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April 29, 2009

Kimberly D. Bose, Secretary
Nathaniel J. Davis, Sr., Deputy Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: *PJM Interconnection, L.L.C.*, Docket Nos. ER05-1410-000, -010, -011, -012;
EL05-148-010, -011, -012; ER09-412-000, -001

Dear Ms. Bose:

The default Avoidable Cost Rates (“ACR”) applicable to the First Incremental Auction (“IA”) of the Reliability Pricing Model (“RPM”) to be conducted by PJM Interconnection, L.L.C. (“PJM”) from June 1–5, 2009 (“June IA”) for the 2011/2012 Delivery Year are higher than appropriate for that auction. While the ACR rates are appropriate for the 2012/2013 Base Residual Auction, the ACR rates are too high for the 2011/2012 June IA. The tariff includes a single table of ACR values applicable to the 2012/2013 Base Residual Auction (“BRA”). The ACR values in the tariff are the default offer caps applicable to capacity offers in the PJM capacity market when the market power test is failed and the seller chooses not to calculate a unit-specific ACR. The ACR values in the tariff were calculated using an annual escalation factor to adjust historical ACR data to the appropriate levels for 2012/2013 operating year. By definition, these values are too high for the 2011/2012 operating year as they include an extra year of escalation. These values are also too high for the 2010/2011 operating year as they include two extra years of escalation. This result is a plain fact that should not be controversial, but if not addressed, the use of excess ACR levels could result in prices greater than a competitive level in the June IA and in the January IA. The Market Monitor therefore requests that the Commission take expedited action in order to correct this problem prior to the June IA and motions for a shortened comment period as necessary to facilitate such action. A decision is needed from the Commission by May 25, 2009, in order to allow time for participants in the June IA to adjust the default values entered into RPM-related systems accordingly.

On September 4, 2007, PJM filed a table of Avoidable Cost Rate values at section 6.7(c) of Attachment DD to the PJM Open Access Transmission Tariff (“OATT”).¹ The Commission approved an updated table of default ACR values when it approved recent revisions to RPM by

¹ PJM compliance filing in Docket Nos. ER05-1410-006, et al.

order issued March 26, 2009.² In both cases, the table was prepared by the Market Monitor and provided to PJM. In preparing these defaults the Market Monitor applied an annual escalation factor (based on the Handy-Whitman Index of utility costs) to the base year ACR values to ensure that the costs are consistent with the future Delivery Year for which the Base Residual Auction is to be conducted.³ The annual escalation factor applied for the current tariff rates was 4.55 percent, the average of the increases in the Handy-Whitman Index over the past 10 years, as specified in the tariff at Attachment DD, Section 6.8(a) Adjustment Factor.

PJM will conduct its first ever First Incremental Auction (the “June IA”) for the 2011/2012 Delivery Year, from June 1–5, 2009. PJM will conduct the Third Incremental Auction for the Delivery Year 2010/2011 (“January IA”), from January 4–8, 2010, prior to the start of the 2010/2011 Delivery Year on June 1, 2010. In both cases, PJM interprets the tariff to permit sellers to use default values that are escalated to the 2012/2013 delivery year. For the June IA, this means that default ACRs are 4.55 percent higher than they should be. For the January IA, this means that default ACRs are 9.31 percent higher than they should be. This result was unintended and is clearly erroneous.

This result is an unintended consequence of the requirement that PJM include a table of ACR values in the tariff, rather than providing the ACR values on the PJM website as needed, and the resultant inclusion of a table including ACR values only for the 2012/2013 BRA. The Market Monitor provided this table to PJM and PJM submitted it to the Commission. The Market Monitor did not consider the fact that multiple auctions would occur in calendar year 2009, each with a different delivery year and each, therefore, with a different ACR. The issue became apparent to the Market Monitor as we focused on the default ACRs appropriate for the June IA.

This problem is significant because default ACRs almost certainly will affect the clearing price in the June IA, and the inaccurate default ACR levels could result in prices as much as 4.55 percent higher than they should be with an effective mitigation program. The same problem exists for the January IA, but the impact is greater. In the 2011/2012 Base Residual Auction, the default ACR option was chosen by 26.8 percent of all generating units offered. In the 2008/2009 Third Incremental Auction, the default ACR option was chosen by 37.6 percent of all generating units offered.

