May	479.7	481.5	525.1	524.9	2.26	2.13	1.59	1.55
	Jun	471.9	482.7	525.1	524.9	2.31	2.36	1.63	1.68

## Market Concentration

In the first six months of 2018, the effective MW weighted average HHI of RegA resources was 2406 which is highly concentrated and the weighted average HHI of RegD resources was 1559 which is also highly concentrated.<sup>72</sup> The weighted average HHI of all resources was 1106, which is moderately concentrated. The HHI of RegA resources and the HHI of RegD resources are higher than the HHI for all resources because different owners have large market shares in the RegA and RegD markets.

Table 10-39 includes a monthly summary of three pivotal supplier (TPS) results. In the first six months of 2018, 84.7 percent of hours had three or fewer pivotal suppliers. The MMU concludes that the PJM Regulation Market in the first six months of 2018 was characterized by structural market power. The TPS values are provided by PJM. The TPS results cannot be verified by the MMU or PJM because PJM indicated that it did not save the necessary data. The MMU has recommended that PJM save this data and make it available so that the TPS test calculations can be replicated by both PJM and the MMU.

<sup>71</sup> The regulation requirement for January 2017 includes eight days of 700 effective MW and 23 days of 800 effective MW.

<sup>72</sup> HHI results are based on market shares of effective MW, defined as regulation capability MW adjusted by performance score and resource specific benefit factor, consistent with the way the regulation market is cleared.

PJM has informed the MMU that the data are now saved. The MMU is in the process of verifying the underlying data.

**Table 10-39 Regulation market monthly three pivotal supplier results: January 2016 through June 2018**

Month	Percent of Hours Pivotal		
	2016	2017	2018
Jan	93.9%	90.6%	88.7%
Feb	90.9%	93.1%	77.5%
Mar	87.8%	92.7%	83.9%
Apr	93.5%	92.9%	90.3%
May	94.0%	88.7%	87.8%
Jun	89.3%	89.2%	79.9%
Jul	92.2%	91.0%	
Aug	93.7%	88.0%	
Sep	94.0%	82.6%	
Oct	90.6%	68.1%	
Nov	96.2%	72.5%	
Dec	90.4%	79.3%	
Average	92.2%	85.7%	84.7%

## Market Conduct

### Offers

Resources seeking to regulate must qualify to follow a regulation signal by passing a test for that signal with at least a 75 percent performance score. The regulating resource must be able to supply at least 0.1 MW of regulation and not allow the sum of its regulating ramp rate and energy ramp rate to exceed its overall ramp rate.<sup>73</sup> When offering into the regulation market, regulating resources must submit a cost-based offer and may submit a price-based offer (capped at \$100/MW) by 2:15 pm the day before the operating day.<sup>74</sup>

Offers in the PJM Regulation Market consist of a capability component for the MW of regulation capability provided and a performance component for the miles ( $\Delta$ MW of regulation movement) provided. The capability component for cost-based offers is not to exceed the increased fuel costs resulting from operating the regulating unit at a lower output level than its economically optimal output level, plus a \$12.00/MW adder. The performance component for cost-based offers is not to exceed the increased costs (increased VOM and increased fuel costs) resulting from moving the unit up and down to provide regulation. Batteries and flywheels have zero cost for lower efficiency from providing regulation instead of energy, as they are not net energy producers. There is an energy storage loss component for batteries and flywheels as a cost component of regulation performance offers to reflect the net energy consumed to provide regulation service.<sup>75</sup>

Up until one hour before the operating hour, the regulating resource must provide: status (available, unavailable, or self scheduled); capability (movement up and down in MW); regulation maximum and regulation minimum (the highest and lowest levels of energy output while regulating in MW); and the regulation signal type (RegA or RegD). Resources may offer regulation for both the RegA and RegD signals, but will be assigned to follow only one signal for a given operating hour. Resources have the option to submit a minimum level of regulation they are willing to provide.<sup>76</sup>

<sup>73</sup> See PJM Manual 11: Energy & Ancillary Services Market Operations, Rev. 97 (July 26, 2018) at 64.

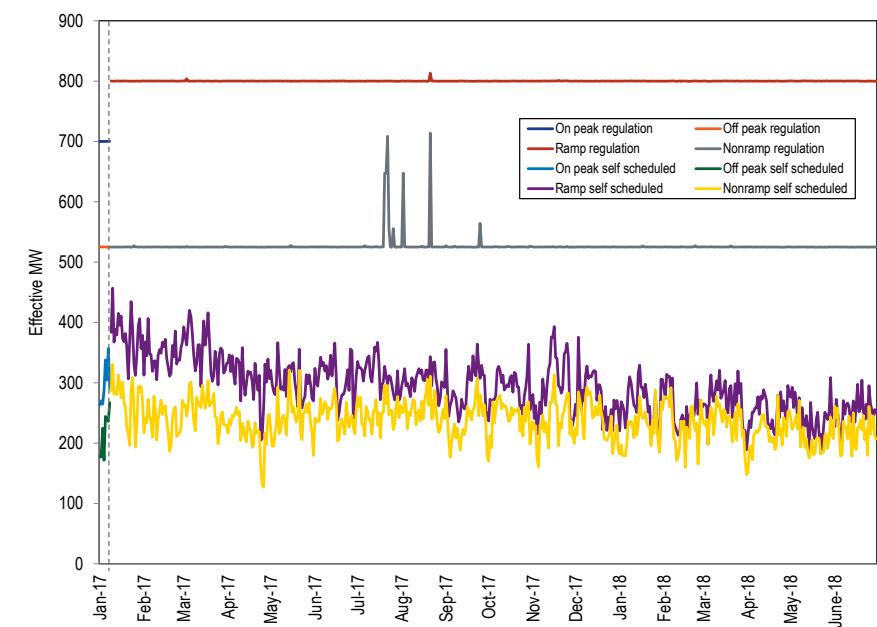
<sup>74</sup> Id. at 69.

<sup>75</sup> See "PJM Manual 15: Cost Development Guidelines," Rev. 29 (May 15, 2017) at 62.

<sup>76</sup> See "PJM Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 67.

All LSEs are required to provide regulation in proportion to their load share. LSEs can purchase regulation in the regulation market, purchase regulation from other providers bilaterally, or self schedule regulation to satisfy their obligation (Table 10-41).<sup>77</sup> Figure 10-26 compares average hourly regulation and self scheduled regulation during ramp and nonramp hours on an effective MW basis. The average hourly regulation is the amount of regulation that actually cleared and is not the same as the regulation requirement because PJM clears the market within a two percent band around the requirement.<sup>78</sup> Self scheduled regulation comprised an average of 32.1 percent during ramp hours and 42.5 percent during nonramp hours in the first six months of 2018.

**Figure 10-26 Off peak, on peak, nonramp, and ramp regulation levels: January 2017 through June 2018<sup>79</sup>**



<sup>77</sup> See "PJM Manual 28: Operating Agreement Accounting," Rev. 80 (June 1, 2018) at 4.1 at 22.

<sup>78</sup> See "PJM Manual 11: Energy & Ancillary Services Market Operations," Rev. 97 (July 26, 2018) at 3.2.9 at 78.

<sup>79</sup> The MW increases during the nonramp hours of 2017 Q3 were a result of PJM operations treating those hours as ramp hours.

Table 10-40 shows the role of RegD resources in the regulation market. RegD resources are both a growing proportion of the market (10.9 percent of the total effective MW at the start of the performance based regulation market design in October 2012 and 42.8 percent of the total effective MW in June 2018) and a growing proportion of resources that self schedule (10.1 percent of all self scheduled MW in October 2012 and 19.5 percent of all self scheduled MW in June 2018). The increase in the share of RegD in 2016 was a result of the use of the unit block method of calculating the MBF over the previous price block method (See Figure 10-22). The decrease in the RegD share of total effective MW for 2017 and the first six months of 2018 were a result of a decrease in the amount of eligible MW of RegD (Table 10-33) in response to the changes to the regulation market on January 9, 2017.

