UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Power Providers Group v. PJM Interconnection, L.L.C.	Docket No. EL11-20-000
PJM Interconnection, L.L.C.	Docket No. ER11-2875-000 (not consolidated)

REQUEST FOR REHEARING AND FOR EXPEDITED CONSIDERATION OF NEW JERSEY DIVISION OF RATE COUNSEL

Pursuant to Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713, New Jersey Division of Rate Counsel ("NJ Rate Counsel"), an intervenor in the above-captioned dockets, respectfully requests that the Commission grant rehearing of its April 12, 2011 Order in this proceeding.[1] In addition, we ask that the Commission address this rehearing application on an expedited basis, both because of the importance of the questions raised here and their direct relevance to ongoing efforts in New Jersey to promote investments in badly needed new generating facilities.

INTRODUCTION

The RPM Order leaves in its wake an unsettling new regulatory paradigm that undermines the states' traditional role in advancing legitimate public policy objectives

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[1] Order Accepting Proposed Tariff Revisions, Subject to Conditions, and Addressing Related Complaint, 135 FERC ¶ 61,022 (2011) ("RPM Order").

and assuring that their citizens and businesses have access to reliable, reasonably priced electric supply.[2] This result is at odds not only with the position taken by New Jersey and its supporters, but contrary even to the wishes of PJM, which in initiating Docket No. ER11-2875-000 took the "firm" position that the Minimum Offer Price Rule ("MOPR") should not apply to legitimate and good faith investments in new generating resources. If not reconsidered and revised, the RPM Order will effectively leave states seeking to encourage such investments with no economically rational option for moving them forward, notwithstanding unassailable demonstrations of need, the failure of the Reliability Pricing Model ("RPM") design to meet that need, and the states' determination to take plainly needed action.

In concluding that the MOPR—adopted as part of a settlement approved by the Commission in 2006 and confirmed against challenge in 2009—is in need of substantial reform, the RPM Order:

(1) starts from false premises regarding the nature of RPM and the function that the MOPR was intended to serve within it. The MOPR was not designed to hinder all "economic" entry. To do so would have been inconsistent with RPM's function as a residual market for satisfying capacity meets unmet through procurement outside of RPM. The RPM Order never supports its characterization of the resulting prices as "suppressed" prices, rather than the natural clearing prices of a smaller, residual market;

(2) wrongly characterizes the state MOPR exemption as a "weakness." The Commission's decision to transform RPM—which was designed to be a "last resort" and "residual" capacity auction process—into the only game in town for meeting capacity obligations is an unjust and unreasonable regulatory bait and switch;

(3) guts the agreed-upon state MOPR exemption, thereby wrongly eliminating bargained-for rights included in a Commission-approved settlement agreement;

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[2] *Cf. Devon Power LLC*, 109 FERC ¶ 61,154, P 47 (2004) ("Resource adequacy is a matter that has traditionally rested with the states, and it should continue to rest there."); *id.* P 70 ("The Commission remains committed to ensuring states have a central role in determining resource adequacy.").

(4) treats the New Jersey and Maryland initiatives as threats to the integrity of the RPM auction, but contains no analysis of the impacts that would occur were the initiatives to be implemented;

(5) leaves states facing resource deficiencies with the untenable choice of paying twice to satisfy the same reliability need or opting out of RPM entirely;

(6) eviscerates market participants' right to self-supply their own capacity obligations and to have those resources acknowledged in the RPM auction process. It does so even when the resources' impact on RPM prices would be negligible or non-existent, and thus oversteps any jurisdictional basis for its action;

(7) approves focusing the MOPR on the combined cycle and combustion turbine units that would likely be built under the New Jersey legislation because they are "more efficient resources to suppress capacity prices," but makes no showing that New Jersey's legislation was an attempt to suppress capacity prices and offers no response to the state's overwhelming showing to the contrary;

(8) provides no reasonable explanation for acting on PJM's filing now, rather than first requiring a stakeholder process to consider alternatives and seek the development of an agreed-upon solution; and

(9) saddles the Commission with the future obligations to pick and choose among state policies and programs to determine which of them seek to pursue sufficiently laudable objectives, and which constitute impermissible "subsidies" to new generators.

The losers under the RPM Order include the states, load serving entities ("LSEs"), the tens of millions of consumers in PJM that face (or may face at some point in the future) the prospect of significant capacity shortages or resource-mix concerns, and, more broadly, any entity seeking to act in reliance upon rights included in a FERC-approved settlement agreement. By contrast, the winners are a more finite group, including (a) incumbent generators that now will enjoy substantial, unwarranted protection against efforts to construct more energy-efficient facilities, and (b) the owners of those resource types that the RPM Order exempts from the MOPR, allowing them to proceed without mitigation, notwithstanding that their presence will have the same "price-suppressing"

effect as the combined cycle and combustion turbine resources that are discriminatorily singled out for mitigation.

The RPM Order responds that concerns not addressed by RPM can be met either by paying twice for needed capacity or dropping out of RPM entirely. Thus, the states are offered an unreasonable choice: give up the ability to take actions aimed at safeguarding electric reliability or abandon competitive markets. Forcing parties to make this choice is neither sound policy nor consistent with the Commission's obligations under the Federal Power Act.

I. STATEMENT OF ERRORS

In accordance with Rule 713(c)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(c)(1), NJ Rate Counsel presents the following specifications of error:

(1) The RPM Order errs by redefining RPM and the MOPR's function within it, and wrongly treating as "suppressed" capacity clearing prices that in fact are natural and appropriate in the context of a residual market. Transforming RPM from a residual market into the sole and exclusive option for market-based procurement of new capacity is an unexplained departure from precedent. The revisionist recasting of the purposes of RPM and the MOPR—which are the premises from which the rest of the order proceeds—renders the RPM Order arbitrary, capricious, and unsupported by reasoned decision-making.

(2) The RPM Order errs in subjecting (some) new self-supplied resources to the MOPR and potentially preventing them from clearing and counting toward meeting an entity's capacity obligation. The RPM Order's rulings regarding mitigation of self-supply are unexplained departures from precedent, and are part and parcel of the unexplained transformation of RPM into an all-or-nothing option for market-based procurement of new capacity. The RPM Order's rulings regarding mitigation of self-supply also exceed the Commission's jurisdiction by compelling states and load-serving entities ("LSEs") to purchase capacity from the specific resources that RPM selects, even if the states or LSEs plan to acquire other capacity resources outside of RPM. Alternatively, if the Commission possesses jurisdiction, it exercises it arbitrarily and capriciously by applying irrelevant economic criteria to reject self-supplied capacity resources that are

technically qualified to fulfill the function for which LSEs are required to provide capacity.

(3) The RPM Order errs in changing the MOPR so that, contrary to its original purpose and to Commission precedent, it (a) no longer focuses on mitigation of market power by entities with an incentive and ability to suppress prices, and (b) now seeks to hinder all "uneconomic" entry (by certain kinds of resources).

(4) The RPM Order is arbitrary, capricious, and unduly discriminatory in singling out some resource types to subject to the MOPR, while exempting others. The purported justifications for the discrimination are contradictory and unsupported. The Order errs in relying on resource types as a proxy for identifying offers likely to have been submitted with nefarious intent while ignoring (a) statements elsewhere that intent does not matter, (b) that the exempted resources will have the same price-reducing effect as gas-fired resources with the same capacity values, (c) that the same characteristics that supposedly make gas-fired resources prime candidates as price-suppression tools also makes them superior resources for quickly and cost-effectively responding to New Jersey's impending capacity deficiency, (d) Commission precedent and testimonial evidence explaining why efforts to suppress price are unlikely in this context, and (e) the New Jersey Legislature's authoritative statement of its intent in enacting the Long-Term Capacity Agreement Pilot Project ("LCAPP"), which it adopted for legitimate, non-price-suppressing reasons.

(5) The RPM Order errs in eliminating the MOPR's state-mandated resource exemption. The factual premises for the Commission's action are unsupported in that the order (a) purports to accept, under Section 205 of the Federal Power Act, the elimination of an exemption that PJM expressly proposed to retain (in modified form), (b) proceeds from a false assumption about the MOPR's original purpose, (c) treats as a "weakness" exposed by unforeseen circumstances a carefully-negotiated, Commission-approved exemption that in 2006 the Commission expressly found just and reasonable, over the same objections raised here, and with full knowledge of a Connecticut resource-procurement initiative similar to New Jersey's LCAPP program, and (d) apparently concludes without evidentiary support that the LCAPP program constitutes a grave threat to RPM. In rewriting the settlement that created the MOPR exemption and the Commission's own order approving it, despite the absence of unforeseen changed circumstances, the Commission departs from precedent without reasoned explanation and acts arbitrarily and capriciously.

(6) The RPM Order errs in eliminating the MOPR impact screen. By proscribing what it deems to be "uneconomic" entry into RPM (and thus interfering with state policy and LSEs' business decisions) even when the effect on wholesale rates is negligible or non-existent, the RPM Order exceeds the Commission's jurisdiction. None of the offered justifications for eliminating the impact screen are valid.

(7) The RPM Order errs in eliminating the "net short" requirement and thus (a) allowing potential mitigation of offers from entities that have no incentive to suppress prices and (b) creating a mechanism by which net sellers can exercise market power to raise prices.

(8) The RPM Order errs in using an unreasonable test to determine whether offers are "economic." This error applies both to the calculation of benchmarks used to screen offers and, even more importantly, to the standard against which individual offer justifications will be measured. The RPM Order fails to support its ruling that individual offers may be justified *only* by showing that they are "consistent with the competitive, cost-based, fixed, nominal levelized, net cost of new entry were the resource to rely solely on revenues from PJM-administered markets." Specifically, the RPM Order errs in (a) finding the Net CONE calculation, which is based on levelized costs and revenues rather than present-value calculations and which ignores entrants' assessment of likely future capacity revenues, is the only permissible method for assessing whether entry is economic; (b) adopting a nominal levelized rather than a real levelized approach to calculating Net CONE; and (c) calculating Net CONE using backward-looking estimates of energy and ancillary-service revenues, when economic entry decisions are based on forward-looking forecasts (which are likely to be higher than historical averages at the times when market-entry decisions are made);

(9) The RPM Order is unreasonable in failing to allow PJM's stakeholders (whether in the context of a PJM sponsored stakeholder process or a Commission supervised settlement proceeding) to attempt to develop better solutions than those adopted by PJM on the fly and in response to a complaint; and

(10) The RPM Order's conclusion, that the theoretical availability of an FRR option is a real alternative that cures or moots the revised RPM's defects, is unsupported by substantial evidence or reasoned decision-making. FRR was designed to meet the needs of the American Electric Power Company, a large, capacity-long, vertically-integrated utility. The order offers no support for its conclusion that FRR is a viable option for restructured retail markets and LSEs that have divested their generating facilities, particularly when, in that context, (a) RPM would serve as a price floor for FRR, and (b) generation resources could wield unchecked market power over potential FRR Entities.

II. STATEMENT OF ISSUES

In accordance with Rule 713(c)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(c)(2), New Jersey Rate Counsel presents the following Statement of Issues:

(1) Whether the RPM Order errs by (a) redefining RPM and the MOPR's function within it, (b) wrongly treating as "suppressed" capacity clearing prices that in fact

are natural and appropriate in the context of a residual market, and (c) transforming RPM from a residual market into the sole and exclusive option for market-based procurement of new capacity, and whether the revisionist recasting of the purposes of RPM and the MOPR—which are the premises from which the rest of the order proceeds—renders the RPM Order arbitrary, capricious, and unsupported by reasoned decision-making; *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 56 (1983) (citing *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D. C. Cir. 1970)); *Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477, 481 (D.C. Cir. 2009); *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, PP 71, 91, 169, 172 (2006); *ISO New England, Inc.*, 135 FERC ¶ 61,029, PP 222, 232 (2011); *Blumenthal v. ISO New England*, *Inc.* 135 FERC ¶ 61,117, P 42 (2011); 16 U.S.C. § 824*v*; Prohibition of Energy Market Manipulation, Order No. 670, 71 Fed. Reg. 4244 (Jan. 26, 2006), FERC Stats. & Regs. ¶ 31,202, *order denying reh'g*, 114 FERC ¶ 61,300 (2006).

