STATE OF MARYLAND

PUBLIC SERVICE COMMISSION

July 26, 2013

Scott Baker, Chair Person
Janell Fabiano, Secretary
PJM Capacity Senior Task Force
PJM Conference & Training Center
Norristown, PA

Re: MOPR Unit Specific Review Development Process

Dear Scott & Janell:

This letter and its attachment responds to your request that the Maryland Public Service Commission ("MD PSC") state in writing its position regarding the development of "Common Assumptions" and "Process" requirements for use in the Unit Specific Review Exception (USR) required by the Federal Energy Regulatory Commission ("FERC") in its May 2 Order at *PJM Interconnection, LLC,* 143 FERC ¶ 61,090 (2013)(USR Order). This Letter summarizes that position, stated orally at the Capacity Senior Task Force (CSTF) Meeting of July 17, and the reasoning which supports it, while the Attachment places that position in a format to be incorporated in the CSTF "MOPR Unit Specific Review Process – OPTIONS MATRIX". In preparing these materials, we understand that their objective is to provide assistance and guidance to PJM in the development of Manual and Tariff language to implement the USR Exception as directed by FERC.

In requiring PJM to maintain the USR Exception, FERC reasoned that "there may be resources that have lower competitive costs than the default offer floor, and these resources should have the opportunity to demonstrate their competitive entry costs. . . . We encourage PJM and its stakeholders to consider, for example, whether the unit-specific review process would be more effective if PJM requires the use of common modeling assumptions for establishing unit-specific offer floors while, at the same time, allowing sellers to provide support for objective, individual cost advantages. "[1] The MD PSC reads FERC's Order as requiring that the USR

[1] USR Order at ¶¶s 141 to 144. FERC also noted a concern that the default offer floor (i.e. Net CONE) "is only an estimate that several interveners, including the IMM, argue is currently too high", and that, absent a meaningful USR Exception process, errors in this estimate could improperly impose additional costs on end-users.

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procedure constitute a process through which generation developers may demonstrate that their proposed RPM BRA Sell Offer reasonably reflects their anticipated and known cost levels for the specific unit they are developing, and further that neither "common modeling" or other assumptions should be permitted to prevent them from making that demonstration. To assure that FERC's objective is met, the MD PSC proposes that the following language stating this objective be included in PJM Manuals describing the USR procedure:

> "The objective of this Unit Specific Review Exception is to permit a generation developer to demonstrate that its Sell Offer is economically reasonable when compared to the actual and anticipated costs and revenues expected to be obtained from the Unit being developed. While PJM and the IMM may establish "Common Modeling Assumptions" for use in simplifying and presenting a USR Exception request, these assumptions shall not prevent a developer from presenting its Unit's anticipated and actual cost data, as well as its willingness to forego higher cost recovery if it so proposes, in support of its Sell Offer. Moreover, in implementing the Unit Specific Review Exception, all demonstrated cost advantages and reductions associated with the Unit under development shall be recognized in establishing its minimum Sell Offer."

We suggest that notification of this proposed Statement be referenced in your Options Matrix as item 1a under the title USR Objective and the designation "Permit demonstration of Unit actual and anticipated costs and revenues as basis for Sell Offer".

As a second point of general information, we think it important that the PJM Manuals contain a statement of the extent and character of documentation or support for a Unit's proffered actual or anticipated costs and revenues that will be accepted as establishing actual or anticipated costs and revenue. We suggest that the following statement would be appropriate:

> "Actual and anticipated costs and revenues may be shown upon the basis of actual accounting records, estimates provided PJM/IMM from expert and authoritative sources, costs or revenues achieved by other similar and similarly situated projects and similar such sources."

We suggest replacing the language in Matrix Item 2a with this language, and further urge that language stated in item 2ai and 2f be clarified to be consistent with the language above.

