

The IMM Protest was filed in response to the August 16, 2016 compliance filing (“PJM Filing”) by PJM Interconnection, L.L.C. (“PJM”).⁴ PJM submitted revisions to the PJM Open Access Transmission Tariff (“Tariff”) and the Amended and Restated Operating Agreement of PJM Interconnection L.L.C. (“Operating Agreement”) to comply with the Commission’s directives in its June 17, 2016 order⁵ and to provide Market Sellers greater flexibility to submit offers throughout the Operating Day that vary by hour.

I. Motion to Leave and Answer

On September 16, 2016, P3 filed comments in the above-captioned proceeding articulating P3’s support of PJM’s Filing with minor revisions (“P3 Initial Comments”). P3’s view is that tariff revisions to allow hourly offers should be expeditiously approved and PJM’s proposed fuel cost policy proposal should be approved with minor modifications. P3’s Answer is narrowly tailored and will ensure that the Commission has a full and complete record of this issue.

II. Answer

A. This Proceeding is About a Single Issue – Addressing the Commission’s Call for Hourly Pricing in PJM.

The pursuit of appropriate energy market price formation in PJM has been a long and winding road. The Commission has appropriately and methodically explored various aspects of the issue for over three years. Technical conferences have been hosted, questions have been posed, PJM has responded to data calls and orders have been issued. Although deliberate at times, the process has produced meaningful market reforms and the Commission is closer to achieving its goal of having the energy market prices reflecting “the true marginal cost of

⁴ *PJM Interconnection, L.L.C.*, Docket No. ER16-372-002, August 16, 2016 (“PJM Compliance Filing”).

⁵ *PJM Interconnection, L.L.C.*, 155 FERC ¶ 61,282 (2016) (“FERC Order 2016”).

production, taking into account all physical system constraints, and these prices would fully compensate all resources for the variable cost of providing service.”⁶

Although not an issue addressed specifically in the AD14-14 docket, hourly offers in PJM clearly will lead to marginal energy prices that properly and transparently reflect the true costs of supplying electricity. The Commission has been clear in its vision that PJM should join other RTOs and allow generators to submit offers that can vary by hour so as to allow actual fuel costs to be reflected in offers.⁷

Unfortunately, the road to this market reform in the context of this proceeding is being paved with distractions from various protesters. This proceeding is not the place for broad discussions about virtually every aspect of the PJM energy market. This proceeding is not the venue to debate what is or is not an appropriate component of cost – the Commission has addressed this issue in prior determinations and it is not the subject of this proceeding. While debates about these broader matters are available to be addressed in other forums, this proceeding is about a single issue – addressing the Commission’s call for hourly pricing in PJM.

The strongest objectors to the PJM filing have one thing in common – they have never purchased gas to run a power plant. They have never had to manage the uncertainty of whether they will be dispatched with the need to procure the exact amount of fuel that will be burned. They have never had to manage the risk and reality of sudden fuel loss due to a third-party pipeline malfunction. They have never had to make calls to numerous gas providers on days of system stress to see if anyone has gas available to sell. They have never been caught in between gas nominating cycles scrambling to secure gas to meet unexpected dispatch.

⁶ *Price Formation in Energy and Ancillary Services Markets Operated by Regional Transmission Organizations and Independent System Operators*, Docket No. AD14-14-000, Notice, June 19, 2014 at p 2.

⁷ FERC Order 2016.

Indeed, the Commission has historically recognized that gas procurement is both an art and a science and has accepted methodologies that provide flexibility within a certain bandwidth *via* the Reference Level-based mitigation in place in other RTOs.⁸ Those who seek to reduce gas procurement to a predictable routine do not truly understand how challenging it can be. For better or worse, the complexity is the product of the interrelationship between the gas and electricity markets today and is not going to change as a result of action taken by the Commission in this proceeding. PJM, the IMM, the Commission and power generators all need to do their jobs within this reality.

In the context of this proceeding, which is designed to bring the numerous benefits of hourly offers to the PJM markets, the Commission must not allow this proceeding to become something it is not. PJM has put forth a reasonable proposal that, with a few modifications that were detailed in P3's Initial Comments, will accomplish the goals the Commission has set forth while giving all market participants and the Commission confidence that market power is not being exercised. P3 urges the Commission to move forward and expeditiously bring this proceeding to a close.