(2) Whether subjecting (some) new self-supplied resources to the MOPR and potentially preventing them from counting toward satisfying an entity's capacity obligation (a) is an unexplained departure from precedent, (b) exceeds the Commission's jurisdiction, or (c) is an arbitrary and capricious exercise of jurisdiction that applies irrelevant economic criteria to answer what should be a technical question: whether the self-supplied resources are qualified to fulfill the function for which LSEs are required to provide capacity; *Md. Pub. Serv. Comm'n v. FERC*, No. 09-1296 (D.C. Cir. 2011) slip op. at 3; *Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477, 481; *Municipalities of Groton v. FERC*, 587 F.2d 1296, 1301 (D.C. Cir. 1978); *Sacramento Mun. Util. Dist. v. FERC*, 474 F.3d 797, 803 (D.C. Cir. 2007) (citing *Cent. Iowa Power Coop. v. FERC*, 606 F.2d 1156, 1172 (D.C. Cir. 1979)); *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, PP 71, 91, 169, 172 (2006); *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, P 13 (2006); *ISO New England, Inc*., 120 FERC ¶ 61,234, P 29 (2007); *Devon Power LLC*, 115 FERC ¶ 61,340, PP 20, 201 (2006), *reh'g denied*, 117 FERC ¶ 61,133, PP 108, 110 (2006); PJM Open Access Transmission Tariff (May 6, 2011); 16 U.S.C. §§ 824(a) and (b)(1), 824a(b), and 824f.

(3) Whether the RPM Order errs in changing the MOPR so that, contrary to its original purpose and to Commission precedent, it (a) no longer focuses on mitigation of market power by entities with an incentive and ability to suppress prices, and (b) now seeks to hinder all "uneconomic" entry (by certain kinds of resources); *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 56 (1983) (citing *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D. C. Cir. 1970)); 2006 RPM Settlement Order P 103;

(4) Whether the RPM Order is arbitrary, capricious, and unduly discriminatory in singling out some resource types to subject to the MOPR on the basis of presumed intent, despite (a) statements elsewhere that intent does not matter, (b) the fact that the exempted resources will have the same price-reducing effect as gas-fired resources with the same capacity values, (c) the fact that the same characteristics

that supposedly make gas-fired resources prime candidates as price-suppression tools also makes them superior resources for quickly and cost-effectively responding to New Jersey's impending capacity deficiency, (d) Commission precedent and testimonial evidence explaining why efforts to suppress price are unlikely in this context, and (e) the New Jersey Legislature's authoritative statement of its intent in enacting the Long-Term Capacity Agreement Pilot Project ("LCAPP"); FCM Order, PP 13 n.19, 170; P. L. 2011, c. 9, sec. 1 (N.J. 2011); *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 568 (2005); 2A Norman J. Singer and J.D. Shambie Singer, Sutherland Statutory Construction § 48:4 (7th ed. 2007); *New York Indep. Sys. Operator, Inc.*, 124 FERC ¶ 61,301 (2008), *clarified*, 131 FERC ¶ 61,170 (2010);

(5) Whether the RPM Order's elimination of the MOPR's state-mandated resource exemption was unsupported by substantial evidence or reasoned decision-making and departed from precedent without explanation, because it (a) purports to accept, under Section 205 of the Federal Power Act, the elimination of an exemption that PJM expressly proposed to retain (in modified form), (b) proceeds from a false assumption about the MOPR's original purpose, (c) treats as a "weakness" exposed by unforeseen circumstances a carefully-negotiated, Commission-approved exemption that in 2006 the Commission expressly found just and reasonable, over the same objections raised here, and with full knowledge of a Connecticut resource-procurement initiative similar to New Jersey's LCAPP program, (d) apparently concludes without evidentiary support that the LCAPP program constitutes a grave threat to RPM, and (e) without justification re-writes the terms of a Commission-approved settlement. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *Port of Seattle v. FERC*, 499 F.3d 1016, 1033 (9th Cir. 2007); *PJM Interconnection, L.L.C.*, 126 FERC ¶ 61,275 (2009); *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, PP 71, 91, 100, 104, 169, 172; *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, P 13 (2006); *PacifiCorp v. Reliant Energy Servs., Inc.*, 99 FERC ¶ 61,381, P 27 & n. 21 (2002), *reh'g granted*, 105 FERC ¶ 61,184 (2003);

(6) Whether the RPM Order's elimination of the impact screen causes the MOPR to interfere with state policy and LSEs' business decisions even when the effect on wholesale rates is negligible or non-existent, thus exceeding the Commission's jurisdiction, and whether any of the offered justifications for eliminating the impact screen are valid; *Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d at 485;

(7) Whether elimination of the "net short" requirement errs by (a) allowing potential mitigation of offers from entities that have no incentive to suppress prices and (b) creating a mechanism by which net sellers can exercise market power to raise prices;

(8) Whether the RPM Order errs in using an unreasonable test to determine whether offers are "economic," both in calculating the benchmarks used to screen offers and, even more importantly, in judging individual-offer justifications, by (a)

finding the Net CONE calculation, which is based on levelized costs and revenues rather than present-value calculations and which ignores entrants' assessment of likely future capacity revenues, is the only permissible method for assessing whether entry is economic; (b) adopting a nominal levelized rather than a real levelized approach to calculating Net CONE; and (c) calculating Net CONE using backward-looking estimates of energy and ancillary-service revenues, when economic entry decisions are based on forward-looking forecasts (which are likely to be higher than historical averages at the times when market-entry decisions are made);

(9) Whether the RPM Order is unreasonable in failing to allow PJM's stakeholders (whether in the context of a PJM sponsored stakeholder process or a Commission supervised settlement proceeding) to attempt to develop better solutions than those adopted by PJM on the fly and in response to a complaint; PJM Members Handbook at 9 (Jan. 22, 2009); *Devon Power LLC*, 112 FERC ¶ 61,179, *clarified*, 113 FERC ¶ 61,031 (2005); *Devon Power LLC*, 113 FERC ¶ 61,075, P 5 (2005); *NEPOOL and ISO New England, Inc.*, 105 FERC ¶ 61,211 (2003); *Braintree Elec. Light Dept.,* 128 FERC ¶ 61,008, P 54 (2009); and

(10) Whether the RPM Order's conclusion, that the theoretical availability of an FRR option is a real alternative that cures or moots the revised RPM's defects, was supported by substantial evidence or reasoned decision-making, when (a) FRR was designed to meet the needs of a large, capacity-long, vertically-integrated utility; and (b) there is no support for the conclusion that FRR is a viable option for restructured retail markets and LSEs that have divested their generating facilities.

III. REQUEST FOR REHEARING

This rehearing request is organized to address each of the errors associated with the specific market-design changes that the RPM Order either accepted or required. Before doing so, however, we address an error that cuts across all of the issues in this proceeding and ultimately undermines the Commission's approval of virtually all of those changes.

A. The RPM Order errs by redefining RPM and the MOPR's function within it, and treating capacity clearing prices that are appropriate in the context of a residual market as "suppressed".

The fundamental question in this case is easily stated: whether it is legitimate for states and LSEs to be able to meet a portion of their capacity needs with new resources

procured outside RPM, without being required to opt out of RPM entirely.[3] While the answer originally was "yes," it now is "no," at least in the case of an entity seeking to construct gas-fired generation.[4] The RPM Order has fundamentally changed both RPM's purpose and design and the MOPR component of that design, although the Commission has failed to justify its marked changes in course.[5] The failure to do so renders its actions arbitrary and capricious, and means that the RPM Order must be reconsidered and reversed.[6]

The P3 Complaint, PJM's Section 205 filing, and the RPM Order all proceed from false and unsupported premises that are at odds with the Commission's earlier approval of RPM as a residual market. The RPM Order rests on the asserted need to forestall uneconomic entry and resulting "price suppression." But the RPM Order never

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[3] We explain below why the availability of an FRR option to opt out of RPM completely does not render just and reasonable the newly imposed restrictions on how states and LSEs can satisfy their resource-adequacy obligations within the context of RPM.

[4] The RPM Order is internally inconsistent. It expands the hard-wired exemptions that allow below-cost, "price suppressing" offers to be submitted for certain Commission-preferred resource types, at the same time that it rejects the submission of such offers for other types of resources that states or LSEs may procure outside of RPM. As explained below, the distinction is unduly discriminatory and unreasoned. It also exceeds the Commission's jurisdiction by going beyond merely establishing resource-adequacy requirements for transmission customers, or determining prices for capacity-deficient customers, to dictating the specific resources that may be used to satisfy those requirements.

[5] "An agency's view of what is in the public interest may change . . . But an agency changing its course must supply a reasoned analysis . . . " *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 56 (1983) (citing *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970)), *cert. denied*, 403 U.S. 923 (1971); *see also Hatch v. FERC*, 654 F.2d 825, 834 (D.C. Cir.1981) ("it is [well] settled that an agency must provide a reasoned explanation for any failure to adhere to its own precedent").

[6] In order for an agency decision to not be considered arbitrary and capricious, the agency must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (citing *Burlington Truck Lines, Inc. v. United States*, 371 U. S. 156, 168 (1962)); *see also Green Island Power Authority v FERC*, 577 F.3d 148 (2d Cir. 2009) (vacating Commission Order as arbitrary and capricious when decision was predicated on reasons not contemplated by Commission regulations and agency failed to conduct a proper analysis of the evidence before it); *Port of Seattle v. FERC*, 499 F.3d 1016, 1032-33 (9th Cir. 2007) (holding Commission's findings arbitrary and capricious and not supported by substantial evidence when the record did not provide evidence clarifying the basis for the findings).

establishes that lower prices resulting from reliance on non-RPM resources are indeed wrongfully "suppressed" prices—as opposed to being just and reasonable market prices for the role that RPM was in fact designed to serve: a smaller, residual market that would supplement resources procured through other means. Instead, the RPM Order misstates the task for which RPM was created, and, in turn, a series of erroneous conclusions follow.[7]

As we explained at length in our protest of the P3 complaint and PJM's section 205 filing, RPM is—and was designed to be—a residual mechanism for the procurement of capacity *not obtained by other means*. Its centerpiece is named the "Base *Residual* Auction." It never was intended to operate as the only means by which new generation could be procured and existing generation retained in PJM—or even within RPM. Nor were RPM prices intended to be propped up artificially to attempt to counter the impacts of actions taken outside RPM by market participants pursuing legitimate business purposes or state governments pursuing legitimate state policy interests. To the contrary, an important corollary to RPM's role as a residual market was that RPM prices were to be affected by supply and demand changes resulting from extra-RPM decisions. Now, without acknowledging its drastic paradigm shift, the RPM Order turns the historical structure and purpose of RPM on its head by declaring that participation in RPM must be an all-or-nothing affair.

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[7] The MOPR modifications approved by the Commission change the focus of that provision from a targeted approach to market power mitigation to a presumption that mitigation is required for certain types of new resources, regardless of the resource owner's intent or ability to "suppress" prices or the extent to which the owner's conduct has an actual impact on RPM prices.

