UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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PJM Interconnection, L.L.C.	)	Docket No. ER11-2287-000
	)	

PROTEST AND COMMENTS OF THE
INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 211 of the Commission's Rules and Regulations, 18 CFR § 385.211 (2010), Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[1] ("Market Monitor"), submits this protest to and comments on certain revisions to the definition of a Planned Generation Capacity Resource in the filing submitted by PJM Interconnection, L.L.C. ("PJM") on December 2, 2010 in the above referenced docket ("December 2nd Filing"). The proposed revisions redefine a "Planned Generation Capacity Resource" to include upgrades to existing Generation Capacity Resources that improve the installed capacity rating, referred to as "capacity modifications" or "cap mods." To date the definition of a "Planned Generation Capacity Resource" has been limited to include only new generating units, either planned or under construction. Because Planned Generation Capacity Resources are subject to significantly relaxed market power mitigation rules, redefining cap mods so that they are included in this category will greatly expand the application of the relaxed rules in a manner that will undermine mitigation of market power in the capacity market for both existing and planned resources. The proposed

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[1] Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT").

change would regularly excuse from market power mitigation a portion of the capacity offered by existing Generation Capacity Resources in the form of cap mods. The proposed change would also weaken the application of the relaxed market power mitigation rules applicable to entire new units because part of the market structure test applied to new units is based on the number of planned units. Under PJM's proposal, the result would be that the presence of a minor upgrade to an existing unit would result in a significant weakening of the market power mitigation rules applied to a planned unit that would otherwise be subject to market power mitigation. There is no substantive difference between an LDA with a single large planned unit and the same LDA with the same planned unit plus a one MW cap mod. But PJM's proposed rule change would treat these two situations as fundamentally different from a market structure perspective.

PJM has not anywhere addressed the ramifications to its markets of making this significant departure from current practice. PJM fails to offer any explanation of why this change is needed. PJM has not offered any explanation of the impact of this changed definition on market power mitigation nor has it explained whether it has even considered the issue.

Aside from this important but discrete issue, the December 2nd Filing, for the most part, significantly improves RPM's "Offer Requirement for Capacity Resources," commonly referred to as the "must offer" rule, which is set forth at Section 6.6 of Attachment DD to the OATT, and further developed in Section 5.6.6 of Attachment DD to the OATT and Section II.C of the Attachment M–Appendix to the OATT. Collectively, these rules establish a critically important design element that ensures that sellers of existing generating capacity in PJM must fully participate in the RPM just as Load-Serving Entities in PJM must fully

participate. Violations of the must offer rule typically indicate an attempt to exercise market power in RPM through withholding.

I. BACKGROUND

In the course of PJM's and the Market Monitor's work administering and overseeing, respectively, the special auctions convened to integrate the ATSI Zone into PJM, PJM and the Market Monitor identified a number of problems with the tariff provisions setting forth and relating to the "must offer" rule. Some of these issues required emergency filings with the Commission to resolve.[2] It became clear to both PJM and the Market Monitor that revisions to the must offer rules were needed to avoid future problems with their effective and appropriate implementation. Certain other changes to the definition of a Planned Generation Capacity Resource were also made. The Market Monitor and PJM agreed to develop a filing aimed at clarifying the rules. The December 2nd Filing is the result of that collaborative process. This process has also surfaced a dispute over an issue of central importance to preserving the effectiveness of the RPM market power mitigation rules.

II. PROTEST

A. The Commission Should Reject Changes to the Definition of a Planned Generation Capacity Resource that Would Inappropriately Include Capacity Modifications in that Definition and Thereby Undermine the Ability of Market Power Mitigation to Ensure the Competitiveness of RPM Auctions.

Structural market power is and will remain endemic to the PJM Capacity Market. The Capacity Market cannot produce competitive results without the inclusion of

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[2] *See, e.g.*, Motion for Clarification and Reconsideration filed by the Market Monitor in Docket No. ER09-1589 (January 15, 2010).

appropriately designed and effective market power mitigation rules. The PJM Capacity Market currently includes effective market power mitigation rules.[3]

The existing tariff rules significantly relax market power mitigation as it applies to Planned Generation Capacity Resources.[4] This makes sense when the term "Planned Generation Capacity Resources" refers, as it has since RPM was implemented, to the construction and interconnection to the grid of entire new generating units. The entry of new units from new investors was considered to be a source of competition for incumbent generators. In addition it was believed that there would be adequate competition among those wishing to invest in new generation such that stronger market power mitigation rules were not required for new entry. Nonetheless, market power mitigation rules were implemented for Planned Generation Capacity Resources.