B. The IMM Proposes to Usurp PJM's Authority as the Public Utility.

The IMM, in its quest not to be placed in a "subordinate" role, proposes to usurp PJM's authority as the public utility. However, the Commission made it clear with Order No. 719 that the RTO must have the ultimate authority to decide whether its own tariff and manuals are being followed. The IMM can provide input and advice but the ultimate tariff administration responsibility rests with the RTO. Thus, the Commission has already decided that the IMM has a "subordinate" role when it comes to tariff administration. PJM's proposal is consistent with

⁸ See *e.g.*, ISO-NE Tariff, Section III, Market Rule 1, Appendix A.3; *see also, e.g.*, NYISO Market Administration and Control Area Services Tariff, Attachment H, Market Mitigation Measures.

Order No. 719, and is not a dramatic reassignment of roles or a power grab by PJM as the IMM and other commenters would lead the Commission to believe.

Consideration of the IMM's Protest, moreover, confirms the wisdom of the Commission's holding in Order No. 719 that the public utility (i.e., PJM) should be the ultimate authority to approve or reject fuel cost policies. It is critical that market participants be able to rely upon the provisions in the PJM Tariff and Manuals that expressly define recoverable costs and acceptable practices for preparing offers into PJM markets. As shown by the IMM's comments, however, the IMM has a fundamentally different view of what costs should be recovered and, under its proposed review process and authority, could be expected to seek fuel cost policy revisions consistent with that view. When such fundamental differences exist between (i) the current practice and proposed standards, on one hand, and (ii) the IMM's view of what constitutes an exercise of market power on the other, the ability of PJM to have the ultimate authority to approve or reject a policy is absolutely critical. While PJM should consider input from the IMM, the utility controlling the Tariff is best positioned to assure the orderly and fair operation of the PJM market.

PJM has proposed a fuel cost policy approval process similar to that used for the calculation of RPM avoidable cost rate offer caps, and the IMM has not explained why that process would not work for cost-based energy offers as well. As P3 noted in its Initial Comments, in many ways, PJM's proposed process is nearly identical to the RPM offer cap review process accepted by the Commission in 2009 as consistent with both Order No. 719 and

the PJM/MMU Settlement Agreement.⁹ In that order, the Commission recapped its reasoning behind Order No. 719 as follows:

. . . Order No. 719 adopted a balanced approach, allowing modified participation by the MMU in mitigation matters, while protecting against the conflict of interest and subordination concerns inherent in the MMU's unfettered participation. In striking this balance, the Commission relied, in part, on the distinction between prospective and retrospective mitigation. Specifically, the Commission held that a sole internal or sole external MMU would be permitted to conduct retrospective mitigation, but would be prohibited from conducting prospective mitigation, subject to the allowance that the RTO or ISO may permit its MMU to provide inputs to its respective RTO or ISO to assist these entities in conducting prospective mitigation.¹⁰

The IMM, various state commissions, and other intervenors vigorously protested the establishment of the RPM offer cap process, making many (if not all) of the same arguments they present in their protests in the instant case¹¹ and predicting dire consequences of PJM's proposed review process. The Commission accepted PJM's proposal over these myriad of challenges. It is noteworthy that in the years since, the IMM has repeatedly concluded that there has been "no exercise of market power in the PJM Capacity Market," because "[e]xplicit market power mitigation rules in the RPM construct offset the underlying market structure issues in the PJM Capacity Market under RPM."¹² The IMM has not expressed concern that the RPM

⁹ *PJM Interconnection, L.L.C.*, 129 FERC ¶ 61,250 at P. 145 (2009).

¹⁰ *Id.* at P. 117 (internal citations omitted).

¹¹ These arguments included, among others, that (i) the PJM review process was inconsistent with the PJM/MMU Settlement Agreement, (ii) Order No. 719 did not really intend to remove the market monitoring function from all aspects of tariff administration, (iii) the IMM could not perform its core functions without control over the mitigation processes at issue, (iv) market mitigation input development is not "tariff administration," (v) the proposed process of having the IMM provide support to the RTO in tariff administration would place the IMM in a "subordinate" role, (vi) PJM did not have the expertise to properly evaluate offer caps, and (vii) the ability for PJM to substitute its judgment for that of the IMM would weaken the market monitoring function and undermine incentives to comply with the IMM. *PJM Interconnection, L.L.C.*, 129 FERC ¶ 61,250 (2009) at PP. 122-135.

