

individual Market Seller⁵ policies is heightened by the implementation of hourly offers in PJM's markets. PJM's August 16 Filing proposes a process that is transparent, workable, and would lead to just and reasonable results. By contrast, the IMM's suggested alternative is unworkable, lacks clear standards for compliance, and would not lead to just and reasonable results, as the IMM's latest answer demonstrates.

I. ANSWER

A. *PJM Is the Proper Entity To Approve Fuel Cost Policies and IMM Performs Complementary Advisory Functions Developing Inputs for Prospective Mitigation.*

Central to PJM's role as administrator of its energy, ancillary service and capacity markets is overseeing workably competitive markets and ensuring just and reasonable rates through efficient price formation and prospective market power mitigation. PJM has authority over final price determinations⁶ and prospective mitigation,⁷ and is responsible for ensuring that submitted cost-based offers are at levels that produce just and reasonable market outcomes.⁸ Therefore, PJM "may accept an offer, bid or decision not to offer a committed resource regardless of whether the [IMM] has made a finding that such conduct raises market power concerns."⁹

⁵ All capitalized terms that are not otherwise defined herein shall have the same meaning as they are defined in the PJM Open Access Transmission Tariff ("Tariff") or Amended and Restated Operating Agreement of PJM Interconnection, L.L.C. ("Operating Agreement").

⁶ See Tariff, section 12A.

⁷ See e.g. *PJM Interconnection, L.L.C.*, 129 FERC ¶ 61,250, at P 148 (2009) ("Order No. 719 Compliance Order"); *Wholesale Competition in Regions with Organized Electric Markets*, Order No. 719, 2008-2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,281, at P 375 (2008), as amended, 126 FERC ¶ 61,261, order on reh'g, Order No. 719-A, 2008-2013 FERC Stats. & Regs., Regs. Preambles ¶ 31,292, reh'g denied, Order No. 719-B, 129 FERC ¶ 61,252 (2009).

⁸ See Tariff, section 12A (PJM "has the final authority to determine whether an offer, bid or decision not to offer a committed resource complies with the PJM Market Rules"); Operating Agreement, Schedule 1.10.8(a) (stating that PJM accepts offers that result in the least-cost solution).

⁹ Tariff, section 12A.

Further, it is well settled that the IMM is entrusted with the complementary role of developing inputs for prospective mitigation, investigating Market Sellers' conduct *after-the-fact* for market power concerns, and referring Market Sellers to the Commission for retrospective market power concerns.¹⁰ The IMM may not prescribe market offers on a prospective basis, and is limited to providing *input to PJM* with regard to prospective market power mitigation. The Commission detailed the reasons for this approach in Order No. 719, finding that “[i]t is only prospective mitigation that affects the operation of the market, and therefore it is only prospective mitigation that creates a potential conflict of interest for a[] Market Monitoring Unit (“MMU”).”¹¹ The Commission also determined in Order No. 719 that “the MMU may provide the inputs required by the RTO or ISO to conduct prospective mitigation, including determining reference levels, identifying system constraints, cost calculations and the like.”¹² However, such inputs do not rise to the level of effectively establishing its own separate standards or processes for approving Fuel Cost Policies. Fuel Cost Policies govern how Market Sellers price their fuel, which in turn impacts the level of their submitted cost-based offer, and accordingly falls under prospective mitigation. This understanding of the approval of Fuel Cost Policies comports with the Commission’s recent holding that “the authority to approve or reject Fuel Cost Policies *lies with PJM*, and the role of the IMM is to advise the generator and PJM.”¹³

With respect to the IMM’s role in advising PJM on Fuel Cost Policies, PJM has proposed a process to allow the IMM to provide its advice in a timely and efficient

¹⁰ See e.g. Order No. 719 Compliance Order at P 161.

¹¹ Order No. 719 at P 375.

