

represent a negotiated outcome and have no analytical basis other than the parties' willingness to agree to them.⁵ CONE values should be based on the most accurate and objective calculation possible, not numbers that have been agreed to for reasons that are not stated in the record. As the record now stands, the values filed by PJM are the only values that should be approved without a hearing to further develop the record.

I. ANSWER

A. The Market Monitor Continues to Support PJM's Filed Position on the Basis of PJM's Filed Affidavit, and Continues to Dispute the Exact Genuine Issue of Material Fact That Is the Subject of This Proceeding, and Which the Settlement Leaves Unresolved.

The genuine issues of material fact in this proceeding are the same issues that the Commission set for hearing: (i) "a number of issues of disputed fact as to the proper calculation of the Gross CONE values" and (ii) "the region-wide Gross CONE value."⁶ The black box settlement proposed specifically declines to resolve any of these disputed issues, much less provide record support for any resolution.⁷ Because the Commission has already identified genuine issue of material fact in this proceeding and those issues remain in dispute, PJM's argument (at 8–9) that no genuine issue of material fact remains in dispute should be rejected.

What still remains to be decided, whether at hearing, or more productively, on the basis of the existing record, is which values included in the record, the values filed by PJM or the settlement values are best supported. The Commission set this matter for hearing

⁵ See PJM, Settlement Agreement and Offer of Settlement in Docket No. ER12-513-000, -003, Affidavit of Dr. Samuel Newell on Behalf of PJM Interconnection, L.L.C. ("Newell Settlement Affidavit").

⁶ See *PJM Interconnection, L.L.C.*, 138 FERC ¶ 61,062 at PP 39–41 (January 30, 2012) ("January 30th Hearing Order"), *order on reh'g and clarification, etc.*, 139 FERC ¶ 61,031 at P 19 (April 11, 2012) ("April 11th Rehearing Order").

⁷ See Newell Settlement Affidavit at 5–7.

because it found material issues in PJM's filed case.⁸ The settlement includes no method for calculating the black box values it includes that can be analyzed for its accuracy.

PJM's initially filed CONE values, which the Market Monitor continues to support and the Maryland Public Service Commission supports,⁹ remain the best supported values. The only way that most of the issues identified by the Commission can be resolved is to further develop the record at hearing, or, preferably, accept PJM's values on the condition that they are replaced as soon as possible by values with better support. This condition does not impose any significant burden on PJM beyond the time and resources that it will need under the current triennial review provision, which requires new CONE values in place by the BRA in May 2015 for the 2018/2019 Delivery Year. The Commission can resolve the Region-Wide CONE Area on the basis of the existing record, consistent with its finding in the April 11th Rehearing Order.

The affidavit supporting PJM's filed position is the Newell Cost Study Affidavit, submitted on December 1, 2011, by PJM, along with the supporting study prepared by The Brattle Group with CH2M Hill and Wood Group Power Operations.¹⁰ The Market Monitor supported this position when it was filed, and believes that it is the best supported set of CONE values in the record as it now stands. Accordingly, arguments that no affidavit exists in support of the Market Monitor's position are incorrect.¹¹

⁸ January 30th Hearing Order at PP 39–41.

⁹ See Reply Comment of Public Service Commission of Maryland in Support of Comments of the PJM Independent Market Monitor in Docket No. ER12-513-000, -003 (December 21, 2012) at 2 (“We also agree with the IMM that the Settlement proposal for Region-wide Gross CONE does not comport with FERC’s January 30th Order.”).

¹⁰ See 18 CFR § 385.602(f)(4); December 1st Filing, Attachment D, Exhibit 2 (Kathleen Spees, Samuel A. Newell, etc., “Cost of New Entry Estimates for Combustion-Turbine and Combined Cycle Plants in PJM” (August 24, 2011)).

¹¹ See PJM at 8.

