

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

PJM Interconnection, L.L.C.)	Docket No. ER16-76-000
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)	

**COMMENTS OF THE
INDEPENDENT MARKET MONITOR FOR PJM**

Pursuant to Rule 211 of the Commission’s Rules and Regulations,¹ Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM² (“Market Monitor”), submits these comments responding to the filing submitted by PJM Interconnection, L.L.C. (“PJM”) on October 14, 2015 (“October 14th Filing”). The October 14th Filing includes proposed revisions to the rules for the system offer cap in order to allow for the recovery of fuel costs at times when fuel is unusually expensive. The Market Monitor supports the October 14th Filing as a reasonable way to include unusually high fuel costs in the markets insofar as it reflects the stakeholder agreement on these issues, but takes exception to certain features of PJM’s filing. In its transmittal letter, PJM indicates that it will increase the scarcity pricing level from \$2,700 per MWh to \$3,700 per MWh despite the fact that this is contrary to the stakeholder agreement, the basis for this Section 205 filing. PJM failed to include the condition for offers in excess of \$1,000 per MWh that a generation owner have an approved fuel cost policy, despite the fact that this condition was part of the stakeholder agreement. PJM did not adequately clarify PJM’s and the Market Monitor’s role

¹ 18 CFR § 385.211 (2015).

² Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff (“OATT”), the PJM Operating Agreement (“OA”) or the PJM Reliability Assurance Agreement (“RAA”).

in the review of costs when an offer exceeds \$2,000 per MWh. With the identified flaws corrected, and only with the identified flaws corrected, the October 14th Filing should be approved.

I. BACKGROUND

A. History

The \$1,000 per MWh offer cap was part of the original design of the PJM markets.³ Although there is no written historical record of the basis for the \$1,000 cap, it appears that the cap was designed to be a multiple of the highest likely cost based offer at the time it was introduced. Together with the requirement that generators could submit only a single energy offer for each day, the aggregate offer cap was put in place as a way to put a very high cap on the ability to exercise aggregate market power in PJM markets. Any modification to the aggregate offer cap should explicitly address how aggregate market power will be addressed. The October 14th Filing addresses the aggregate market power issue by requiring that any offer in excess of \$1,000 per MWh be cost based.

B. Stakeholder Agreement

The underlying issue is how to permit increases in the market cost of gas to be reflected in generator offers and in LMP without permitting the exercise of market power. If the market cost of gas exceeds a value which would result in an energy offer of more than \$1,000 per MWh, the offer would be capped at \$1,000 per MWh under the current rules.

The Market Monitor supports a temporary solution to managing offer caps and price formation issues prior to the upcoming winter. A temporary solution was agreed to by PJM stakeholders, and its terms were stated in a presentation to the October 1, 2015, meeting of the PJM Markets & Reliability Committee entitled “Energy Market Offer Cap Potential

³ See PJM Filing, Docket Nos. OA97-261-000 & ER97-1082-000 (April 1, 1997); *Pennsylvania-New Jersey-Maryland Interconnection, et al.*, 81 FERC ¶ 61,257 (1997).

Consensus Framework” (“Consensus Framework”).⁴ The Consensus Framework is the basis for the October 14th Filing.

The Market Monitor was one of four stakeholders supporting the Consensus Framework in the stakeholder process, along with ODEC, Direct Energy and Calpine, which led to the stakeholder vote in support of the solution.

The Consensus Framework permits cost based energy offers to reflect the market value of gas without limit. The cost based offers can be reflected in LMP if they are less than or equal to \$2,000 per MWh.

The Market Monitor supports the 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.⁵ 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.

Limiting such offers to cost based offers will help prevent the exercise of aggregate market power. Local market power is created when local markets created by transmission constraints are concentrated and fail the three pivotal supplier (TPS) test. Aggregate market power is created when supply and demand conditions in the entire PJM market make three or fewer generation owners jointly or singly pivotal. In such cases, these generators have the ability to increase the price of energy in PJM even in the absence of a constraint. Limiting offers above \$1,000 per MWh to cost based offers is equivalent to requiring competitive offers above \$1,000. This is a positive way to address the potential to exercise

⁴ The Consensus Framework can be accessed at: <http://www.pjm.com/~media/committees-groups/committees/mrc/20151001/20151001-item-03d-potential-consensus-framework.ashx>.