¹² See e.g., page 31 of the State of the Market Report, available at: http://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2015/2015-som-pjm-volume1.pdf.

process has diminished the incentive of market sellers to follow the Tariff, and the IMM's claim that PJM's proposed changes would do so here¹³ is not credible.

As P3 and other commenters noted, the current fuel cost policy review process is not just and reasonable. As the IMM stated a number of fuel cost policy negotiations were "paused," leaving a number of Market Sellers without an approved fuel cost policy for an extended period of time.¹⁴ There needs to be some discipline to the current process to ensure that Market Sellers are not stuck in limbo for years. As the PJM Utilities Coalition correctly pointed out, "Market Sellers are in the middle of the perfect storm created by ambiguous governing documents, new Commission directives, and complete lack of clarity concerning the role of the IMM."¹⁵

The IMM has proposed that when a fuel cost policy is rejected, the previous policy may not remain in place.¹⁶ Without an approved fuel cost policy, a Market Seller is relegated to offering zero for a potentially extended period of time. As mentioned in the P3's Initial Comments, there needs to be a well-developed review process with milestones and deadlines. The Commission should require PJM to include in Manual 15 a timeline for processing the fuel cost policy with similar milestones to that provided with respect to RPM offer caps in Section 6.6(b) of Attachment DD of the Tariff.¹⁷ This concern is founded upon the experience of P3 members, some of whom have negotiated with the Market Monitor for over a year, often with a

¹³ IMM Protest at p. 33.

¹⁴ IMM Protest at p. 10.

¹⁵ *PJM Interconnection, L.L.C.*, Comments of the PJM Utilities Coalition, Docket No. ER16-372-002, September 16, 2016 ("PJM Utilities Coalition Comments") at p. 9.

¹⁶ IMM Protest at p. 40.

¹⁷ See PJM OATT, Attachment DD, Section 6.6(b)(milestones include submittal due date, period for IMM review, date for notifying PJM of a disagreement, deadline for PJM's response, and provisions/deadlines in the event of a lack of response by the IMM).

delay of months between market participant submittals and the IMM response. Additional guidance with respect to the timing of the review process will help ensure that administrative backlogs do not conscript a generator to submitting only offers at \$0/MWh. Moreover, amendments to fuel cost policies may require expedited review in response to a change in conditions. Manual 15 or the Tariff should also provide for such expedited review in limited circumstances.

Despite the arguments of various protestors, PJM has put forth a workable process for fuel cost policy approval that is consistent with Commission precedent and policy with respect to these matters and that should be promptly accepted by the Commission with only minor modifications to direct PJM to be more specific with respect to milestones and timelines.

C. The IMM Erroneously Proposed Tariff Modifications that are Well Beyond the Scope of this Proceeding, and Has Not Justified Changing the Current Provisions of the PJM Tariff To Implement Radical and Unsupported Claims Regarding The Types of Marginal Costs That Should be Included in Offers

Numerous Tariff provisions are proposed to be changed by the IMM with the IMM reserving even more authority than the role it currently possesses.¹⁸ For example in Attachment A of the IMM Protest, the IMM proposes changes to Attachment M, Section II.A.4 to the effect that notwithstanding the results of the three pivotal supplier (“TPS”) test, the IMM can file with the Commission to remove the offer capping suspensions otherwise authorized. The IMM wrongly claims that many elements of the current PJM Tariff and Manuals regarding the calculation of cost-based offers are inadequate to protect against the exercise of market power. In actuality, the IMM is seeking to implement a radical overhaul of many tariff and manual provisions that currently govern cost-based offers under the guise of a “clarification.” In

¹⁸ The IMM has essentially rewritten Section 6.4.2, Schedule 2, and Attachment M, without providing a redline to the current Tariff.

addition, the IMM mischaracterizes the Commission’s findings by suggesting that the IMM’s radical positions have been endorsed by the Commission when that is not the case. This proceeding clearly deals with the calculation of hourly offers, and the mitigation mechanisms that should exist to properly bound those offers. By seeking to change the established components of incremental costs as set forth in the PJM Tariff and Manuals, the IMM is improperly expanding the scope of this proceeding well beyond these already broad issues.