The Market Monitor shares responsibility for this oversight and the consequent need for emergency corrective action. However, the Market Monitor does not have a choice, consistent

² *PJM Interconnection, L.L.C.*, 126 FERC ¶61,275 (2009).

³ Section 6.8(a) of Attachment DD (definition of “Adjustment Factor”) expressly identifies the Handy-Whitman index as the reference for adjusting unit-specific ACRs “in order to account for expected inflation from the time interval between the submission of the Sell Offer and the commencement of the Delivery Year” (i.e., a Delivery Year-specific basis). Default ACRs, as the Market Monitor argues here, should be calculated consistent with that approach.

with its duties, about whether to bring this error to the attention of the Commission and request the simple correction needed. The rules requiring that the Market Monitor detect and prevent the exercise of market power in PJM markets extend to all participants without discrimination or discretion.⁴ The problem is plain and it can be corrected with the simple adjustment as shown on the corrected table provided in Attachment A below. The addition of columns for each Delivery Year is all that is needed. The development of this table required no computation of additional inputs. The annual escalation factor is the same factor that the Market Monitor used in preparing the default values that already have been submitted and approved for Delivery Year 2012/2013. The only difference is that the escalation factor is applied in order to calculate the correctly escalated values for each separate Delivery Year.

The Market Monitor has raised this issue with PJM staff. However, PJM is unwilling to take corrective action for the January IA for the following reason:

I am responding to the Independent Market Monitor's request that PJM make a filing with the Commission to modify the ACR table in the PJM Tariff for the upcoming 2011/2012 Incremental Auction to "include ACR values that do not include the final year of 4.5 percent escalation that is appropriately included in the ACR table for the 2012/2013 Base Residual Auction. The values in the modified table, applicable to the 2011/2012 Incremental Auction, would be 4.35 percent less than the values in the ACR table in the tariff that was calculated to apply to the 2012/2013 Base Residual Auction." PJM's position is that the default ACR values approved by the Commission on March 26, 2009 in the RPM Docket Nos. ER05-1410, EL05-148 and ER09-412 are within the zone of reasonableness for use in the First Incremental Auction in June 2009 for the 2011-2012 Delivery Year. Consequently, PJM does not believe that a Section 205 filing to revise the default ACR values, with no prior stakeholder discussion or review, a request for waiver of the Federal Power Act's notice requirement, and a request for expedited FERC approval, is warranted in this instance.⁵

The Market Monitor disagrees. The Commission has applied a "zone of reasonableness" in circumstances that are not conducive to objective or precise determinations.⁶ The classic

⁴ See PJM OATT, Attachment M § IV.B.4.

⁵ E-mail from Jacqui Hugue, Senior Counsel, PJM, to Joseph Bowring, President, Monitoring Analytics, dated April 16, 2009. This e-mail provided was provided by PJM at the request of the Market Monitor in order to allow PJM to explain its decision. A complete copy of this e-mail is provided as Attachment B.

⁶ See *Colorado Interstate Co. v. FPC*, 324 U.S. 581, at 589 (1945) (rate design "involves judgment on a myriad of facts"; it has "no claim to an exact science"); *Blumenthal v. FERC*, 552 F.3d 875, 883-885 (D.C. Cir. 2009) (there is no single just and reasonable rate, but rather a zone of reasonableness and "the Commission must be given the latitude to balance the competing considerations and decide on the best resolution");

example is a rate of return on investment based on an inherently imprecise risk/reward analysis.⁷ In this case there is no room for reasonable disagreement. It is plainly unreasonable to escalate a default ACR for three years when the costs will be incurred and payment will occur in two years. The issue is limited to whether the escalation for three years appropriate for a Delivery Year three years in the future should also apply to a Delivery Year two years in the future. There is no room for reasonable disagreement on this point.

Moreover, the Commission has taken a different approach to the application of the “zone of reasonableness” concept in the context of market-based rates, such as those that the June IA will establish. In order to ensure that market-based based rates are within the zone of reasonableness, the Commission has specifically relied on the existence of a mitigation program and a market monitoring function.⁸ It is therefore imperative to ensure that the mitigation program is as accurate as possible.⁹ Market Monitoring cannot be relied upon to preserve just and reasonable market-based pricing if plain and correctable errors identified ex ante in market pricing are ignored. The zone of reasonableness is more appropriately relied upon as a basis to refrain from retrospective interference in market outcomes, not to permit a known defect in the mitigation program when there is ample opportunity to correct it.