As respects Inflation Rate and Permitted Revenue Sources (Matrix Items 2ai & 2f), we urge that Developer offered projections should be accepted wherever the Developer can provide a credible and expert source for its projections. Such sources could include the forecasts of respected forecasting and economics firms even if available only to subscribers, so long as the Developer can arrange for PJM/IMM access to that part of the forecast needed to confirm the Developer's appropriate use of the forecast. As respects capital costs (Items 2aii to 2aiv), the MD PSC urges that a similar position as to Inflation Rate and Revenue should apply (i.e. accept credible source forecasts) and urges that Developers who wish to accept the lowest reasonable equity costs be permitted to do so. We also urge that PJM/IMM should accept all reasonable Unit development parameters, such as Balance Sheet financing from a strong Balance Sheet, existence of a long or intermediate term Purchase Power Agreement covering the unit (whether considered as providing revenue from within or outside PJM markets) which can substantially reduce capital attraction costs or other similar factor, high debt/equity ratings, etc., as acceptable Developer provided explanations for reasonable but lower capital attraction costs.

Turning to "asset life" and "residual value", the MD PSC notes that, as also noted by both PJM and IMM during the July 17 CSTF Meeting, that the generation equipment to which the MOPR applies, i.e. natural gas fired CT, combined cycle and IGCC equipment, has an expected service life of at least 35 to 40 years. The MD PSC urges that the combination of "Asset Life" and "Residual Value" employed as MOPR Common assumptions should permit generation developers to employ this or an even longer life if based on a reasoned analysis. As for "sunk costs", Developer identification of such costs and their elimination from costs upon which the reasonableness of the Developer's bid is evaluated should be accepted where the Developer can show that the costs have in fact been expended before the BRA in connection with which the MOPR evaluation is being made.

The Maryland PSC agrees with the preference of PJM/IMM and the Brattle Report [2] that a future estimate of E & AS Revenues be used and proposes that a three year period immediately following the Unit in-service date be employed as the basis of the estimate. A single year forward estimate risks that the chosen period would be abnormal for some reason and more often require subjective and controversial normalization adjustments. Finally, the MD PSC strongly opposes the use of Nominal Levelized cost recovery treatment both as inappropriate to a truncated one year cost evaluation (i.e. that of the BRA) and as inconsistent with the use of a one or three year revenue offset estimate. As described in the Brattle Report, Nominal Levelized assumes that investment and other fixed costs are recovered in equal installments over the life of major, capital intensive equipment such as generation equipment rather than with increasing payments over the equipment's life reflecting annual inflation. As Brattle explains, this advances expected inflation recovery into the early years of project life. [3] While either Nominal Levelized or Real Levelized, in inflation corrected terms, produces the same result over the unit's entire life, that is not true where the only value used for cost recovery is a first year value as in the case of the BRA. For this reason, Brattle recommends adoption of

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[2] The Brattle Group, Second Performance Assessment of PJM's Reliability Pricing Model at p. 86 (August 26, 2011)(Brattle Report).

[3] Brattle Report at pp. 82-86.

Real Levelized, stating that Nominal Levelized will result in cost over-recovery and over-procurement of generation resources under the RPM. [4] The MD PSC also urges adoption of the Real Levelized costing method.

The MD PSC expects to participate in the further development of this matter before the CSTF, and may have further suggestions to make in those further Stakeholder Meetings. This is particularly the case with respect to possible alternative costing assumptions being used by other RTO's (specifically ISO-NE) in similar evaluation processes which the MD PSC is still investigating and identifying.

Sincerely yours,

Walter R. Hall II

Walter R. Hall II
Senior Markets Advisor

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[4] Brattle Report at pp. 81 & 85. "[W]e believe setting CONE equal to level-nominal costs will overstate annualized costs over time and, as a result, could lead to over-procurement under RPM . . . ." Indeed, as respects defining minimum bid thresholds under MOPR, Brattle states an even stronger position, stating that: "We believe level-real annualization is more consistent with market fundamentals and competitive bidding behavior. As a result, we recommend against retaining the level-nominal approach for CC and CT offer thresholds under the MOPRs."