UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Fern Solar LLC	)	Docket Nos. ER20-2186-003 and EL20-62-001

REPLY BRIEF ON EXCEPTIONS OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 711 of the Commission's Rules and Regulations,[1] Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor ("Market Monitor") for PJM Interconnection, L.L.C. ("PJM"),[2] submits this Reply Brief on Exceptions to the Briefs on Exceptions to the Initial Decision issued April 13, 2023, filed on May 15, 2023, by Fern Solar, LLC ("Fern") and by Commission Trial Staff ("Staff").[3]

Fern argues that the Initial Decision "erred if and to the extent that it recommended that any decision in this case rely on the arguments advanced by IMM."[4] Staff argues (at 4), "The Initial Decision erred in finding that no participant challenged Dr. Bowring's assertion that the capacity markets compensate for a generator's entire cost." Neither argument has merit. Neither Fern nor Staff provide any valid reason why the issues raised by the Market Monitor should not be resolved in this proceeding, either by order of the Commission, or after remand with appropriate guidance, by the Presiding Judge.

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1 18 CFR § 385.711 (2022).

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").

3 Joint Customers also filed a Brief on Exceptions on the same day, but they do not address the Initial Decision as it relates to any issue raised by the Market Monitor.

4 Fern at 16, citing Initial Decision at PP 936–937.

I. ARGUMENT

A. The Recommendations in the Initial Decision Are Proper and Should Be Addressed in this Proceeding.

Fern argues (at 16) that the Initial Decision "erred if and to the extent that it recommended that any decision in this case rely on the arguments advanced by [the] IMM."

Fern objects to the finding in the Initial Decision (at P 937), that the "IMM's points deserve serious consideration, by the full Commission, now." The Market Monitor raises fundamental issues on how Schedule 2 to the PJM OATT ("Schedule 2") should be interpreted and applied. Prior Schedule 2 cases have been resolved through settlements that did not permit consideration of such issues. The few cases decided on the merits did not involve fundamental challenges to the *AEP* Method or the failure to identify incremental costs attributable to reactive capability. Those cases provide no justification for charging PJM customers for the costs of reactive capability incurred by generators in order to obtain interconnection service from PJM. Those cases did not address how the energy and ancillary services (EAS) offset limits the level of revenue requirements that can be approved as just and reasonable under Schedule 2.

Fern mischaracterizes the Market Monitor's position on Schedule 2 revenue requirements as a "challenge to the basic operations of the PJM markets." Fern has it backwards. The Market Monitor seeks a decision in this case fully consistent with the basic operations of the PJM markets. It is, of course, Fern that takes a position fundamentally inconsistent with the basic operation of PJM markets. Fern seeks to continue a process that provides market resources with substantial and unsupported guaranteed cost of service side payments that are fundamentally inconsistent with markets. The EAS offset operates to account for revenue received under Schedule 2 in the operation of the PJM markets in recognition of the fact that 100 percent of avoidable costs, with no exclusion for any asserted reactive costs, are includable in offers in the capacity market. The excessive revenue requirement proposed by Fern, if approved, would result in Fern recovering costs in its Schedule 2 revenue requirement that are already recoverable through markets. That result would be unjust and unreasonable.

Fern argues (at 98) that the "PJM capacity markets do not compensate generators for providing reactive power," and claims "Staff witness Patterson agrees." Fern misrepresents the purpose of Schedule 2. Schedule 2 is not designed to "compensate generators for providing reactive power." PJM pays generators providing reactive services at its direction under Section 3.2.3 of Schedule 1 to the PJM Operating Agreement. Schedule 2 explicitly acknowledges the role of Section 3.2.3 in compensating reactive services.[5]

Schedule 2 permits resources to file a revenue requirement with the Commission for reactive capability compensation. Schedule 2 does not provide any role for review by PJM or the Market Monitor prior to filing. Schedule 2 does not provide any specification or indication of the criteria that the Commission would apply to evaluate a revenue requirement. The Commission must determine what costs can be recovered in filing for a revenue requirement under Schedule 2. Such determination must be consistent with the fact that Schedule 2 exists in the broader PJM market design and therefore must be consistent with the operation of the PJM markets, including the PJM Capacity Market and the EAS offset in the capacity market. Such determination must be consistent with Commission policy.

Fern argues that the Market Monitor's "issues were clearly not set for hearing." In the Hearing Orders, the Commission states (at P 14), "we are setting the Rate Schedule for hearing in its entirety." The directive is broadly phrased. The Market Monitor raises issues within the scope of the "entirety" of the rate schedule.