⁵ 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.

market power when market gas costs are high and energy offers are high. This approach will limit the exercise of aggregate market power while permitting energy offers to rise as high as necessary to reflect the market cost of gas.

II. COMMENTS

A. PJM Should Be Directed Not to Increase the Maximum Scarcity Price from \$2,700 per MWh to \$3,700 per MWh, Consistent with the Explicit Understanding of Stakeholders.

The Market Monitor agrees that it is essential to the functioning of the PJM energy market that the costs of fuel be reflected in energy offers by generating units and that those offers can set LMP.

PJM incorrectly asserts that the stakeholder agreement results in specific changes to the level of scarcity pricing in PJM. The agreement explicitly did not include any impact on scarcity pricing. The issue was discussed at length in the stakeholder process and no agreement was reached and no modification to scarcity pricing is appropriate. The agreement as voted on by market participants did not include an increase in the scarcity price to \$3,700 per MWh from \$2,700 per MWh. PJM's proposal to increase the scarcity price to \$3,700 per MWh should be rejected for that reason.

Consideration of changes to scarcity pricing associated with raising the aggregate offer cap level should be deferred to a comprehensive review of PJM's scarcity pricing rules or to the Commission's consideration of broader rules addressing price formation.

PJM suggests several reasons why PJM believes that it is acceptable to change the stakeholder agreement in this fundamental way. PJM states that "it follows" from the increase in the offer cap that shortage prices must increase. PJM asserts that "this approach is consistent with what was proposed by PJM, and accepted by the Commission, in the December 2014 Filing." PJM asserts that not making this modification "would undermine the purpose of raising the energy market offer cap."

In its wording, PJM appears to acknowledge that the proposed change was not part of the agreement and only asserts (at 15) that "it follows" from the agreement and that it "is

consistent” with the agreement and that to not do so would “undermine” the purpose of the agreement.

None of PJM’s reasons is an acceptable basis for changing the stakeholder agreement. It does not logically follow that scarcity prices must increase and it was never stated that scarcity prices must increase as a result of the terms of the agreement during the lengthy discussions on the agreement. It is irrelevant whether an increase in scarcity pricing was consistent with PJM’s filing last year. PJM’s filing last year was different in several respects from this year’s filing, including the limitation of the ten percent adder in last year’s filing and it does not appear that last year’s filing included language about scarcity pricing like that included in this year’s filing. It is not correct that retaining the \$2,700 per MWh scarcity pricing limit would undermine the purpose of increasing the energy market offer cap. The purpose of increasing the energy market offer cap is to permit high market gas costs to be included in energy offers and in LMP. That will be the result without any increase in the scarcity price.

PJM “notes that it is not proposing any changes to its shortage pricing provisions.” But then PJM proceeds to do just that. PJM simply asserts that “Under PJM’s current proposal, because offer prices will be permitted to exceed \$1,000/MWh, it follows that shortage prices could exceed \$2,700/MWh.”

PJM is acting beyond the scope of its authority specified in the tariff. This filing is submitted under Section 205 of the Federal Power Act based on tariff provisions that require such proposals to have sufficient stakeholder support.⁶ PJM stakeholders explicitly determined not to address this issue in this proceeding and the filed language makes no reference to scarcity pricing. PJM is stating that it intends to interpret the proposed tariff provisions in a manner contrary to what the stakeholders approved. PJM should be instructed that scarcity prices should not exceed the current limit of \$2,700 per MWh as a

⁶ See OA §§ 8.8, 10.4(xiii), 18.6.

result. If PJM wants to revise this rule, it should take the issue back to the stakeholders or file under Section 206 of the Federal Power Act.