The Commission first explained the residual nature of RPM in its order on PJM's initial RPM filing, which explained why the pre-RPM construct was no longer just and reasonable and why RPM was needed:

> [A] forward procurement auction is necessary because the market alone under the existing market rules and market conditions is not eliciting the amount of resources needed to meet reliability needs. Thus, we conclude that, *after LSEs have had an opportunity to procure capacity on their own*, it is reasonable for PJM to procure capacity in an open auction at a time when further delay in procurement could jeopardize reliability. *This, however, should be a last resort.*

PJM Interconnection, L.L.C., 115 FERC ¶ 61,079, P 71 (2006) ("Initial Order") (emphasis added). RPM's purpose, the Commission explained, was to "provide price signals and price stability that will enable LSEs to purchase capacity, and generators to offer to provide capacity, in a more informed and efficient fashion." *Id.* P 169. Using that information, LSEs still would "make their own business decisions about how much capacity to build or procure in long-term contracts and at what cost, and *how much* to obtain through PJM's auction." *Id.* (emphasis added).

The Commission went on to explain even more clearly how the process would work:

> Under RPM, LSEs may procure capacity in advance and outside of the four-year-ahead procurement auction. *An LSE's capacity that is procured in advance would be offered into the procurement auction at a price of $0, but it would receive the applicable market-clearing capacity price established in the auction. The LSE would be required to pay the capacity price as determined in the auction for the amount of capacity needed to meet its full capacity obligation. But the auction revenues received by the LSE for its capacity would be used to offset the LSE's purchase payments, thereby reducing its net bill.* To the extent that the amount of capacity procured in advance fell short of its capacity requirement, its net bill would reflect the capacity

> price for the amount of its net capacity deficiency. Conversely, to the extent that the amount of capacity procured in advance exceeded its capacity requirement, the LSE would be rewarded with a net payment.

Id. P 91 (emphasis added). Until the instant Order, the Commission never suggested that RPM participation was a binary choice, requiring an LSE either to acquire all of its capacity needs through the RPM auction or to opt out entirely using the FRR option.

On the contrary, the Commission relied on the flexibility that RPM afforded to LSEs when it rejected state commission claims that RPM would usurp state jurisdiction over generation facilities:

> The West Virginia Commission asserts that by accepting the RPM proposal, we would be endorsing PJM's intrusion into state jurisdiction over generation. This is, however, an incorrect understanding of the RPM proposal. Under the RPM proposal as filed, LSEs may either (a) build their own needed capacity or create an incentive for the construction of new capacity by entering into long-term bilateral agreements, (b) refrain from entering into bilaterals and pay the (presumably higher) prices set by the demand curve, or (c) develop transmission or demand response solutions to capacity problems. PJM is not proposing to mandate or in any way require the construction of new generation. Rather, it seeks to render transparent the choices that LSEs make to fulfill their capacity needs, so that they may make those choices in a more informed fashion.

Id. P 172.

And until it changed course during this proceeding, PJM shared the understanding of RPM as a residual market through which LSEs could choose to satisfy only some of their needs for new capacity. For example, during the New Jersey Board of Public Utilities' ("NJ BPU's") technical conference to consider the sufficiency of the capacity

procured through RPM to meet New Jersey's needs,[8] PJM's Senior Vice President for Reliability Services recapped:

> I think you've heard RPM is working well. RPM is not working at all. I would offer the truth is probably someplace in between those two.
>
> We are committed to continue working on RPM. Ultimately, there may be a replacement. I don't know that answer whether we will get there or not. *I would offer that RPM was never meant to be the end-all and be-all for the capacity markets. We always envisioned to be a piece of it. We envisioned that there would be longer term contracts. There are ways to self supply. There are ways to literally pull yourself out of RPM. Those options were always, always built in there.*[9]

PJM's post-conference comments expanded on the limited nature of RPM, explaining that "RPM was never intended to be the sole source of revenue through which resource development decisions would be made, nor was it intended to be the only mechanism through which new capacity resources could be financed or constructed."[10] Instead, RPM was designed to "augment long-term contracting" (*id*. at 5):

> RPM was never intended to be the sole market mechanism to complement the Energy and Ancillary Service Markets by which investment in new capacity resources would be made. In fact, the name of the main procurement auction held three years in advance of the delivery year, "Base *Residual* Auction," was selected specifically to convey the message that *RPM does not foreclose long-term resource*

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8 Notice of Technical Conference, In the Matter of the New Jersey Board of Public Utilities Review of the State's Electric Power and Capacity Needs, Docket No. EO09110920 (N.J.B.P.U. June 14, 2010), *available at* http://www.state.nj.us/bpu/pdf/announcements/20100624.pdf ("Notice of Technical Conference").

9 Transcript of the June 24, 2010 New Jersey Capacity Issues Technical Conference at 196-197, In the Matter of the New Jersey Board of Public Utilities Review of the State's Electric Power and Capacity Needs, Docket No. EO09110920 (June 29, 2010) (emphasis added).

10 Comments of PJM Interconnection, LLC at 2, In the Matter of the New Jersey Board of Public Utilities Review of the State's Electric Power and Capacity Needs, Docket No. EO09110920 (July 6, 2010), http://www.state.nj.us/bpu/pdf/energy/PJM_comments.pdf ("PJM BPU Comments").

> *procurements outside of RPM auctions*. Load Serving Entities (LSEs) or other entities with capacity obligations and developers of new capacity resources are free to enter into contracts at mutually agreeable prices and terms that would help the LSEs and other entities meet their capacity obligations while providing revenue certainty for the resource developer. *The resulting capacity addition would then be entered into RPM auction, but the actual financial settlement between the LSE and resource developer would be governed by the contract terms. This self-supply of a load's capacity obligation in RPM results in load and the resource developer being indifferent to the RPM clearing price.*

Id. at 6-7 (emphasis added).

These depictions of how RPM was supposed to work comport exactly with the picture offered by New Jersey Rate Counsel's witness, James F. Wilson. Mr. Wilson explained in his affidavit (appended to NJ Rate Counsel's March 4, 2011, Protest Opposing P3 Complaint and PJM Section 205 Filing[11] in this proceeding) ("Wilson Aff.") that the P3 and PJM proposals (now adopted in the RPM Order) were based on "fundamental misconception regarding how major new resources are developed and offered into RPM."[12] As he explained, such decisions are made based on considerations outside of RPM and are then taken into account in the offers made into the RPM auction:

> The proposal rests on the belief that the sponsors of new power plants will (or should) offer their projects into RPM's auctions at prices based on their full levelized cost of new entry net of an estimate of net earnings from energy and ancillary services markets, and allow the auction result to determine whether or not they will build the resource . . . [I]n fact, the sponsors of new power plants generally will not, and certainly should not be forced to, offer their plants into an RPM auction at prices determined in this manner. Decisions to build new long-lived power plants are

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[11] eLibrary No. 20110304-5199.

[12] Wilson Aff. ¶ 13.

> rationally based on a long-term view of plant economics, and sponsors will generally not submit their decision to the result of an auction whose outcomes are notoriously volatile and which in any case determine a capacity payment for only a single year. *Instead, decisions to build major new power plants generally occur outside of RPM and then are reflected in offers into RPM that the sponsors fully expect will clear.*

Id. (emphasis added).

Consistent with the original conception of RPM as a residual capacity market, Mr. Wilson explained why RPM prices neither are—nor should be expected to be—the primary driver of new entry. First, he explained, "both buyers and sellers prefer longer-term commitments and the price stability and assurance of supply that go with longer-term arrangements." *Id.* ¶ 19. Mr. Wilson's observation is consistent with the Commission's own recounting of "'the comments made to us by representatives of the financial community, that dependence on price volatility for investment is an inadequate foundation for cost-effective financing of new infrastructure,'" including "'[a] clear preference for long-term contracts and/or reliable revenue streams.'" Initial Order P 68 (quoting *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112, P 20 (2004)). Second, he noted, "resource additions are increasingly being selected based on a range of attributes that RPM and the other PJM spot markets do not value," such as "environmental attributes, fuel diversity, and operational characteristics, among other factors." Wilson Aff. ¶ 20. And once entry decisions reflecting these considerations are made, it is consistent with both the proper functioning of a residual capacity market and economic rationality for the resource to be offered into the capacity auction at a low price (reflecting its going-forward costs) and for the residual market price to respond

accordingly, which may send a price signal to some older, higher cost resources that they are no longer needed.

It is true that procurement of resources outside of RPM will tend to reduce the residual RPM clearing price.[13] But so long as the non-RPM procurement furthers a legitimate business purpose unconnected to the price reduction, it is not price "suppression."[14] Nor is it illegal, anticompetitive, or against public policy.[15] It is simply the residual spot (one-year commitment) capacity market working as designed.[16]

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[13] In its companion order addressing New England's Forward Capacity Market ("FCM"), *ISO New England, Inc.*, 135 FERC ¶ 61,029, P 222 (2011) ("FCM Order"), the Commission recounted that certain LSEs contended that the FCM rules "preclude[d] any possibility of price suppression by the simple means of concurrently removing [from the auction] both the self-supplied capacity and the load it is obligated to serve." The Commission disagreed, noting that removing load from the auction by means of self-supply "has the same price effect as offering the new resource at a price of zero." *Id.* P 232.

[14] *See Blumenthal v. ISO New England, Inc.* 135 FERC ¶ 61,117, P 42 (2011) (rejecting claim of market manipulation because the conduct at issue was a "legitimate business decision"); *Brian Hunter*, 135 FERC ¶ 61,054, P 52 (2011) ("[I]t is often *scienter*—i.e., manipulative intent—that 'is the only factor that distinguishes legitimate trading from improper manipulation.'") (quoting *ATSI Commc'ns v. Shaar Fund Ltd.*, 493 F.3d 87 (2d Cir. 2007)); *see also id.* P 94 (affirming the ALJ's credibility determinations and finding that the evidence did not support Hunter's claims that his trading was driven by the proffered business reasons). The Commission has ample tools to protect against activity that serves no legitimate business purpose besides reducing RPM prices in order to produce economic gains on a portfolio basis. *See* 16 U.S.C. § 824*v*; Prohibition of Energy Market Manipulation, Order No. 670, 71 Fed. Reg. 4244 (Jan. 26, 2006), FERC Stats. & Regs. ¶ 31,202, *order denying reh'g*, 114 FERC ¶ 61,300 (2006).

[15] P3's own expert, Professor Hogan, acknowledged the conflict between P3's mitigation proposals and states' legitimate policy needs:

> Introduction of subsidized investment in generation capacity is not *per se* the exercise of buyer market power. As pointed out by many others in the present matter, there are reasons other than price manipulation for government policies to support certain types of generation capacity. For example, government efforts to promote green technology development may involve initial subsidies to support learning-by-doing and early technology development. Economic development policies could be part of broad policy of economic recovery. Long-term contracts beyond the three year horizon of New Jersey's Basic Generation Service could provide economic hedges. There is no disagreement that there can be legitimate public purposes served through various types of government policy support.

Statement of William W. Hogan, Ph.D. at 9:7-15, Ex. 7 to P3 Answer to Motions to Dismiss (Mar. 18, 2011), eLibrary No. 20110318-5132 ("P3 Answer") (footnotes omitted).

[16] *See Conn. Dept. Of Pub. Util. Control v. FERC*, 569 F.3d 477, 481 (D.C. Cir. 2009) (emphasis added):

> State and municipal authorities retain the right to forbid new entrants from providing new capacity, to require retirement of existing generators, to limit new construction to more expensive, environmentally friendly units, or to take any other action in their role as regulators

Against this backdrop of RPM's role as a residual market, it should be apparent that the MOPR's function within RPM originally was a limited one. It was not intended to prevent all "uneconomic" entry as the RPM Order now claims.[17] Yet the RPM Order revamps the MOPR in a way that precludes much non-RPM procurement and transforms PJM's residual capacity market into an all-or-nothing proposition (except for entry by favored resource types that are exempted from the rule). The Commission attempts to justify this about-face by asserting that it is necessary to respond to "mounting evidence of risk from what was previously only a theoretical weakness in the MOPR rules that could allow uneconomic entry."[18] But that is revisionist history. What the RPM Order describes as "previously . . . theoretical[] weakness in the MOPR" (*id.*) were, in fact, Commission-approved tariff elements reflecting a conscious and purposeful decision to design RPM as a residual market. The only "risk" reflected in the record of this case is the risk of RPM being used as it was designed. The Commission has presented no reasoned basis for changing course.