No additional affidavit is needed to address the Newell Settlement Affidavit. That affidavit specifically declines to explain how the values included were calculated. Those values are the product of an agreement. The Market Monitor does not dispute that settling parties have agreed to support the CONE settlement values. The real question in this proceeding about affidavits is whether the Newell Settlement Affidavit actually satisfies the requirement of Rule 602 that a contested settlement include "substantial evidence upon which to base a reasoned decision."¹²

If this matter proceeds to hearing, the Market Monitor would consider whether it is worthwhile for it to prepare and file its own study supporting accurate CONE values. But the Market Monitor was convinced based on its independent review and evaluation of the Newell Cost Study Affidavit and supporting documentation, and remains convinced, that the values filed by PJM adequately reflect prevailing industry conditions. Based on information presented during months of confidential settlement discussions and other sources, the Market Monitor believes that the values filed are at the high end of values reasonably reflective of prevailing industry conditions.

Other parties have filed testimony supporting other values, some higher than PJM, others lower. Those filings are not in dispute unless this matter proceeds to hearing, as the parties that filed those values now support the settlement along with PJM.

The choice now is between values filed by PJM initially, which are supported by the Newell Cost Study Affidavit, and the values filed by PJM for settlement reasons, which are supported by the Newell Settlement Affidavit. The CONE values filed by PJM are based on an extensive cost study and a substantive affidavit included in the record. PJM continues to prefer those values.¹³ No cost study or substantive affidavit supports the CONE settlement values. Indeed, the CONE settlement values differ from the values in every cost study

¹² 18 CFR § 385.602(h).

¹³ PJM at 9.

included in the record. Nevertheless, the settling parties have determined that the CONE settlement values are consistent with their interests as they define them. The bases for the judgment and assessment of interests are known only to the individual parties. There is no reason to assume that those interests have anything to do with calculating accurate CONE values.

If the purpose of this proceeding is to establish the most accurate CONE values possible in support of competitive and efficient markets, consistent with the Commission's prevailing market-based regulatory approach, then the best approach for resolution of this matter is to approve the best supported values in the record, those filed by PJM on the basis of a cost study. The best way to address the concerns raised by the Commission about the values filed by PJM in the January 30th Hearing Order would be to condition approval on a requirement that PJM file updated CONE values and an updated process to develop CONE values as soon as possible.

The second best way to address those concerns would be to set the matter for hearing and obtain a complete record basis to resolve those concerns.

The approach furthest from the objective to obtain accurate CONE values would be to approve values agreed to for unstated reasons and having no substantive support.

B. *Trailblazer* Requires a Decision on the Merits of the Contested Settlement.

PJM cites to the *Trailblazer* proceeding and cases citing to *Trailblazer* for a roadmap showing how the Commission should resolve this proceeding.¹⁴ PJM argues that *Trailblazer* offers two "relevant" means for approval of the settlement over the Market Monitor's

¹⁴ PJM at 7–8, citing *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 at 62,341 ("*Trailblazer II*"), order on reh'g, 87 FERC ¶ 61,110 ("*Trailblazer III*"), *aff'd*, 88 FERC ¶ 61,168; *Pub. Utils. Comm'n of Cal. v. El Paso Natural Gas Co.*, 105 FERC ¶ 61,201 at P 44 (2003), *reh'g denied*, 106 FERC ¶ 61,315 (2004). PJM does not discuss the first *Trailblazer* decision, *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,082 (1998) ("*Trailblazer I*").

objections.¹⁵ These include “Approach No. 1, where the Commission renders a binding merits decision on each of the contested issues” and “Approach No. 2, where approval of the contested settlement is based on a finding that the overall settlement as a package provides a just and reasonable result.”¹⁶ Whether considered issue by issue or as a package, the settlement values cannot survive an analysis based on their substantive merits.