**Table 10-40 RegD self scheduled regulation by month: October 2012 through June 2018**

Year	Month	RegD Self Scheduled Effective MW	RegD Effective MW	Total Self Scheduled Effective MW	Total Effective MW	Percent of Total MW Scheduled	RegD Percent of Total Self Scheduled	RegD Percent of Total Effective MW	RegD Percent of Total Effective MW
2012	Oct	66.3	71.8	264.7	658.1	40.2%	10.1%	10.9%	
2012	Nov	74.4	88.3	196.5	716.5	27.4%	10.4%	12.3%	
2012	Dec	82.5	88.8	188.8	701.1	26.9%	11.8%	12.7%	
2013	Jan	35.7	82.5	133.6	720.0	18.6%	5.0%	11.5%	
2013	Feb	84.8	90.2	212.2	724.3	29.3%	11.7%	12.5%	
2013	Mar	80.1	119.3	279.8	680.7	41.1%	11.8%	17.5%	
2013	Apr	82.3	106.9	266.0	594.1	44.8%	13.8%	18.0%	
2013	May	74.0	109.0	268.2	616.2	43.5%	12.0%	17.7%	
2013	Jun	79.6	122.7	334.9	730.6	45.8%	10.9%	16.8%	
2013	Jul	77.6	120.4	303.6	822.9	36.9%	9.4%	14.6%	
2013	Aug	83.6	127.6	366.0	756.8	48.4%	11.0%	16.9%	
2013	Sep	112.2	152.1	381.6	669.9	57.0%	16.7%	22.7%	
2013	Oct	120.2	163.7	349.6	613.3	57.0%	19.6%	26.7%	
2013	Nov	133.9	175.7	396.5	663.3	59.8%	20.2%	26.5%	
2013	Dec	136.5	180.7	313.6	663.5	47.3%	20.6%	27.2%	
2013 Average		91.7	129.2	300.5	688.0	44.1%	13.6%	19.0%	
2014	Jan	132.9	193.5	261.1	663.6	39.3%	20.0%	29.2%	
2014	Feb	134.3	193.4	289.0	663.6	43.5%	20.2%	29.1%	
2014	Mar	131.8	193.8	287.2	663.8	43.3%	19.9%	29.2%	
2014	Apr	126.8	212.4	270.8	663.7	40.8%	19.1%	32.0%	
2014	May	121.7	248.5	265.6	663.6	40.0%	18.3%	37.4%	
2014	Jun	123.3	231.0	365.5	663.9	55.0%	18.6%	34.8%	
2014	Jul	126.4	235.5	352.7	663.5	53.2%	19.0%	35.5%	
2014	Aug	117.6	229.8	368.2	663.6	55.5%	17.7%	34.6%	
2014	Sep	121.0	242.6	393.8	663.6	59.3%	18.2%	36.6%	
2014	Oct	116.1	255.4	352.7	663.6	53.2%	17.5%	38.5%	
2014	Nov	113.5	235.1	347.5	664.2	52.3%	17.1%	35.4%	
2014	Dec	116.7	254.3	353.0	663.6	53.2%	17.6%	38.3%	
2014 Average		123.5	227.1	325.6	663.7	49.1%	18.6%	34.2%	
2015	Jan	116.4	250.1	304.8	663.7	45.9%	17.5%	37.7%	
2015	Feb	111.3	245.8	242.6	663.5	36.6%	16.8%	37.0%	
2015	Mar	113.8	255.2	229.9	663.8	34.6%	17.1%	38.5%	
2015	Apr	110.1	248.2	283.7	663.7	42.7%	16.6%	37.4%	
2015	May	121.8	265.1	266.7	663.6	40.2%	18.4%	39.9%	
2015	Jun	158.9	283.1	321.2	663.7	48.4%	23.9%	42.6%	
2015	Jul	161.4	278.3	314.0	663.8	47.3%	24.3%	41.9%	
2015	Aug	159.5	276.0	300.7	663.6	45.3%	24.0%	41.6%	
2015	Sep	155.4	289.2	286.0	663.5	43.1%	23.4%	43.6%	
2015	Oct	147.1	299.0	292.8	663.4	44.1%	22.2%	45.1%	
2015	Nov	164.9	302.1	298.1	664.2	44.9%	24.8%	45.5%	
2015	Dec	144.6	317.2	260.7	663.9	39.3%	21.8%	47.8%	
2015 Average		138.8	275.8	283.4	663.7	42.7%	20.9%	41.6%	

**Table 10-40 RegD self scheduled regulation by month: October 2012 through June 2018 (continued)**

Year	Month	RegD Self Scheduled Effective	RegD Effective	Total Self Scheduled Effective	Total Effective	Percent of Total Self Scheduled	RegD Percent of Total Self Scheduled	RegD Percent of Total Effective
		MW	MW	MW	MW	%	%	MW
2016	Jan	187.7	335.9	295.3	663.8	44.5%	28.3%	50.6%
2016	Feb	179.9	339.0	274.6	663.6	41.4%	27.1%	51.1%
2016	Mar	182.6	340.8	280.1	663.7	42.2%	27.5%	51.3%
2016	Apr	182.2	339.5	287.0	663.5	43.3%	27.5%	51.2%
2016	May	183.9	341.1	301.5	663.5	45.4%	27.7%	51.4%
2016	Jun	178.8	340.5	302.4	663.6	45.6%	26.9%	51.3%
2016	Jul	165.2	337.5	273.3	663.5	41.2%	24.9%	50.9%
2016	Aug	165.8	338.5	283.2	663.5	42.7%	25.0%	51.0%
2016	Sep	160.9	341.4	279.9	663.6	42.2%	24.2%	51.4%
2016	Oct	168.6	340.0	283.0	663.5	42.6%	25.4%	51.2%
2016	Nov	156.2	338.0	259.8	664.3	39.1%	23.5%	50.9%
2016	Dec	162.2	342.7	274.7	663.6	41.4%	24.4%	51.6%
<b>2016 Average</b>		<b>172.8</b>	<b>339.6</b>	<b>282.9</b>	<b>663.7</b>	<b>42.6%</b>	<b>26.0%</b>	<b>51.2%</b>
2017	Jan	187.1	334.9	318.0	673.9	47.2%	27.8%	49.7%
2017	Feb	192.7	337.8	296.6	674.2	44.0%	28.6%	50.1%
2017	Mar	172.2	315.3	297.5	638.5	46.6%	27.0%	49.4%
2017	Apr	159.9	306.4	255.0	639.6	39.9%	25.0%	47.9%
2017	May	167.6	297.0	265.7	639.7	41.5%	26.2%	46.4%
2017	Jun	178.6	315.6	284.3	696.9	40.8%	25.6%	45.3%
2017	Jul	171.9	310.3	290.0	703.1	41.3%	24.5%	44.1%
2017	Aug	176.7	314.0	286.3	700.9	40.8%	25.2%	44.8%
2017	Sep	156.9	297.8	259.0	640.4	40.4%	24.5%	46.5%
2017	Oct	158.6	295.3	263.7	639.7	41.2%	24.8%	46.2%
2017	Nov	158.6	298.1	261.7	640.4	40.9%	24.8%	46.5%
2017	Dec	147.7	290.8	260.6	674.0	38.7%	21.9%	43.1%
<b>2017 Average</b>		<b>164.1</b>	<b>286.2</b>	<b>269.6</b>	<b>332.0</b>	<b>40.6%</b>	<b>8.2%</b>	<b>45.7%</b>
2018	Jan	130.6	274.3	247.4	673.8	36.7%	19.4%	40.7%
2018	Feb	131.1	276.6	245.5	674.0	36.4%	19.5%	41.0%
2018	Mar	126.6	270.9	249.4	639.8	39.0%	19.8%	42.3%
2018	Apr	124.8	266.5	232.3	639.6	36.3%	19.5%	41.7%
2018	May	124.7	275.7	223.0	639.6	34.9%	19.5%	43.1%
2018	Jun	136.0	298.4	241.5	696.8	34.7%	19.5%	42.8%
<b>2018 Average</b>		<b>129.5</b>	<b>273.9</b>	<b>247.5</b>	<b>662.6</b>	<b>37.4%</b>	<b>19.5%</b>	<b>41.4%</b>

Increased self scheduled regulation lowers the requirement for cleared regulation, resulting in fewer MW cleared in the market and lower clearing prices. Of the LSEs' obligation to provide regulation in the first six months of 2018, 61.5 percent was purchased in the PJM market, 33.6 percent was self scheduled, and 4.9 percent was purchased bilaterally (Table 10-41). Table 10-42 shows the total regulation by source including spot market regulation, self scheduled regulation, and bilateral regulation for the first six months of each year from 2012 to 2018. Table 10-41 and Table 10-42 are based on settled (purchased) MW.

**Table 10-41 Regulation sources: spot market, self scheduled, bilateral purchases: January 2017 through June 2018**

Year	Month	Spot Market		Self Scheduled		Bilateral		Total Regulation (Unadjusted MW)
		Regulation (Unadjusted MW)	Spot Market Percent of Total	Regulation (Unadjusted MW)	Self Scheduled Percent of Total	Regulation (Unadjusted MW)	Bilateral Percent of Total	
2017	Jan	181,386.7	45.8%	188,924.6	47.7%	25,490.5	6.4%	395,801.8
2017	Feb	179,488.3	50.4%	154,308.8	43.3%	22,371.0	6.3%	356,168.1
2017	Mar	174,026.3	46.3%	177,638.3	47.3%	23,963.0	6.4%	375,627.5
2017	Apr	206,895.4	55.7%	145,424.6	39.1%	19,207.5	5.2%	371,527.5
2017	May	212,510.8	57.8%	139,361.6	37.9%	15,967.5	4.3%	367,839.9
2017	Jun	221,942.4	57.5%	142,537.9	36.9%	21,535.0	5.6%	386,015.3
2017	Jul	227,034.0	55.8%	152,610.9	37.5%	27,183.5	6.7%	406,828.4
2017	Aug	238,692.9	59.2%	141,756.7	35.1%	22,844.5	5.7%	403,294.0
2017	Sep	206,361.1	58.1%	130,432.8	36.7%	18,197.0	5.1%	354,990.9
2017	Oct	213,228.1	58.3%	136,134.9	37.2%	16,631.0	4.5%	365,994.1
2017	Nov	201,998.5	57.5%	132,863.4	37.8%	16,257.5	4.6%	351,119.3
2017	Dec	233,845.1	59.1%	141,051.3	35.7%	20,536.5	5.2%	395,432.9
	Total	2,497,409.5	55.1%	1,783,045.7	39.4%	250,184.5	5.5%	4,530,639.7
2018	Jan	241,046.0	60.6%	134,251.7	33.8%	22,447.0	5.6%	397,744.7
2018	Feb	221,617.9	61.9%	120,581.1	33.7%	15,846.5	4.4%	358,045.5
2018	Mar	213,227.4	57.0%	141,161.2	37.7%	19,749.0	5.3%	374,137.6
2018	Apr	221,404.8	60.8%	125,524.8	34.5%	16,941.5	4.7%	363,871.1
2018	May	236,757.3	64.3%	115,879.6	31.5%	15,670.0	4.3%	368,306.9
2018	Jun	252,944.3	64.4%	120,041.8	30.6%	19,547.5	5.0%	392,533.7
	Total	1,386,997.8	61.5%	757,440.3	33.6%	110,201.5	4.9%	2,254,639.6