The harm resulting from the Commission's abrupt course-reversal (and revisionist justification) is substantial. As a result of the RPM Order, states and LSEs are now

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> of generation facilities without direct interference from the Commission. Of course, those choices affect the pool of bidders in the Forward Market, which in turn affects the market clearing price for capacity. And in an extreme situation where local regulators utterly refused to allow creation of any new capacity to offset increases in the ICR, the price would rise towards the initial offering price of two times the cost of new entry. *But this is all quite natural: if consumer constituents of state commissions prefer to forbid the construction of new power plants, they will appropriately bear the costs of that decision, including paying more for system reliability from older and less efficient units.*

The converse is equally natural. If consumer constituents of state commissions prefer to meet some of their capacity needs with resources procured outside of RPM—for example, because they value resource attributes that RPM does not value—they will pay the cost of doing so but will need to purchase less capacity from the residual market, which naturally reduces prices in that market.

[17] RPM Order P 104 ("The very purpose of the MOPR, in fact, is to hinder such uneconomic entry.").

precluded from relying on RPM to procure only their residual capacity needs. They may use RPM to supply all of their needs or none of them, but nothing in between. Absent opting out entirely, the only way a state or LSE can procure a resource that RPM would deem to be uneconomic, is to buy and to pay for duplicative capacity. In that instance, the state or LSE would pay for the resource, but would receive no RPM credit for it, and would nonetheless be required to buy its full complement of RPM capacity. That outcome is both inefficient and unreasonable. It is not a reasonable condition to impose on entities that believe RPM is beneficial and that seek to use it but do not believe that RPM alone can secure the right mix of resources.

Such considerations are why, contrary to the RPM Order's assumption (P 102), "[m]itigating an offer that is below a new resource's actual costs" *can* "be considered 'over mitigation.'" The residual RPM market was designed to allow such offers (absent an excessive impact on RPM prices and certain other conditions which, taken together, constituted evidence of an attempt to suppress prices) because there are legitimate reasons why states and LSEs would want to procure resources outside of RPM that RPM would deem uneconomic, without abandoning RPM altogether.

Not only do states and local governments have a long history of determining which resources will best meet their citizens' needs. Governments at all levels—including the Federal government—have an equally long history of using various forms of subsidies or taxes to promote or discourage the development of such resources. Governmental licensing, permitting, and siting decisions directly affect generator market entry and cost structures. Transmission siting decisions affect the size of the geographic

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[18] RPM Order P 139; *see also id*. P 108.

market and, thus, the supply available within a market. Governmental incentives to promote use of favored generation technologies (including incentives for new transmission investment), re-use of brownfield sites, or development in economically-disadvantaged areas directly affect—indeed, they are intended to affect—market outcomes. So too do governmental policies promoting the development of qualifying facilities, demand response, energy efficiency, and conservation. These incentive programs employ various mechanisms to achieve their policy ends, including tax credits, deductions, and other incentives such as accelerated depreciation; government loans and loan guarantees; direct contracting; favorable rate treatment; and other measures. Conversely, governments commonly tax technologies and activities that they deem to be harmful to their citizens. Every single one of these mechanisms affects wholesale price outcomes in power markets, and none is contingent upon prior review and potential mitigation by the Commission. There is no reason for the Commission to seek to identify and nullify every such effect and no reason to treat the Maryland and New Jersey programs any differently.

Nor can it be argued sensibly that such subsidies are permissible only so long as they do not discriminate between new and existing resources. Some legitimate state interests can be satisfied effectively *only* by new resources. States that are worried about reliability or about an excessive reliance on certain fuels or resource types are, by definition, dissatisfied with the mix of existing resources. That problem can be solved only by targeting new resources. The same is true for other legitimate state interests. For example, redevelopment of vacant brownfield sites can be accomplished only by new

resources, not existing ones. Similarly, new resource construction spurs job creation and economic development more effectively than the expansion of existing resources.

These interests, which can be satisfied only by new resources, are at the core of New Jersey's Long-Term Capacity Pilot Program ("LCAPP"). As we explain further below, New Jersey's legislature and governor enacted the LCAPP law because of a confluence of circumstances: RPM has not resulted in the addition of intermediate or base load resources in the state, New Jersey's in-state generation fleet is aging, with more than 50 percent being more than 30 years old, and New Jersey has become heavily reliant on imports of coal-fired generation at risk of retirement.[19] These problems cannot be solved with existing generation alone. They require the entry of new generation, which RPM has not procured. Likewise, in implementing the LCAPP law, the NJ BPU selected resources that provide substantial economic-development benefits that are largely unique to new resources. As recounted in the Board's Order:

> The [LCAPP] Agent has determined that the recommended SOCA portfolio offers substantial socioeconomic benefits to the State of New Jersey on an expected value basis. These benefits are primarily due to the expansion of direct employment for the duration of the associated construction phases of the projects, and the new on-site permanent jobs associated with operation and maintenance of the new generation facilities during their operating lives. In addition, employment and incomes are expected to increase due to the indirect impacts of increasing the demand for goods and services procured from New Jersey firms during the construction and operations phases, giving rise to what is known as an economic multiplier effect . . . .
>
> The Agent has determined that the recommended SOCA portfolio also offers significant environmental benefits to New Jersey's electric customers. These environmental

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[19] P.L. 2011, ch. 9, § 1 (N.J. 2011).

> benefits result from the displacement of incumbent generation with the portfolio of cleaner, gas-fired generation, resulting in lower net emissions of NOx, SO2, and mercury across the PJM region, much of which is upwind of New Jersey. In addition, two of the three projects, the Newark Energy Center and the Woodbridge Energy Center, will be located on brownfield sites. The beneficial reuse of formerly impaired properties represents a significant environmental benefit that may ultimately confer additional economic benefits as well.

LCAPP Order at 8-9, NJ BPU, Docket No. EO11010026 (Mar. 29, 2011) (footnotes omitted). It is entirely legitimate—and consistent with RPM's original design as a residual market—for New Jersey to pursue such policies without MOPR interference.

New Jersey's ability to pursue these policies should not depend on whether the resources needed to do so happen to be the same ones that RPM deems to be economic. And the price for choosing resources that RPM deems to be uneconomic should not be forcing New Jersey either to build duplicative capacity or to give up RPM. Putting New Jersey to such choices is unreasonable and inconsistent with the Commission's prior approval of RPM as a residual market.

B. The RPM Order errs in subjecting (some) new self-supplied resources to the MOPR and potentially preventing them from clearing.

As recounted in the RPM Order (PP 184-85), P3 construed PJM's existing MOPR as not applicable to new self-supplied resources, while PJM denied the existence of such an exemption. Both asserted that, in any event, the MOPR should not exempt new self-supply. *Id.* The RPM Order "agree[s] with PJM that its current tariff does not exempt resources that are planned to be self-supply from the MOPR and therefore agree that the current revisions do not change the tariff." *Id.* P 192. The RPM Order goes on to find that, "even if this did constitute a change, we agree with PJM that planned generation

designated by a load serving entity as self-supply should . . . be subject to an offer floor based on its entry costs until it clears in the base residual auction." *Id.* These findings are in error for several reasons.

1. RPM was designed to permit self-supply with new resources without any judgment as to whether they were "economic."

The finding that PJM's tariff subjected new self-supplied resources to mitigation—and potentially prevented it from clearing if it were deemed uneconomic—cannot be squared with the previously unquestioned understanding of RPM as a residual market designed to meet capacity needs "after LSEs have had an opportunity to procure capacity on their own."[20] Nor can it be squared with the Commission's explanation that "[u]nder RPM, . . . [a]n LSE's capacity that is procured in advance would be offered into the procurement auction at a price of $0, but it would receive the applicable market-clearing capacity price established in the auction."[21] These decisions were reflected in the terms of PJM's tariff and the Reliability Assurance Agreement ("RAA").

The ability to rely on the RPM market in whole or in part is consistent with the self-supply right that the Commission has repeatedly confirmed is an essential component of the Commission's capacity market design. Self-supply was identified in the Commission's order approving the settlement creating RPM as a primary option for meeting capacity needs, with RPM serving as a backstop in the event that LSEs were unable to meet their needs through other means:

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[20] Initial Order P 71; *id.* P 169 ("LSEs will still make their own business decisions about how much capacity to build or procure in long-term contracts and at what cost, and how much to obtain through PJM's auction.")

[21] *Id.* P 91.

> To meet the capacity needs of Load Serving Entities that failed to procure enough capacity through self-supply or bilateral contracts, PJM proposed to hold an auction each year, in which PJM would procure the remainder of the capacity requirement.

PJM Interconnection, L.L.C., 117 FERC ¶ 61,331, P 13 (2006) ("2006 RPM Settlement Order"). Similarly, the Commission stated as much in approving the FCM in New England.

> FCM allows load-serving entities to self-supply: load-serving entities may use owned and contracted resources (in whole or in part) to supply their capacity obligations. Thus a load-serving entity can meet its capacity obligations without paying the auction clearing price. Resources designated as self-supply are subject to the same performance obligations and qualification requirements as other resources participating in the FCM and the FCAs.

Devon Power LLC, 115 FERC ¶ 61,340, P 20 (2006). The Commission has continued to say as much with respect to RPM, referring to it as being "for the procurement and pricing of unmet capacity obligations[.]" RPM Order P 4.

Consistent with these understandings, the introduction to PJM Tariff Attachment DD, establishing RPM, explained that RPM was intended to provide:

> (a) support for LSEs in satisfying Daily Unforced Capacity Obligations . . . through Self Supply of Capacity Resources; [and]
>
> (b) a competitive auction mechanism to secure the forward commitment of additional Capacity Resources . . . as necessary to satisfy the portion of LSEs' Unforced Capacity Obligations *not* satisfied through Self-Supply . . . ;

Attachment DD to PJM Open Access Transmission Tariff (May 6, 2011), *available at* http://www.pjm.com/~/media/documents/agreements/tariff.ashx ("PJM Tariff Attachment DD") (emphasis added). Similarly, the tariff defined the term "Base Residual Auction" to mean "the auction conducted three years prior to the start of the Delivery Year to secure

commitments from Capacity Resources as necessary to satisfy any portion of the Unforced Capacity Obligation of the PJM Region not satisfied through Self-Supply." *Id.* § 2.5.

The tariff defined "Self-Supply" to mean capacity resources secured by an LSE "by ownership or contract, outside a Reliability Pricing Model Auction" that are used to "meet obligations under this Attachment or the [RAA] through submission in a Base Residual Auction of a Sell Offer indicating [an] intent that such Capacity Resource be committed *regardless of clearing price*." *Id.* § 2.65 (emphasis added).[22] Capacity Resource has the meaning given to it by the RAA, *id.* § 2.12, which defines the term to include either existing *or* planned resources.[23] Given that RPM was designed to allow LSEs to meet their capacity obligations with self-supplied Planned resources that would be committed *regardless* of clearing price, using the Base Residual Auction ("BRA") to procure only the remainder of their needs, there is no reasonable basis on which to conclude that such offers were subject to the MOPR.