1. The CONE Settlement Values Cannot Be Analyzed Issue by Issue Under *Trailblazer* Approach No. 1.

PJM’s argument that *Trailblazer* Approach No. 1 is relevant to this proceeding is misplaced. Issue by issue analysis of black box settlement CONE values is impossible. Because the settlement does not provide a calculation of or identify the individual components of any CONE value, it defies substantive analysis on the merits. The Newell Settlement Affidavit describes how individual numbers proposed in different cost studies in the record could equal the agreed upon settlement CONE values, but he does not explain why the parties agreed to values at these levels.¹⁷ Witness Newell does not explain why some cost elements are included and some are rejected.¹⁸ He cannot, because they are not identified. Witness Newell’s point is that the numbers fall within the range of what has

¹⁵ *Id.*

¹⁶ *Trailblazer II* summarizes (at 61,436 n.5) four approaches for the Commission to approve contested settlements: “Approach No. 1, where the Commission renders a binding merits decision on each of the contested issues; Approach No. 2, where approval of the contested settlement is based on a finding that the overall settlement as a package provides a just and reasonable result; Approach No. 3, where the Commission determines whether the benefits of the settlement outbalance the nature of the objections, in light of the limited interest of the contesting party in the outcome of the case; and Approach No. 4, where the Commission approves the settlement as uncontested for the consenting parties, and severs the contesting parties to litigate the issues.”

¹⁷ See Newell Settlement Affidavit at 6 (“Thus, accepting some or all of just these three adjustments, which would properly apply to every CONE Area, and to both the CT and CC plant configurations, would be sufficient to produce CONE values comparable to those in the Settlement Agreement, which are 2 to 6 percent higher than the CONE values in the December 2011 Filing.”).

¹⁸ *Id.*

been proposed.¹⁹ The Newell Settlement Affidavit does not permit, and is therefore irrelevant to, an issue by issue comparison on the merits with the Newell Cost Study Affidavit that the Market Monitor supports.

2. The CONE Settlement Values Cannot Be Approved As a Package Under Trailblazer Approach No. 2.

PJM also points to *Trailblazer* Approach No. 2, which provides that the Commission “can approve a settlement as a package where the overall result is just and reasonable, even if some aspects of the settlement are problematic and might not warrant approval outside the context of the settlement.”²⁰ This path further provides for “a balancing of the benefits of the settlement against the costs and potential effects of continued litigation.”²¹ This path for approval of a settlement does not justify approval of the settlement CONE values proposed under consideration here.

Trailblazer Approach No. 2 does not avoid analysis of the settlement on the merits, it holds only that a settlement can be approved if the overall settlement has merit and adequate support as a package even if some elements of that package are “problematic.” Because the settlement CONE values are “black box” values, they cannot be analyzed on the merits collectively or individually. There is no support for the specific values proposed as a package. The settlement CONE values have no specific support other than an opaque agreement.

When parties supporting the settlement claim that the settlement CONE values are supported by the record evidence, they mean that it is possible to take the divergent cost studies filed in this proceeding and extract a group of cost elements that equal a pre agreed

¹⁹ See Newell Settlement Affidavit at 7 (“Considering the comparisons and adjustments described above, I believe the CONE values in the Settlement Agreement are very much in the reasonable range of the levelized cost of new CT and CC plants in PJM.”).

²⁰ *Trailblazer* III at 61,440.

²¹ *Id.* at 61,439.

level. Witness Newell provides an example of how this could be done.²² The settling parties leave it to the Commission to make a final determination of which inputs will be extracted from which studies included in the record that will sum to equal the proposed black box values.²³ It is not appropriate to ask the Commission to create a post facto justification for what the parties have agreed to, especially when the parties are unable to do so for themselves.

PJM argues that the Commission “is clearly entitled to give weight to the support of customers when deciding whether to approve a settlement offer.”²⁴ The Commission may consider customers’ support as a factor when evaluating a contested settlement, but this does not change the fundamental requirements that a contested settlement must be approved based on a substantive analysis of its merits, i.e. a finding that the settlement package is just and reasonable.²⁵

²² See Newell Settlement Affidavit at 5–7.

