UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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PJM Interconnection, L.L.C.	)	Docket No. ER16-76
	)	

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

Pursuant to Rule 213 of the Commission's Rules and Regulations,[1] Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[2] ("Market Monitor"), submits this answer to answers filed in this proceeding on November 19, 2015, by PJM Interconnection, L.L.C. ("PJM"); Dominion Resources, Inc. and American Electric Power Service Corporation ("Dominion/AEP"); Old Dominion Electric Cooperative ("ODEC") and the PJM Power Providers Group ("Power Providers").

The general theme of these parties' comments is that the long-standing system offer cap of $1,000 per MWh can be increased to $2,000 per MWh for cost-based offers without the need for any related steps to protect the markets from the increased risks of market power or to coordinate the changes with the market rules on scarcity pricing. The proposed changes are significant. It is important to get the details right with respect to how the changes will be implemented. The inclusion of the modest steps recommended by the Market Monitor in its comments filed November 18, 2015, all of which are consistent with

1 18 CFR § 385.213 (2015).

2 Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT") or the PJM Operating Agreement ("OA").

the agreement reached among stakeholders supporting the filing, should be among the minimum conditions for approval.

I. COMMENTS

A. An Approved Fuel Cost Policy Should be Explicitly Included in PJM's Tariff as a Requirement to Submit Cost Based Offers Above $1,000 per MWh.

PJM argues (at 5): "… because a Market Seller is required to have a fuel cost policy that conforms to the Tariff, Operating Agreement, and PJM Manual 15 regardless of whether the Market Seller intends to submit cost-based offers above $1,000/MWh… no additional language on fuel cost policies in the proposed revised section 1.10.1A(d) is needed."

The existing language in the tariff and manuals that concern fuel cost policies is not sufficient. Allowing cost-based offer above $1,000 is a significant change to rules that the protect PJM markets from the potential exercise of market power. Stronger rules for fuel cost policies are needed.

The Market Monitor was part of and supported the stakeholder compromise because it limits offers above $1,000 per MWh to cost based offers based on the verifiable market value of gas. The market value of gas will be verifiable based on fuel cost policies approved by the Market Monitor.[3] The fuel cost policies must be algorithmic, verifiable and systematic. The Market Monitor will verify the fuel costs after the fact based on the approved fuel cost policy.

It was explicitly understood that a condition of offers above $1,000 per MWh was an approved fuel cost policy and an approved fuel cost policy consistent with Fuel Cost Policy

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3 *See* PJM Manual 15 (Cost Development Guidelines) § 2.3 at 9–11. The Market Monitor has posted guidelines to participants' development of fuel policies, which can be accessed at: <*http://www.monitoringanalytics.com/reports/Market_Messages/Messages/IMM_Fuel_Cost_Policy_Guidelines_20150924.pdf*>.

Guidelines posted by the Market Monitor and discussed by the Market Monitor at stakeholder meetings.

The Market Monitor repeatedly made clear in the stakeholder process that existing fuel cost policies are not adequate and that, in order to be adequate for purposes of supporting offers in excess of $1,000 per MWh and in order to be adequate in the new gas market environment and in order to prevent the exercise of market power, fuel cost policies must be consistent with the Fuel Cost Policy Guidelines. A copy of these Guidelines, posted by the Market Monitor, is provided as an attachment.

Dominion/AEP argue (at 3): "The IMM can also consult directly with the market participant when a cost-based offer appears inconsistent with a fuel cost policy, and can request some form of documentation to verify the cost of fuel used for the offer. Therefore, simply requiring that a fuel cost policy be submitted should continue to be sufficient for the proper monitoring of offers above $1000/MWh.

Dominion/AEP apparently misunderstand what is meant by an approved fuel cost policy. An approved fuel cost policy is one that is submitted and approved ex ante and is verifiable ex post. If the policy is not verifiable, i.e. "submitted" but not "approved," the policy cannot be used for the purpose that Dominion/AEP reference.