The centrality of unmitigated self-supply to RPM's original design also undermines arguments purporting to show why mitigation is necessary. The RPM Order claims that mitigation is necessary "[t]o protect the integrity of PJM's wholesale capacity markets under RPM." RPM Order P 193. But LSEs' ability to self-supply with new resources procured outside RPM, without mitigation, has been one of RPM's core features since its inception, and no one has claimed that any of the first seven auctions conducted under those rules produced unjust and unreasonable rates. As RPM was

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[22] Sell offers with a price bid are not considered "self-supply" for purposes of RPM. *Id.*

[23] PJM Attachment DD § 1.8.

designed to be a residual market, the RPM Order fails to show how market integrity can be threatened by allowing it to function as designed.

The RPM Order claims that "permitting new self supply investment to compete as a price-taker in RPM impermissibly shifts the investment costs of self-supply to competitive supply by suppressing market clearing prices, and will create an environment in which only such self supply investment will occur." RPM Order P 195. But the RPM Order fails to identify any basis for now labeling impermissible what it previously hailed—indeed, even relied on for jurisdictional support—as an important feature of the Commission-approved market: the flexibility afforded LSEs to "make their own business decisions about how much capacity to build or procure in long-term contracts and at what cost, and how much to obtain through PJM's auction."[24]

Nor does offering new self supply as a price-taker in RPM "shift . . . investment costs of self-supply to competitive supply by suppressing market clearing prices," as claimed. If the new self supply is owned generation or a long-term contract, then the load that finances the construction explicitly bears the investment cost of the new resource. Admittedly, some new resources that otherwise would clear RPM at the higher price may not be built at the lower price, and some existing resources that would have to invest capital to continue operations may retire. But that means that potential investors in those RPM resources will *avoid* investment costs; it does not mean that they will bear investment costs associated with the non-RPM supply.

Finally, the RPM Order suggests that "permitting new self-supply to participate in RPM as a price-taker[] would significantly impede competition from all types of private

investment and shift long-term investment risk from private investors to captive customers." RPM Order P 195. Yet "permitting new self supply to participate in RPM as a price-taker" is not new; it is how RPM's base residual auction has worked all along. Under that design, it was to be the captive customers or their representatives—the LSEs and the states—who decide how much capacity to procure outside of RPM (i.e., through self-build construction, bilateral contracts, etc.) and how much to procure through the auction. Presumably, sophisticated load-side interests are capable of judging for themselves whether their long-term interests are best served by meeting their needs exclusively through RPM or through a mix of RPM and non-RPM resources. It is self-contradicting to rely on markets (which depend in turn on the parties' equal sophistication and bargaining power) to establish just and reasonable rates, while treating one side of the market as too unsophisticated or short-sighted to judge whether it is in their long-term interest to participate.

2. It is beyond the Commission's jurisdiction—or, alternatively, is an arbitrary and capricious exercise of it—to compel unneeded capacity purchases by denying RPM credit to technically-capable, self-supplied reliability resources.

Neither the existence of a market nor the sale of electric capacity is an end in itself. They are means to other ends. As the D.C. Circuit has explained, RPM—the Reliability Pricing Model—is the mechanism that PJM uses to "prevent[] interruptions to the delivery of electricity in that region by ensuring that its system has sufficient generating capacity."[25] The determination of whether a self-supplied resource can be used

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[24] Initial Order P 169; *see also id.* P 172.

[25] *Md. Pub. Serv. Comm'n v. FERC*, No. 09-1296 (D.C. Cir. 2011) slip op. at 3.

to satisfy an LSE's obligation to secure adequate capacity should turn on its technical ability to contribute to system reliability, not on extraneous economic judgments.

Although the Commission has jurisdiction over the rates for wholesale sales and over practices affecting such rates, the Federal Power Act does not give the Commission authority to compel LSEs to purchase energy or capacity that they do not need. The D.C. Circuit upheld the Commission's authority to review New England's "Installed Capacity Requirement" ("ICR") precisely because it viewed ICR *not* as an actual requirement but, rather, as a component of the FCM pricing mechanism—a mechanism that, at the time, imposed costs on LSEs *only* to the extent that they had not self-supplied their capacity needs.[26]

In this case, we are not challenging the Commission's jurisdiction to review the region's overall ICR or the share of it assigned to individual LSEs.[27] Nor are we challenging the Commission's jurisdiction to review rates charged by transmission providers to capacity-deficient LSEs.[28] But what PJM proposed here and what the Commission approved—subjecting new self-supply to "mitigation" that may prevent it from being used to satisfy an LSE's capacity obligation—goes beyond determining how much total capacity an LSE must either self-supply or procure through the market and

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[26] *Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477, 481 (D.C. Cir. 2009) (describing ICR as "woefully misnamed" because it "doesn't actually 'require' anyone to 'install' any new 'capacity' at all" and is "better understood not as a capacity *requirement* but as something more like a peak demand estimate").

[27] *Id.* at 485 ("Determination of the ICR affects rates within the Commission's jurisdiction and, in evaluating whether that determination is just and reasonable, the Commission neither regulates generation facilities in violation of section 201 nor runs afoul of any other provision of the Federal Power Act.").

[28] *See id.* at 482 ("In *Municipalities of Groton v. FERC*, [587 F.2d 1296 (D.C. Cir. 1978),] we sustained the Commission's jurisdiction to review the 'deficiency charges' that NEPOOL charged as ISO-NE's predecessor when member utilities failed to live up to their share of NEPOOL's reliability requirement.").

setting the price for capacity that is so procured. Here, the Commission has allowed PJM to compel LSEs to purchase capacity from the specific resources selected using RPM, even if the LSE has planned to acquire other capacity resources that meet all the same technical requirements.[29]

In doing so, the Commission reaches well beyond any authority it has previously claimed. In supporting its authority to review New England's ICR, the Commission explained that:

> Nothing in the ICR requirement prevents a state from requiring its LSEs to meet capacity requirements through demand response, or through contracts to purchase power (from resources located inside or outside the state), or through more environmentally-friendly generation, or, generally speaking, through resources that meet state health or environmental or land-use planning goals. In essence, ISO-NE says to its LSEs, "Provide X amount of resources." But *how* those resources are provided is up to the LSEs and the states.[30]

Now, with the RPM Order's elimination of self-supply,[31] that is no longer the case. It is no longer "up to the LSEs and the states" (*id.* P 29) to determine how to satisfy the relevant reliability requirements.

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[29] As explained below, the FRR alternative—which was designed in response to concerns raised by vertically integrated utilities that retained their generation resources and engaged in traditional, long-term resource planning using those resources—is not a viable option for LSEs in states with restructured electricity markets that have divested their generation facilities. For this reason, designing RPM to foreclose self-supply (except with resources deemed economic under RPM) effectively compels such LSEs to purchase capacity from the specific resources that RPM selects.

[30] *ISO New England, Inc.*, 120 FERC ¶ 61,234, P 29 (2007); *see also id.* P 13 (noting that the Commission was "not requiring that any state build generation, or that any participant satisfy its capacity obligation via a particular resource").

[31] It is no answer to say that self-supply remains available so long as the resources are economic. If the resources are economic (and therefore would clear in RPM), they do not *need* to be self-supplied. The notion of self-supply only has meaning in the context of resources that may not be deemed to be "economic" (according to the standards set forth in the relevant tariff) and therefore may not clear.

This change transgresses the limits of the Commission's jurisdiction in several respects. First, the designation of specific resources and resource types to be used to satisfy applicable capacity requirements constitutes a prohibited exercise of jurisdiction over electric generating facilities.[32] Second, the RPM Order encroaches on traditional state authority to conduct integrated resource planning and to oversee the resource mix that LSEs use to provide reliable service to their customers, thereby overstepping the limitation of Federal regulation to "matters . . . not subject to regulation by the states."[33] Third, as a result of the RPM Order, LSEs with planned self-supplied resources that PJM deems uneconomic will be forced to procure duplicative RPM resources. The RPM Order thus impermissibly "compels the enlargement of generating facilities," contrary to 16 U.S.C. §§ 824a(b) and 824f.[34] In earlier cases, the availability of self-supply allowed the Commission to avoid such jurisdictional difficulties.[35] Now, with the elimination of an option to self-supply using non-RPM resources, that is no longer the case.

But even if the RPM Order did not exceed the Commission's jurisdiction, it would have to be reversed as an impermissibly arbitrary and capricious (and, as explained

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[32] *See* 16 U.S.C. § 824(b)(1).

[33] *Id.* § 824(a).

[34] *See, e.g.* Otter Tail Power Co. v FPC, 473 F.2d 1253, 1258 (8th Cir. 1973) (a requirement that utility provide a public power agency with all energy on a firm basis while at the same time providing the public power agency with credits for costs incurred for purchasing a generation plant held to "clearly constitutes [a] violation of the statutory prohibition against the forced enlargement of generating facilities" because utility was being "required to in effect purchase standby facilities")

[35] *Devon Power LLC*, 115 FERC ¶ 61,340, P 201 (2006) ("Objecting Parties' argument that load-serving entities are required to participate in the FCM (thus mandating participation in a resource adequacy program contrary to the FPA's limitations) fails because the provisions in the Settlement Agreement permit parties to self-supply their capacity obligations, and Objecting Parties have not explained why these provisions are insufficient."), *reh'g denied,* 117 FERC ¶ 61,133, PP 108, 110 (2006) ("The Commission denies Objecting Parties' request for rehearing with regard to jurisdiction . . . Objecting Parties still do not explain why they believe the FCM system is mandatory when there is a self-supply option.").

below, unduly discriminatory) application of it.[36] The basis for requiring LSEs to self-supply or procure capacity is to support the reliability of the transmission system. The characteristics relevant to assessing whether self-supplied resources will serve that purpose are technical, not economic.[37] Whether a new self-supplied resource would be deemed economic, according to the standards adopted in the RPM Order, has no bearing on whether that resource would fulfill the reliability needs for which the capacity-requirement was imposed. Thus, the Commission has not previously employed economic criteria in addition to technical criteria in determining when an LSE is capacity-deficient, and, consequently, courts have not endorsed such steps. The Commission and the courts have held, however, that the imposition of criteria unrelated to the objectives of the underlying rule is unreasonable and unduly discriminatory.[38]

C. The RPM Order errs in requiring MOPR changes that alter the purpose of the provision.

The RPM Order removes from the MOPR the "net buyer" and "impact" tests, and eliminates the state exemption unless the state is seeking to construct certain types of Commission-approved forms of generation. The net-buyer and impact tests are central to

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[36] As explained below, the RPM Order suffers from multiple layers of arbitrariness. We demonstrate in this section that the RPM Order is arbitrary and capricious in interposing an economic criterion, unrelated to the reliability basis for requiring LSEs to supply or purchase capacity, in determining whether an LSE may use a new self-supplied resource to satisfy its reliability obligation. We demonstrate below that the RPM Order is arbitrary, capricious, and unduly discriminatory in subjecting only some resource types to that economic test.

[37] *Cf. Municipalities of Groton v. FERC*, 587 F.2d at 1301 ("NEPOOL is affected by a capacity shortage on the basis of the number of kilowatts a participant is short, not the percentage by which the participant is below its capability responsibility.")

[38] *See Sacramento Mun. Util. Dist. v. FERC*, 474 F.3d 797, 803 (D.C. Cir. 2007) ("In *Mid-Continent*, the Commission found the agreement discriminatory because the distinction between in-kind and monetary compensation was not '*reasonably related* to the . . . objectives' of the challenged agreement.") (citing *Cent. Iowa Power Coop. v. FERC*, 606 F.2d 1156, 1172 (D.C. Cir. 1979)).

the use of the MOPR as a market-power mitigation measure. The impact test focuses on whether an entity's actions have actual effects upon market prices. Unless the threshold is exceeded, the impact is considered insufficient to trigger mitigation. Similarly, the net buyer test is used to identify entities with an incentive to impact market prices. Where the entity at issue is not a net purchaser in the market, it should not be subject to mitigation.

