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DATE: **October 12, 2023**

TO: **Deactivation Enhancements Senior Task Force (DESTF)**

FROM: **IMM**

SUBJECT: **IMM State of the Market Report discussion of Part V (RMR) issues**

PJM must make out of market payments to units that want to retire (deactivate) but that PJM requires to remain in service, for limited operation, for a defined period because the unit is needed for reliability.[1] This provision has been known as Reliability Must Run (RMR) service but RMR is not defined in the PJM tariff. Here the term Part V reliability service is used. The need to retain uneconomic units in service reflects a flawed market design and/or planning process problems. If a unit is needed for reliability, the market should reflect a locational value consistent with that need which would result in the unit remaining in service or being replaced by a competitor unit. The planning process should evaluate the impact of the loss of units at risk and determine in advance whether transmission upgrades are required.[2] It is essential that the deactivation provisions of the tariff be evaluated and modified. It is also essential that PJM look forward and attempt to plan for foreseeable unit retirements, whether for economic or regulatory reasons.

When notified of an intended deactivation, the MMU performs a market power study to ensure that the deactivation is economic, not an exercise of market power through withholding, and consistent with competition.[3] PJM performs a system study to determine whether the system can accommodate the deactivation on the desired date, and if not, when it could.[4] If PJM determines that it needs a unit for a period beyond the intended deactivation date, PJM will request a unit to remain in service, generally only as an option in the event the unit is needed for reliability.[5] The PJM market rules do not require an owner to remain in

1 OATT Part V §114

2 See, e.g., 140 FERC ¶ 61,237 at P 36 (2012) ("The evaluation of alternatives to an SSR designation is an important step that deserves the full consideration of MISO and its stakeholders to ensure that SSR Agreements are used only as a 'limited, last-resort measure.'"); 118 FERC ¶ 61,243 at P 41 (2007) ("the market participants that pay for the agreements pay out-of-market prices for the service provided under the RMR agreements, which broadly hinders market development and performance.[footnote omitted] As a result of these factors, we have concluded that RMR agreements should be used as a last resort."); 110 FERC ¶ 61,315 at P 40 (2005) ("The Commission has stated on several occasions that it shares the concerns . . . that RMR agreements not proliferate as an alternative pricing option for generators, and that they are used strictly as a last resort so that units needed for reliability receive reasonable compensation.").

3 OATT § 113.2; OATT Attachment M § IV.1.

4 OATT § 113.2.

5 Id.

service, but owners must provide advance notice of a proposed deactivation (See Table 5-26).[6] The owner of a generation capacity resource must provide notice of a proposed deactivation in order to avoid a requirement to offer in RPM auctions.[7] In order to avoid submitting an offer for a unit in the next three-year forward RPM base residual auction, an owner must show "a documented plan in place to retire the resource," including a notice of deactivation filed with PJM, 120 days prior to such auction.[8]

Under the current rules, a unit remaining in service at PJM's request can recover its costs of continuing to operate under either the deactivation avoidable cost rate (DACR), which is a formula rate, or the cost of service recovery rate. The deactivation avoidable cost rate is designed to permit the recovery of the costs of the unit's "continued operation," termed "avoidable costs," plus an incentive adder.[9] Avoidable costs are defined to mean "incremental expenses directly required for the operation of a generating unit."[10] The incentives escalate for each year of service (first year, 10 percent; second year, 20 percent; third year, 35 percent; fourth year, 50 percent).[11] The rules provide terms for the repayment of project investment by owners of units that choose to keep units in service after the defined period ends.[12] Project investment is capped at $2 million, above which FERC approval is required.[13] The cost of service rate is designed to permit the recovery of the unit's "cost of service rate to recover the entire cost of operating the generating unit" if the generation owner files a separate rate schedule at FERC.[14]

Table 5-29 shows units that have provided Part V reliability service to PJM, including the Indian River 4 unit, which began providing RMR service on June 1, 2022.

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6 OATT § 113.1.

7 OATT Attachment DD § 6.6(g).

8 Id.

9 OATT § 114 (Deactivation Avoidable Credit = ((Deactivation Avoidable Cost Rate + Applicable Adder) * MW capability of the unit *Number of days in the month) – Actual Net Revenues).

