UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.	)	Docket No. EL08-47-006

MOTION FOR LEAVE TO ANSWER AND ANSWER OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rules 212 and 213 of the Commission's Rules and Regulations, 18 CFR §§ 385.212 & 385.213 (2009), Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM ("Market Monitor"),[1] moves for leave to answer and answers the answers of the PJM Power Providers Group ("Power Providers") and Dayton Power and Light Company ("Dayton Power") filed on January 20, 2011. Power Providers and Dayton Power argue that PJM's proposed rules for evaluating non regulatory opportunity costs are unreasonably deficient because they fail to include a provision that would require PJM and the Market Monitor to accept a self-prepared analysis purporting that an operational limitation establishes its eligibility to include non regulatory opportunity costs in its cost capped offers. Such a provision is unnecessary, would undermine the ability of PJM and the Market Monitor to administer and monitor the implementation of PJM's market power mitigation program, and was unacceptable to stakeholders who were otherwise generously accommodating of generators' proposals related to opportunity costs. Power Providers have not shown that PJM's proposal is unreasonable because it limits reliance on analyses to sources that can be expected to be

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[1] PJM Interconnection, L.L.C. is a FERC-approved Regional Transmission Organization. Capitalized terms used herein and not otherwise defined have the meaning provide in the PJM Open Access Transmission Tariff or the PJM Operating Agreement.

relatively indifferent to the potential impact on market outcomes. Accordingly, the Commission should reject the requested relief.

I. ANSWER

The fundamental purpose of this proceeding is to protect PJM markets during times when and at locations where these structurally noncompetitive local markets have been identified as vulnerable to the exercise of market power. Years of effort have been devoted to the development of rules that indicate to generators in advance what behavior is unacceptable in PJM markets. The rules do not relieve generators of responsibility for the accuracy of their cost offers, they instead notify generators that they would need to explain certain conduct to the Commission, and they will not be able to claim lack of notice that such behavior risked sanction.

One general aim of these rules, as it concerns operations, has been to identify and distinguish the kinds of operational limitations that result in valid opportunity costs from other operational limitations that do not. It is fundamental to the nature of capacity resources in PJMthat the generation resources must maximize their availability. Performance incentives must be designed to be consistent with that requirement.

Some operational limitations result from unexpected changes to the physical nature of the equipment. Other operational limitations are the result of neglectful management, which could be avoided. It is improper to reward neglect by creating a loophole in the mitigation rules that would convert an impaired unit into a means for withholding.

The Market Monitor does not believe that any generation owner could disagree with this dinstinction. The definition of a capacity resource means that generators must be available. Nonetheless, Power Providers and Dayton argue for a rule that would force those administering the mitigation process to accept the opinion of a company employee with no

specific expertise as to whether, how and why a unit is impaired instead of the existing relatively objective standards intended to capture the distinction. This result would significantly undermine the ability of the mitigation process to uniformly communicate ex ante what behavior is acceptable and what behavior would be subject to an enforcement action.

A. PJM's Proposed Limitations on Acceptable Engineering Studies to Support Opportunity Cost-Based Offers Are Just and Reasonable.

Power Providers claim (at 6) that "generators are accountable for their bidding behavior and take very diligent efforts to ensure their offers to PJM are, in fact, accurate." No one disputes this. The issue is how to create the rules to which generators must adhere and which are the benchmarks against which accuracy is defined. If the "engineering" analysis proposal were accepted, it would result in a bad standard to which generation owners could accurately adhere. Thus the issue here is the rules and not the degree of accuracy in adhering to the rules. It is also undeniable that generators have an interest in the significant influence on market outcomes that a self-prepared "engineering" analysis could have. This conflict of interest cannot be ignored. PJM has reasonably proposed to limit reliance on engineering analyses supporting opportunity cost-based offers to those from OEMs and insurance carriers.

PJM's filing reflects stakeholders' agreement to allow opportunity cost-based offers based on engineering analyses provided from original equipment manufacturers ("OEM") and insurance carriers. Power Providers provide no evidence that PJM's decision to limit reliance on these sources is unjust or unreasonable. The assertion by Dayton (at 8) that OEM's are in many cases out of business and that plants often self-insure is not

substantiated. Moreover, contrary to Dayton's claim (*Id.*), OEM operational recommendations cover the lifetime of a unit, not just their operations as they enter service.