With the changes wrought by the RPM Order, the MOPR has a new function, as the use of mitigation no longer depends upon some demonstration of an incentive to exercise market power, or its actual exercise with a resulting impact on the market price. Instead, the RPM Order shifts the purpose of the MOPR from market power mitigation to the deterrence of what the Commission regards as "uneconomic entry"—but only when it from certain types of generating resources. This new MOPR in no way hinges on whether there is evidence of an attempt to suppress prices; indeed, under the new MOPR an offer will be mitigated even if the resource has no incentive or ability to suppress prices and even if, as in this case, a persuasive case is made that the resource is being procured outside of RPM for legitimate business or state-policy reasons. Thus, while there has been considerable discussion in the course of this proceeding about deliberate attempts to suppress capacity prices, as set forth in the RPM Order, the new policy is clear—"mitigation" no longer depends on any evidence of possible market power or its exercise.

This is an unexplained change in Commission policy, under which market power mitigation hinges on a showing that of evidence of some attempt by the party being

mitigated to suppress market prices. Absent explanation, the change is arbitrary and cannot be sustained.

D. The RPM Order is arbitrary, capricious, and unduly discriminatory in singling out some resource types to subject to the MOPR.

The RPM Order wrongly singles out certain new resources to subject to the reengineered MOPR while exempting others categorically, and does so for reasons that do not hold up under scrutiny. As such, this is another reason why the RPM Order is arbitrary, capricious, and unduly discriminatory.

As explained above, the MOPR originally was designed to perform a limited function: to guard against large price reductions resulting from certain below-cost offers submitted by net buyers with a motive to seek lower RPM prices.[39] It was not designed to "hinder" all "uneconomic entry" (RPM Order P 104), because doing so would have been inconsistent with RPM's role as a residual market. Consistent with that role, the MOPR was designed to ensure that new self-supplied resources would clear the auction.[40] It also was designed to exempt from mitigation offers from entities without an apparent incentive to suppress prices, offers that would not have a large effect on RPM prices, and offers for certain resource types. This limited role was agreed upon in the Commission-

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[39] *See* 2006 RPM Settlement Order P 103 ("Section 5.14(h) of the Tariff addresses the concern that net buyers might have an incentive to depress market clearing prices by offering some self-supply at less than a competitive level. Subject to certain exemptions, if the supply offer of a net buyer falls below certain specified levels, and if its net purchases exceed certain specified levels, and if it does not convince the PJM Market Monitor that the offer is cost-justified, the Market Monitor may establish an alternative higher bid.").

[40] *See* PJM Tariff Attachment DD, Section 5.14(h)(4) provided that "PJM shall then accept Sell Offers to provide Capacity Resources in accordance with the following priority and criteria for allocation: (i) first, all Sell Offers in their entirety designated as self-supply; (ii) then, all Sell Offers of zero, prorating to the extent necessary, and (iii) then all remaining Sell Offers in order of the lowest price."

approved settlement creating RPM, and was relied upon by New Jersey in creating the challenged legislation.

Although the RPM Order now announces a different role for the MOPR—hindering *all* uneconomic entry (RPM Order P 104)—it is unjustifiably selective in carrying out that new aim. While shoring up what it now characterizes as "weaknesses" in the existing MOPR, the RPM Order simultaneously *adds* wind and solar facilities to the existing, categorical MOPR exemptions for nuclear, coal, integrated gasification combined cycle facilities, and hydroelectric resources.[41] LSEs may submit new self-supply or zero-price offers for *those* facilities without risk of mitigation—no matter how much such offers would reduce RPM prices. The result of tightening the MOPR in some ways and loosening it in others is to target squarely, and without cause, a subset of resources that includes the very gas-fired, combined-cycle resources that New Jersey has determined that it needs for reliability.[42]

The purported justifications for this unjust discrimination do not survive scrutiny. The RPM Order distinguishes among resource types because, it asserts, some resource types are more likely than others to be tools of intentional price manipulation or to produce a substantial price impact:

> CTs and CCs have the shortest development time to respond to capacity needs and thus are more efficient resources to suppress capacity prices. In addition, as PJM notes, wind and solar resources are a poor choice if a developer's primary purpose is to suppress capacity market prices. Due to the intermittent energy output of wind and solar resources, the capacity value of these resources is

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[41] RPM Order PP 144-45, 152.

[42] RPM Order P 153 (accepting PJM's justification for "applying the MOPR to CTs and CCs and not the exempted resources").

> only a fraction of the nameplate capacity. This means that wind and solar resources would need to offer as much as eight times the nameplate capacity of a CT or CC resource in order to achieve the same price suppression effect.

Id. P 153. Yet, at the same time that the RPM Order makes inferences about intent and impact, it ignores or deems irrelevant evidence that bears on those issues more directly.

The RPM Order exempts wind and solar resources because they would produce a smaller price impact than other resource types. Elsewhere, however, the RPM Order refuses to establish a *de minimis* self-supply exemption on grounds that "the sloped demand curve used in PJM's base residual auctions is very steep, and as a result, even small amount of additional supply can result in large price reductions."[43] The contradiction cannot be reconciled. A combustion turbine and a wind farm with equal capacity values could produce the same price impact, but the former would be mitigated and the latter would not.

The exemption of wind and solar resources also conflicts with the RPM Order's elimination of the impact screen. As discussed below, elimination of the impact screen means that offers for *some* resource types—notably, CCs and CTs—could be mitigated and prevented from clearing even if accepting those offers would have virtually no impact on RPM prices.[44] The RPM Order attempts to justify this result by arguing that only uneconomic offers would be mitigated and that "[t]he very purpose of the MOPR . .

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[43] RPM Order P 196 (rejecting self-supply exemption for small municipal and cooperative utilities).

[44] *See* RPM Order P 104 ("We acknowledge the New Jersey Rate Counsel's concern that mitigating offers from new resources that would have little or no impact on clearing prices may cause them not to clear and another resource to clear instead."). For this reason, the elimination of the impact screen is arbitrary and capricious and beyond the Commission's jurisdiction, as we explain below.

. is to hinder such uneconomic entry,"[45] regardless of its impact. But if the MOPR's "very purpose" is now to hinder all uneconomic entry—even that which has no demonstrable effect on wholesale prices—it makes no sense to exempt wind and solar resources because of their lower capacity values and concomitantly lower "price-suppressing" potential. (To be clear, we are not arguing that wind and solar resources should be subject to the MOPR; we are pointing out the RPM Order's illogic to demonstrate why its expansion of the MOPR, as applied to new CCs and CTs, should be reversed.)

Likewise, the RPM Order errs in treating various resource characteristics as indicators of whether a given resource type is more or less likely to be used as a tool of intentional manipulation.[46] First, it is not clear why the RPM Order deems such factors to be relevant when its companion order expressly declares intent to be irrelevant to the appropriateness of mitigation.[47] Second, and more important, the cited characteristics are a poor basis from which to infer intent to suppress price, because those same traits are equally important to fulfilling other, legitimate aims. The RPM Order concludes that CCs and CTs are "more efficient resources to suppress capacity prices" because they are relatively large facilities (compared to wind and solar resources) but can be built

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[45] *Id.* In fact, as we showed above, the MOPR's purpose was *not* to hinder all uneconomic entry, as doing so would have been inconsistent with RPM's design as a residual market.

[46] RPM Order P 153 (finding that "CTs and CCs have the shortest development time to respond to capacity needs and thus are more efficient resources to suppress capacity prices," while wind and solar resources would be a "poor choice").

[47] FCM Order, P 13 n.19 ("OOM designation does not imply bad intent; all the categorization means is that the resource is seeking to participate in the FCA at a price below its long-run average cost net of non-FCA market revenues"); *id.* P 170 ("[w]e agree with arguments contending that OOM capacity suppresses price regardless of intent").

relatively quickly.[48] But those same characteristics are exactly why such facilities are the most efficient means identified by New Jersey to avert its impending capacity deficiency.

Third, the RPM Order errs in relying on inferences about intent when direct evidence—the legislative findings set forth in the New Jersey law itself—is available. We reviewed those findings in detail in order to (a) explain why LCAPP resources fit within the MOPR exception for state-mandated resources needed to cure a capacity deficiency and (b) refute the false accusations that the LCAPP law was a scheme to suppress RPM prices. As we explained, the New Jersey legislature found that:

> While [RPM] has resulted in significant capacity additions in the form of new demand response resources, new energy efficiency resources, reversals of generation unit retirements, upgrades of existing generating units and certain new peaking facilities available to the region and the State, [it] has not resulted in large additions of peaking facilities or any additions of intermediate or base load resources available to the region and the State.

P. L. 2011, c. 9, sec. 1b (N.J. 2011) (footnotes omitted). The Legislature further determined that, "[a]s a result of a lack of new, efficient electric generating facilities, New Jersey has become more reliant on coal-fired power plants." *Id.* sec. 1f. The Legislature found that increased reliance to be problematic because, according to the PJM Independent Market Monitor, "there are over 11,000 megawatts . . . of coal-fired units at risk of retirement due to their inability to cover their avoided costs." *Id.* sec. 1g.

Additionally, the Legislature found that "New Jersey's in-State fleet of electric generation facilities is aging, with over 50 percent of these facilities being more than 30

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[48] RPM Order P 153.

years old and over 70 percent being more than 20 years old." *Id.* sec. 1h. Thus, the Legislature concluded that:

> Fostering and incentivizing the development of a limited program for new electric generation facilities will help ensure sufficient capacity to stabilize power prices to assist the State's economic development and create opportunities for employment in the energy sector while helping to reduce the cost and volatility of electricity prices in New Jersey.

Id. sec. 1i. It further concluded that "the construction of new, efficient generation must be fostered by State policy that ensures sufficient generation is available to the region, and thus the users in the State in a timely and orderly manner." *Id.* sec. 1d.[49]

The RPM Order does not even recount the evidence regarding the New Jersey legislature's intent in enacting the LCAPP law, let alone respond to it or attempt to explain why it may be discounted. The failure to do so undermines the RPM Order's reliance[50] (in subjecting CCs and CTs to a much expanded MOPR while exempting other resource types entirely) on apparent inferences that the New Jersey legislation was intended to suppress prices rather than to secure needed capacity.

In fact, the LCAPP law's legislative findings may not be discounted, as they form the authoritative statement of the Legislature's intent in passing the law. *Exxon Mobil*

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[49] As noted in the RPM Order, the "New Jersey Board states New Jersey and much of the rest of the Mid-Atlantic region, where capacity prices are the highest, have seen little if any new generation built in the area since the advent of RPM and expect significant additional retirements of generation in the near future." RPM Order P 209 & n.108.

[50] *Universal Camera Corp. v. Nat'l Labor Relations Bd.*, 340 U.S. 474, 488 (1951) ("The substantiality of evidence must take into account whatever in the record fairly detracts from its weight.")); *accord Port of Seattle v. FERC, 499 F.3d 1016, 1035 (9th Cir. 2007)* ("an agency must account for evidence in the record that may dispute the agency's findings."); *La. Pub. Serv. Comm'n v. FERC*, 184 F.3d 892,897 (1999) (finding that "For the agency to reverse its position in the face of a precedent it has not persuasively distinguished is quintessentially arbitrary and capricious" and requiring FERC to either provide a reasoned explanation for taking a position that is unresponsive to allegations before it or to set the matter to hearing).