Association of Oil Pipe Lines v. FERC, 83 F.3d 1424, at 1431 (D.C. Cir. 1996) (ratemaking involves “complex industry analyses and difficult policy choices”).

⁷ See, e.g., *Pioneer Transmission, LLC*, 126 FERC ¶61,281 (2009).

⁸ See *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697-A, 123 FERC ¶61,055 at P 431 (2008) (“[U]nlike *Farmers Union*, where the court identified as a ‘fundamental flaw’ the absence of any monitoring to ensure that rates remain within a zone of reasonableness, the market-based rate program does not rely solely on the market, without adequate regulatory oversight, to determine rates. Rather, the market-based rate program includes post-approval oversight through reporting requirements and ongoing monitoring. In addition, market monitoring by the Commission helps ensure that rates remain within a zone of reasonableness.”); *PJM Interconnection, L.L.C.*, 121 FERC ¶ 61,173 at P 23 (2007) (“In the case before us, the Commission is faced with the non-cost factor of ensuring that sufficient capacity is procured and reliability is maintained in the PJM region. Further, not only is every jurisdictional seller in the capacity market required to have individual seller market-based rate authorization (based on a demonstration that it lacks horizontal and vertical market power), but it is also subject to mitigated bids and market monitoring to ensure that rates in PJM remain within a zone of reasonableness. This is in full accord with the Commission’s statutory obligation. [n.30: *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) (“when there is a competitive market the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a ‘just and reasonable’ result”)]; see also *Midwest Independent Transmission System Operator, Inc.*, 120 FERC P61,202 at PP 9, 12 (2007), citing *Farmers Union Cent. Exchange, Inc. v. FERC*, 734 F.2d 1486, 1501–03 (D.C. Cir. 1984).

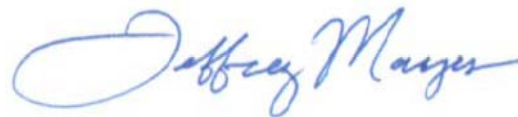
⁹ See *Enron Power Marketing Inc.*, 103 FERC ¶61,343 at P 54 (2003) (“[Defendants’] actions resulted in “manipulated prices in the California market and congestion fees in excess of what Enron would have received with accurate schedules and bids” and “resulted in rates that were outside the zone of reasonableness.”)

If the Commission agrees, the Market Monitor requests that it take action to ensure that the default ACR values included in Attachment A are the offer caps applied for the June IA. The Commission could grant such relief in any of the following ways:

- The Commission could find that the use of known incorrect values for ACR defaults is unjust and unreasonable pursuant to its own investigation under section 206 of the Federal Power Act, or the Commission could deem the instant filing a complaint filed pursuant to section 206 of the Federal Power Act and initiate a new docket accordingly.
- The Commission could address this issue in conjunction with an errata filing that PJM has indicated that it will file shortly in order to address typographical errors in the ACR default tables at issue here. Although, these errors cannot be fairly characterized as “typographical,” they constitute such clear and objective error that the Commission could appropriately treat them as such for the same reason that it would correct such typographical errors, i.e. that they are clear, objective and contrary to what was intended. The Commission may deem this request an advance motion to consolidate this filing with PJM’s errata filing, and the Commission could appropriately apply the motion for expedited treatment and shortened notice period to that filing and resolve the matter.
- The Commission could also avoid consideration of the PJM tariff entirely, and instead order an emergency modification to the authorization it confers on entities selling electric power at wholesale in PJM that they must adhere to the default values provided in Attachment A hereto if they submit default values in the specified Incremental Auction.

Whether the Commission chooses to resolve this matter using one of the options above, or another approach, the Market Monitor respectfully urges that the Commission resolve this issue in a manner that ensures an effective and efficient mitigation program and a competitive market outcome in the June IA.

Respectfully submitted,



Jeffrey W. Mayes

Joseph E. Bowring

Independent Market Monitor for PJM

President

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CERTIFICATE OF SERVICE

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

Dated at Eagleville, Pennsylvania,
this 29th day of April, 2009.