**Table 10-42 Regulation sources: January through June, 2012 through 2018**

Jan-Jun	Spot Market		Self Scheduled		Bilateral		Total Regulation (Unadjusted MW)
	Regulation (Unadjusted MW)	Spot Market Percent of Total	Regulation (Unadjusted MW)	Scheduled Percent of Total	Regulation (Unadjusted MW)	Bilateral Percent of Total	
2012	3,065,069.1	76.0%	847,576.2	21.0%	122,641.0	3.0%	4,035,286.2
2013	1,740,438.6	64.9%	849,955.3	31.7%	92,120.0	3.4%	2,682,513.9
2014	1,370,386.4	57.9%	889,917.5	37.6%	106,365.5	4.5%	2,366,669.4
2015	1,282,300.1	55.7%	894,595.8	38.8%	126,408.6	5.5%	2,303,304.4
2016	1,139,515.1	48.5%	1,086,532.7	46.3%	122,808.5	5.2%	2,348,856.3
2017	1,176,249.8	52.2%	948,195.8	42.1%	128,534.5	5.7%	2,252,980.1
2018	1,386,997.8	61.5%	757,440.3	33.6%	110,201.5	4.9%	2,254,639.6

In the first six months of 2018, DR provided an average of 11.8 MW of regulation per hour during ramp hours (8.8 MW of regulation per hour during ramp hours in the first six months of 2017), and an average of 10.5 MW of regulation per hour during nonramp hours (7.8 MW of regulation

per hour during off peak hours in the first six months of 2017). Generating units supplied an average of 735.0 MW of regulation per hour during ramp hours in the first six months of 2018 (704.0 MW of regulation per hour during ramp hours in the first six months of 2017), and an average of 476.0 MW per hour during nonramp hours in the first six months of 2018 (489.9 MW of regulation per hour during nonramp hours in the first six months of 2017).

## Market Performance

### Price

After regulation performance was implemented on October 1, 2012, both regulation price and regulation cost per MW were higher than they were prior to October 1, 2012, for the first six months of each subsequent year (Table 10-46). The weighted average RMCP for the first six months of 2018 was \$32.99 per MW. This is an increase of \$17.91 per MW, or 118.8 percent, from the weighted average RMCP of \$15.08 per MW in the first six months of 2017. This increase in the regulation clearing price was the result of an increase in energy prices in the first six months of 2018 and the related increase in the opportunity cost component of RMCP. The decrease in self supply and \$0.00 offers from RegD resources since 2016 also contributed to higher prices.

In September 2016, an issue was identified concerning the real-time clearing price for five minute intervals in the Regulation Market. Regulation units available to set price in a given five minute interval are based on the latest five minute RT-SCED 15 minute look ahead scheduling and assignment of regulation resources. This means that at the end of an hour, pricing in five minute intervals starting at 00:45, 00:50, and 00:55 is based on RT-SCED scheduling information (regulation assignments) from 01:00, 01:05, and 01:10 of the following hour. In cases where units provided regulation in an hour, but are not

assigned to provide regulation in the following hour, these deassigned units appeared as unavailable for purposes of determining price in the last three, five minute intervals of their assigned regulation hour (00:45, 00:50, and 00:55). The pricing algorithm instead used the list of resources assigned to regulation for the next hour to set the price in intervals 00:45, 00:50, and 00:55 of the current hour. The result was that the prices did not accurately reflect the units actually running in intervals 00:45, 00:50, and 00:55. In November 2016, PJM corrected this problem by forcing the pricing algorithm to use the regulation availability status of the current hour to determine which units are eligible to set the regulation price for the current hour.

Figure 10-27 shows the daily weighted average regulation market clearing price and the opportunity cost component for the PJM Regulation Market on a performance adjusted MW basis. This data is based on actual five minute interval operational data. The increase in January was the result of increases in energy prices and the corresponding increase in the opportunity cost component of the RMCP.

Figure 10-27 illustrates that the opportunity cost (blue line) is the largest component of the clearing price.

**Figure 10-27 Regulation market-clearing price, opportunity cost and offer price components (Dollars per MW): January through June, 2018**

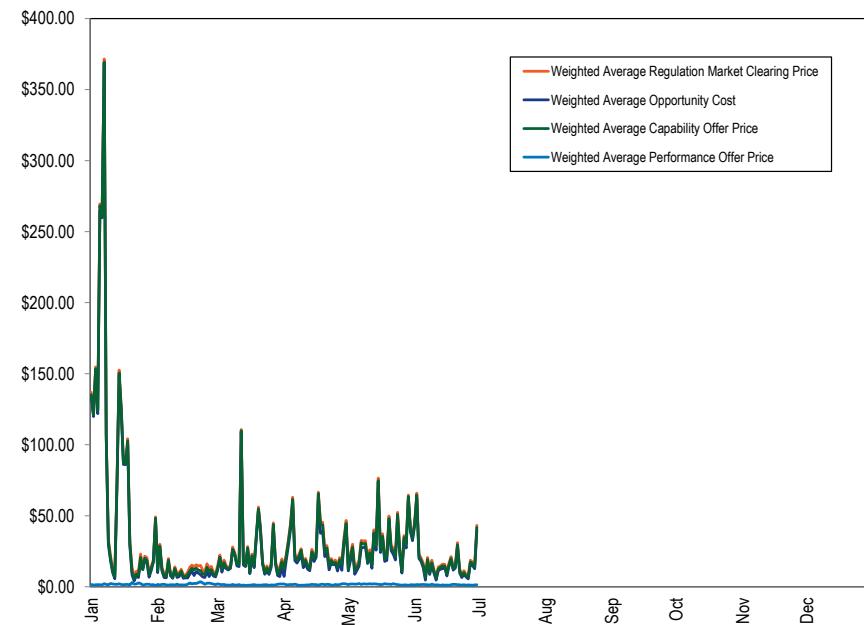


Table 10-43 shows the capability and performance components of the monthly average regulation prices. These components differ from the components of the marginal unit's offers in Figure 10-27 because the performance component of the settlement price for each hour is determined from the average of the highest performance offers in each five minute interval, calculated independent of the marginal unit's offers in those intervals.

**Table 10-43 PJM regulation market monthly component of price (Dollars per MW): January through June, 2018**

Month	Weighted Average Regulation Market Capability Clearing Price (\$/Perf. Adj. Actual MW)	Weighted Average Regulation Market Performance Clearing Price (\$/Perf. Adj. Actual MW)	Weighted Average Regulation Market Clearing Price (\$/Perf. Adj. Actual MW)
Jan	\$79.11	\$1.72	\$80.83
Feb	\$10.91	\$1.90	\$12.80
Mar	\$22.36	\$1.36	\$23.73
Apr	\$26.16	\$1.54	\$27.70
May	\$29.09	\$1.75	\$30.84
Jun	\$17.27	\$1.38	\$18.65
Average	\$30.82	\$1.61	\$32.43

Monthly, total annual, and total year to date scheduled regulation MW and regulation charges, as well as monthly and monthly average regulation price and regulation cost are shown in Table 10-44. Total scheduled regulation is based on settled performance adjusted MW. The total of all regulation charges for the first six months of 2018 was \$91.8 million, compared to \$46.6 million for the first six months of 2017.

**Table 10-44 Total regulation charges: January 2017 through June 2018**

Year	Month	Scheduled Regulation (MW)	Total Regulation Charges (\$)	Weighted Average Regulation Market Price (\$/MW)	Cost of Regulation (\$/MW)	Cost of Regulation Price as Percent of Cost
2017	Jan	395,801.8	\$6,867,859	\$14.08	\$17.35	81.2%
2017	Feb	356,168.1	\$5,351,147	\$11.12	\$15.02	74.0%
2017	Mar	375,627.5	\$8,604,989	\$16.32	\$22.91	71.2%
2017	Apr	371,527.5	\$9,057,296	\$16.21	\$24.38	66.5%
2017	May	367,839.9	\$8,949,242	\$18.85	\$24.33	77.5%
2017	Jun	386,015.3	\$7,729,571	\$13.85	\$20.02	69.1%
2017	Jul	406,828.4	\$8,698,583	\$15.66	\$21.38	73.3%
2017	Aug	403,294.0	\$8,396,208	\$13.70	\$20.82	65.8%
2017	Sep	354,990.9	\$10,511,205	\$21.98	\$29.61	74.2%
2017	Oct	365,994.1	\$8,807,785	\$16.96	\$24.07	70.5%
2017	Nov	351,119.3	\$7,994,687	\$16.65	\$22.77	73.1%
2017	Dec	395,432.9	\$13,406,934	\$26.06	\$33.90	76.9%
Yearly		4,530,639.7	\$104,375,507	\$16.78	\$23.04	72.8%
2018	Jan	397,744.7	\$39,126,109	\$80.83	\$98.37	82.2%
2018	Feb	358,045.5	\$6,260,199	\$12.81	\$17.48	73.2%
2018	Mar	374,137.6	\$10,735,239	\$23.73	\$28.69	82.7%
2018	Apr	363,871.1	\$12,783,266	\$27.70	\$35.13	78.8%
2018	May	368,306.9	\$14,004,175	\$30.84	\$38.02	81.1%
2018	Jun	392,533.7	\$8,881,307	\$18.65	\$22.63	82.4%
Year to Date		2,254,639.6	\$91,790,294	\$32.99	\$40.71	81.0%

The capability, performance, and opportunity cost components of the cost of regulation are shown in Table 10-45. Total scheduled regulation is based on settled performance adjusted MW. In the first six months of 2018, the monthly average total cost of regulation was \$40.71 per MW, 97.0 percent higher than \$20.67 in the first six months of 2017. In the first six months of 2018, the monthly average capability component cost of regulation was \$32.04, 147.7 percent higher than \$12.93 in the first six months of 2017. In the first six months of 2018, the monthly average performance component cost of regulation was \$3.56, 41.6 percent lower than \$6.09 in the first six months of 2017.