¹² *Id.*

¹³ *PJM Interconnection, L.L.C.*, 153 FERC ¶ 61,289, at P 47 (2015) (emphasis added).

manner so that PJM may administer its markets in a workably competitive manner. PJM's proposal also imposes no limitations on the IMM's processes or standards of review with respect to the IMM's role in reviewing Fuel Cost Policies for market power, requesting information from Market Sellers at any time if such information is needed to perform its review for market power, informing PJM of its concerns prior to PJM's approval of a Fuel Cost Policy, and informing the Commission of its concerns with Fuel Cost Policies PJM approves. That being said, PJM's concern is that the IMM's "market power" review and the process it has proposed to conduct that review is in fact a rather obvious attempt to perform functions that the Commission has ruled, time and again, are not within the IMM's purview.

B. *The IMM's Alternative Fuel Cost Policy Approval and Review Process Lacks Legal Foundation.*

The IMM's alternative Fuel Cost Policy approval and review process improperly reduces PJM to merely a perfunctory administrative role in the review of Fuel Cost Policies, contrary to Commission precedent.¹⁴ The IMM's proposal simply does not work as a matter of law:

- First, the IMM has not adequately addressed the fundamental issue that it is not a jurisdictional utility and that the Commission would effectively lack the ability to hear, through the complaint process, Market Seller challenges to the IMM's disapproval of a proposed Fuel Cost Policy;¹⁵
- Second, the IMM's proposal cannot be squared with the plain language of Tariff, section 12A.

On the second point, while the IMM asserts that it "does not propose to change PJM's administrative responsibility with respect to fuel cost policies" and that it "does

¹⁴ See e.g. October 7 Answer at 20.

¹⁵ See *id.* at 17-19.

not propose to approve fuel cost policies,”¹⁶ the IMM seeks to perpetuate the current process, under which PJM’s “approval” is *an automatic result* of the IMM coming to agreement with a Market Seller over a Fuel Cost Policy.¹⁷ Thus, from a practical standpoint, the entity deciding whether a Fuel Cost Policy gets approved would be the IMM.¹⁸

In supporting its proposal, the IMM repeatedly misconstrues Commission precedent and the plain language of Tariff, section 12A. Section 12A states that “[t]he 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.” PJM’s proposal is consistent with this language, as PJM can review an offer, including the level of an offer, in order to fulfill its responsibilities (prospective mitigation, proper price formation, tariff compliance, and ensuring just and reasonable rates) while the IMM can review the offer to fulfill its responsibilities (providing input to PJM for PJM’s

¹⁶ See IMM Answer at 1.

¹⁷ See *id.* at 19 (“The Market Monitor has accepted fuel cost policies for 616 units, which means that PJM deems them approved without additional review.”).

¹⁸ The IMM relies heavily on the process for review and approval of unit-specific Avoidable Cost Rate (“ACR”) determinations for offers into PJM’s capacity market—the Reliability Pricing Model—to support its argument that the IMM should be the party responsible for review and approval of Fuel Cost Policies. To the extent the ACR process is analogous to the current Fuel Cost Policy approval process, the ACR process is also out of line with Commission precedent and improperly empowers the IMM to perform functions that are not within its Commission-defined role. If this is true, rather than perpetuating this flawed paradigm, the proper recourse would be for the Commission to order PJM to conform the ACR process to Commission precedent, not conform the Fuel Cost Policy approval process to an ACR process out of line with Commission precedent. PJM does not believe that the ACR process is within the scope of this proceeding given that it relates to PJM’s capacity market and has no bearing on PJM’s hourly offer proposal. However, if, in the course of its review, the Commission finds that the ACR process may be inconsistent with applicable Commission precedent, PJM would welcome the opportunity to address issues related to the current ACR process in a separate proceeding.

prospective mitigation review, retrospective market power review, referral of possible exertions of market power to the Commission). Rather than following this straightforward application of section 12A, which is squarely in line with Commission precedent, the IMM contorts section 12A to mean that any substantive PJM review of a cost-based offer somehow infringes upon the IMM's review for market power. However, this interpretation of section 12A would subsume all of PJM's responsibilities within the IMM's "market power" review, rendering Commission precedent and the plain language of section 12A meaningless.¹⁹ Accordingly, the IMM's effort to misappropriate any and all domains under the PJM rules governing Market Seller offers in the name of "market power review" is not legally sound because it encroaches on functions which the Commission repeatedly has told the IMM must be reserved to the RTO as the regulated public utility.