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Attachment A

Technology Classes Not Likely to be the Marginal Price Setting Resource

Technology	2010/2011		2011/2012		2012/2013	
	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)
Nuclear	N/A	N/A	N/A	N/A	N/A	N/A
Pumped Storage	\$20.77	\$29.17	\$21.72	\$30.50	\$22.71	\$31.89
Hydro	\$71.01	\$92.87	\$74.24	\$97.10	\$77.62	\$101.52
Sub-Critical Coal	\$170.48	\$188.98	\$178.24	\$197.58	\$186.35	\$206.57
Super Critical Coal	\$176.13	\$192.65	\$184.15	\$201.42	\$192.53	\$210.59
Waste Coal - Small	\$224.83	\$272.31	\$235.06	\$284.70	\$245.75	\$297.65
Waste Coal - Large	\$83.15	\$100.45	\$86.94	\$105.02	\$90.89	\$109.80
Wind	N/A	N/A	N/A	N/A	N/A	N/A

Maximum Avoidable Cost Rates by Technology Class

Technology	2010/2011		2011/2012		2012/2013	
	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)	Avoidable Cost Rate (\$/MW-Day)
CC - Two on One Frame F Technology	\$30.92	\$43.86	\$32.33	\$45.85	\$33.80	\$47.94
CC - Three on One Frame E/Siemens Technology	\$34.33	\$46.48	\$35.89	\$48.60	\$37.52	\$50.81
CC - Three or More on One or More Frame F Technol	\$26.76	\$37.16	\$27.98	\$38.85	\$29.26	\$40.62
CC - NUG Cogeneration Frame B or E Technology	\$114.93	\$154.43	\$120.16	\$161.45	\$125.62	\$168.80
CT - First & Second Generation Aero (P&W FT 4)	\$24.57	\$32.68	\$25.69	\$34.17	\$26.86	\$35.73
CT - First & Second Generation Frame B	\$24.28	\$32.40	\$25.38	\$33.87	\$26.54	\$35.42
CT - Second Generation Frame E	\$23.08	\$30.89	\$24.13	\$32.29	\$25.23	\$33.76
CT - Third Generation Aero (GE LM 6000)	\$55.87	\$82.36	\$58.42	\$86.10	\$61.07	\$90.02
CT - Third Generation Aero (P&W FT - 8 TwinPak)	\$29.30	\$43.20	\$30.64	\$45.17	\$32.03	\$47.23
CT - Third Generation Frame F	\$23.69	\$34.12	\$24.77	\$35.68	\$25.90	\$37.30
Diesel	\$26.29	\$33.39	\$27.49	\$34.91	\$28.74	\$36.49
Oil and Gas Steam	\$65.21	\$79.39	\$68.18	\$83.01	\$71.28	\$86.78

Attachment B

Jeffrey Mayes

From: Hugee, Jacquelyn [hugeej@pjm.com]
Sent: Thursday, April 16, 2009 12:11 PM
To: Joseph Bowring
Cc: Ott, Andy; Duane, Vincent P.; Jeffrey Mayes; PAUL FLYNN
Subject: ACR Levels

Joe:

I am responding to the Independent Market Monitor's request that PJM make a filing with the Commission to modify the ACR table in the PJM Tariff for the upcoming 2011/2012 Incremental Auction to "include ACR values that do not include the final year of 4.5 percent escalation that is appropriately included in the ACR table for the 2012/2013 Base Residual Auction. The values in the modified table, applicable to the 2011/2012 Incremental Auction, would be 4.35 percent less than the values in the ACR table in the tariff that was calculated to apply to the 2012/2013 Base Residual Auction." PJM's position is that the default ACR values approved by the Commission on March 26, 2009 in the RPM Docket Nos. ER05-1410, EL05-148 and ER09-412 are within the zone of reasonableness for use in the First Incremental Auction in June 2009 for the 2011-2012 Delivery Year. Consequently, PJM does not believe that a Section 205 filing to revise the default ACR values, with no prior stakeholder discussion or review, a request for waiver of the Federal Power Act's notice requirement, and a request for expedited FERC approval, is warranted in this instance.

Should you have any questions, please let me know.

Sincerely,

Jacqui Hugee

JACQUYLYNN HUGEE, ESQ.

SENIOR COUNSEL

PJM INTERCONNECTION

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