Corp. v. Allapattah Servs., Inc., 545 U.S. 546, 568 (2005) ("[T]he authoritative statement is the statutory text, not the legislative history or any other extrinsic material.") That earlier versions of the bill referred to high RPM capacity prices, while such references were omitted from the enacted law, demonstrates that the Legislature chose to act on the basis of the reasons set forth in the law itself and not on the basis of the omitted material. 2A Norman J. Singer and J.D. Shambie Singer, Sutherland Statutory Construction § 48:4 (7th ed. 2007) ("[W]here the language under question was rejected by the legislature and thus not contained in the statute it provides an indication that the legislature did not want the issue considered.")[51]

Nor may the Commission ignore its own precedent. In *New York Indep. Sys. Operator, Inc.*, 124 FERC ¶ 61,301 (2008), *clarified*, 131 FERC ¶ 61,170 (2010), the Commission explained why individual states in multi-state RTOs are unlikely to subsidize new generation for price-suppressing reasons:

> [I]n a multi-state Regional Transmission Organization (RTO) like PJM and ISO-New England, individual state support for new entry that happens to be uneconomic translates into subsidies for customers in other states—that is, the customers of one state pay for new capacity that is bid into a capacity market at a below-market price in order to guarantee it clears the market. This drives down the market-clearing price for all market participants including those in other states. An individual state is much less likely to do this in a multi-state RTO like PJM and ISO-New England than in a single state RTO like NYISO, given the localization of costs and dispersion of benefits in the case of a multi-state RTO.

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[51] That the New Jersey BPU held a technical conference and solicited written comments regarding the sufficiency of existing resources to meet New Jersey's capacity needs also demonstrates that New Jersey's actions were motivated by legitimate reliability-related concerns. Unlike New Jersey, entities interested in depressing RPM prices would not have conducted a proceeding to determine whether existing supplies were adequate because they would not have cared one way or the other.

124 FERC ¶ 61,301, P 37. The Commission's observation aligns with a related point made by P3 witness Roy J. Shanker, who explained why individual market participants—even those that are net short of capacity—are unlikely to subsidize new entry for price-suppression reasons.[52] New Jersey Rate Counsel witness Wilson observed that such dynamics were especially likely to be at play—and to disincentivize subsidizing new generation for price-suppressing reasons—in the upcoming auction. Because transmission enhancements and lower electric demand reduced the likelihood that Local Delivery Area ("LDA") prices would separate in the upcoming auction, Mr. Wilson concluded that "most PJM load-serving entities will be buying capacity in a large, multi-state market area, and the benefits of any price suppression they might be able to cause would be shared with many other buyers, making it unlikely to be profitable."[53]

To summarize, the RPM Order unreasonably expands the MOPR's interference with State-sponsored construction and LSEs' out-of-market procurement of *some* generation resources, while exempting other resource types from the MOPR entirely. The RPM Order relies on assertions about resources' relative price-suppressing effects and

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[52] Testimony of Roy J. Shanker, Ph.D., on Behalf of the PJM Power Providers Group, Exhibit 1 to Complaint ("Shanker Testimony"). In his testimony supporting the P3 Complaint, witness Shanker was asked whether market participants who attempt to exercise buyer-side market power but who represent only a fraction of the market will sustain a competitive disadvantage. He answered:

> Yes. This occurs because the party exercising buyer-side market power—the party bidding into the market below cost—incurs the "extra" cost of the uneconomic new resource. It benefits from the price suppression, but it also has to incur the cost of building a new unit. Everyone else—all of the remaining participants who purchase capacity—get the same price suppression benefit without the expense of building the unit.

Id. at 13. Although witness Shanker asserted that State support could make such strategies profitable for market participants, *id.*, he never explained why he believed—contrary to the Commission's finding in *New York Indep. Sys. Operator, Inc.*—that such a strategy would be sensible for one state in a multi-state RTO.

[53] Wilson Aff. ¶ 30.

construction lead times to identify resources that are purportedly more likely to be used as tools of intentional price suppression. But in doing so, the RPM Order ignores (a) Commission precedent suggesting that intent is irrelevant, (b) the New Jersey legislature's authoritative statement of its reasons for acting, (c) Commission precedent explaining why individual states in PJM are not likely to subsidize new generation for the purpose of suppressing prices, and (d) testimonial evidence supporting the foregoing points. The failure to grapple with this evidence prevents the RPM Order from being upheld as the product of reasoned decision-making. It also gives rise to the appearance that the Commission has moved beyond "protecting wholesale markets" or overseeing wholesale rates and has begun to select favored and disfavored generation resources for reasons unrelated to the matters within its jurisdiction.[54]

E. The RPM Order erred in eliminating the state exemption from the MOPR.

The RPM Order explains that the "MOPR exempts from its operation any planned resource being developed in response to a state regulatory or legislative mandate to resolve a projected capacity shortfall, as determined pursuant to a state evidentiary proceeding that includes due notice, PJM participation and an opportunity to be heard." RPM Order P 124 (footnote omitted). This provision is not new: it was included in the 2006, FERC-approved settlement agreement creating RPM,[55] and remained in place when the Commission rejected a challenge to the MOPR mounted in 2009.[56]

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[54] An agency's decision will be considered arbitrary and capricious if it "relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.'" *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43 (1983),

[55] Settlement Agreement and Explanatory Statement of the Settling Parties Resolving All Issues, *PJM*

The state MOPR exemption provides assurance to states that they can take action in circumstances in which generation needs are not being met, while providing certainty that the resulting resources will be eligible to satisfy RPM capacity obligations. The significance of this option cannot be overstated. Where a state lacks, for example, sufficient baseload generation, the MOPR exemption allows the state to seek to encourage the construction of such resources, while assured that whatever resources are built can be bid successfully into the RPM auction. By striking the exemption, the RPM Order turns a mechanism designed to address real-world capacity deficiencies into an untenable choice: either file a lawsuit at the Commission or opt out of RPM entirely. This is unfair, inappropriate, and contrary to the deal cut in creating RPM. Absent a showing of a significant circumstantial change—and none has been demonstrated here—there is no reasonable basis for eliminating the exemption.

More fundamentally, by removing the state MOPR exemption, the Commission turns RPM on its head. As noted *supra*, just five years ago, those participating in RPM were assured the ability to self-supply whatever portion of their resources could be procured outside of RPM, with the remainder to be met through the auction. The RPM Order flips that logic, concluding that self-supplied resources are permissible only when they are able to clear in the Base Residual Auction, meaning that the resources are otherwise economic and therefore would not need to be treated as self-supplied.

The Commission's decision to eliminate the state MOPR exemption suffers from significant procedural and substantive flaws, and should be reconsidered and reversed.

Interconnection L.L.C., Docket Nos. ER05-1410-000 *et al*. (Sept. 29, 2006), eLibrary No. 20061004-0156.

[56] *PJM Interconnection, L.L.C.*, 126 FERC ¶ 61,275 (2009).

1. The RPM Order erred in striking the state MOPR exemption where PJM proposed no such action and the Commission made no Section 206 finding that the existing exemption was unjust and unreasonable.

The RPM Order's discussion of the fate of the state MOPR exemption begins with a misstatement: "we accept as just and reasonable PJM's proposal to eliminate the current state exemption." RPM Order P 139. PJM advocated keeping the exemption, proposing in the filing initiating Docket No. ER11-2875-000 "to retain an exception for offers that are justified on state policy grounds, but to place it under the same process as any other sell offer seeking a MOPR exception, *i.e.*, an FPA section 206 filing with the Commission." Transmittal Letter at 14 (Feb. 11, 2011), eLibrary No. 20110211-5121. The RPM Order rejects this "replacement mechanism" (RPM Order P 140), finding objectionable that "PJM's proposed state exemption restates an affected party's right to file to prospectively change a filed rate schedule (other than its own), which is embodied in section 206 of the FPA. This is a statutory right, not a right created by contract."

Given the Commission's rejection of PJM's proposed state MOPR exemption, then the only way in which the Commission could eliminate the existing exemption would be to take action under Federal Power Act Section 206.[57] The statute is clear that in order to do so, the Commission must make certain prerequisite findings. FPA Section 206(a), 18 U.S.C. 824e(a), provides that the Commission "shall determine the just and reasonable rate" in those circumstances in which the Commission "shall find that

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[57] *See*, *e.g.*, *Port of Seattle v. FERC*, 499 F.3d 1016, 1033 (9th Cir. 2007) (concluding FERC's interpretation of the scope of petitioner's complaint was "arbitrary, capricious, and an abuse of discretion" when FERC excluded certain purchases from its refund order when "on its face" the complaint provided "no indication" of an intent to exclude those purchases.)

any rate . . . demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, . . . is unjust, unreasonable, unduly discriminatory or preferential . . . . ”

While the Commission is free to act under FPA Section 206 “upon its own motion or upon complaint,” the key prerequisite to Commission action is a “find[ing]” that the challenged rate “is unjust, unreasonable, unduly discriminatory or preferential.” The RPM Order contains no such finding. Equally important, as demonstrated earlier in this proceeding and reiterated *infra*, no such finding can or should be made because the evidence before the Commission demonstrates that the existing state MOPR exemption is just and reasonable.[58]

2. The Commission acted without substantial evidentiary support in apparently concluding that the New Jersey program constituted a grave threat to RPM.

The RPM Order states that a reexamination of the Commission’s earlier approval of the state MOPR exemption is appropriate in light of “mounting evidence of risk from what was previously only a theoretical weakness in the MOPR rules.” RPM Order P 139. Similarly, the RPM Order refers (P 108) to the presentation of “ample evidence that circumstances have changed—that recent efforts have brought to the fore what were previously unrecognized, or, if recognized, only theoretical, weaknesses in the current MOPR rules.” The RPM Order does not detail the “evidence” referenced in these passages, though we assume (given the outcome) that the Commission is referring to

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[58] *See supra* at 39.

New Jersey's enactment of its LCAPP legislation is at least part of the "mounting" and "ample" evidence.[59]

When the Commission seeks to take action on the basis of factual findings, it is obliged to state those findings with specificity, to reference supporting evidence, and to address any significant contrary evidence.[60] The RPM Order contains no statement of the findings on which its conclusions about the "weakness" posed by the MOPR exemption are founded, nor does it specify any evidence that purportedly supports those findings. Indeed, there is no discussion in the RPM Order linking the decision to revoke the state MOPR exemption and any specific evidentiary showing. The RPM Order contains no discussion of any evidence as to the likely costs/bids associated with LCAPP-selected resources.[61] It is devoid of quantitative analysis of the extent to which LCAPP's implementation, and the resulting resource bids in ensuing RPM auctions, would in fact have resulted in price suppression, let alone at levels in excess of the existing "impact screen."

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[59] We address *infra* the comments in the RPM Order that the "weakness" was "previously unrecognized" and only "theoretical" in nature.

[60] *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, (1983)(citing *Burlington Truck Lines, Inc. v. United States*, 371 U. S. 156, 168 (1962)) (In order for an agency decision to not be considered arbitrary and capricious, the agency must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'").

[61] *See, e.g.*, *Port of Seattle v. FERC*, 499 F.3d 1016, 1032-33 (9th Cir. 2007) (holding FERC's findings arbitrary and capricious and not supported by substantial evidence when the record did not provide evidence clarifying the basis for the findings).

3. The RPM Order's elimination of the state MOPR exemption is an unjustified departure from the 2006 decision expressly approving the contested settlement—including the MOPR exception for state-mandated resources—as just and reasonable.

In removing the state MOPR exemption, the RPM Order uses a Section 205 filing as the vehicle for eliminating and rewriting the terms of a carefully-crafted, Commission-approved settlement agreement. As discussed *supra,* the premise for this extraordinary action appears to come down to two statements in which the Commission asserts that circumstances have changed since 2006, and that drastic action is necessary. First, the RPM Order states:

> mounting evidence of risk from what was previously only a theoretical weakness in the MOPR rules that could allow uneconomic entry has caused us to reexamine our acceptance of the existing state exemption, which we approved as part of the 2006 RPM Settlement Order.