In his Order Denying Motion for Partial Summary Disposition, the Presiding Judge rejected Fern's unduly narrow interpretation of the scope of proceeding, explaining:

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[5] OATT Schedule 2 ("In addition to the charges and payments set forth in this Tariff, Schedule 2, Market Sellers providing reactive services at the direction of the Office of the Interconnection shall be credited for such services, and Market Participants shall be charged for such services, as set forth in Tariff, Attachment K-Appendix, section 3.2.3B.").

> Whether the simultaneity of cost-based compensation and market-based compensation causes duplicative recovery, and whether any duplicative recovery renders the filed rate unjust and unreasonable, are genuine issues of material fact. On those issues, the participants disagree. The Commission itself has acknowledged the issue.[footnote omitted] This proceeding must address it.[6]

The Presiding Judge also rejects Fern's claim that Schedule 2 "sets forth the compensation methodology for generators that provide Reactive Service."[7] The Presiding Judge observes: "Schedule 2 states no 'compensation methodology.' It merely mentions 'revenue requirement,' without instructing how to set that revenue requirement."[8]

Fern did not appeal the denial of its motion seeking to prevent consideration of whether its Schedule 2 rate results in over recovery. The Initial Decision did not directly address the Market Monitor's issues, but it does urge that the issues be addressed. Neither the Initial Decision, Fern nor Staff indicate an alternative forum to this FPA Section 205/206 proceeding where the question of whether Fern's Schedule 2 revenue requirement is unjust and unreasonable could be considered. The issues can and should be addressed in this proceeding.

Fern argues (at 99): "Commission precedent is clear that modifications to the AEP Methodology can be addressed only in a generic proceeding, which this is not." Fern relies on *FPL Energy Marcus Hook, L.P.*, where a request to consider the merits of applying the *AEP* Method in Schedule 2 proceedings was denied without a reasoned explanation.[9] *Marcus Hook* pointed only to the *recommendation* in a prior individual case that the *AEP*

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6 *Fern Solar LLC*, 180 FERC ¶ 63,024 at P 30 (2022).

7 *Id*. at P 18.

8 *Id*.

9 Fern at 16–20, citing 110 FERC ¶ 61,087 at P 16 (2002).

Method be used in order to promote consistency, efficiency and clarity.[10] None of the cases cited by Fern provide a reasoned explanation of how the *AEP* Method provides a logical basis for a Schedule 2 revenue requirement.[11] Experience over the past decade shows the *AEP* Method fails to provide any consistency, efficiency and clarity. Revenue requirements vary significantly and arbitrarily for the same MW of reactive capability. Wasteful administrative processes are required to produce this result. Revenue requirements created in "black boxes" are the opposite of clarity.

Fern's proposed use of the *AEP* Method should be considered in Fern's proceeding. The *AEP* Method originated in an FPA Section 205 case. Fern's argument for use of the *AEP* Method rests entirely on misplaced reliance on individual Schedule 2 cases. The *AEP* Method is not the product of a generic proceeding and evaluation of the merits of its use does not require a generic proceeding. There is no reason why the *AEP* Method cannot be evaluated in this proceeding.

Rather than attempt to support use of the *AEP* Method on the merits, Fern's strategy was to ignore the issue. Fern asserts (at 99), had it not regarded the Market Monitor's arguments as "baseless musings," it "would have presented evidence on the issues." Fern concedes it has offered nothing in record. Fern has offered nothing in response to the extensive analysis of the *AEP* Method and the role and operation of the EAS offset in PJM markets in the testimony provided by Dr. Bowring. Fern has had over a year in litigation to present a response. Fern does not describe the evidence that it "would have presented." Fern provides no response because it has no response.

There is no logical defense for use of the *AEP* Method in Schedule 2 proceedings. The *AEP* Method has no relevance in competitive markets. Use of the *AEP* Method was never really justified even in the cost of service regulatory model where it originated. Fern hopes to coast along with the many black box settlements preceding its case that avoided

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[10] 101 FERC ¶ 61,290 at P 14 (2002).

[11] Fern at 16–18.

analysis of the core flaws in its position. But this is not a settlement judge proceeding, it is a hearing, and Schedule 2 must be interpreted and applied consistent with the just and reasonable standard.

B. The Initial Decision Correctly Determined that No Party Challenged the Ability of PJM Markets to Compensate a Generator's Entire Cost.