The Commission should reject the portions of PJM's filings related to scarcity pricing and direct PJM to maintain the current limits on scarcity pricing levels.

B. An Approved Fuel Policy Should Be Required for Eligibility to Submit Cost Based Offers Above \$1,000.

A fundamental feature of the agreement among stakeholders that is the basis for the October 24th Filing under Section 205 of the Federal Power Act is the requirement that a participant have an approved fuel cost policy before it can submit a cost based offer higher than \$1,000.⁷ This requirement was discussed repeatedly in the stakeholder meetings leading to the agreement and it is the Market Monitor's view that all participants understood that this requirement was part of the agreement and would be part of the rules.

The October 24th Filing should not be approved without the inclusion of the requirement that a participant have an approved fuel cost policy as a condition for making cost based offers above \$1,000 per MWh. PJM's cover letter describes fuel cost policies and states that market sellers can submit offers above \$1,000 per MWh when calculated in accordance with Cost Development Guidelines (Manual 15) and applicable fuel cost policy. While PJM's approach (at 6) is a step in the right direction, the proposed approach is not clear enough and it is not reflected in the implementing tariff language. The requirement should be to have an approved fuel cost policy rather than an applicable fuel cost policy and the requirement should be included in the tariff language.

The Market Monitor does not determine participants' fuel cost policies. How participants procure fuel is entirely within the discretion of market participants. The Market Monitor reviews fuel cost policies solely to determine whether they describe ex ante the participants' approach to fuel procurement in adequate detail such that they can be verified

⁷ See PJM Manual 15 (Cost Development Guidelines) §§ 2.3 at 9–11.

ex post by the Market Monitor and the Commission, if necessary, to evaluate whether market conduct constitutes an attempt to exercise market power or engage in prohibited manipulation.

Participants should not be eligible to submit offers at levels above \$1,000 without an approved fuel cost policy. Approved fuel cost policies are essential tools for the effective monitoring of participant behavior, particularly when fuel costs are at unusual and highly elevated levels.

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. The Proposed Process for Review of the Costs and Documentation for Receiving Operating Reserve Credits Should Be Clarified to Specify PJM's Role and the Market Monitor's Role Consistent with the Tariff.

The proposed tariff revisions included in the October 14th Filing include specification of a process for the review of costs and associated documentation intended to mitigate the exercise of market power. This review process is within the scope of Section 12A of the OATT, which specifies PJM's role in such review processes and distinguishes that role from the different role performed by the Market Monitor.⁸

⁸ See OATT § 12A ("The Office of the Interconnection does not make determinations about market power, including, but not limited to, whether the level or value of inputs or a decision not to offer a committed resource involves the potential exercise of market power. Acceptance or rejection of an offer or bid by the Office of the Interconnection does not include an evaluation of whether such offer or bid represents a potential exercise of market power.").

The Market Monitor's role is specified in Attachment M and Attachment M-Appendix to the PJM OATT.⁹ The Market Monitor's role is to review the levels of offers and the documentation supporting such offers to determine whether they raise market power concerns.

PJM's role is to ensure compliance with the tariff. If PJM finds that the tariff has not been complied with, it may reject an offer or refuse to recognize an obligation to make payment under the tariff. PJM's role does not involve determining whether there are market power concerns, which generally means determining whether an offer is too high or low based on the definition of a competitive offer and the documentation of the costs incurred by a seller.

PJM's and the Market Monitor's reviews apply different criteria. PJM does not review the Market Monitor's determinations about whether the level of an offer raises market power concerns. The process ensures that the Market Monitor can make such determinations. Market participants have the responsibility to submit offers that do not involve the exercise of market power and/or attempted manipulation.¹⁰ If an offer raises