**Table 10-45 Components of regulation cost: January 2017 through June 2018**

Year	Month	Scheduled Regulation (MW)	Cost of Regulation Capability (\$/MW)	Cost of Regulation Performance (\$/MW)	Opportunity Cost (\$/MW)	Total Cost (\$/MW)
2017	Jan	395,801.8	\$13.19	\$2.43	\$1.69	\$17.31
	Feb	356,168.1	\$9.91	\$3.68	\$1.38	\$14.97
	Mar	375,627.5	\$13.93	\$6.99	\$1.98	\$22.91
	Apr	371,527.5	\$12.94	\$9.78	\$1.64	\$24.36
	May	367,839.9	\$16.77	\$5.78	\$1.77	\$24.31
	Jun	386,015.3	\$10.81	\$7.95	\$1.26	\$20.02
	Jul	406,828.4	\$13.19	\$6.37	\$1.82	\$21.38
	Aug	403,294.0	\$10.10	\$9.34	\$1.38	\$20.82
	Sep	354,990.9	\$18.83	\$8.82	\$1.96	\$29.61
	Oct	365,994.1	\$13.88	\$8.51	\$1.67	\$24.07
	Nov	351,119.3	\$14.55	\$6.12	\$2.09	\$22.77
	Dec	395,432.9	\$24.33	\$5.29	\$4.29	\$33.90
	Yearly	4,530,639.7	\$14.36	\$6.75	\$1.93	\$23.04
2018	Jan	397,744.7	\$80.31	\$3.76	\$14.29	\$98.37
	Feb	358,045.5	\$11.17	\$4.47	\$1.84	\$17.48
	Mar	374,137.6	\$22.92	\$2.91	\$2.86	\$28.69
	Apr	363,871.1	\$26.78	\$3.57	\$4.78	\$35.13
	May	368,306.9	\$29.85	\$3.78	\$4.39	\$38.02
	Jun	392,533.7	\$17.77	\$2.93	\$1.93	\$22.63
	Year to Date	2,254,639.6	\$32.04	\$3.56	\$5.11	\$40.71

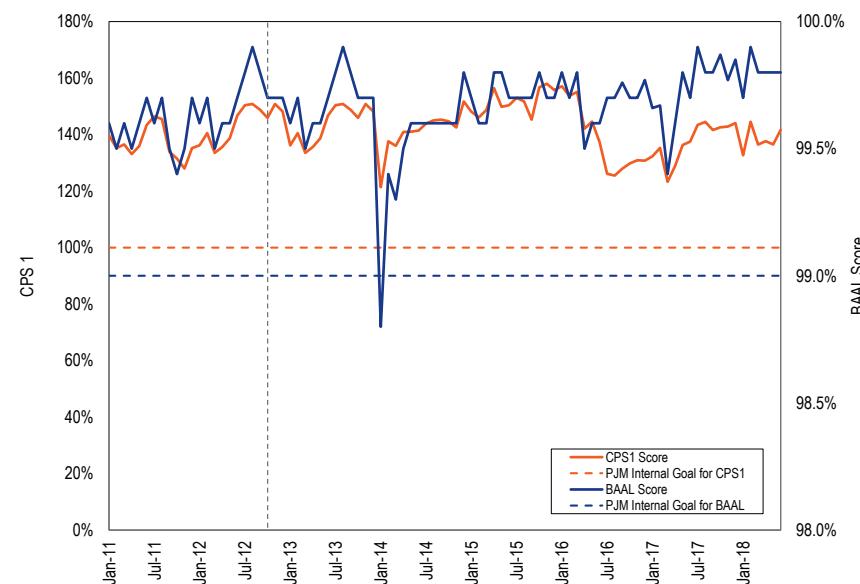
Table 10-46 provides a comparison of the average price and cost for PJM regulation. The ratio of regulation market price to the cost of regulation in the first six months of 2018 was 81.0 percent, an 11.1 percent increase from 73.0 percent in the first six months of 2017.

**Table 10-46 Comparison of average price and cost for PJM regulation: January through June, 2009 through 2018**

Year (Jan-Jun)	Weighted Regulation Market Price	Weighted Regulation Market Cost	Regulation Price as Percent Cost
2009	\$25.23	\$33.82	74.6%
2010	\$18.33	\$31.43	58.3%
2011	\$15.31	\$31.00	49.4%
2012	\$13.89	\$18.34	75.7%
2013	\$32.04	\$37.04	86.5%
2014	\$62.71	\$75.97	82.5%
2015	\$40.94	\$49.57	82.6%
2016	\$15.90	\$18.30	86.9%
2017	\$15.08	\$20.67	73.0%
2018	\$32.99	\$40.71	81.0%

## Performance Standards

PJM's performance as measured by CPS1 and BAAL standards is shown in Figure 10-28 for every month from January 2011 through June 2018 with the dashed vertical line marking the date (October 1, 2012) of the implementation of the Performance Based Regulation Market design.<sup>80</sup> The horizontal dashed lines represent PJM internal goals for CPS1 and BAAL performance. While PJM did not meet its internal goal for BAAL performance in January 2014, PJM remained in compliance with the applicable NERC standards.

**Figure 10-28 PJM monthly CPS1 and BAAL performance: January 2011 through June 2018**

<sup>80</sup> See 2017 State of the Market Report for PJM, Appendix F: Ancillary Services.

## Black Start Service

Black start service is necessary to ensure the reliable restoration of the grid following a blackout. Black start service is the ability of a generating unit to start without an outside electrical supply, or the demonstrated ability of a generating unit to automatically remain operating when disconnected from the grid.

PJM does not have a market to provide black start service, but compensates black start resource owners on the basis of an incentive rate or for the costs associated with providing this service.

PJM defines required black start capability zonally, while recognizing that the most effective way to provide black start service may be across zones, and ensures the availability of black start service by charging transmission customers according to their zonal load ratio share and compensating black start unit owners. Substantial rule changes to the black start restoration and procurement strategy were implemented on February 28, 2013, following a stakeholder process in the System Restoration Strategy Task Force (SRSTF) and the Markets and Reliability Committee (MRC) that approved the PJM and MMU joint proposal for system restoration. These changes gave PJM substantial flexibility in procuring black start resources and made PJM responsible for black start resource selection.

On July 1, 2013, PJM initiated its first RTO-wide request for proposals (RFP) under the new rules.<sup>81</sup> <sup>82</sup> PJM identified zones with black start shortages and began awarding contracts on January 14, 2014. PJM and the MMU coordinated closely during the selection process.

PJM issued two additional RFPs in 2014. On April 11, 2014, PJM sought additional black start in the AEP Zone and one proposal was selected. On November 24, 2014, PJM sought additional black start in Northeastern Ohio and Western Pennsylvania, but no proposals were selected because they did not meet the bid requirements. On July 28, 2015, PJM issued an Incremental Request for Proposals, for Northeastern Ohio and Western Pennsylvania

<sup>81</sup> See PJM, "RTO-Wide Five-Year Selection Process Request for Proposal for Black Start Service," (July 1, 2013).

<sup>82</sup> RFPs issued can be found on the PJM website. See PJM. <<http://www.pjm.com/markets-and-operations/ancillary-services.aspx>>.

together. On August 8, 2016, PJM made one award which will cover both areas.

On February 1, 2018, PJM issued its second RTO wide request for proposals (RFP) in accordance with the five year black start selection process. The RFP process is a two-tiered process. Level one submissions were due March 8, 2018. On March 30, 2018, PJM notified participants if a level two response would be requested. Level two bidders were requested by PJM to provide their detailed proposal by May 31, 2018. From June 1, 2018, through December 21, 2018, PJM will make awards.

Total black start charges are the sum of black start revenue requirement charges and black start operating reserve charges. Black start revenue requirements for black start units consist of fixed black start service costs, variable black start service costs, training costs, fuel storage costs, and an incentive factor. Section 18 of Schedule 6A of the OATT specifies how to calculate each component of the revenue requirement formula. Black start resources can choose to recover fixed costs under a formula rate based on zonal Net CONE and unit ICAP rating, a cost recovery rate based on incremental black start NERC-CIP compliance capital costs, or a cost recovery rate based on incremental black start equipment capital costs. Black start operating reserve charges are paid to units scheduled in the Day-Ahead Energy Market or committed in real time to provide black start service under the automatic load rejection (ALR) option or for black start testing. Total black start charges are allocated monthly to PJM customers proportionally to their zone and nonzone peak transmission use and point to point transmission reservations.<sup>83</sup>

In the first six months of 2018, total black start charges were \$33.2 million, a decrease of \$2.595 million (-7.3 percent) from the same six month period in 2017. Operating reserve charges for black start service decreased from \$0.146 million in the first six months of 2017 to \$0.023 million in the first six months of 2018. Table 10-47 shows total revenue requirement charges from 2010 through 2018. Prior to December 2012, PJM did not define a separate black start operating reserve category. Starting December 1, 2012, PJM defined a

<sup>83</sup> OATT Schedule 6A (paras. 25, 26 and 27 outline how charges are to be applied).

separate black start operating reserve category. By April 2015, all ALR units had been replaced and no longer provided black start service which resulted in decreased operating reserve charges.

