Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. §§ 385.212, 385.213, PJM Interconnection, L.L.C. ("PJM") submits this Motion for Leave to Answer ("Motion") and Limited Answer ("Answer") in response to the Comments of the Independent Market Monitor For PJM ("IMM Comments") and other parties filed in this proceeding on December 23, 2014 in response to PJM's proposed revisions to the Amended and Restated Operating Agreement of PJM Interconnection L.L.C. ("Operating Agreement") and the PJM Open Access Transmission Tariff ("Tariff"), submitted in this proceeding on December 15, 2014, to temporarily revise PJM’s rules related to the $1,000/MWh energy offer cap for cost-based offers in excess of $1,000/MWh through March 31, 2015 ("Initial Filing"). The main revisions PJM proposed in the Initial Filing 1) allow cost-based offers to be submitted and set Locational Marginal Price ("LMP") up to $1,800/MWh for the upcoming winter period provided such offers are submitted in accordance with PJM’s Cost Development Guidelines; and 2) allow generators to recover actual incurred costs above $1,800/MWh through uplift payments, with such costs being subject to an after-the-fact review by PJM and the IMM.

1 Cost-based offers are based on the short-run marginal cost of the unit as explained in PJM Manual 15. The unit’s cost based-offer is prepared in accordance with the provisions of Schedule 2 of the Operating Agreement and PJM Manual 15 ("Cost Development Guidelines").

2 In addition to the Independent Market Monitor for PJM ("IMM"), sixteen (16) other parties submitted substantive comments and/or protests in response to the Initial Filing on December 23, 2014.

3 All capitalized terms that are not otherwise defined herein shall have the same meaning as they are defined in the Tariff or Operating Agreement.
I. Motion for Leave to Answer

The Commission’s rules provide that a party may answer a protest where the decisional authority permits the answer for good cause shown.\(^4\) The Commission frequently has accepted responses to protests when doing so will ensure a more accurate and complete record or will assist the Commission in its deliberative process by correcting errors and clarifying the issues.\(^5\) As demonstrated below, all of these criteria are met. Therefore, PJM respectfully requests that the Commission grant its Motion because the Answer will help clarify the record and contribute to an understanding of the issues.

II. Answer

a. Natural Gas Fuel Prices Should Not Be The Only Acceptable Reason For Cost-Based Offers To Rise Above $1,000/MWh

The IMM asserts that only increases in natural gas fuel prices should be allowed to justify cost-based offers greater than $1,000/MWh.\(^6\) PJM did not limit the Initial Filing’s application to increases in natural gas fuel prices due to potential implementation issues associated with such an approach. Adding such narrowing language to the Tariff and Operating Agreement may create unintended consequences where legitimate costs could be disallowed for cost-based offers above $1,000/MWh due to difficulties in ascertaining whether such costs are indeed related to “increases in natural gas fuel prices” under the terms of the Tariff and Operating Agreement. PJM seeks to avoid such a scenario, and believes the revisions proposed in the Initial Filing, and particularly the Cost Development Guidelines, provide reasonable limits on the type of costs that may be included in any cost-based offers that are submitted to PJM.

\(^4\) See 18 C.F.R. Section 385.213(a)(2).


\(^6\) See IMM Comments at 3-4.
However, given the temporary nature of this filing, if the Commission shares the IMM’s concerns and believes that cost-based offers should only be permitted to rise above $1,000/MWh as a result of an increase in natural gas fuel prices, PJM requests that the Commission order PJM to submit a compliance filing with Tariff and Operating Agreement revisions that will accomplish this outcome. Section 1.10.1A(d) of Schedule 1 of the Operating Agreement\(^7\) should be revised in the following manner if the Commission believes it is appropriate for PJM’s proposal in this proceeding to apply only to cost-based offers greater than $1,000/MWh that result solely from an increase in natural gas fuel prices:

(viii) [s]hall not exceed an energy offer price of $1,000/megawatt-hour for all generation resources, unless the resource’s cost-based offer, calculated in accordance with Schedule 2 of the Operating Agreement, section 6.4.2 of Attachment K-Appendix of the Tariff and the parallel provisions of Schedule 1 of the Operating Agreement, and PJM Manual 15, exceeds $1,000/megawatt-hour, in which case the resource may submit an offer that accounts for the increased cost to procure fuel, but for which no other component of the calculation used to determine the resource’s cost-based offer is changed, and is no greater than an amount equal to that cost-based offer which shall not exceed $1,800/megawatt-hour; and

PJM has reviewed this proposed language with the IMM and the IMM believes that these proposed revisions would be acceptable.

b. Interaction Between Cost-Based Offers Greater Than $1,000/MWh And Shortage Pricing

The IMM argued that the increased energy offer cap for cost-based offers should not modify the maximum system shortage price.\(^8\) Shortage pricing is a methodology for accurately co-optimizing the pricing of energy and reserves so that prices reflect the state of the system during reserve shortages. The IMM asserts that PJM does not explain what would happen if

\(^7\) Schedule 1 of the Operating Agreement is identical to Attachment K-Appendix of the Tariff. Where PJM refers herein to provisions of Schedule 1 of the Operating Agreement, those references also are intended to encompass the parallel provisions of Attachment K-Appendix of the Tariff.

