



MOPR Unit Specific Review Standardization

PJM CSTF

April 11, 2014



ACES
excellence in energy

History



FERC's May 2, 2013 Order (143 FERC ¶ 61,090) suggested that PJM conduct a stakeholder process to consider revisions to the unit-specific review process to make it more standardized:

144. While PJM asserts that, under its existing procedures, estimating certain costs and revenues is difficult, PJM can submit a section 205 filing to remedy these asserted deficiencies. 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**. Moreover, we encourage PJM and its stakeholders to consider these modifications to the unit-specific review process together with possible enhancements to the calculation of Net CONE (emphasis added).

Context



- To the extent a sell offer in any RPM auction cannot obtain a Competitive Entry or Self-supply exemption option, the unit specific review process in the PJM Tariff is available.
- Section 5.14(h)(8) iii) allows for a sell offer below the MOPR Floor Offer Price based on competitive cost advantages relative to the costs estimated for the MOPR screen, including costs resulting from the capacity market seller's business model, financial condition, tax status, access to capital or other similar conditions affecting the applicant's costs.
- FERC's 2013 Order suggested "Standardization" of the unit specific review.
- PJM has proposed Package A which standardizes many levelized cost items.
- Package C consists of many of the components in PJM's Package A with changes for the Cost of Capital and Asset life, and entails PJM annually publishing three sell offer values for each MOPR exemption category:
 1. Merchant;
 2. Self-supply IOU;
 3. Self-supply electric cooperative or public power entity.

Proposal



- PJM would publish a “standard” offer price for each of the three main MOPR exemption categories (Merchant, Self-supply IOU and Self-supply Electric cooperatives) subject to the ability of a seller to further utilize the unit specific review process in Section 5.14(h)(8) iii) to further refine their sell offers.
- These three sell offer prices would differ by:
 - Legal status of market participant in 3d;
 - Asset Life (Economic Life) in 2a(v);
 - Tax rate in 2e;
 - Overall weighted average cost of capital (WACC) pursuant to the WACC inputs found in CSTF Matrix cells 2a(ii), 2a(iii), 2a(iv);
- A resource needing to avail itself of the unit specific review would start with one of the sell offer price floors for one of the applicable MOPR exemption categories.
- Consistent with Para 144, the applicant would then be allowed to **“to provide [further] support for objective, individual cost advantages”**.

ATWACC



Component:	Category:	MOPR Process Matrix Cite	Merchant	LSE IOU	LSE Cooperative
Cost of Equity Methodology		2a(iv)	DCF or CAPM (Note 1)	DCF or CAPM	DCF or CAPM
Proxy Group for determination of cost of equity capital		2a(iv)	Merchant entities, but current proxy group is too small (under 3). (Note 2)	Vertically integrated utilities in PJM. FERC generally requires use of proxy group companies operating in the same region. (Note 4)	No publicly available companies to include in proxy group. A proxy group of low-beta, vertically integrated IOUs would be used to determine LSE Cooperative Cost of equity capital.
Typical Capital Structure		2a(ii)	40% Debt 60% Equity	45% Debt 55% Equity	70% Debt (or greater) 30% Equity
Credit Rating			“BB” or “B+”	“BBB”, all IOU group members are rated “BBB” or “BBB+”	“BBB” or greater.
Debt Cost rate with Credit Rating		2a(ii)	4.53% average yield (last 60 observations, from 4/4/14). (Note 3)	3.72% average yield (last 60 observations (from 4/4/14).	Same as LSE IOU.
Taxable? (Legal Status)		3d	Taxable	Taxable	Non-taxable (generally)
Indicative ATWAAC for starting Unit Spec. Review		-	$((4.53\% * .4) * (1-.35)) + (10\% *.6) = 7.18\%$.	$((3.72\% * .45) * (1-.35)) + (9.5\% *.55) = 5.6\%$.	$(3.72\% *.7) + (8\% *.3) = 5\%$.

Note 1: Note that FERC policy is that “a proxy group should consist of at least four, and preferably at least five members, if representative members can be found” Opinion No. 511, SFPP, L.P., 134 FERC ¶ 61,121 at P 203 (2011).

Note 2: FERC policy is to use the DCF. FERC has stated that “The Commission has found that the problems of estimating the betas on which the CAPM methodology relies make betas, in isolation, unreliable predictors of risk. They therefore make the CAPM methodology, alone, inappropriate for determining the ROE for an individual company”. ITC Holdings Corp., 121 FERC ¶ 61,229 at P43 (2007).

Note 3: <http://research.stlouisfed.org/fred2/release?rid=209>

Note 4: See Atlantic Path 15, LLC, 122 FERC ¶ 61,135 (2008) at Para 22: “We find that being located in the same geographic and economic region is a relevant factor to consider in determining whether companies face similar business risks”

Asset Life (Economic Life)



<u>Category:</u>	MOPR Process Matrix Cite	Merchant	LSE IOU	LSE Cooperative
<u>Component:</u>				
Asset Life (Economic Life)	2av	20 years	20 years	30 years

Benefits



-
- This default minimum offer price for each MOPR exemption category would result in an easier starting point for a seller that was not able to obtain a Competitive Entry or Self-supply exemption and that wishes to use the unit specific review:
 - forcing a IOU or Cooperative to “start” from a merchant cost perspective on WACC or useful life is inappropriate, since an IOU or cooperative will almost certainly have a ATWACC and possibly a useful life that is different than a merchant entrant.