**Table 10-47 Black start revenue requirement charges: January through June, 2010 through 2018**

Jan-Jun	Revenue Requirement Charges	Operating Reserve Charges	Total
2010	\$5,481,206	\$0	\$5,481,206
2011	\$5,968,676	\$0	\$5,968,676
2012	\$7,873,702	\$0	\$7,873,702
2013	\$10,584,683	\$48,075,584	\$58,660,267
2014	\$10,874,608	\$14,339,174	\$25,213,781
2015	\$23,348,866	\$5,036,053	\$28,384,918
2016	\$33,778,388	\$168,645	\$33,947,033
2017	\$35,617,856	\$146,223	\$35,764,079
2018	\$33,145,724	\$23,301	\$33,169,024

Black start zonal charges in the first six months of 2018 ranged from \$0.05 per MW-day in the DLCO Zone (total charges were \$25,579) to \$4.37 per MW-day in the PENELEC Zone (total charges were \$2,287,099). For each zone, Table 10-48 shows black start charges, the sum of monthly zonal peak loads multiplied by the number of days of the month in which the peak load occurred, and black start rates (calculated as charges per MW-day). For black start service, point to point transmission customers paid on average \$1.16 per MW day of reserve capacity during the first six months of 2018.

**Table 10-48 Black start zonal charges for network transmission use: January through June, 2017 and 2018<sup>84</sup>**

Zone	Jan-Jun 2017					Jan-Jun 2018						
	Revenue Requirement Charges	Operating Reserve Charges	Peak Load (MW)	Black Start Rate (\$/MW-day)	Revenue Requirement Charges	Operating Reserve Charges	Peak Load (MW)	Black Start Rate (\$/MW-day)				
AECO	\$1,310,889	\$5,349	\$1,316,238	2,673	181	\$2.72	\$1,382,457	\$773	\$1,383,230	2,541	181	\$3.01
AEP	\$8,723,517	\$36,723	\$8,760,240	22,475	181	\$2.15	\$8,810,416	\$897	\$8,811,313	21,647	181	\$2.25
APS	\$1,927,899	\$1,394	\$1,929,293	8,717	181	\$1.22	\$1,948,578	\$0	\$1,948,578	8,755	181	\$1.23
ATSI	\$1,508,925	\$0	\$1,508,925	12,752	181	\$0.65	\$1,527,398	\$0	\$1,527,398	12,052	181	\$0.70
BGE	\$3,221,643	\$2,592	\$3,224,235	6,601	181	\$2.70	\$838,685	\$0	\$838,685	6,448	181	\$0.72
ComEd	\$2,423,388	\$15,010	\$2,438,397	21,175	181	\$0.64	\$2,417,164	\$2,943	\$2,420,107	20,351	181	\$0.66
DAY	\$121,948	\$9,966	\$131,914	3,341	181	\$0.22	\$128,749	\$2,330	\$131,079	3,225	181	\$0.22
DEOK	\$519,970	\$2,057	\$522,027	5,308	181	\$0.54	\$520,538	\$0	\$520,538	5,036	181	\$0.57
DLCO	\$25,105	\$0	\$25,105	2,797	181	\$0.05	\$25,579	\$0	\$25,579	2,682	181	\$0.05
Dominion	\$2,148,000	\$28,576	\$2,176,576	19,538	181	\$0.62	\$2,160,777	\$9,576	\$2,170,353	19,661	181	\$0.61
DPL	\$1,138,090	\$3,349	\$1,141,439	4,127	181	\$1.53	\$931,869	\$3,612	\$935,481	3,813	181	\$1.36
EKPC	\$204,941	\$0	\$204,941	2,878	181	\$0.39	\$204,382	\$0	\$204,382	2,860	181	\$0.39
JCPL	\$3,399,241	\$9,358	\$3,408,600	5,955	181	\$3.16	\$3,432,220	\$0	\$3,432,220	5,721	181	\$3.31
Met-Ed	\$305,894	\$16,549	\$322,443	2,947	181	\$0.60	\$320,680	\$0	\$320,680	2,897	181	\$0.61
PECO	\$787,317	\$1,777	\$789,094	8,364	181	\$0.52	\$830,728	\$1,305	\$832,033	8,141	181	\$0.56
PENELEC	\$2,253,666	\$0	\$2,253,666	2,909	181	\$4.28	\$2,287,099	\$0	\$2,287,099	2,890	181	\$4.37
Pepco	\$1,256,044	\$3,873	\$1,259,916	6,584	181	\$1.06	\$1,269,548	\$0	\$1,269,548	6,097	181	\$1.15
PPL	\$599,373	\$0	\$599,373	7,025	181	\$0.47	\$608,728	\$0	\$608,728	7,401	181	\$0.45
PSEG	\$2,084,279	\$2,805	\$2,087,084	9,800	181	\$1.18	\$2,106,297	\$861	\$2,107,159	9,567	181	\$1.22
RECO	\$0	\$0	\$0	NA	181	NA	\$0	\$0	\$0	NA	181	NA
(Imp/Exp/Wheels)	\$1,657,729	\$6,846	\$1,664,575	7,620	181	\$1.21	\$1,393,832	\$1,002	\$1,394,834	6,678	181	\$1.15
Total	\$35,617,856	\$146,223	\$35,764,079	163,585		\$1.21	\$33,145,724	\$23,301	\$33,169,024	158,463		\$1.16

Table 10-49 provides a revenue requirement estimate by zone for the 2016/2017, 2017/2018 and 2018/2019 delivery years.<sup>85</sup> Revenue requirement values are rounded up to the nearest \$50,000 to reflect uncertainty about future black start revenue requirement costs. These values are illustrative only. The estimates are based on the best available data including current black start unit revenue requirements, expected black start unit termination and in-service dates, changes in recovery rates, and owner provided cost estimates of incoming black start units at the time of publication and may change significantly. Prior to November 26, 2017, new black start units were not paid until their costs had been provided with appropriate support and approved. In some cases black start units were completed and went into service before costs had been supported and therefore costs were not approved. In these cases the unit did not receive any payments until the costs were appropriately supported. Once their costs were approved the units received all payments going back to the in service date. The result was a lumpy payment by load for black start service. After November 26, 2017, PJM accrued payments for the black start units each month, until the units costs were supported and approved in order to smooth out monthly payments for black start service.

<sup>84</sup> Peak load for each zone is used to calculate the black start rate per MW day.<sup>85</sup> The System Restoration Strategy Task Force requested that the MMU provide estimated black start revenue requirements.

**Table 10-49 Black start zonal revenue requirement estimate: 2018/2019 through 2020/2021 delivery years**

Zone	2018 / 2019 Revenue Requirement	2019 / 2020 Revenue Requirement	2020 / 2021 Revenue Requirement
AECO	\$2,900,000	\$2,900,000	\$2,500,000
AEP	\$18,200,000	\$18,200,000	\$18,200,000
APS	\$4,150,000	\$4,150,000	\$4,150,000
ATSI	\$3,250,000	\$3,250,000	\$3,250,000
BGE	\$450,000	\$450,000	\$400,000
ComEd	\$4,450,000	\$4,450,000	\$2,900,000
DAY	\$250,000	\$250,000	\$250,000
DEOK	\$500,000	\$400,000	\$400,000
DLCO	\$1,150,000	\$2,250,000	\$2,250,000
Dominion	\$3,750,000	\$3,700,000	\$2,650,000
DPL	\$2,400,000	\$2,350,000	\$2,350,000
EKPC	\$350,000	\$350,000	\$350,000
JCPL	\$7,150,000	\$7,100,000	\$1,150,000
Met-Ed	\$550,000	\$550,000	\$500,000
PECO	\$1,450,000	\$1,450,000	\$1,450,000
PENELEC	\$4,650,000	\$4,600,000	\$4,600,000
Pepco	\$2,600,000	\$2,600,000	\$850,000
PPL	\$1,250,000	\$1,200,000	\$1,200,000
PSEG	\$4,400,000	\$4,400,000	\$1,850,000
RECO	\$0	\$0	\$0
Total	\$63,850,000	\$64,600,000	\$51,250,000

## NERC – CIP

Currently, no black start units have requested new or additional black start NERC – CIP Capital Costs.<sup>86</sup>

## Minimum Tank Suction Level (MTSL)

Some units that participate in the PJM energy market have oil tanks. All oil tanks at PJM units have a MTS defense regardless of whether the units provide black start service (unless they use direct current pumps). The MTS defense is the amount of fuel at the bottom of a tank which cannot be recovered for use.

PJM has required that customers pay black start unit owners carrying cost recovery for one hundred percent of the MTS defense for tanks which are shared

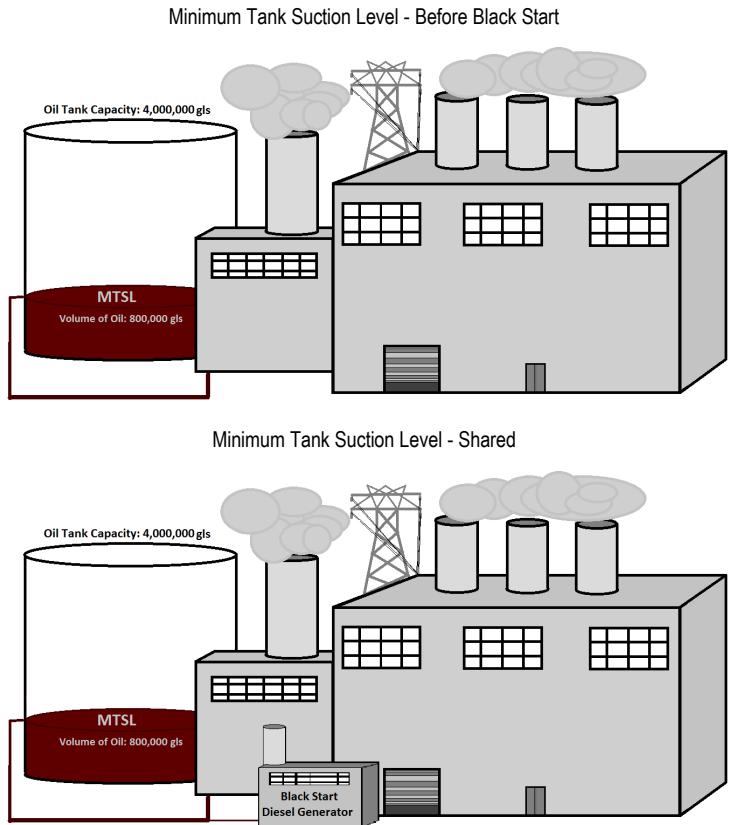
<sup>86</sup> OATT Schedule 6A para. 21. "The Market Monitoring Unit shall include a Black Start Service summary in its annual State of the Market report which will set forth a descriptive summary of the new or additional Black Start NERC-CIP Capital costs requested by Black Start Units, and include a list of the types of capital costs requested and the overall cost of such capital improvements on an aggregate basis such that no data is attributable to an individual Black Start Unit."

with units in the energy market. These tanks were sized to meet the needs of the generating units, which use significantly more fuel than the black start units. In some instances the MTS defense is greater than the total amount of fuel that the black start unit needs to operate to meet its black start obligations. When a black start diesel is added at the site of an oil-fired generating unit, the additional MTS defense is zero.