C. *PJM's Compliance Filing Does Not Provide Market Sellers a "Safe Harbor."*

Throughout its answer, the IMM asserts that PJM's proposal provides a "safe harbor" to Market Sellers. To make this claim, the IMM misconstrues PJM's statements. In the October 7 Answer, PJM merely explained that Market Sellers that submit offers in compliance with their approved Fuel Cost Policies "should be reasonably certain that a cost-based offer submitted based on such Fuel Cost Policy would not on its face constitute an exercise of market power absent fraud, some manipulative scheme, or other extreme circumstances."²⁰ It is PJM's *opinion* that, unless the Market Seller's Fuel Cost

¹⁹ As discussed, PJM believes that its proposal is in line with the plain meaning of section 12A. However, to the extent the Commission believes that the language of section 12A is ambiguous and not clearly in line with relevant Commission precedent, PJM requests that the Commission order PJM to revise the language of section 12A in a compliance filing.

²⁰ October 7 Answer at 15.

Policy is based on fraud or some other improper scheme, then the Market Seller should have confidence that, *if* its offer complies with its *accepted* Fuel Cost Policy, such compliant offer should *not likely* raise market power concerns.²¹ To think otherwise begs the question: why bother having Fuel Cost Policies in the first instance? Of course, the IMM's retrospective review of such offers may reveal indications otherwise, and the IMM should refer such Market Sellers to the Commission under such circumstances. This has and should continue to be the course of practice. Nothing in PJM's proposal in any way abridges the ability of the IMM to refer Market Sellers to the Commission for market power concerns.

Additionally, more important than PJM's opinion as to whether Market Sellers should be subject to referrals by the IMM if they submit cost-based offers in accordance with a PJM-approved Fuel Cost Policy but raise market power concerns is the fact that

²¹ PJM's proposed standards strike a reasonable balance to afford Market Sellers a reasonable degree of comfort and certainty with regard to compliant offers, while recognizing that no single, workable set of standards for electricity markets can be expected to solve in all cases for hypothetical price excursions in fuel markets, by dispositively determining *ex ante* whether such excursions are driven by fundamentals and scarcity or instead by uneconomic factors. Indeed, PJM's proposed Fuel Cost Policy standards may not offer answers to each and every broad regulatory policy question presented, at least theoretically, by the confluence of separate (but related) fuel markets and wholesale electricity markets. For example, could there ever be circumstances where it would constitute the exercise of market power for a Market Seller to simply pass through its fuel costs, where such costs reflect a highly illiquid or dysfunctional natural gas market? Broader regulatory policy questions, particularly involving the performance of fuel markets outside PJM's purview, are properly left to the Commission to address, if and when necessary. And for these reasons, PJM has carefully avoided describing compliance with an accepted Fuel Cost Policy as grounds affording a Market Seller "safe harbor" protection. As PJM has discussed, PJM's proposed policy, however, does meet Commission requirements for workably competitive wholesale markets. Finally, it should be noted, that PJM can, when confronted with actual conditions in real time, evaluate a Market Seller's offer with advice from the IMM, and based on a full consideration of the facts and circumstances decide not to accept an offer that would lead to unjust and unreasonable outcomes in the market. *See* Tariff, Section 12A (PJM "has the final authority to determine whether an offer, bid or decision not to offer a committed resource complies with the PJM Market Rules"); Operating Agreement, Schedule 1.10.8(a) (stating that PJM accepts offers that result in the least-cost solution).