The IMM asserts in its Protest that “[s]ufficient review of cost based offers requires . . . validation that cost-based offers include only short run marginal costs.”¹⁹ Elsewhere, the IMM “recommends that the Commission require a *clarification* in Attachment M of the current requirement for incremental costs to more explicitly require that the levels not exceed short run marginal costs.”²⁰ The IMM Protest further proposes modifications to Attachment M-Appendix that “identif[y] the inclusion of incremental costs that exceed short run marginal costs levels as an exercise of market power. . . .”²¹ The IMM Protest, in particular, is critical of elements of Manual 15, stating that as currently drafted “Manual 15 may serve as a shield for Market Sellers submitting excessive cost-based offers by using outdated provisions, such as the calculations based on FERC accounting codes.”²²

In fact, the IMM has not demonstrated that there is a need to change the current PJM Tariff and Manuals to protect against the exercise of market power even if that matter were

¹⁹ IMM Protest, p. 3.

²⁰ *Id.*, p. 36 - 37 (emphasis added).

²¹ *Id.*, p. 43.

²² *Id.*, p. 37.

deemed to come within the scope of the instant proceeding. The IMM puts forth a narrow interpretation of “short term marginal costs” whereby most incremental costs would be excluded from cost-based bids. For example, the IMM claims that the manner in which maintenance costs are allowed to be included in cost-based offers is “out of date.”²³ Thus, Manual 15 states that the “Combustion Turbine - Maintenance Adder” should be calculated as “[t]he total dollars from FERC Account 553 divided by Equivalent Service Hours (ESH).” Essentially, under this method, the total maintenance costs are divided by the number of hours of historical operations including a multiplier for the number of starts and operations at peak levels. This calculation thus allows maintenance costs to be included in energy market bids in a manner that correlates with how much energy the unit provides. The unit operator can reasonably include such a value in a competitive bid because it represents an amount that will be incurred if the unit is dispatched and conversely can be avoided if the unit is not dispatched. The IMM never provides any explanation as to why this practice is unreasonable.

The IMM’s reliance on the Commission’s findings in two *Southwest Power Pool, Inc.* (“SPP”) decisions is also misplaced.²⁴ The IMM Protest claims that those cases stand for the broad proposition that the Commission supports the IMM’s radical view of short-term marginal costs whereby, apparently, only the costs associated with the last MW of production are marginal. In fact, those cases do not support the IMM’s claims. Yet, while the Commission did direct that the SPP tariff should include a provision providing that mitigated offers should be

²³ See IMM Protest, p. 37, n.55.

²⁴ See IMM Protest, p. 37 (citing *Southwest Power Pool, Inc.*, 141 FERC ¶ 61,048 (2012)) and *Southwest Power Pool, Inc.*, 152 FERC ¶ 61,226 (2015).

based on “short term marginal cost,”²⁵ it never found that short term marginal costs should be given such restricted scope. For example, generators argued in *SPP* that major maintenance costs as reported in FERC Accounts, and as proposed by SPP, should be allowed to be the basis of mitigated energy offers.²⁶ The Commission never made any findings that conceptually rejected this approach. The Commission did find that SPP failed to demonstrate that its particular proposals were just and reasonable but did so based on the lack of specificity regarding which FERC Accounts were relevant and which type of expenditures in each account could be considered.²⁷ The IMM’s claims that the Commission has spoken categorically in a manner that upholds the IMM’s narrow view of short run marginal costs are misplaced.

D. The IMM Proposes an Unworkable Standard For Approval of Natural Gas Fuel Cost Policies

The IMM also proposes an entirely different standard of review for Fuel Cost Policies – one that simply will not work during the exact market conditions that the Commission was attempting to address with its hourly offer reforms. The IMM also proposes to change other long-standing rules for establishing fuel costs with little or no justification and advances other misleading and unsupported critiques of PJM’s proposal.

1. The IMM’s Standard Is Not Viable During Periods of Gas Illiquidity.

P3 supports PJM’s proposed subsection (f) of Schedule 2, which sets forth the standard that PJM will apply when reviewing and approving a fuel cost policy. PJM has proposed a standard for review that is appropriately designed to reflect the how Market Sellers procure and

²⁵ *Southwest Power Pool, Inc.*, 141 FERC ¶ 61,048 (2012) at P 420.