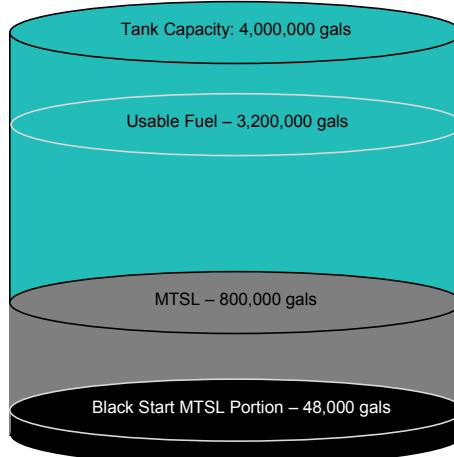
Figure 10-29 illustrates that the size of the oil tank does not change with the addition of the black start unit. Figure 10-30 shows how the MTS defense could be proportionally divided between the generator and the black start unit. The tank is 4,000,000 gallons with an MTS defense of 800,000 gallons leaving 3,200,000 gallons of usable fuel. The black start unit running 16 hours using 12,000 gallons per hour would need a total of 192,000 gallons, or six percent of the total usable fuel. Assigning six percent of the MTS defense (800,000 gallons) would yield 48,000 gallons which could be assigned to the black start proportion for the MTS defense.

The MMU recommends that for oil tanks which are shared with other resources that only a proportionate share of the MTS defense be allocated for black start units. The MMU further recommends that the PJM tariff be updated to clearly state how the MTS defense will be calculated for black start units sharing oil tanks.

**Figure 10-29 Oil tank MTSL not changed from addition of black start generator**



**Figure 10-30 Oil tank black start MTSL portion**



## Reactive Service

Suppliers of reactive power are compensated separately for reactive capability, day-ahead operating reserves, and for real-time lost opportunity costs. Compensation for reactive capability must be approved by FERC per Schedule 2 of the OATT. Generators may obtain FERC approval to recover a share of units' fixed costs by calculating a reactive revenue requirement, the reactive capability rate, and to collect such rates from PJM transmission customers.<sup>87</sup>

Any reactive service provided operationally that involves a MW reduction outside of its normal operating range or a startup for reactive power will be logged by PJM operators and awarded uplift or LOC credits.

Reactive Service, Reactive Supply and Voltage Control are provided by generation and other sources of reactive power (such as static VAR compensators and capacitor banks).<sup>88</sup> While a fixed requirement for reactive

<sup>87</sup> See "PJM Manual 27: Open Access Transmission Tariff Accounting," Rev. 89, (April 1, 2018) at 3.

<sup>88</sup> OATT Schedule 2.

power is not established, reactive power helps maintain appropriate voltages on the transmission system.

Total reactive capability charges are the sum of FERC approved reactive supply revenue requirements which are posted monthly on the PJM website.<sup>89</sup> Zonal reactive supply requirement charges are allocated monthly to PJM customers proportionally to their zone and to any nonzone (i.e. outside of the PJM Region) peak transmission use and point to point transmission reservations.<sup>90</sup>

In 2016, the FERC began to reexamine its policies on reactive compensation.<sup>91</sup> Changes in the default capabilities of generators, disparities between nameplate values and tested values and questions about the way the allocation factors have been calculated have called continued reliance on the *AEP* method into question.<sup>92</sup> The continued use of fleet rates rather than unit specific rates is also an issue.

## Recommended Market Approach to Reactive Costs

The best approach for recovering reactive capability costs is through markets where markets are available as they are in PJM and some other RTOs/ISOs. The best approach for recovering reactive capability costs in PJM is through the capacity market. The capacity market already incorporates reactive costs and reactive revenues. The treatment of reactive costs in the PJM market needs to be modified so that the capacity market incorporates reactive costs and revenues in a more efficient manner.

Reactive capability is an integral part of all generating units; no generating unit is built without reactive capability.<sup>93</sup> There is no reason that the fixed costs of reactive capability either can be or should be separated from the total fixed costs of a generating unit. There is no reason that reactive capability

<sup>89</sup> See PJM. Markets & Operations: Billing, Settlements & Credit, "Reactive Revenue Requirements," <<http://www.pjm.com/~media/markets-ops/settlements/reactive-revenue-requirements-table-may-2016.aspx>> (June 8, 2016).

<sup>90</sup> OATT Schedule 2.

<sup>91</sup> See *Reactive Supply Compensation in Markets Operated by Regional Transmission Organizations and Independent System Operators*, Docket No. AD16-17-000 (March 17, 2016) (Notice of Workshop).

<sup>92</sup> See 88 FERC ¶ 61,141 (1999).

<sup>93</sup> See *Reactive Power Requirements for Non-Synchronous Generation*, Order No. 827, 155 FERC ¶ 61,277 at P 9 (2016) ("[T]he equipment needed for a wind generator to provide reactive power has become more commercially available and less costly, such that the cost of installing equipment that is capable of providing reactive power is comparable to the costs of a traditional generator.").

should be compensated outside the markets when the units participate in organized markets. Reactive capability is a precondition for participating in organized markets. Resources must invest in the equipment needed to have minimum reactive capability as a condition of receiving interconnection service from PJM and other markets.<sup>94</sup> The Commission has recently extended the interconnection service requirement to have reactive capability to wind and solar units, which previously had been exempt.<sup>95</sup> Reactive capability is a requirement for participating in organized markets and is therefore appropriately treated as part of the gross Cost of New Entry in organized markets.

PJM requires a power factor of at least 0.95 leading to 0.90 lagging for synchronous units and at least 0.95 leading to 0.95 lagging for nonsynchronous units.<sup>96</sup> The regulations specify a minimum power factor range of 0.95 leading and 0.95 lagging power factor unless the market operators' rules specify otherwise.<sup>97</sup>

There are two ways to address the cost of reactive in the PJM market design.

Under the current capacity market rules, the gross costs of the entire plant, including any reactive costs, are included in the gross Cost of New Entry (CONE) and the revenues from reactive service capability rates are an offset to the gross CONE. The result is that, conceptually, the cost of reactive is not part of net CONE.<sup>98</sup> This is logically consistent with the separate collection of reactive costs through a cost of service rate in that there is no double counting if the revenue offset is done accurately. Under this approach there is a separate collection of reactive capability costs. This approach also requires that any capacity resource calculating unit specific net revenues must include

<sup>94</sup> See 18 CFR § 35.28(f)(1); *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, FERC Stats. & Regs. ¶ 31,146, Appendix G (Large Generator Interconnection Agreement (LGIA)), *order on reh'g*, Order No. 2003-A, FERC Stats. & Regs. ¶ 31,160, *order on reh'g*, Order No. 2003-B, FERC Stats. & Regs. ¶ 31,171 (2004), *order on reh'g*, Order No. 2003-C, FERC Stats. & Regs. ¶ 31,190 (2005), *aff'd sub nom. Nat'l Ass'n of Regulatory Util. Comm'r v. FERC*, 475 F.3d 1277 (D.C. Cir. 2007), *cert. denied*, 552 U.S. 1230 (2008); *Standardization of Small Generator Interconnection Agreements and Procedures*, Order No. 2006, FERC Stats. & Regs. ¶ 31,180, Attachment F (Small Generator Interconnection Agreement), *order on reh'g*, Order No. 2006-A, FERC Stats. & Regs. ¶ 31,196 (2005), *order granting clarification*, Order No. 2006-B, FERC Stats. & Regs. ¶ 31,221 (2006).

<sup>95</sup> *Reactive Power Requirements for Non-Synchronous Generation*, Order No. 827, 155 FERC ¶ 61,277 (2016); see also 151 FERC ¶ 61,097 at P 28 (2015).

<sup>96</sup> See OATT Attachment 0 Appendix 2 § 4.7.

<sup>97</sup> See LGIA Article 9.6.1 ("Interconnection Customer shall design the Large Generating Facility to maintain a composite power delivery at continuous rated power output at the Point of Interconnection at a power factor within the range of 0.95 leading to 0.95 lagging, unless Transmission Provider has established different requirements that apply to all generators in the Control Area on a comparable basis").

<sup>98</sup> See OATT Attachment DD § 5.10(a)(iv).

the cost of service reactive revenues in the calculation. In fact, the revenue offset is defined as a fixed number in the tariff and does not correctly reflect the current revenue requirement of a new unit.

An alternative approach to the current treatment of reactive costs in the capacity market would be to include the gross costs of the entire plant including any reactive costs in the gross Cost of New Entry (CONE) but to calculate net CONE without a reactive revenue offset for reactive service capability rates. The result of this approach would be that the cost of reactive is part of net CONE. This is logically consistent with the elimination of the separate collection of reactive costs through a cost of service rate in that there is no double counting if done accurately. Under this approach there would be no separate collection of reactive capability costs.