²³ See PJM at 12; Newell Settlement Affidavit at 7 (“Were the Commission to accept even a small fraction of these claims, it would readily arrive at CONE values comparable to those in the Settlement Agreement.”)

²⁴ PJM at 8, citing *NorAm Gas Transmission Co. v. FERC*, 148 F.3d 1158, 1165 (D.C. Cir. 1998), The passage to which PJM cites provides: “As we have explained before, the Commission is clearly entitled to give weight to the support of customers when deciding whether to approve a settlement offer. [citation omitted] However, customer support is not dispositive, even when a settlement offer is uncontested. Even if Tennessee’s customers had unanimously supported the proposed settlement, the Commission would still have the responsibility to make an independent judgment as to whether the settlement is “fair and reasonable and in the public interest.” 18 C.F.R. § 385.602(g)(3); [additional citation omitted]. Although the Commission may take widespread customer support into account, such support is not an excuse to ignore arguments raised by a competitor who opposes the settlement.” *Id.* at 1164–65.

²⁵ *Id.*; *Trailblazer III* at 61,440 n.21 (“In *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 314 (1974), the [Supreme] Court explained that the Commission can approve an uncontested settlement if it is in the public interest, and can also approve a contested settlement rate if there is substantial evidence in the record to support an finding that the settlement rate is just and reasonable. Both approvals are decisions on the merits, as opposed to procedural decisions. Thus, there are different types of merits decisions, and approval of the settlement as a whole as reasonable does not involve a merits decision on each issue in the proceeding.”).

Trailblazer expressly recognizes that the Commission must reject the “rationale that the settlement was appropriate because it was in the mid-range of the parties’ various proposals.”²⁶ The courts have squarely rejected settlements that attempt to split the difference and required a “meaningful review of the objections” to the settlement.²⁷ The courts refused to accept the split the difference rationale in a traditional rate case.

In this proceeding, the need to look further than the parties’ agreement is even more compelling than it was in *Trailblazer*. *Trailblazer* involved a traditional review of a cost-of-service rate. This proceeding involves evaluation of a market design parameter that will be used to determine just and reasonable rate levels through competitive markets. This significantly heightens the need for the Commission to evaluate the merits of the method and not whether parties agreed to certain values.

Trailblazer recognizes that “some issues are more appropriate for settlement than others.” The Commission found, “When presented with a settlement, the first issue for the Commission is whether the proposed settlement presents an acceptable outcome for the

²⁶ *Trailblazer II mimeo* at 43, citing *Laclede Gas Company v. FERC*, 997 F.2d 936 (D.C. Cir. 1993). The Laclede court stated (at 947): “FERC’s confidence in the reasonableness of the settlement amount appears to rest primarily on the observations that (1) the \$ 19 million refund ‘is much less than what [the] Enforcement Staff argues for, but much more than United has conceded it owes,’ [citation omitted]; and (2) Enforcement’s high-end estimate, which was based on the ALJ’s proposed methodology, would prove accurate only if all of the outstanding issues were resolved against United, [citation omitted] Turning to the first of these two rationales, the mere fact that the settlement figure fell somewhere within the vast gulf between United’s estimate of its own liability (approximately \$ 1 million) and the alternative advanced by Enforcement (approximately \$ 53 million by the time of the order denying rehearing) provides scant support for the Commission’s decision. As an initial matter, it is entirely possible that the preliminary liability estimate of a party in United’s position might reflect a strategy designed to strengthen its position in the ensuing settlement negotiations or litigation. More importantly, relying solely on such estimates would lead to the untenable result that if United initially estimated its liability at one dollar, a settlement of a penny more would be “within the expected range of recovery.”