Staff argues (at 4), "The Initial Decision erred in finding that no participant challenged Dr. Bowring's assertion that the capacity markets compensate for a generator's entire cost." Staff refers to Dr. Bowring's statement:

> Elimination of the ancillary services revenue offset of $2,199 per MW-Year would mean that the prices on the capacity market demand curve (VRR curve) for each MW level would be higher and the clearing prices for capacity that result from the interaction of the supply curve and the VRR curve, would be higher. The result would be the recovery of additional reactive capacity revenues in the price of capacity for all resources.[12]

Staff objects to the finding that "[n]o one in this proceeding has rejected, via fact or theory, Dr. Bowring's [witness for the IMM] expert assertion that the capacity markets compensate for a generator's entire cost."[13]

Staff claims (*id.*) that Staff Witness Patterson "specifically rejected Dr. Bowring's assertion, explaining that double recovery would not result from compensating for Reactive Service." Witness Patterson testified:

> Fern Solar's market-based rate tariff does not 'give Fern Solar the authority to provide Reactive Service to any party at market-based rates,'[footnote omitted] so 'no Reactive Service revenues [are] recovered through the PJM market'[footnote omitted] while a correctly calculated ARR would 'recover[]

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12 *See* Exhibit No. IMM-0001 at 5:6–11.

13 Staff at 30, citing Initial Decision at P 936.

> costs related to the provision of Reactive Service only.'[footnote omitted][14]

The Initial Decision is correct. Witness Patterson does not challenge Dr. Bowring's testimony. What Fern's market based rate tariff authorizes is not relevant. Witness Paterson ignores the fact that Fern is obligated to provide reactive capability under the terms of its ISA.[15] What Fern's market based rate tariff authorizes has no implications for whether revenues related to Reactive Service are recovered through PJM markets. Witness Patterson does not address or challenge Dr. Bowring's point that capacity markets, and all PJM markets, provide the opportunity for recovery of a "generator's entire cost." Witness Patterson does not address or challenge the fact that generators' offers in the capacity market include all going forward costs and do not subtract any costs allegedly associated with reactive capability. Witness Patterson does not address or challenge the fact that there is a reactive revenue EAS offset in the capacity market in explicit recognition of the fact that all going forward costs are included in generator offers in the capacity market.

In addition, Witness Patterson's points are incorrect. Schedule 2 concerns reactive capability, not reactive service. Resources dispatched for reactive service do receive market compensation under Section 3.2.3 of Schedule 1 to the OA.

Staff argues further that Witness Patterson "specifically rebutted Dr. Bowring's assertion that 'the capacity costs of an integrated power plant are not separable' by pointing out that '[t]he Commission has adopted the AEP Methodology for determining the cost of providing Reactive Service.'" Setting aside the fact that most Schedule 2 proceedings result in black box settlements unsupported by the *AEP* Method or any method, Witness Patterson does not rebut or attempt to rebut any part of Dr. Bowring's extensive critique of the *AEP* Method. Witness Patterson simply asserts that the Commission has "adopted" it. There is

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[14] S-0045 at 25:19–26:24.

[15] *See* Exhibit No. S-0006 PRIV; OATT Attachment O § 12 (Power Factor Requirement).

no attempt to explain where any past decision explains or justifies the use of the *AEP* Method in Schedule 2 proceedings. Neither Witness Patterson nor any other witness make any attempt to provide the missing explanation and justification in this proceeding.

This Initial Decision is correct that a decision is urgently needed on the continued use of the *AEP* Method. The Initial Decision did not make this determination, but it did make findings (at P 937) supporting the need for a determination. Whether use of the *AEP* Method should continue is now an issue properly before the Commission, and it should be decided now, in this proceeding.

Staff cites (at PP 24–26) to Order No. 893, as though that order supports its position that the issue for over recovery raised by Dr. Bowring should be ignored.[16] Order No. 893 establishes "rules for incentive-based rate treatment for certain voluntary cybersecurity investments" required under Section 219A of the Federal Power Act.[17] Order No. 893 includes language (at P26) rejecting arguments that resources charging market based rates should be allowed to also file a cost-based rate component for recovering cybersecurity costs.

Staff argues (at 30 n.107) that Order No. 893 means:

> One cannot include a cost-based component in a market-based rate, or in other words that a market-based service cannot recover costs of a cost-based service. A market-based service only recovers costs associated with the service offered at market-based rates

Staff appears to misunderstand Order No. 893. Order 893 is about maintaining a consistent market based approach or cost of service based approach and not mixing them. Staff wants to mix them.