²⁶ *Southwest Power Pool, Inc.*, 152 FERC ¶ 61,226 (2015) at P 16.

²⁷ *Id.*, at P 97.

price fuel during periods where there is limited market liquidity, which (as PJM acknowledges) makes verification through published indices difficult, if not impossible, to effectuate. The IMM argues that proposed subsection (f) should be rejected in favor of a different standard, which is proposed to be inserted into Attachment M of the PJM Tariff:

(b) the Market Monitoring Unit shall review all Fuel Cost Policies submitted by Market Sellers for market power concerns, including, specifically, whether such policy is algorithmic, systematic and verifiable, and can be reasonably relied upon to produce accurate fuel cost inputs for Offer Price Caps. . .²⁸

For the reasons discussed below, the rigid standard proposed by the Market Monitor is not viable for natural gas fuel cost policies, especially during times when the natural gas market is illiquid, such as the intraday gas market or during times of system stress.

During the Polar Vortex in 2014, for example, the intraday gas price swung wildly and caused actual gas costs to be much higher than expected costs included in the day-ahead offer.²⁹ It was this experience that informed the Commission’s determination that PJM’s Tariff may be unjust and unreasonable and unduly discriminatory because it did not allow market participants the flexibility to update their offers to reflect their actual costs during conditions of system stress.³⁰ The Commission further found that offer flexibility, when combined with appropriate market power mitigation, also supports proper price formation and efficient real-time dispatch.³¹

²⁸ IMM Protest, Attachment A, proposed OATT attachment M – Appendix § II.A., Section II.A.2(b).

²⁹ See PJM Interconnection, LLC, *Analysis of Operational Events and Market Impacts During the January 2014 ColdWeather Events*, May 8, 2014, available at: <https://www.pjm.com/~media/documents/reports/20140509-analysis-of-operational-events-and-marketimpacts-during-the-jan-2014-cold-weather-events.ashx>

³⁰ *PJM Interconnection, L.L.C.*, 155 FERC ¶ 61,282 at P 32 (2016); see also, *Duke Energy Corporation, et al., PJM Interconnection, L.L.C.*, 151 FERC 61,206 at P 69 (2015) (finding PJM’s Tariff may be unjust and unreasonable “because [the Tariff provisions] do not appear to allow market participants to submit day-ahead offers that vary by hour and do not appear to allow market participants to update their offers in real-time, including during emergency situations”).

³¹ *PJM Interconnection, L.L.C.*, 155 FERC ¶ 61,282 at P. 32 (2016).

The PJM proposal strikes the right balance between offer flexibility and appropriate market power mitigation while the Market Monitor’s “algorithmic, verifiable, and systematic” standard is nearly impossible to satisfy on an intraday basis or during the very emergency situations that the Commission aimed to address.³² P3 therefore urges the Commission to reject the IMM’s protest and accept PJM’s proposed subsection (f) of Schedule 2, which is just, reasonable and consistent with the Commission’s price formation goals.³³

The concerns P3 has with respect to the Market Monitor’s proposed “algorithmic, verifiable, and systemic” standard are informed in part by negotiations that have been on-going between the Market Monitor and individual P3 members with respect to fuel cost policies previously presented for review. During periods of extreme illiquidity, situations have arisen in which there are no offers available on exchanges for natural gas (such as the Intercontinental Exchange, or ICE) and brokers have informed P3 members that no gas is currently available. When asked how to address such situations, the Market Monitor has informed P3 members that fuel cost policies must nonetheless allow for after-the-fact verification of exchange information or broker quotes indicating prevailing natural gas costs at the time cost-based offers are submitted. That is, the Market Monitor has demanded that sellers be able to document published or third-party pricing information that may not exist depending on the circumstances of natural gas availability at the time. And now the Market Monitor seeks to enshrine this requirement in

³² *Id.*

³³ See June 19, 2014 Notice, Docket No. AD14-14-000 at 2 (“[i]deally the locational market prices in the energy and ancillary services markets would reflect the true marginal cost of production, taking into account all physical system constraints and these prices would fully compensate all resources for their variable cost of providing service”).

the PJM tariff through its proposed “algorithmic, verifiable, and systematic” standard. This should not be allowed.