PJM currently uses the first approach. There is no reason that PJM could not easily implement the second approach.

The second approach is preferable. The second approach relies on competitive markets to provide incentives to provide energy, both real and reactive, at the lowest possible cost. The second approach provides a consistent and nondiscriminatory approach to compensation, avoiding reliance on a large number of costly and sporadic ratemaking proceedings. The second approach does not require the use of arbitrary, approximate and generally inaccurate allocators to determine the cost of providing reactive. The second approach does not require the use of estimated, average and inaccurate net reactive revenue offsets to calculate Net CONE. It is critical in the PJM Capacity Market that Net CONE be as accurate as possible. Only the second approach assures this.

Units are compensated for reactive capability costs under the second approach. But the compensation is based on the outcome of a competitive capacity market rather than based on current or historical cost of service filings for units or fleets of units.

The first approach, although internally logically consistent, relies on unnecessary and inaccurate approximations. The reactive allocator is such an approximation. The reactive revenue offset is an inaccurate estimate based on historical data from reactive revenue requirement filings. The reactive revenues used in the net CONE calculation are based on an average of reactive filings over the three years from 2005 through 2007 and therefore do not reflect even the allocated reactive costs and revenues for a new unit, as would be required to be consistent with the CONE logic.<sup>99</sup> To the extent that the reactive portion of the Net Energy and Ancillary Services Offset is inaccurate, the net CONE is inaccurate.

The reactive revenue offset is set equal to \$ 2,199/MW-year in the OATT.<sup>100</sup> This figure is the average annual reactive revenue for combustion turbines from 2005 through 2007, based on the actual costs reported to the Commission in reactive service filings of CTs, as developed by the MMU.

The Net Cost of New Entry is a key parameter in the PJM Capacity Market as it affects the location of the VRR or demand curve and thus has a direct impact on capacity market prices.<sup>101</sup>

If revenues for reactive capacity were removed from the Net Energy and Ancillary Services Revenue Offset, then the fixed costs for investment in reactive capability would be recoverable through the capacity market. By employing a simple and direct approach using CONE with no offset, the rules for cost of service compensation included in Schedule 2 could be eliminated and the requirement for cost of service filings would be eliminated.

As a result of the nature of reactive filings, it is not possible to identify the reactive capability revenues for all individual units that receive reactive

<sup>99</sup> OATT Attachment DD § 5.10(a)(v)(A) ("The Office of the Interconnection shall determine the Net Energy and Ancillary Services Revenue Offset each year for the PJM Region as (A) the annual average of the revenues that would have been received by the Reference Resource from the PJM energy markets during a period of three consecutive calendar years preceding the time of the determination, based on (1) the heat rate and other characteristics of such Reference Resource; (2) fuel prices reported during such period at an appropriate pricing point for the PJM Region with a fuel transmission adder appropriate for such region, as set forth in the PJM Manuals, assumed variable operation and maintenance expenses for such resource of \$6.47 per MWh, and actual PJM hourly average Locational Marginal Prices recorded in the PJM Region during such period; and (3) an assumption that the Reference Resource would be dispatched for both the Day-Ahead and Real-Time Energy Markets on a Peak-Hour Dispatch basis; plus (B) ancillary service revenues of \$2,199 per MW-year.").

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

capability revenues. As a result, the offer caps in the capacity market are not as accurate as they should be.

Relying on capacity markets instead of cost of service allocations would enhance competition and efficient pricing.

Actual experience with the cost of service approach suggests that customers would be better off under a competition based approach. The Commission's recent investigations into particular rates raises questions about the accuracy and basis of rates currently charged for reactive capability.

Cost of service ratemaking creates unnecessary monitoring difficulties. Because service providers do not have to file rates periodically, suppliers have no incentive to adjust reactive capability rates except when they increase. Suppliers have direct access to information about the costs for their own units. The Commission and other parties do not have such access. When rates are established on a fleet basis or result from a black box settlement, the ability of parties to review and challenge rates is further reduced.

The current FERC review provides an excellent opportunity to discard an anachronistic cost of service approach that has not been working well and that is inconsistent with markets and is unnecessary in organized markets.<sup>102</sup> Increased reliance on markets for the recovery of reactive capability costs would promote efficiency and consistency. Customers, market administrators and regulators will be better served by a simpler and more effective competition based approach.

The MMU recommends that separate payments for reactive capability be eliminated and the cost of reactive capability be recovered in the capacity market.

## Improvements to Current Approach

If OATT Schedule 2 reactive capability payments are not eliminated, then the MMU recommends, at a minimum, that steps be taken to ensure that payments are based on capability that is measured in tests performed by PJM or demonstrated in market data showing actual reactive output and based on capability levels that are useful to PJM system operators to maintain system stability. FERC has initiated a number of investigations into the basis for reactive rates, and the MMU has intervened in and is participating in those proceedings.<sup>103</sup>

Under the *AEP* method, units must establish their MVAR rating based on "the capability of the generators to produce VArS."<sup>104</sup> Typically this has meant reliance on manufacturers' specified nameplate power factor.<sup>105</sup> More recently, the Commission has, in the *Wabash Orders*, required that "reactive power revenue requirement filings must include reactive power test reports."<sup>106</sup> Noting a difference between tested reactive MVAR ratings and nameplate MVAR ratings, the Commission has, in a number of cases, set the issue of MVAR rating degradation for hearing.<sup>107</sup>

The Commission has identified a significant issue. Tests are essential to "evaluate and analyze" proposed reactive revenue requirements.<sup>108</sup> The MVAR rating has a significant influence on the level of the requirements and should accurately reflect the MVAR capability actually available to maintain reliability.

There is no reason to use the nameplate MVAR rating to develop a reactive allocation and there is no basis in the *AEP* method for reliance on the nameplate MVAR rating. Nameplate reactive power ratings are generally higher than the actual ratings as defined by the PJM mandated tests of capability because

<sup>102</sup> See e.g., FERC Dockets Nos. EL16-32, EL16-44, EL16-51, EL16-54, EL16-65, EL16-66, EL16-79, EL16-89, EL16-98, EL16-72, EL16-100, EL16-103, EL16-118, EL16-1004, ER16-1456, ER16-2217, EL17-19, EL17-38, EL17-39, EL17-49, ER17-259 and ER17-801.

<sup>104</sup> AEP *mimeo* at 31.

<sup>105</sup> See, e.g., *id.*

<sup>106</sup> 154 FERC ¶ 61,246 at P 28 (2016); see also 154 FERC ¶ 61,246 at P 29 (*Wabash Orders*).

<sup>107</sup> See, e.g., *Talen Energy Marketing, LLC*, 154 FERC ¶ 61,087 at P 10 (2016) ("The Informational Filing contains information that raises concerns about the justness and reasonableness of Ironwood's reactive power rate, including, but not limited to, the degradation of the Facility's current MVAR capability as compared with the MVAR capability that was originally used to calculate the revenue requirement for Reactive Service included in Ironwood's reactive power rate.").

<sup>108</sup> 154 FERC ¶ 61,246 at P 28 (2016); see also 154 FERC ¶ 61,246 at P 29.

<sup>102</sup> See FERC Docket No. AD16-17-000.

nameplate power ratings are generally calculated using leading and lagging power factors that are lower than are achievable when installed in a specific plant interconnected to a specific transmission network. Although this issue is characterized as degradation, the difference between pre installation nameplate ratings and post installation tested capability exists even when units are new. Testing reveals whether the tested capability changes. Reliance on tested results would address both the issue of degradation and the issue of theoretical versus actual MVAR ratings.

The logic of the *Wabash* orders should be extended to exclude manufacturers' nameplate MVAR ratings and the corresponding theoretical power factors. Nameplate MVAR ratings should not be relied upon to define the allocator used to calculate the costs of reactive capability. Current performance and testing show significant disparities between nameplate MVAR output and actual output. This is significant regardless of whether the cause is degradation of power factors or simply the difference between theoretical and tested power factors.<sup>109</sup> PJM determined in 1999 that nameplate MVAR and power factor ratings do not reflect the value to the system operator of a unit's reactive output after it is interconnected at a specific location.<sup>110</sup> Only operator evaluation of reactive capability can provide a meaningful measure of reactive capability.

The information for MVAR ratings should come from data on the MVAR output provided. System operators can evaluate the usefulness and value of reactive capacity based on the actual availability and use of such capability.

Data from periodic testing for reactive capability is another approach to measuring MVAR output. Testing at relatively long intervals is not likely to be as accurate as actual market operations data, but it is more reliable than an untested and dated manufacturers' nameplate rating.

<sup>109</sup> In response to a 1999 low voltage event, PJM performed a root cause analysis. The analysis concluded that "PJM narrowly avoided a voltage collapse" and that "if PJM had realized that the MVAR reserves that the EMS indicated were available were not realistic, other action could have been taken [sic] to stabilize the system." PJM State & Member Training Dept., Slides, Reactive Reserves and Generator D-Curves at 13 (included as an Attachment) <<http://www.pjm.com/~media/training/nerc-certifications/gen-exam-materials/gof/20160104-reactive-reserves-and-d-curve.ashx>>.

<sup>110</sup> *Id.*, including Attachment.

The estimated capability costs also include estimated heating losses relative to MVAR output.<sup>111</sup> Heating losses are variable costs and not fixed costs and should not be included in the definition of reactive capability costs.<sup>112</sup> Heating losses can be accurately calculated for each hour of operation if each unit had an accurate, recent D-curve test. Heating losses are variable costs and should not be included in the cost of reactive capability. The production of reactive power slightly reduces the MWh output of the generator as the generator follows its D-curve. The value of this heating loss component is generally estimated based on estimated operation and associated estimated losses and estimated market prices, treated as a fixed cost, and included in the cost of reactive capability. Losses are minimal and occur during normal operations and should not be treated as a fixed cost. Losses can be better and more accurately accounted for as a variable cost based on actual unit operations and market conditions.