Neither Power Providers nor Dayton have any response to the range of concerns raised by stakeholders that resulted in the rejection of proposed reliance on self-prepared "engineering" analyses.

First, there is a substantial difference in an evaluation performed by an OEM or insurance carrier and an employee working for the resource owner. The key difference between an analysis prepared by OEM and insurance carriers versus company employees and contractors is the obvious conflict of interest and potential for bias and even fraud that Power Providers and Dayton attempt to downplay. It is not an accusation of bad behavior to recognize objective incentives. It would be naive not to do so. Power Providers and Dayton equate a refusal to take their employees at their word as a presumption of misconduct. Although supplier misconduct does occur,[2] there are other reasons why the companies' self representations are insufficient. The companies and their employees have an incentive to increase their cost-based offers because it increases margins on the unit and the profits of the portfolio when units have local market power and are offer capped as a result. Employees may also be reluctant to identify mismanagement as the basis for an operational limitation.

A systematic bias presents a serious problem if the objective is accurate and efficient pricing in the markets and the effective prevention of the exercise of local market power. OEM and insurance carrier limits are imposed by outside entities, who have much less

[2]*See, e.g., Enron Power Marketing, Inc.*, 126 FERC ¶61,230 (2009).

incentive to increase units cost-based offers by imposing limits on operations. Some stakeholders reasonably had greater comfort that analyses by third parties would be less biased than the analyses of company employees.

The potential impact on the markets from self-prepared analyses are significant and largely irreversible. Plant personnel cannot reasonably be expected to be indifferent to market outcomes, the effect of their analysis and the goals of management. The self-prepared analysis at issue here does not serve as the basis for cost-of-service rates potentially subject to refund. These analyses would instead support the determination of a market price paid by all load in the relevant market to all generating units within the relevant market.

Allowing self-prepared analyses creates the wrong incentives. If generators gain market power through self-determined operational constraints, then an incentive is created to withhold from the market.

PJM has included appropriate safeguards by ensuring that analyses relied upon come from OEM and insurance carriers. Even these sources are not perfect, as vendors and insurers who are otherwise indifferent may want to benefit their customers and clients. PJM's stakeholders have been persuaded to take on that risk. There is no reason to impose on stakeholders an additional unnecessary and unacceptable risk.

B. The Rejected Proposal Does Not Require That an Actual Engineer Perform the Analysis or that the Sponsor Confirm Knowledge of the Potential Market Impact.

An "engineering analysis" does not mean here, as one might suppose, an analysis prepared by an actual certified professional engineer. The proposal to which Power Providers refer (at 4) and Dayton summarizes (at 6) is unreasonably broad and has no

adequate procedural safeguards. The proposal to which they refer, and which PJM stakeholders considered and rejected, provides:

> The second proposal [sic] allow for an Engineering Analysis to serve as grounds for requesting use of an opportunity cost to document a physical equipment limitation. The proposal requires documenting such a request with declaration by a Qualified Individual, like a metallurgical specialist, plant manager or engineer and an affidavit signed by an Officer of the company for all entities requesting non-regulatory opportunity costs. This document provides the description, background, references and engineering analyses required to establish the basis for requesting non-regulatory opportunity costs.[3]

The rejected proposal refers to a "Qualified Individual," which could be any company employee including those "***like*** a metallurgical specialist, plant manager ***or*** engineer" (emphasis added). Moreover this individual's declaration does not include confirmation that the he or she understands the actual engineering issues or understands the potential ramifications to the market that his or her declaration will be used to support. Only the corporate officer signs an affidavit and the proposal does not specify the contents of the affidavit. This provision does not require any "engineering analysis" at all.