²⁷ *Id.*, quoting *Laclede* at 947.

case that is consistent with the public interests protected by the Commission.” The Commission noted:

For example, at least since Order No. 436, the Commission has sought to promote a more competitive natural gas market. Where the issues in a proceeding significantly affect the ability of participants in the market to compete on even terms, the Commission’s primary interest has been to achieve a resolution of those issues that promotes competition.

This proceeding concerns establishing auction parameters in an electricity market regulated through competition. This context is consistent with the Commission’s description of the type of matter that is less appropriate for settlement than other matters.

Trailblazer holds that in situations where contested matters are not “too small and attenuated to warrant altering the settlement,” then “the Commission must rule on the merits of each objection based on the record in this case.”²⁸ The matters at issue here are not small and attenuated. The dispute is not just about the details of how these CONE values were calculated, even though these details have significant influence over the RPM parameters established. This dispute is fundamentally about whether accurate CONE values are the priority objective of this proceeding or whether the acceptability of CONE values to the settling parties are the priority objective of this proceeding. The priority objective must be accurate CONE values.

Trailblazer requires that the merits must be considered when evaluating significant disputes. Minority or underrepresented interests would have little protection in the process otherwise. The settlement parties do not want to recognize that *Trailblazer* requires a need for a decision on the merits here because that requirement is fatal to any proposal that specifically avoids providing a reasoned explanation.

²⁸ *Trailblazer I* at 61,291.

A consideration when applying *Trailblazer* Approach No. 2 is a “balancing of the benefits of the settlement against the costs and potential effects of continued litigation.” The Market Monitor does not favor continued litigation. The better approach is to approve PJM’s filed CONE values subject to condition of another filing as soon as possible. However, continued litigation is preferable to approving unsupported settlement CONE values over the CONE values initially filed by PJM. Moreover, *Trailblazer* directs consideration of both cost of continued litigation *and* its potential effects. The examples provided in *Trailblazer* involve situations where the contesting party is better off under the settlement based on an assessment of the likely litigation results or where the matter contested is a speculative harm. None of these considerations apply to this case.

In the *Trailblazer* proceeding, the Commission applied its approach to evaluating contested settlements to reject a broadly supported settlement based on one party’s objection.²⁹ The dispute in *Trailblazer* concerned a single natural gas pipeline’s rate for a limited set of customers. At issue here are the parameters that will define PJM’s capacity market prices for customers in a significant portion of the eastern United States, possibly for a number of years. The strong public interest in efficient and competitive markets is at stake here. The Maryland PSC has also weighed in on behalf of the public interest of its citizens.³⁰ A decision on the merits is appropriate in these circumstances.

²⁹ The Commission later found the issue “severable” under *Trailblazer* Approach No. 4, but PJM does not argue for severance. See *Trailblazer III* at 61,435. *Trailblazer* Approach No. 4 is unavailable here because the settlement CONE values are presented in the aggregate, with no explanation of how there were derived.

³⁰ Reply Comments of Public Service Commission of Maryland in Support of Comments of the PJM Independent Market Monitor filed in Docket No. ER12-513-000, -003 (December 21, 2012).

C. The Commission Has the Authority to Condition Its Approval of Revised RPM Auction Parameters and to Reject Unsupported Automatic Adjustments to Those Values.

PJM argues that the Commission has no authority to condition approval of the CONE values filed by PJM on PJM's filing new proposed CONE values as soon as possible. The Commission routinely conditions its approval of PJM's section 205 filings and those filed by traditional public utilities.³¹ Conditioning approval of a rate filing is not the same as a usurpation of a utility's statutory right to file a rate in the first instance. PJM's filing commenced this proceeding.

The cases cited by PJM are traditional rate filings. The filing under consideration here is to establish core market parameters. These parameters must reflect as closely as possible contemporary prevailing economic conditions. A centralized capacity market with administratively determined parameters cannot work otherwise. PJM has not shown where the courts have applied the precedent cited to such filings. There is no basis for PJM's assertion that the Commission cannot take action needed to ensure that the administratively determined components of the organized markets reasonably reflect prevailing economic conditions.