Indeed, the Market Monitor acknowledges that “[m]arket participants frequently face lack of transparency, lack of locational pricing, and illiquidity in the natural gas market at times of high gas demand.”³⁴ Yet in proposing to replace the standard for approval outlined by PJM in subsection (f) with a standard that requires fuel costs to be “algorithmic, verifiable, and systematic” even during times of market illiquidity, the Market Monitor is ignoring and oversimplifying the natural gas markets and the issues that arise on a day-to-day basis due to (i) the interaction with the gas day and the deadlines for offering power, (ii) the absence of price indices for intraday gas, and (iii) market conditions during times of system stress. It is during these times of system stress that the natural gas markets are most likely to be illiquid and prices are most likely to be volatile. It is also the time when market sellers are most likely to be cost-capped. As Exelon’s Managing Director – Wholesale Trading, Leslie Dedrickson, testified in Docket No. RM16-5-000, even during a typical day, the gas market will have periods of lower liquidity, which renders a price index less accurate:

The gas market may or may not coalesce around a relatively narrow range of prices during the short period of time for trading before the 10:00 AM deadline for power market offers. During critical periods, such as severe cold weather, gas prices are often increased, the gas market may experience very light trading, and there may be very wide bid-ask spreads for delivered gas until much later in the morning. Liquidity may also be very low during certain periods of the day, such as after 4:00 PM during the energy market rebidding period (emphasis added).³⁵

Likewise, Mr. Dedrickson also explained with respect to intraday gas that

³⁴ IMM Protest at 9.

³⁵ *Offer Caps in Markets Operated by Regional Transmission Organizations and Independent System Operators, Comments of Exelon Corporation*, Testimony of Leslie O. Dedrickson, Docket No. RM16-5-000 at 15 (April 4, 2016)(emphasis added).

. . . the intraday gas market is generally more illiquid than the day-ahead market, making prices more volatile and accordingly more difficult to predict for purposes of making a cost based offer. And there is no intraday price index, so the generator owner must make a best estimate based on available information.³⁶

He noted that in both instances (day-ahead and intraday) a market seller also would have to consider balancing costs, which are the costs associated with managing the expected quantity of fuel needed in relation to the actual quantity of fuel burned, in formulating its overall fuel costs.³⁷

As Mr. Dedrickson explained in his testimony, in most cases the determination of fuel cost inputs requires that the market participant make a judgement on the expected actual dispatch level and how much gas to procure at different times in advance of dispatch. The process of predicting future events inherently requires that the market participant make imperfect decisions based on experience and the relevant known environmental factors. For instance, while the gas price index from the day prior to the operating day can inform expectations, if the circumstances change in real time resulting in illiquid market conditions there will be wide bid-ask spreads and increased volatility that limits the data available to inform energy market offers. The impact of gas price uncertainty and potential fuel cost volatility is compounded because a generator's actual dispatch level often varies. In addition, a market participant must use its judgment to respond to and account for possible changes in temperature, an unexpected generator or transmission outage, and gas pipeline constraints in determining when to purchase gas and how much. Due to the absence of intraday price indices and illiquidity, which is characterized by wide bid-ask spreads, low volume trading and high imbalance penalties, during emergency conditions, actual fuel costs are highly unlikely to be accurately represented through the

³⁶ *Id.* at 23-24.

³⁷ *Id.* at 17 .

“algorithmic, verifiable and systemic” – that is, a formulaic, index-based -- standard that is proposed by the Market Monitor. Fuel procurement in a dynamic market is, by its very nature, and algorithmic or systemic and exact verification can be challenging unless gas purchasers have perfect foresight. Fuel procurement (especially on an intraday basis and under emergency conditions) is more complex than simply pulling index values from *Gas Daily* and inputting them into a formula that generates a cost-based offer. The Market Monitor’s standard for approval of Fuel Cost Policies simply fails to acknowledge the complexity involved in fuel procurement and thus proposes a standard that is unworkable and that must be rejected.