10 OATT § 115.

11 Id.

12 OATT § 118.

13 OATT §§ 115, 117

14 OATT § 119.

Table 5-29 Part V reliability service summary

Unit Names	Owner	ICAP (MW)	Cost Recovery Method	Docket Numbers	Start of Term	End of Term
Indian River 4	NRG Power Marketing LLC	411.9	Cost of Service Recovery Rate	ER22-1539	01-Jun-22	31-Dec-26
B.L. England 2	RC Cape May Holdings, LLC	150.0	Cost of Service Recovery Rate	ER17-1083	01-May-17	30-Apr-19
Yorktown 1	Dominion Virginia Power	159.0	Deactivation Avoidable Cost Rate	ER17-750	06-Jan-17	08-Mar-19
Yorktown 2	Dominion Virginia Power	164.0	Deactivation Avoidable Cost Rate	ER17-750	06-Jan-17	08-Mar-19
B.L. England 3	RC Cape May Holdings, LLC	148.0	Cost of Service Recovery Rate	ER17-1083	01-May-17	24-Jan-18
Ashtabula	FirstEnergy Service Company	210.0	Deactivation Avoidable Cost Rate	ER12-2710	01-Sep-12	11-Apr-15
Eastlake 1	FirstEnergy Service Company	109.0	Deactivation Avoidable Cost Rate	ER12-2710	01-Sep-12	15-Sep-14
Eastlake 2	FirstEnergy Service Company	109.0	Deactivation Avoidable Cost Rate	ER12-2710	01-Sep-12	15-Sep-14
Eastlake 3	FirstEnergy Service Company	109.0	Deactivation Avoidable Cost Rate	ER12-2710	01-Sep-12	15-Sep-14
Lakeshore	FirstEnergy Service Company	190.0	Deactivation Avoidable Cost Rate	ER12-2710	01-Sep-12	15-Sep-14
Elrama 4	GenOn Power Midwest, LP	171.0	Cost of Service Recovery Rate	ER12-1901	01-Jun-12	01-Oct-12
Niles 1	GenOn Power Midwest, LP	109.0	Cost of Service Recovery Rate	ER12-1901	01-Jun-12	01-Oct-12
Cromby 2 and Diesel	Exelon Generation Company, LLC	203.7	Cost of Service Recovery Rate	ER10-1418	01-Jun-11	01-Jan-12
Eddystone 2	Exelon Generation Company, LLC	309.0	Cost of Service Recovery Rate	ER10-1418	01-Jun-11	01-Jun-12
Brunot Island CT2A, CT2B, CT3 and CC4	Orion Power MidWest, L.P.	244.0	Cost of Service Recovery Rate	ER06-993	16-May-06	05-Jul-07
Hudson 1	PSEG Energy Resources & Trade LLC and PSEG Fossil LLC	355.0	Cost of Service Recovery Rate	ER05-644, ER11-2688	25-Feb-05	08-Dec-11
Sewaren 1-4	PSEG Energy Resources & Trade LLC and PSEG Fossil LLC	453.0	Cost of Service Recovery Rate	ER05-644	25-Feb-05	01-Sep-08

Only two of eight owners have used the deactivation avoidable cost rate approach. The other six owners used the cost of service recovery rate.

In each of the cost of service recovery rate filings for Part V reliability service, the scope of recovery permitted under the cost of service approach defined in Section 119 has been a significant issue. Owners have sought to recover fixed costs, incurred prior to the noticed deactivation date, in addition to the cost of operating the generating unit. Owners have cited the cost of service reference to mean that the unit is entitled to file to recover costs that it was unable to recover in the competitive markets, in addition to recovery of costs of actually providing the Part V reliability service.

The cost of service recovery rate approach has been interpreted by the companies using that approach to allow the company to develop the type of rate case filing used by regulated utilities, using a test year with adjustments, to establish a rate base including investment in the existing plant and new investment necessary to remain in service and to earn a return on that rate base and receive depreciation of that rate base, plus guarantee recovery of estimated operation and maintenance expenses. Companies developing the cost of service recovery rate have ignored the tariff's limitation to the costs of operating the unit during the Part V reliability service period and have included costs incurred prior to the decision to deactivate and costs associated with closing the unit that would have been incurred regardless of the Part V reliability service period.[15] In some cases, the filing included costs that already had been written off, or impaired, on the company's public books.[16] [17] The requested cost of service recovery rates substantially exceed the actual costs of operating to provide the reliability required by PJM.

15 See, e.g., FERC Dockets Nos. ER10-1418-000, ER12-1901-000 and ER17-1083-000.

16 See GenOn Filing, Docket No. ER12-1901-000 (May 31, 2012) at Exh. No. GPM-1 at 9:16–21.

17 See NRG Filing, Docket No. ER22- 1539-000 (April 1, 2022).

Because such units are needed by PJM for reliability reasons, and the provision of the service is voluntary in PJM, owners of units that PJM needs to remain in service after the desired retirement date have significant market power in establishing the terms of this reliability service.

This reliability service should be provided to PJM customers at reasonable rates, which reflect the riskless nature of providing such service to owners, the reliability need for such service and the opportunity for owners to be guaranteed recovery of 100 percent of the actual costs required to operate to provide the service.

The MMU recommends elimination of the cost of service recovery rate in OATT Section 119, that this service should be provided under the deactivation avoidable cost rate in Part V, and that the investment cap under the avoidable cost rate option be eliminated.

The MMU also recommends, based in part on its experience with application of the deactivation avoidable cost rate and proceedings filed under Section119, the following improvements to the DACR provisions:

- Revise the applicable adders in Section 114 to be 15 percent for the second year of Part V reliability service and 20 percent for the provision of Part V reliability service in excess of two years.
- Add true up provisions that ensure that the service provider is reimbursed for, and consumers pay for, the actual incremental costs associated with the service, plus the applicable adder.
- Eliminate the $2 million cap on project investment expenditures.
- Clearly distinguish operating expenses and project investment costs.
- Clarify the tariff language in Section 118 regarding the refund of project investment in the event the unit continues operation beyond the defined term of service.