\(^8\) See IMM Comments at 4. The IMM referred to shortage pricing as “scarcity pricing” in its Comments, although the two terms refer to the same concept.
cost-based offers between $1,000/MWh and $1,800/MWh applied during shortage conditions, and requests clarification that the maximum shortage price would never be greater than the current maximum allowable shortage price (which is $2,700/MWh) even if cost-based offers exceed $1,000/MWh.\(^9\)

The proposed language that PJM submitted in the Initial Filing would allow maximum shortage prices to rise above their current levels if energy offers are permitted above the current $1,000/MWh offer cap. Shortage pricing in PJM is based on simultaneous optimization of energy and reserves and the energy price during reserve shortage conditions is a function of energy offers and Reserve Penalty Factors. If the Commission were to limit energy prices to $2,700/MWh when Reserve Penalty Factors are applicable and cost-based offers are greater than $1,000/MWh, it would depress reserve prices below the appropriate levels needed to capture operator actions in market clearing prices. This would in effect reduce the incentive for resources to follow PJM’s dispatch instructions during the most critical operating periods and create out-of-market uplift payments that undermine the pricing signals.

Given that PJM’s proposal in this proceeding is temporary, PJM does not propose to alter the shortage pricing provisions of the Tariff or Operating Agreement. However, if the Commission believes that current maximum allowable shortage price should not be permitted to rise above $2,700/MWh even if cost-based offers are submitted above $1,000/MWh and set LMP, PJM requests that the Commission direct PJM to submit a compliance filing to revise its Tariff in order to achieve this outcome.

c. Reasonableness of the $1,800/MWh Offer Cap

The IMM, and several parties, commented on the $1,724/MWh offer that was submitted to PJM during the winter of 2013/2014 and whether this offer was in fact valid.\(^10\) While PJM

\(^9\) See IMM Comments at 4.  
\(^10\) See e.g. id. at 2.
covered this topic in its Initial Filing, PJM would like to clarify for the record that the $1,724/MWh offer was the highest cost-based offer ever submitted by a Market Seller of a generation resource in accordance with PJM’s Cost Development Guidelines. During last winter, PJM and the IMM reviewed several such offers, and based on an after-the-fact review of such offers’ actual gas costs, imputed heat rates, and elimination of the 10% adder that all cost-based offers are eligible to receive, some of these offers were accordingly reduced. Thus, the lower, revised offer referred to in the IMM Comments was calculated using a different process than what is found in PJM’s Cost Development Guidelines, and the $1,724/MWh offer was validly submitted in accordance with PJM’s Cost Development Guidelines.

As discussed in the Initial Filing, PJM’s proposed overall energy offer cap of $1,800/MWh is appropriately based on the highest cost-based offer ever submitted by a Market Seller of a generation resource in accordance with PJM’s Cost Development Guidelines. Further, as also noted in the Initial Filing, the compromise proposal submitted at the November 20, 2014, meeting of the PJM Members Committee proposed an overall energy offer cap of $1,800/MWh and was supported by many PJM Members. Thus, PJM’s proposed overall $1,800/MWh energy offer cap is part of a reasonable, temporary proposal that alleviates the current unjust and unreasonable application of the $1,000/MWh energy offer cap to cost-based offers greater than $1,000/MWh; is based on historical values of offers submitted to PJM as well as stakeholder input; and strikes a reasonable compromise between the diametrically opposed positions of many generator interests (which effectively believe there should be no energy offer cap on cost-based offers and that all such offers should be eligible to set LMP) and many load.

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11 See Initial Filing at 8-9, n.22.
12 The after the fact review process PJM utilized last winter is essentially the same process that PJM will employ for cost-based offers greater than $1,800/MWh under its current proposal.
13 See IMM Comments at 2.
14 See Initial Filing at 9.
state commission and consumer advocate interests (which do not believe it is appropriate to change the current $1,000/MWh energy offer cap at all, or would allow recovery of costs greater than $1,000/MWh only through out-of-market uplift payments).\textsuperscript{15}

In addition, PJM’s filing allows for recovery of costs above $1,800/MWh, provided such costs are reviewed prior to their collection through out-of-market uplift payments. Although not an ideal overall market design, given the remaining gas/electric coordination issues and their potential impact on gas prices this winter, PJM believes this approach is just and reasonable for purposes of this time-limited filing while the Commission explores the larger issues associated with energy offer caps and gas/electric coordination.

\textbf{III. Conclusion}

For the foregoing reasons, PJM respectfully requests that the Commission (1) grant its Motion and (2) consider its Answer herein.

Respectfully submitted,

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\textsuperscript{15} Some parties filed comments addressing PJM’s proposed treatment of the cost-based adder that all cost-based offers are eligible to receive. \textit{See e.g.} Motion to Intervene and Comments On Behalf of Dominion Resources Services, Inc., filed December 23, 2014 in this proceeding, at 5. PJM outlined and explained its position related to the cost-based adder in the Initial Filing. \textit{See} Initial Filing at 10, 13 n. 27. PJM notes that under its proposal, it is not eliminating the adder, but merely limiting the cost-based adder in a manner that is just and reasonable.
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 Audubon, PA, this 5th day of January, 2015.

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