The Market Monitor does not propose that it should approve fuel cost policies based on their substance, i.e., the details of the method used to purchase fuel. The point is to have the market participant define in detail how they determine the cost of fuel prior to submitting day ahead offers so that it can be verified after the fact if a question arises. Market Monitor will take any concerns on the substance of a fuel policy to the Commission.

B. The Specific Review Process Should Be Defined in the Tariff.

PJM argues (at 5–6) that "the respective roles of the IMM and PJM already are sufficiently described elsewhere in the Tariff, and no further description or clarification of those roles is needed in the proposed new subsection 3.2.3(r)." ODEC (at 4) also questions the need to specify the review process that should apply.

Section 12A of the OATT conceptually defines the respective nature of the roles of the IMM and PJM. The process itself should be specified in the tariff consistent with other tariff provisions for specific rule processes. PJM does not explain why this review should be any different.

The review process in this case should require approval from either the Market Monitor or the Commission, if the Market Participant objects to the Market Monitor's position and takes the issue to the Commission. The Market Monitor does not have authority to approve or reject a fuel cost policy over the objections of a market participant. In the case of a disagreement, only the Commission has that authority. Consistent with its role to review compliance with the tariff, PJM should not accept an offer if the fuel cost policy has not been approved.

ODEC's description of the review process (at 4) demonstrates confusion about how the process would operate.

Allowing cost-based offers above $1,000 is a significant change. A requirement that an approved fuel policy be in place ex ante is needed to deter the exercise of market power. The Market Monitor believes that market power was exercised in the recent winter events that are driving the proposal to raise the system offer cap. The issue of raising the cap and alternative protection for the market against the potential exercise of marker power are linked and any changes to the market power rules in response to the winter events must account for this linkage.

Approval of the October 24th Filing should be conditioned on the following modification to the proposed revised Section 1.10.1(d) of Schedule 1 to the OA:

> viii) Shall not exceed an energy offer price of $1,000/megawatt-hour for all generation resources, **except when a Market Seller has an approved fuel cost policy and** except (1) when a Market Seller's cost-based offer is above $1,000/megawatt-hour and less than or equal to $2,000/megawatt-hour, then its market-based offer must be less than or equal to the cost-based offer; and (2) when a Market Seller's cost-based offer is greater than $2,000/megawatt-hour, then its market-based offer must be less than or equal to $2,000/megawatt-hour; and

C. PJM Has Not Supported Raising the Scarcity Price Cap $1,000; The Level of the Scarcity Price Cap Is Not Within the Scope of This Proceeding.

PJM states (at 6): "While it is true that stakeholders did not agree to change the shortage pricing rules, the effect of PJM's proposed Operating Agreement revisions will be to increase the maximum shortage price from $2,700/MWh to $3,700/MWh under the existing shortage pricing rules."

The objective of PJM's offer cap proposal is to accommodate very high gas costs in cost-based offers. The objective of scarcity pricing is to price energy when energy is scarce. The current cap on scarcity pricing is $2,700 per MWh. PJM has not supported a scarcity price of $3,700 per MWh. That a formulaic relationship exists does not in itself support as just and reasonable this significant increase in the scarcity pricing cap. Changing the scarcity price cap is not the purpose of the proceeding. Changing the scarcity price cap is not within the scope of this proceeding. No support exists in the record to raise the scarcity price cap. Acceptance of PJM's proposal should be conditioned on changes to the filed revisions that avoid an unsupported and unjustified increase in the scarcity price cap. There was no agreement in the stakeholder process in this matter to increase the scarcity price cap to $3,700 per MWh. If PJM wants to change the scarcity pricing rules, it should raise the issue in the stakeholder process. The Market Monitor would welcome a stakeholder process problem statement directed to reform of the scarcity pricing rules.

D. PJM Should Clarify What Constitutes an Incremental Operating Cost Above $2,000 per MWh used for the Operating Reserve Credit Calculation.

The new Section 3.2.3(r) of Schedule 1 to the OA introduces a trigger for compensating units that have incremental operating costs above $2,000 per MWh. PJM should clarify what constitutes an incremental operating cost greater than $2,000 per MWh. For example, will this determination be based on the incremental offer curve, the incremental offer curve plus no load offer or the incremental offer curve plus no load offer plus startup offer?