In this filing, PJM proposes to significantly expand the definition of a Planned Generation Capacity Resource by including capacity modifications to existing generation facilities (cap mods) along with planned new generating facilities. PJM states its position (at 22):

> [A] capacity modification increase to the available installed capacity of an already Existing Generation Capacity Resource should be deemed to be a Planned Generation Capacity Resource until the megawatts of capacity in question are in service or have bid into and cleared an RPM Auction for a prior Delivery Year, which is consistent with how PJM treats a newly constructed Generation Capacity Resource. In other words, the capacity modification increase is either 'planned' or 'existing' for purposes of the must-offer requirement and offer-capping. Therefore, if it is

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[3] OATT Attachment DD § 6; Attachment M–Appendix § II.C.

[4] OATT Attachment DD § 6.5(a)(ii).

> planned, then it is not subject to the must-offer requirement, and if it is offered, is not subject to offer capping. The clarity PJM is looking to achieve with this filing is to delineate very specifically between Planned Generation Capacity Resources and Existing Generation Capacity Resources, and it simply does not make sense to say that a capacity modification increase is planned for one purpose but existing for another.

PJM focuses only on a narrow aspect of consistency. PJM ignores the fact that its proposal is not consistent with the fact that cap mods are part of existing units; that its proposal is not consistent with the way that the rules have been successfully implemented since the outset of RPM; that its proposal is not consistent with the market power mitigation rules; that its proposal would not treat cap mods up and cap mods down consistently; and that the APIR rules have been applied to cap mods of all kinds since the outset of RPM. The rules should be consistent in the manner that best promotes and protects competitive markets.

Cap mods are part of existing resources and should therefore be treated as existing resources. The existing rules have been consistently applied since the introduction of RPM in 2007 without any identified issues with the treatment of cap mods. Capacity modifications can be increases in capacity (cap mods up) or decreases in capacity (cap mods down). The current rules treat cap mods up and down consistently. Under PJM's proposed rules, an existing unit could reduce its capacity using a cap mod down, later increase its capacity using a cap mod up and have the cap mod up be exempt from market power mitigation. Under PJM's proposed rules, a generation owner with a portfolio of units could have a cap mod down, a corresponding cap mod up on a different unit and as a result, be in a position to significantly affect the market clearing price with exactly the same position in the market.

Cap mods that add to an existing unit's capacity have occurred, and can be expected to continue to occur, much more frequently than investments in entire new units. The proposed rule can be expected to create a potentially radical change in the nature of offers from existing units. The last MW that clears the auction sets the market price, so this proposed rule change could fundamentally alter the nature of market power mitigation in the capacity market. Currently, market power mitigation caps the offers of existing units at their avoidable costs, and those offers are the basis for the auction results except when a new unit is marginal. Under the proposed rule, offers could have a hockey stick shape reflecting most MW at the avoidable costs plus a small unrestricted cap mod offer at the end. The ability to make such offers would create a low risk mechanism to fine tune market power. This result would undermine the protection afforded by market power mitigation to RPM auctions.

The relaxed market power mitigation rules for Planned Generation Capacity Resources were designed under the assumption that only new units and not cap mods would qualify.[5] In summary, the rule provides that a Planned Generation Capacity Resource will not be mitigated if certain market structure tests are satisfied and the owner is not a single pivotal supplier.[6] If the new unit passes the market structure tests, an offer

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5 *See* OATT Attachment DD § 6.5(a)(ii).

6 *See* OATT Attachment DD § 6.5(a)(ii)(B) ("Sell Offers based on Planned Generation Capacity Resources (including External Planned Generation Capacity Resources) submitted for the first year in which such resources qualify as Planned Generation Capacity Resources shall be deemed competitive and not be subject to mitigation if: (1) collectively all such Sell Offers provide Unforced Capacity in an amount equal to or greater than two times the incremental quantity of new entry required to meet the LDA Reliability Requirement; and (2) at least two unaffiliated suppliers have submitted Sell Offers for Planned Generation Capacity Resources in such LDA. Notwithstanding

from a Planned Generation Capacity Resource is mitigated only to the extent it exceeds 140 percent of the estimated costs of capacity from the same asset type.[7]

Again, PJM's proposal is inconsistent with the market power mitigation rules. The market power mitigation rules provide that the offer of a new unit that fails the defined market structure tests must be less than 140 percent of offers for units from the same asset class. While this is a meaningful condition for a new unit, it makes no sense for a cap mod. What is in the same asset class as a cap mod? There is no reason to believe that the additional capacity costs of a cap mod bear any relationship whatsoever to the capacity costs of a new unit, regardless of the asset class.

The market structure tests apply to entire new generating units. If cap mods are deemed planned resources, these tests are much more likely to be passed with the result that not even the weaker market power mitigation rules would be applied to offers from new units. Cap mods are generally minor upgrades to a unit's installed capacity, and they can be as small as one MW.