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16 Staff at 30, citing *Incentives for Advanced Cybersecurity Investment*, Order No. 893, 183 FERC ¶ 61,033 at P 26 (2023) ("Order No. 893").

17 Order No. 893 at P 1; Infrastructure Investment and Jobs Act of 2021, Pub. L. 117-58, § 40123, 135 Stat. 429, 951 (to be codified at 16 U.S.C. 824s-1).

Order No. 893 states (at P 26):

> We disagree with EPSA's contentions that utilities that make sales of energy, capacity, or ancillary services at market-based rates should be able to continue to make those sales and also separately recover the costs of, and receive incentive-based rate treatment on, eligible cybersecurity investments. The Incentive permitted in this final rule may only be recovered through a cost-of-service rate. As noted above, the ability to seek incentive-based rate treatment under this final rule meets the requirements of FPA section 219A.[footnote omitted] All sellers of energy, capacity, and ancillary services are free to file cost-of-service rates under FPA section 205. Thus, we note that utilities currently making sales of energy, capacity, and ancillary services under market-based rate authority may make a filing to recover their entire cost of service, including costs of and an incentive on, eligible cybersecurity investments and proceed to make sales exclusively under that cost-based rate.[footnote omitted]

Order No. 893 prohibits mixing market based rates and cost of service rates in the context of incentives for cybersecurity investments. Order No. 893 finds that participants currently making sales of energy, capacity, and ancillary services under market based rate authority should not be permitted to file cost of service component to recover cybersecurity investment. Participants under market based rates cannot decide to add on a cost-based payment. Participants have to choose one or the other, exclusively.

The principle identified in Order No. 893 provides additional confirmation of the Market Monitor's position on how Schedule 2 should be interpreted and applied. Under Order No. 893, revenue requirements filed under Schedule 2 would only be approved for resources recovering all of their costs for capacity in PJM through cost of service rates, such as resources included in an FRR plan.[18] Applying the principle identified in Order

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[18] *See* Order No. 893 at P 26, citing *PJM Interconnection, L.L.C.*, 178 FERC ¶ 61,121, at P 115 (2022) (noting generators' ability to choose between selling capacity at cost-based or market-based rates). The cited order explains (at P 115): "In any case, Vistra is not bound to offer its capacity into PJM's capacity market. Rather, Vistra, like all

No. 893, Fern's revenue requirement should be rejected because it is not part of an FRR plan and Fern does not otherwise recover all of its costs through a cost of service rate. Fern Solar proposes exactly the combination of market based and cost-based rates prohibited in principle under Order No. 893. Order No. 893 provides additional grounds for either rejecting Fern's revenue requirement or, alternatively, limiting it to a level no higher than the EAS offset.

The Market Monitor's position, consistent with the applicable PJM market rules and the scope of this Schedule 2 proceeding, addresses the potential overlap of cost of service and market based rates for reactive capability by acknowledging the EAS offset. The EAS offset is an attempt to make the reactive revenue recovery consistent with the market based approach and to minimize the associated distortion. The PJM market rules, Schedule 2 and the EAS offset working together, imperfectly address the problem of combined market-based and cost-based compensation. Staff ignores the significance of the EAS offset and ignores the issue, and thus ignores the principle determined in Order No. 893.

The Market Monitor disagrees with Staff's statement that "a market-based service cannot recover costs of a cost-based service" because it is based on the false premise that reactive capability is inherently a cost-based service. It is not. There is no such thing as an inherently cost-based service. As the Commission has made clear, utility regulation can proceed under a market based regime or a cost-based regime but the two cannot be mixed at the discretion of a market participant.

> sellers located in the PJM footprint, has options to exercise its section 205 filing rights and to seek to sell its capacity outside the PJM capacity market mitigation construct at whatever price it can secure from a willing counterparty.[footnote omitted] As described below, these options include: (1) selling via bilateral agreement within PJM; (2) selling to load outside of PJM; and (3) selling to a Fixed Resource Requirement (FRR) load serving entity within PJM. If a seller elects to pursue sales under one of these three options and does so by making a cost-based rate filing under FPA section 205, as opposed to pursuant to market-based rate authority, then the Commission would review the proposed rate, but that review would not be undertaken as part of the seller's participation in the PJM capacity market."

II. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to the arguments in this reply brief on exceptions as it resolves the issues raised in this proceeding.

Respectfully submitted,

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Dated: June 5, 2023

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 5th day of June, 2023.

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