Even if it were somehow demonstrated that PJM's proposal is unlawful for want of a provision for a self-prepared "engineering" analysis, the rejected provision that Power Providers and Dayton promote is entirely inadequate. At least certified engineers, duly informed of the potential market consequences, know that their professional credibility is on the line and have the professional qualifications to make the type of determination

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[3] Cost Development Task Force Report to the PJM Members Committee (November 18, 2010), which can be accessed at: <*http://www.pjm.com/~/media/committees-groups/committees/mc/20101118/20101118-item-10-non-regulatory-opportunity-cost-propsal.ashx*>.

involved. For the proposed "engineering analysis" to match its billing, an actual engineer must put his or her name squarely behind the conclusion, with full knowledge of its import, by signing a sworn Affidavit.

C. The Procedural Safeguards for Cost Development Are Not Sufficient to Accommodate the Kind of Analysis Power Providers and Dayton Advocate.

Power Providers complain (at 5), "In no other regulatory proceeding has this Commission, nor PJM, ever implied or held that a company's internal or external engineering analysis could not be trusted." PJM's proposal does not prevent Power Providers from submitting self-prepared evidence in any regulatory proceeding. PJM's rules concern ex ante determinations about what conduct could result in a regulatory action.

Generators claim that they have made a "significant concession" because "[t]he MMU and PJM would have the ability to ask questions or solicit additional external technical expertise to evaluate the legitimacy and verifiable aspects of the generators filing as part of their oversight." This concession has no substance when analysis that Power Providers and Dayton propose to include could be the self-interested, unattested, non technical opinion of a plant employee that walked into the facility for the first time a week before and who has no idea what the analysis will be used for. The role of the Market Monitor on which the Power Providers and Dayton so heavily rely does not appear to be consistent with the Market Monitor's current role in the cost development process.[4] It is more essential that ever the rules about what can be considered are reasonably stringent and specific. In addition the process must explicitly afford time for the review of this kind

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[4] *See PJM Interconnection, L.L.C.*, 129 FERC ¶61,250 (2009).

of evidence by the MMU and its experts. If PJM should, in the future, decide to propose a rule that allows consideration of a real engineering analysis in the process that proposal should, at a minimum include the following requirements:

- A certified professional engineer must prepare the analysis and sign an affavit verifying that the analysis is correct based on their engineering expertise, personal information and belief, and that the accuracy of this analysis may have a significant impact on market prices.
- A company officer must sign an affidavit stating that they understand the potential impact on markets and that the analysis is true and correct.
- Full documentation of the issue must be submitted to PJM and the MMU far enough in advance of applying any related adders to permit complete analysis and response to questions.
- The proposed cost adder must be submitted in advance, providing adequate time for a complete review by the MMU, considered and approved, including Commission action, if necessary, in advance of submitting an offer based on the adder.
- The MMU should be required to provide a public report on all such adders in a way that protects confidential information.

Unless and until such a proposal is on the table, the Commission should reject Power Providers and Dayton protest in this proceeding.

II. MOTION FOR LEAVE TO ANSWER

The Commission's Rules of Practice and Procedure, 18 CFR § 385.213(a)(2), do not permit answer 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.[5] In this answer, the Market Monitor provides the

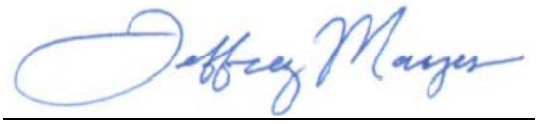
[5] *See*, *e.g.*, *PJM Interconnection, L.L.C.*, 119 FERC ¶61,318 at P 36 (2007) (accepted answer to answer that "provided information that assisted … decision-making process"); *California Independent System Operator Corporation*, 110 FERC ¶61,007 (2005) (answer to answer permitted to assist Commission in decision-making process); *New Power Company v. PJM Interconnection, L.L.C.*, 98

Commission with information that may clarify an issue in a manner useful to the Commission's decision-making process. Therefore, this answer should be permitted.

III. CONCLUSION

The Market Monitor respectfully requests that the Commission consider this answer as it resolves the issues raised in this proceeding.

Respectfully submitted,



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FERC ¶61,208 (2002) (answer accepted to provide new factual and legal material to assist the Commission in decision-making process).

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 4th day of February, 2011.

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