It is the Market Monitor's position that incremental operating costs include the marginal costs included in the incremental offer curve plus the marginal costs included in the no load costs plus the marginal costs included in the start costs.

In addition, PJM should be directed to clarify and include in Section 3.2.3(r) an explicit condition that the rule governing when units are paid more than $2,000 per MWh only applies to generation resources that are following PJM's dispatch directions. Section 3.2.3(r) should also explain under what explicit conditions generation resources that claim incremental operating cost above $2,000 per MWh will not be paid operating reserve credits. Units should not be paid more than $2,000 per MWh if they do not have an approved fuel cost policy, if they have not supported their costs consistent with the fuel cost policy and if they were not following PJM's dispatch instructions.

E. Now Is the Time to Address Market Power Concerns

Power Providers argue at (3–4) that: "Concerns raised by the IMM [and others] can all be dismissed as issues that can be addressed after this winter and with the benefit of guidance from the Commission in its ongoing price formation proceeding."

Nothing persists like temporary changes. Addressing market power issues cannot and should not be postponed. The flaws identified by the Market Monitor mean that the proposal as filed fails the just and reasonable requirement of the Federal Power Act. The issues raised are not especially complicated and do not require additional deliberation. There is no reason not to consider and take action on the market power concerns that the Market Monitor raises.

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.[4] 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.

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: December 3, 2015

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4 *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 FERC ¶ 61,208 (2002) (answer accepted to provide new factual and legal material to assist the Commission in decision-making process); *N.Y. Independent System 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).

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 3rd day of December, 2015.

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Attachment

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Monitoring Analytics

DATE: **September 24, 2015**

TO: **PJM Members**

FROM: **Joseph Bowring**

SUBJECT: **Fuel Cost Policy Guidelines: Gas Replacement Cost**

Generation owners that choose to offer their gas fired units based on replacement cost should follow these guidelines:

- Replacement cost should be derived from a verifiable, algorithmic, systematic approach. The MMU must be able to replicate the calculations after the fact, by following the procedure outlined in the fuel cost policy. The fuel cost policy may include multiple approaches to the calculation of replacement cost that vary with verifiable, identifiable system and market conditions.
- Replacement cost should be for an identified gas region for which there is a reported regional index of delivered prices.
  - Units in a location without a reported regional index of delivered prices should select the closest reported regional index and include any applicable transportation costs to the unit location. For example, units located behind a gas LDC should include the reported index most representative of the LDC city-gate and defined additional tariff transportation costs.
- Generation owners should use the available reported data consistent with the data used to construct the regional indices as their base replacement cost. For example a price that is within the current day's applicable index trading range on ICE prior to the day-ahead energy offer submission.
  - The regional index values (e.g. Platts and ICE) are not posted until late in the day.
  - The base replacement cost may be adjusted using an algorithmic, verifiable and reproducible method.
- For days when price discovery is limited, e.g. if there are no bid/offers on ICE for a generator's location, the base replacement cost must be based on the closest publicly available reportable regional index plus any applicable transportation charges.
- Alternative regional indices may be utilized if a generation owner can demonstrate the applicability of such index. For example a generation owner may use a Gulf Coast index if they own firm transportation from that region to their unit's location. If a generation owner uses a method relying on firm transportation, the MMU will request a copy of the contract.
- If the base replacement data are not publicly available, the value used must be verifiable and supportable. Examples of methods are: a screen shot from ICE or NYMEX demonstrating that no data are available; documented offers from three independent third parties, e.g. IM; email; recorded conversation; or an electronic NAESB confirmation of a purchase made prior to energy offer.

- All documentation supporting fuel cost components used must be saved. The MMU will request such documentation periodically or when the MMU has questions about specific offers.
- The fuel cost policy must include a calculation of the development of the replacement fuel cost used in an actual eMKT offer for a specific unit and date in order to illustrate the method. The date should be one where gas price volatility created uncertainty around the purchase cost. The calculation should include the index starting price and any additional transportation or other charges with all components shown separately. This example should illustrate the methodology used to adjust the base replacement cost and be verifiable.