D. The Commission Has the Authority to Reject Unsupported Automatic Adjustments to RPM Auction Parameters.

PJM argues (at 11–13) that an adjustment to the CONE Settlement Values is needed for their first application in the May 2013 auction for the 2016/2017 Delivery Year because the parties had studies available to them during settlement discussion intended to reflect conditions relevant to the May 2012 BRA for the 2015/2016 Delivery Year.

Suggestions about what the black box settlement values aimed to accomplish cannot be relied upon. The settlement discussions were confidential. The black box CONE

³¹ See, e.g., *PJM Interconnection, L.L.C.*, 141 FERC ¶ 61,134 (2012).

settlement values are offered with no specific basis other than that the parties agreed to them. There is nothing in the record related to any party's motives to agree to settlement. There is no reason for anyone to believe that any party agreed to the CONE settlement values solely or even primarily because that party believed that the CONE settlement values are accurate or had adequate support in the record.

The purpose of the triennial review is to periodically establish calculated CONE values rather than to continually rely on index adjusted values. Approving the application of an adjustment to CONE values in the first year that they are used is inconsistent with that purpose. Accordingly, the proposal to apply an adjustment to the black box CONE settlement values in the first year that they are used should be rejected.

E. The Commission Has the Authority to Approve Region-Wide CONE Values That Are Supported in the Record and to Reject the Values Included in the Settlement That Are Unsupported.

Dominion argues (at 4) that the IMM (and, implicitly, the Commission in its January 30th Hear Order at PP 62–64) adopts a “simplistic view regarding building new capacity.” Dominion reargues claims about SCR and other expenses in CONE Area 5, the areas with the lowest gross CONE value, that the Commission already has rejected. Dominion concludes, theoretical reference unit does not contemplate all specific location related issues (such as the localities residential or political appetite for such development) and therefore does not necessarily reflect the actual location of a new unit.”

The purpose of the RPM auction parameters is not to forecast where investment in new units in PJM will occur. Investors can and do factor in numerous considerations, both objective and subjective, economic and political, rational and irrational, when making their investment decisions. Rather, the RPM auction parameters assume objective, economic and rational behavior and attempt to establish the best available cost reference on that basis. If the best available analysis determines the net costs of investment in a certain location are lowest, all other consideration held equal, it is reasonable to base the market design parameters on the costs at that location.

II. MOTION FOR LEAVE TO ANSWER

The Commission's Rules of Practice and Procedure, 18 CFR § 385.213(a)(2), do not permit answers to answers or protests unless otherwise ordered by the decisional authority. The Commission has made exceptions, however, where an answer clarifies the issues or assists in creating a complete record.³² In this answer, the Market Monitor provides the Commission with information useful to the Commission's decision-making process and which provides a more complete record. Accordingly, the Market Monitor respectfully requests that this answer be permitted.

³² See, e.g., *N.Y. Indep. Sys. Operator, Inc.*, 121 FERC ¶61,112 at P 4 (2007) (answer to protest accepted because it provided information that assisted the Commission in its decision-making process); *PJM Interconnection, L.L.C.*, 119 FERC ¶61,318 at P 36 (2007) (accepted answer to answer that "provided information that assisted ... decision-making process"); *California Independent System Operator Corporation*, 110 FERC ¶ 61,007 (2005) (answer to answer permitted to assist Commission in decision-making process); *New Power Company v. PJM Interconnection, L.L.C.*, 98 FERC ¶ 61,208 (2002) (answer accepted to provide new factual and legal material to assist the Commission in decision-making process).

III. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to this answer as the Commission resolves the issues raised in this proceeding.

Respectfully submitted,



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Dated: January 7, 2013

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Eagleville, Pennsylvania,
this 7th day of January, 2013.



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