One of the market structure tests is a requirement that at least two unaffiliated sellers offer Planned Generation Capacity Resources in an RPM Locational Deliverability Area ("LDA"). If cap mods are included in the definition of Planned Resources, this test could be satisfied if an LDA hosts both an offer for a major new facility and a one MW upgrade from an unaffiliated existing generator. This result cannot be reconciled with any

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the foregoing, any Capacity Market Seller, together with Affiliates, whose Sell Offers based on Planned Generation Capacity Resources in that LDA are pivotal, shall be subject to mitigation.").

[7] *See* OATT Attachment DD § 6.5(a)(ii)(C).

reasonable explanation of the intent of this rule. This rule was clearly written under the assumption that Planned Generation Capacity Resources were new units and not minor upgrades to existing units. Under PJM's proposal, the result would be that the presence of a minor upgrade to an existing unit would result in a significant weakening of the market power mitigation rules applied to a planned unit that would otherwise be subject to market power mitigation. There is no substantive difference between an LDA with a single large planned unit and the same LDA with the same planned unit plus a one MW cap mod. But PJM's proposed rule change would treat these two situations as fundamentally different from a market structure perspective.

Consequently, PJM's proposal to include cap mods in the definition of Planned Generation Capacity Resources should be rejected because it would undermine market power mitigation for planned resources.

The December 2nd Filing has not alleged any practical deficiency in the approach that has been applied to cap mods to date. The most sensible approach is to continue current policy, which applies market power mitigation to cap mods but does not attempt to impose on them a must offer requirement.

There is no incentive or compensation issue for cap mods. The full costs of such investments, including the return on and of capital, may be included in Market Seller Offer Caps using the Avoidable Project Investment Recovery ("APIR") component of the calculation of Avoided Cost Rates (ACR). Through this mechanism, the owner of an existing Generation Capacity Resource can test the market for the cap mod before committing, without threatening to undermine PJM's market power mitigation program.

The existing text that defines APIR in Section 6.8 of Attachment DD is sufficient to permit the use of APIR in this manner, and PJM has applied the APIR rule to all cap mods.

PJM points out (at 22–23) that the text refers to "availability," which could be read to emphasize applicability to forced outage rates, and not to "capability," which would include increases in capacity. However, both availability and capability result in an increase in unforced capacity or UCAP, so there is not in fact an ambiguity. However, a reasonable solution would be to clarify Section 6.8 by replacing "availability" with "availability or capability." This would bring the text of the tariff into clear conformity with existing practice without the possibility of ambiguous interpretation. Improving the clarity of the tariff as it relates to PJM's current practices is consistent with the primary purpose of the December 2nd Filing.

Despite the multiple and significant negative consequences for market power mitigation associated with PJM's proposed modification to the rule governing cap mods, the December 2nd Filing fails to identify any negative consequence, in practice or in theory, with the current treatment of cap mods. Indeed, there is no evidence that the prospect for these possible outcomes has received any consideration from PJM prior to the December 2nd Filing.

The Market Monitor respectfully urges that the Commission determine that PJM has not demonstrated that it is just and reasonable to change its existing practice and treat cap mods as Planned Generation Capacity Resources for the purpose of market power mitigation. PJM has not offered any explanation of the impact of this change of definition on market power mitigation nor has it explained whether it has even considered the issue. The Commission should instead require that cap mods remain fully subject to market power mitigation under section 6 of Attachment DD of the PJM tariff.

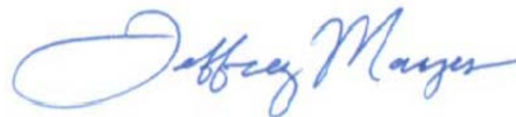
B. The Commission Should Accept the Proposed Changes Which Clarify the Must Offer Rule in a Manner That Protects and Enhances the RPM Market Design

The December 2nd Filing includes other revisions that the Market Monitor agrees mostly clarify and streamline the must offer rule. These changes do not include every change that the Market Monitor recommends, nor in every instance do they reflect the Market Monitor's preferred phrasing, but the Market Monitor appreciates PJM's willingness to work collaboratively on this effort and welcomes, with the exception of the critical matter discussed above, this otherwise overall positive result.

III. CONCLUSION

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

Respectfully submitted,



Jeffrey W. Mayes

General Counsel
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8053
jeffrey.mayes@monitoringanalytics.com

Joseph E. Bowring
Independent Market Monitor for PJM
President
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610) 271-8051
joseph.bowring@monitoringanalytics.com

Dated: December 20, 2010

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 20th day of December, 2010.

Jeffrey W. Mayes
General Counsel
Monitoring Analytics, LLC
2621 Van Buren Avenue, Suite 160
Valley Forge Corporate Center
Eagleville, Pennsylvania 19403
(610)271-8053
jeffrey.mayes@monitoringanalytics.com