⁹ See OATT Attachment M § E-1 ("Determinations about market power are the responsibility of the Market Monitoring Unit under Attachment M and Attachment M-Appendix. The Market Monitoring Unit shall review all proposed sell offers for a determination of whether they raise market power concerns. The Market Monitoring Unit shall determine whether the level of offer or cost inputs raises market power concerns. The Attachment M-Appendix sets forth the Market Monitoring Unit's role in evaluating these offer or cost inputs. The Market Monitoring Unit and market participants shall, in accordance with the applicable procedures and as set forth elsewhere in the Tariff, attempt to come to agreement about the level or value of offers or cost inputs. The Market Monitoring Unit shall make a determination about whether offer or cost inputs or a decision not to offer a committed resource is physical or economic withholding or otherwise involves a potential exercise of market power. In the event that a market participant determines to use an offer or cost input at a level or value that the Market Monitoring Unit has found to involve a potential exercise of market power, the Market Monitoring Unit may file a petition or initiate other regulatory proceedings addressing the issue.").

¹⁰ See OA Schedule 1 § 6.4(d) ("Market Participants shall have exclusive responsibility for preparing and submitting their offers on the basis of accurate information and in compliance with the FERC Market Rules, inclusive of the level of any applicable offer cap, and in no event shall PJM be held

market power concerns even after discussions with the Market Monitor, PJM may approve the offer as consistent with the tariff and the Market Monitor will take the issue to the Commission. A participant can also raise the issue with the Commission before it submits an offer at a level that is disputed by the Market Monitor.

The new language (OA Schedule 1 § 3.2.3(r)) included in the October 14th Filing provides:

Market Sellers that incur incremental operating costs for a generation resource greater than \$2,000/megawatt-hour, determined in accordance with Schedule 2 of the Operating Agreement and PJM Manual 15, will be eligible to receive credit for Operating Reserves upon review of the Market Monitoring Unit and the Office of the Interconnection, and approval of the Office of the Interconnection. Market Sellers must submit to the Office of the Interconnection and the Market Monitoring Unit all relevant documentation demonstrating the calculation of costs greater than \$2,000/megawatt-hour. The Office of the Interconnection must approve any Operating Reserve credits paid to a Market Seller under this subsection (r).

The filed language appropriately does not state that PJM will review the Market Monitor's determinations about market power, specifically whether the level of costs included is reasonable and documented and consistent with a competitive offer. Section 12A of the OATT states that PJM does not engage in any such review. However, if the filed language is read in isolation, it could appear that the payment of operating reserve credits depends upon PJM's review of the level of the costs and documentation and thus market power issues rather than whether the offer meets the criteria specified in the tariff for an eligible offer.

liable for the consequences of or make any retroactive adjustment to any clearing price on the basis of any offer submitted on the basis of inaccurate or non-compliant information.”).

In order to eliminate potential confusion, the Market Monitor recommends that the language be revised to clarify the different purpose of PJM's and the Market Monitor's review of relevant offers.

The Market Monitor proposes the following revisions:

(r) Market Sellers that incur incremental operating costs for a generation resource greater than \$2,000/megawatt-hour, determined in accordance with Schedule 2 of the Operating Agreement and PJM Manual 15, will be eligible to receive credit for Operating Reserves upon review of the Market Monitoring Unit for market power concerns and the Office of the Interconnection for tariff compliance, and approval of the Office of the Interconnection for tariff compliance. Market Sellers must submit to the Office of the Interconnection and the Market Monitoring Unit all relevant documentation demonstrating the calculation of costs greater than \$2,000/megawatt-hour. The Office of the Interconnection must approve any Operating Reserve credits paid to a Market Seller under this subsection (r).

Approval of the October 14th Filing should be conditioned on including these revisions so that the review process is clearly consistent with the general provisions in the tariff explaining the nature and purpose of such reviews.

D. Reporting Requirement

PJM proposes (at 7-8), "to report to the Commission any offers in excess of the \$1,000/MWh cap" and "to provide annual, post-winter reports until such time that an upcoming Commission rule modifies or supersedes the revisions." The Market Monitor recommends that any order on the October 14th Filing also direct the Market Monitor to file annual reports reviewing the experience with the revised offer caps and related changes.

III. CONCLUSION

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

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Respectfully submitted,



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Dated: November 4, 2015

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 November, 2015.



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