Reactive service is supplied during normal operation as needed and directed by PJM dispatchers. Most reactive service is provided with no impact to operational dispatch. When a need for reactive service requires that a unit's MW output be reduced outside of its normal operational range, or when a unit is started to provide reactive power, it is logged by PJM dispatchers and will be paid reactive service credits in the zone or zones where the reactive service was provided proportionally to their zone and nonzone peak transmission use and point to point transmission reservations.

Cost of service rates are established under Schedule 2 of the OATT and may cover rates for single units or a fleet of units.<sup>113</sup> Until the Commission took corrective action, fleet rates remained in place in PJM even when the actual units in the fleet changed as a result of unit retirements or sales of units.<sup>114</sup> New rules require unit owners to give notice of fleet changes in an informational filing or to file a new rate based on the remaining units, but do not yet require unit specific reactive rates.<sup>115</sup> Fleet rates should be eliminated. Compensation

<sup>111</sup> See, e.g., *id.* at P 10 n12, citing *PPL Energy Plus, LLC*, Letter Order, Docket No. ER08-1462-000 (Sept. 24, 2008); *Dynegy Midwest Generation, Inc.*, 125 FERC ¶ 61,280 at P 35 (2008).

<sup>112</sup> See Transcript, *Reactive Supply Compensation in Markets Operated by Regional Transmission System Operators Workshop*, AD16-17-000 (June 30, 2016) at 26:21-27:23.

<sup>113</sup> See, e.g., OATT Schedule 2; 114 FERC ¶ 61,318 (2006).

<sup>114</sup> See 149 FERC ¶ 61,132 (2014); 151 FERC ¶ 61,224 (2015); OATT Schedule 2.

<sup>115</sup> *Id.*

should be based on unit specific costs. Fleet rates make it almost impossible to monitor whether compensation for reactive capability is based on actual unit specific performance and costs.

To the extent that the Commission decides that PJM and other markets should continue to rely on a cost of service method to compensate reactive capability, the rules should be modified to improve the accuracy of the calculations of reactive capability cost. Rates that do not accurately reflect the cost of the service provided are not just and reasonable.

Reactive capability rate schedules must be accurate, and they must also coordinate properly with the PJM market rules. Revenues received for reactive capability are revenues for ancillary services that should be netted against avoidable costs whenever avoidable cost rate offers are submitted in RPM capacity market auctions.<sup>116</sup> Participants have not been properly including reactive revenues in capacity market offers, and the MMU has notified participants of its compliance concerns. The identification of revenues for reactive capability on a unit specific basis is necessary for the calculation of accurate avoidable cost rate offers and is needed to avoid disputes that could interfere with the orderly administration of RPM auctions. The MMU has sought to address this issue through participation in proceedings at FERC concerning reactive capability rates for PJM units.<sup>117</sup>

## Reactive Costs

In the first six months of 2018, total reactive charges were \$175.7 million, a 8.9 percent increase from the \$161.3 million for the first six months of 2017. Reactive capability revenue requirement charges increased from \$152.0 million in the first six months of 2017 to \$165.0 million in the first six months of 2018 and reactive service charges increased from \$9.4 million in the first six months of 2017 to \$10.7 million in the first six months of 2018.<sup>118</sup> All \$10.7 million in the first six months of 2018 were paid for reactive service provided by 22 units in 208 hours. Due to high voltage issues in ComEd, DPL and low voltage issues in PENELEC and AEP reactive service charges were incurred.

Table 10-50 shows reactive service charges in the first six months of 2017 and 2018, reactive capability revenue requirement charges and total charges. Reactive service charges show charges to each zone for reactive service provided and not credits to plants in each zone. Reactive capability revenue requirement charges show charges to each zone for reactive capability.

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<sup>116</sup> See OATT Attachment DD §§ 6.4, 6.8(d).

<sup>117</sup> See, e.g., FERC Dockets Nos. EL16-44 et al.; ER16-1456; EL16-57 et al.; EL16-51 et al.; ER16-1004; EL16-32; EL16-72; EL16-66; EL16-65; EL16-54; EL16-90 et al.; EL16-103 et al.; EL16-89 et al.; EL16-98 et al.; EL16-79 et al.; EL16-80 et al.; EL16-81 et al.; EL16-82 et al.; EL16-83 et al.; ER16-2217 et al.; EL17-19; EL16-118.

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<sup>118</sup> See *2017 State of the Market Report for PJM*, Vol. 2, Section 4, "Energy Uplift."

**Table 10-50 Reactive zonal charges for network transmission use: January through June, 2017 and 2018**

Zone	Jan-Jun 2017			Jan-Jun 2018		
	Reactive Capability		Reactive Service Charges	Reactive Capability		Reactive Service Charges
	Charges	Revenue Requirement		Charges	Revenue Requirement	
AECO	\$8,686	\$2,191,386	\$2,200,071	\$0	\$2,683,919	\$2,683,919
AEP	\$172,736	\$19,528,493	\$19,701,229	\$775,231	\$21,387,273	\$22,162,504
APS	\$135,676	\$8,415,734	\$8,551,410	\$0	\$8,453,988	\$8,453,988
ATSI	\$60,696	\$10,670,909	\$10,731,605	\$0	\$10,719,414	\$10,719,414
BGE	\$1,694,486	\$4,044,532	\$5,739,019	\$0	\$4,138,290	\$4,138,290
ComEd	\$3,016,085	\$13,483,733	\$16,499,818	\$9,145,146	\$19,253,716	\$28,398,862
DAY	\$15,845	\$2,555,347	\$2,571,192	\$0	\$3,343,002	\$3,343,002
DEOK	\$25,386	\$4,402,247	\$4,427,633	\$0	\$3,700,108	\$3,700,108
Dominion	\$120,722	\$15,392,029	\$15,512,750	\$22,293	\$20,035,243	\$20,057,536
DPL	\$608,173	\$5,833,893	\$6,442,066	\$257,310	\$6,839,917	\$7,097,227
DLCO	\$12,737	\$389,628	\$402,365	\$0	\$391,399	\$391,399
EKPC	\$12,013	\$1,092,914	\$1,104,927	\$166,357	\$1,097,882	\$1,264,239
JCPL	\$19,441	\$4,348,384	\$4,367,825	\$0	\$4,826,684	\$4,826,684
Met-Ed	\$29,583	\$2,717,294	\$2,746,877	\$0	\$2,422,563	\$2,422,563
PECO	\$103,510	\$11,270,869	\$11,374,379	\$0	\$11,369,085	\$11,369,085
PENELEC	\$1,641,212	\$5,639,125	\$7,280,337	\$354,393	\$5,986,959	\$6,341,352
Pepco	\$1,595,597	\$4,063,001	\$5,658,598	\$0	\$4,257,546	\$4,257,546
PPL	\$37,886	\$12,208,282	\$12,246,168	\$0	\$12,839,769	\$12,839,769
PSEG	\$37,255	\$14,228,158	\$14,265,413	\$0	\$13,543,057	\$13,543,057
RECO	\$1,239	\$0	\$1,239	\$0	\$0	\$0
(Imp/Exp/Wheels)	\$0	\$9,485,909	\$9,485,909	\$0	\$7,703,269	\$7,703,269
Total	\$9,348,963	\$151,961,867	\$161,310,830	\$10,720,730	\$164,993,083	\$175,713,813

## Frequency Response

On November 17, 2016, FERC issued a Notice of Proposed Rulemaking (NOPR) to amend existing Large and Small Generator Interconnection Agreements to require all new generation facilities to maintain and operate a functioning governor or equivalent controls as a precondition for interconnection. The NOPR further amends the agreements to include maximum droop and deadband setting as operating provisions. The NOPR did not propose any headroom requirement nor did it propose a compensation mechanism.<sup>119</sup>

In response to the NOPR, PJM formed a task force under its Markets and Reliability Committee (MRC) to review the NOPR and to propose changes to its tariff and operating manuals and consider compensation mechanisms if needed, the Primary Frequency Response Senior Task Force (PFRSTF).

The MMU recommends that capability to operate under the proposed deadband (+/- 0.036 HZ) and droop (5 percent) settings be mandated as a condition of interconnection and that such capability be required of both new and existing resources. The MMU recommends that no additional compensation be provided as the current PJM market design provides adequate compensation.

119 157 FERC ¶ 61,122 (2016)

## Frequency Control Definition

There are four distinct types of frequency control, distinguished by response timeframe and operational nature: Inertial Response, Primary Frequency Response, Secondary Frequency Control, and Tertiary Frequency Control.

- **Inertial Response.** Inertial response to frequency excursion is the natural resistance of rotating mass turbine generators to change in their stored kinetic energy. This response is immediate and resists short term changes to ACE from the instant of the disturbance up to twenty seconds after the disturbance.
- **Primary Frequency Response.** Primary frequency response is a response to a disturbance based on a local detection of frequency and local operational control settings. Primary frequency response begins within a few seconds and extends up to a minute. The purpose of primary frequency response is to arrest and stabilize the system until other measures (secondary and tertiary frequency response) become active.
- **Secondary Frequency Control.** Secondary frequency control is called regulation. In PJM it begins taking effect within 10 to fifteen seconds and can maintain itself for several minutes up to an hour in some cases. It is controlled by PJM which detects the grid frequency, calculates a counterbalancing signal, and transmits that signal to all regulating resources.
- **Tertiary Frequency Control.** Tertiary frequency control and imbalance control lasting 10 minutes to an hour is available in PJM as Primary Reserve. It is initiated by an all call from the PJM control center.