2. PJM’s Proposal Appropriately Allows Consideration of Actual Fuel Purchases

PJM proposes in subsection (f)(ii) to review and approve a fuel cost policy if it

. . . (ii) Reflects the Market Seller’s applicable commodity and/or transportation contracts (to the extent it holds such contracts), and sets forth all applicable indices as a measure that PJM can use to verify how anticipated spot market purchases are utilized in determining fuel costs

In response, the IMM proposes to delete this subsection and argues that “[f]uel contracts and fuel procurement practices required in (i)(ii) are generally irrelevant to the determination of replacement fuel costs.”³⁸ Manual 15 currently allows Market Sellers to base their fuel cost policy based on “inventoried cost, replacement cost or a combination thereof, that reflect the way fuel is purchase or scheduled for purchase.”³⁹ PJM’s proposed subsection (f) is consistent with this approach and the IMM simply has not justified a switch to an approach limited to replacement costs only. To the extent a Market Seller has a fuel contract that is evidence of its cost of fuel, the contract price should be allowed, at the Market Seller’s request, to be factored

³⁸ IMM Protest at 39.

³⁹ PJM Manual 15 at 10.

into their fuel cost policy. Further, not allowing these contracts to act as evidence of the cost of fuel procured will unreasonably constrain documentation available from the Market Seller. The exclusion of inventoried fuel costs also may result in market clearing prices that will not reflect the actual cost of the marginal unit operating on the system, thereby suppressing efficient prices and proper investment or retirement decisions. To the extent that Market Sellers can identify fuel contracts which they use to supply fuel inventory to their plants and that the Market Monitor and PJM can review, these contracts should be eligible to act as documentation of actual inventoried fuel costs and be reflected in the fuel cost policy. PJM's proposal with respect to actual fuel contracts is consistent with long-standing practice under Manual 15 and should be accepted.

3. The IMM's Objection to the Lack of Definition Surrounding Illiquid Market Conditions Is Spurious and Easily Remedied.

The IMM objects to subsection (f)(iv) on the grounds that PJM's proposal does not make clear what it means for an index to be illiquid or what conditions apply to Market Sellers that have never experienced such conditions.⁴⁰ This lack of definition, the Market Monitor argues, justifies throwing out the concept outlined in subsection (f)(iv) entirely. P3 urges the Commission to accept PJM's proposed standard for approving Fuel Cost Policies during illiquid conditions. If needed, the Commission should require PJM to define illiquidity, perhaps by reference to a low volume of available broker quotes or to the bid-ask spread. It is critical, however, that the standard adopted by PJM make some accommodation for illiquid market

⁴⁰ IMM Protest at 39.

conditions if the hourly offer updates are to serve their purpose and reflect the actual costs of producing power.

The Market Monitor also suggests that some Market Sellers have not experienced illiquidity. While P3 is not certain that such Market Sellers exist, assuming that they do, they should nonetheless be able to outline how they would go about estimating their fuel costs under such circumstances. These Market Sellers can be required to outline that process and explain how they adhered to it should the question about conduct arise. To the extent that the Commission finds the Market Monitor's position to have merit, the Commission should direct PJM to better define illiquid market conditions rather than discard a critically important component of the PJM proposal.

4. PJM's Proposed Standard for Review Does Not Improperly Impinge on the Market Monitor's Ability to Conduct a Market Power Review.

The Market Monitor argues that PJM's proposed subsection (f) will infringe on the Market Monitor's market power review.⁴¹ Specifically, the Market Monitor highlights the standard in (f)(i) that PJM shall review and approve the fuel cost policy if it "provides information sufficient for the verification of the Market Seller's fuel procurement practices and how those practices are used to determine the cost-based offers the Market Seller submits."⁴² P3 disagrees with the Market Monitor that this inhibits its ability to request further information or documentation on the cost-based offers.⁴³ In fact, this provision is absolutely silent with respect to the Market Monitor's ability to request data. However, assuming arguendo that the Market

⁴¹ IMM Protest at 38.

⁴² PJM proposed Schedule 2 (f)(i).

⁴³ IMM Protest at 38

Monitor's authority could be constrained by this section of proposed Schedule 2, P3 supports clarification from the Commission to affirm the Market Monitor's authority to request data and information during the course of the IMM's review. The Commission should not eliminate the proposed standard as the Market Monitor requests.