PJM’s proposed governing document revisions *unequivocally* state that Market Sellers shall have *no* safe harbor.²²

D. *Data Regarding The IMM’s Unilateral Imposition of Its Suggested “Algorithmic, Verifiable, and Systematic” Alternative Demonstrates That It Lacks Clear Standards for Compliance That Would Not Lead to Just and Reasonable Results.*

The IMM admits that, since at least June 2016, it has been unilaterally imposing its requirements that a Market Seller’s Fuel Cost Policy be “algorithmic, verifiable, and systematic,”²³ despite the fact such standard is stated nowhere in the Tariff, Operating Agreement, or PJM Manual 15. The IMM also states that it has “solicited and reviewed” policies for over 1,300 units since unilaterally imposing its requirements, but has accepted policies for only 616 units, or less than half of those submitted.²⁴ In addition, the IMM has rejected 129 *pre-existing* Fuel Cost Policies cost policies because they failed to meet its new algorithmic, verifiable, and systematic standard,²⁵ despite any authority to “reject” pre-existing Fuel Cost Policies.

Holding aside the IMM’s imposition of a standard that does not exist in PJM’s documented rules, the fact that over 50 percent of units in PJM have yet to satisfy the IMM’s new standard, even after months of “consultations” with the IMM, shows that compliance is not straightforward, and may in fact not be practically achievable in many instances. Moreover, the IMM’s statements are *prima facie* evidence that its proposed

²² See August 16 Filing; proposed Operating Agreement, Schedule 2, section (m) (“Nothing in this Schedule 2 is intended to abrogate or in any way alter the responsibility of the Market Monitoring Unit to make determinations about market power pursuant to PJM Tariff, Attachment M and Attachment M-Appendix.”).

²³ See IMM Answer at 10 (“Through consultations, the Market Monitor learns each Market Seller’s individual situation and helps to craft an algorithmic, verifiable, and systematic description of the Market Seller’s cost development practice.”).

²⁴ See *id.* at 19.

²⁵ See *id.*

standard cannot result in workably competitive markets if more than half of all units in PJM are possibly subject to referral to the Commission for “market power” concerns and *automatic application of a penalty* if a Market Seller “attempts” to exercise market power “based on the Market Monitor’s determination”²⁶ despite months of “consultations” with the IMM.

Market Sellers should have a clear set of guidelines set forth in PJM’s governing documents and compliance with those guidelines should result in an acceptable Fuel Cost Policy. The guidelines should clearly provide deadlines and a process allowing for redress of disagreements as to whether its submitted Fuel Cost Policy meets applicable guidelines. PJM’s proposal provides such unambiguous standards, as well as clear standards regarding application of the proposed penalty. Review of Fuel Cost Policies should be based on those stated guidelines, and Market Sellers should not be subject to a review process that has shown to be unworkable, lacks clear standards for compliance, and would not lead to just and reasonable results as the IMM proposes.²⁷

²⁶ *See id.* at 30. The IMM’s proposed application is particularly troubling because it makes the IMM the sole arbiter as to whether a penalty should apply, with such penalties applying based on its determination of whether market power has been exercised. This is a *substantial* expansion of the IMM’s authority, as the IMM may only refer Market Sellers to the Commission for alleged market power violations, and then *the Commission* determines whether market power has been exercised and whether penalties should be imposed. Under the IMM’s proposal, penalties would be apparently imposed by PJM at the IMM’s direction before market power determinations were made by the Commission.

²⁷ *See e.g.* August 16 Filing at 12-13; October 7 Answer at 15-16; Comments of the PJM Power Providers Group, Docket No. ER16-372-002, at 4-5 (Sept. 16, 2016).

II. CONCLUSION

For the foregoing reasons, the Commission should accept and consider PJM's answer, and accept the Tariff changes in the August 16 Filing to be effective as requested.

Respectfully submitted,



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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 Washington, DC, this 10th day of November, 2016.

A handwritten signature in black ink, appearing to read "Stephen M. Shparber". The signature is fluid and cursive, with a long horizontal stroke at the end.

**Stephen Shparber,
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