5. PJM Should be Allowed to Make Exceptions for Policies That Meet a “Consistent With or Superior To” Standard.

Finally, the IMM also opposes Schedule 2 on the grounds that it provides PJM with the authority to grant discretionary exceptions to the Tariff standard. The Market Monitor's argument is disingenuous. Under its proposal, PJM would not have broad discretion to grant exceptions to the Tariff; rather, it would be following the Tariff language, which would allow PJM to make exceptions if they meet a “consistent with or superior to” standard. In this way, PJM's proposal is non-controversial and wholly consistent with the process by which exceptions to the RPM must offer requirement or exceptions to the standard parameter limited schedule requirements are allowed. The Commission has accepted Tariff language providing for PJM's ability to grant “exceptions” to both of these requirements in the past.⁴⁴ Here, PJM would not be granting waivers of the Tariff standard, which are indeed the province of the Commission, but would be allowing a different, “consistent with or superior to” standard to apply in certain instances pursuant to the Tariff. Therefore, P3 urges the Commission to accept PJM's proposed

⁴⁴ See PJM Tariff, Attachment DD, Section 6.6(g)(“ However, generation resource may qualify for an exception to the must-offer requirement, as shown by appropriate documentation, if the Capacity Market Seller that owns or controls such resource demonstrates that it: (i) is reasonably expected to be physically unable to participate in the relevant Delivery Year; (ii) has a financially and physically firm commitment to an external sale of its capacity, or (iii) was interconnected to the Transmission System as an Energy Resource and not subsequently converted to a Capacity Resource”). See also PJM Tariff, Attachment K, Section 6.6 (h)(“ Exceptions to the parameter limited schedule default or unit-specific values shall be categorized as either a one-time temporary exception, lasting 30 days or less; a period exception, lasting at least 31 days and no more than one year; or a persistent exception, lasting for at least one year”).

“consistent with or superior to” standard and reject the Market Monitor’s argument as without merit.

6. The IMM Proposes Penalty Provisions that are Unnecessarily Punitive and Patently Unfair to Certain Customers.

In addition to the issues identified above, the IMM also puts forth a penalty structure that significantly expands upon the structure proposed by PJM in a manner that would be unnecessarily punitive to generators and consumers. The IMM seeks to apply the penalties to both real-time and day-ahead offers without any empirical justification for setting penalties at that level other than to make the penalties “twice as high.”

P3 reiterates its hope and expectation that penalties for non-compliance will be an extremely rare occurrence. Provided fuel cost policies are properly structured and approved, Market Sellers have every interest (including the interest in avoiding allegations of market manipulation) in complying with those policies. But even Market Sellers that act in good faith will occasionally make mistakes (such as mistakes in entering offers into PJM’s systems) from time to time. However, in the event that penalties for this type of behavior are appropriate, they must be fair and appropriately tailored to the offending activity. P3 believes that PJM has put forth a reasonable means of meeting that goal.

Market Sellers that submit and are awarded a day-ahead obligation are financially committed to the market from the moment their offers clear the market. Similarly, those Sellers that are only picked up in the real-time without a day-ahead award are only obligated to the market at the point that their offers are taken. Because of the differing nature of a day-ahead (financial) versus a real-time (physical) award, different fuel cost policy considerations will be invoked for each market. Penalizing a Market Seller twice for a single physical commitment is

unnecessarily punitive and disproportionate to ISO-NE's penalty structure, which has been accepted as just and reasonable by the Commission.⁴⁵ The Commission should reject the IMM's proposed doubling of the size of the penalty.

In addition, the IMM also proposes to prohibit the distribution of any penalty proceeds to affiliates of Market Sellers who run afoul of their fuel cost policies. Although not clear, the IMM's comments suggest that this would mean that both affiliated utilities and affiliated retail suppliers would be ineligible for penalty distributions. Consider the consequence of such of rule for a number of P3 members that have affiliated utilities or large competitive retail load serving business. Any consumers that are served by these companies would be financially harmed in a discriminatory fashion simply by virtue of their corporate affiliation with a Market Seller that made a mistake. The Commission should reject the IMM's proposal for the allocation of penalty proceeds as unnecessarily discriminatory against consumers that had no part in the activity that led to the penalty.

⁴⁵ See PJM Compliance Filing at 31, fn 58.

III. CONCLUSION

For the foregoing reasons, P3 respectfully requests that the Commission consider its Answer and accept PJM's August 16, 2016 Compliance Filing conditioned upon modest revisions detailed in P3's Initial Comments in an order issued no later than October 17, 2016.

Respectfully submitted,

On behalf of the PJM Power Providers Group

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Dated: October 3, 2016

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, D.C., this 3rd day of October, 2016.

On behalf of the PJM Power Providers Group

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