RPM Order P 139. Second, the RPM Order refers (P 108) to the presentation of "ample evidence that circumstances have changed—that recent efforts have brought to the fore what were previously unrecognized, or, if recognized, only theoretical, weaknesses in the current MOPR rules." Given these findings, the Commission finds that Section 205 relief is appropriate. The entirety of paragraph 108 of the RPM Order explains how this works:

> PJM has proposed to change this provision under section 205 and has demonstrated that eliminating the impact screen is just and reasonable. Under section 205, there is no need to demonstrate that the existing tariff is unjust and unreasonable; the filer must demonstrate only that the new tariff is just and reasonable. Moreover, parties have presented ample evidence that circumstances have changed—that recent efforts have brought to the fore what were previously unrecognized, or, if recognized, only theoretical, weaknesses in the current MOPR rules.

Id. P 108.

We have already explained that the "mounting" and "ample" evidence to which the RPM Order refers is neither presented nor cited in the text. To the contrary, we submit that there is ample evidence in the record demonstrating that circumstances have not changed materially. The potential that the state MOPR exception would be utilized by affected states was hardly "theoretical" or "unrecognized" at the time the Commission approved the RPM settlement; in fact, it was called to the Commission's attention by the parties and expressly acknowledged by the Commission itself.[62] In short, there is neither evidence of any weakness in the current rules nor has a showing been made that "previously unrecognized" circumstances have come to light that justify a significant change in course.

The parties to the RPM settlement carefully negotiated the state MOPR exemption, and expressly anticipated the process that New Jersey has now undertaken. As recounted in the Explanatory Statement submitted with the 2006 RPM settlement,[63] the negotiations that produced that settlement were both protracted and intense. More than 150 individuals, representing more than 65 parties, engaged in more than 25 days of settlement discussions with direct Settlement Judge involvement and the assistance of the Commission's Dispute Resolution Service.[64] The settling parties included most of the active parties and spanned a "broad cross-section of load interests, generation owner

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[62] FPA § 205, 16 USC § 824d.

[63] Settlement Agreement and Explanatory Statement of the Settling Parties Resolving All Issues, Part 1 of 4, *PJM Interconnection L.L.C.*, Docket Nos. ER05-1410-000 *et al.* (Sept. 29, 2006), eLibrary No. 20061004-0156 ("Explanatory Statement").

[64] *Id.* at 3-4.

interests, and state regulators."[65] The MOPR, in particular, was a "carefully balanced and limited rule"[66] that reflected give and take on the part of all settling parties.

NJ Rate Counsel's protest in this proceeding reviewed in detail the relevant provisions of the settlement and the bases for the state MOPR exemption. As the RPM Order does not address them, these points are detailed again below. The Commission's assertions with respect to "mounting" and "ample" evidence of "previously unrecognized" "risk" are belied by these data, which show that any such "risk" was well understood at the time the settlement was approved. By neither addressing this information nor reconciling it with the conclusions reached in the RPM Order, the Commission has failed to engage in reasoned decision making.[67]

NJ Rate Counsel explained in its Protest in this proceeding that Robert B. Stoddard—a Vice President of CRA International who represented Mirant in the negotiations and who has testified for generation interests in other cases involving capacity markets around the country[68]—submitted an affidavit in support of the negotiated MOPR provisions included in the settlement agreement.[69] Mr. Stoddard

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[65] *Id.* at 1 n.1. Only six parties opposed the settlement term sheet, while four additional parties opted later to oppose the settlement. *Id.* at 4 n.15, 5 n.17.

[66] Reply Comments of PJM Interconnection, L.L.C. in Support of Settlement at 30, *PJM Interconnection L.L.C.*, Docket Nos. ER05-1410-000 *et al.* (Oct. 30, 2006), eLibrary No. 20061030-5098 ("PJM 2006 Settlement Reply Comments").

[67] *See supra* note 49.

[68] *E.g.*, Affidavit of Robert B. Stoddard, Ex. 3 to Complaint Requesting Fast Track Processing by New England Power Generators Association, *New England Power Generators Association Inc. v. ISO New England, Inc.,* Docket No. ER10-787-000 (Mar. 23, 2010), eLibrary No. 20100323-5076.

[69] Supplemental Affidavit of Robert B. Stoddard, Attachment E to Settlement Agreement and Explanatory Statement of the Settling Parties Resolving All Issues, Part 2 of 4, *PJM Interconnection L.L.C.*, Docket Nos. ER05-1410-000 *et al.* (Sept. 29, 2006), eLibrary No. 20061004-0157 ("Stoddard 2006 Affidavit"). This information was presented in NJ Rate Counsel's filings prior to the issuance of the RPM Order, but was not mentioned by the Commission.

submitted his affidavit "in support of the overall settlement and, in particular, . . . the Minimum Offer Price Rule." *Id.* ¶ 3. Mr. Stoddard noted that, "[a]s with all settlements, the proposed [RPM] market design reflects a number of compromises necessary to resolve this case without litigation" and that, "[w]ith this background in mind, it is my professional opinion that it is a reasonable market design." *Id.* ¶ 4. Mr. Stoddard testified that the MOPR, including the exception for resources developed in response to state-mandated resource-planning and procurement, "should, in my professional opinion, reduce the incentive of buyers to undertake [ ] wasteful over-investment in new capacity without restricting their ability to engage in, and realize the full value of, commercially reasonable bilateral contracts to provide for loads' future reliability needs." *Id.* ¶ 8.

Mr. Stoddard reached his conclusions about the reasonableness of the balance struck in the negotiation over the MOPR with full awareness of the matters that are characterized in the RPM Order as "previously unrecognized" and "theoretical." First, Mr. Stoddard participated actively in the negotiations,[70] during which, presumably, witness Shanker raised the same concerns (discussed *infra*) that he later expressed in opposition to the settlement. Second, Mr. Stoddard was aware of, and discussed in his affidavit, a request for proposals by the Connecticut Department of Public Utility Control "seeking 'new or incremental capacity.'"[71] According to Mr. Stoddard, that new capacity was "required to submit bids into the New England Forward Capacity Market ('FCM') in a way narrowly tailored to be as low as possible without triggering the rule analogous to

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[70] Mr. Stoddard testified that he "participated fully in nearly all settlement meetings and conference calls," had "extensive personal involvement in the development and negotiation of several key aspects of the proposed market design that would be created by the proposed settlement," and "carefully reviewed the Settlement Agreement and the accompanying tariff sheets." *Id.* ¶ 2.

[71] *Id.* ¶ 9 n.3.

the MOPR, regardless of actual costs." *Id.* Connecticut was to "pay the difference between the bid cost and the revenue requirements of the new suppliers through supplemental contract payments." *Id.*

Despite his "concern" about such state programs and their effect on residual capacity prices, *id.*, Mr. Stoddard concluded that the MOPR, with its exceptions, represented a "reasonable" and "workable" market design that "reflect[ed] a widely-supported compromise of suppliers, buyers and regulators." *Id.* ¶ 4. In his view, the MOPR and its exceptions struck "an equitable balance" that gave "contracting parties the benefit of the particular contract, while neutralizing large price distortions created by purchases well in excess of forecast reliability needs." *Id.* ¶ 19.

Three years later, with even more information at his disposal regarding Connecticut's resource procurement and its interaction with FCM, Mr. Stoddard continued to defend PJM's MOPR as appropriately framed to balance states' interests with the need to protect RPM against anti-competitive actions. As Mr. Stoddard explained:

> The complexity of the MOPR is not unwarranted; each of its provisions was carefully and laboriously negotiated in the RPM Settlement Agreement to strike an acceptable balance between protecting wholesale markets from price manipulation, on the one hand, and allowing developers to offer long-lead-time resources rationally and allowing states to take necessary actions to preserve reliability.[72]

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[72] Affidavit of Robert B. Stoddard in Support of The Mirant Parties ¶ 13, Attachment A to Comments of the Mirant Parties Opposing Settlement Offer, *PJM Interconnection L.L.C.*, Docket Nos. ER05-1410-012, *et al.* (Feb. 23, 2009), eLibrary No. 20090223-5122 ("Stoddard 2009 Affidavit"). To the extent Mr. Stoddard's 2009 Affidavit revealed any concern about the MOPR's effectiveness, that concern was mild at worst. *Id.* ¶ 14 ("If there is any weakness in the MOPR, in my view, it is that its exemptions may be over-broad and, therefore, allow some below-market supply offers to suppress the capacity clearing price."). But Mr. Stoddard appeared to accept those exceptions as reasonably necessary to protect states' interests in "tak[ing] necessary actions to preserve reliability." Id. ¶ 13. In any case, Mr. Stoddard—who

The RPM Order does not refer to Mr. Stoddard's testimony (in either proceeding) concerning Connecticut's actions.

Moreover, other P3 members objected to the MOPR during the 2006 RPM settlement process, raising arguments identical to those advanced in the P3 complaint in this proceeding.[73] But the objecting parties persuaded neither PJM nor the Commission. As the Commission explained in the Order approving the settlement, PPL Corporation ("PPL") and Public Service Electric and Gas Company ("PSEG") "assert[ed] that new entry faces the possible suppression of prices through buyer actions, such as the decision of states to mandate new reliability projects that could reduce clearing prices to zero" and that "the Settlement's Minimum Offer Price Rule provision does not go far enough to address this problem." 2006 RPM Settlement Order P 99.

In its reply comments supporting the settlement, PJM recounted this opposition and explained why the concerns expressed were off-base:

> PSEG/PPL nonetheless want the [MOPR] provision to go farther, by eliminating one of its exceptions. The [MOPR] establishes that certain types of new entry offers . . . will not require further scrutiny, such as base load resources that presumably recover all of their revenue requirements in the energy market. Similarly, a zero-price new entry offer will not be subject to re-pricing if the resource is being developed "in response to a state regulatory or legislative mandate to resolve a projected capacity shortfall in the Delivery Year affecting that state, as determined pursuant to

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joined Dr. Shanker as a witness in support of the New England Power Generators' efforts to modify New England's "Alternative Price Rule," *see* Complaint Requesting Fast Track Processing by New England Power Generators Association, *New England Power Generators Association Inc. v. ISO New England, Inc.*, Docket No. ER10-787-000 (Mar. 23, 2010), eLibrary No. 20100323-5076—has not espoused any need to modify either the PJM MOPR or its exceptions.

[73] *See* Affidavit of Roy J. Shanker, Ph.D. ¶¶ 42-52, Ex. B-1 to the Initial Comments of the PPL Parties and the PSEG Companies In Opposition To Proposed Settlement, *PJM Interconnection L.L.C.*, Docket Nos. ER05-1410-000, *et al.* (Oct. 19, 2006), eLibrary No. 20061019-5068 ("Shanker 2006 Affidavit").

> a state evidentiary proceeding that includes due notice, PJM participation, and an opportunity to be heard."[74]

PJM explained that "[the] mandated RTO participation, along with the other conditions on that exception, distinguish[ed] the state action contemplated by the settlement from" the anti-competitive price-suppressing scheme described by PSEG/PPL. *Id.* at 32. PJM went on to explain why the MOPR's balanced provisions were superior to PPL/PSEG's approach:

> While PSEG/PPL apparently would have the Commission develop a rule that attempts in advance to proscribe or limit a broad range of possible state actions, *the settlement takes a respectful, reasonable, and balanced approach on this question. Not surprisingly, this exception was very important to certain state regulatory authorities, and helped the parties reach a compromise that allowed the Minimum Offer Price Rule to be added to RPM.*

Id. (emphasis added).

PJM was correct in that assessment, and the RPM Order erred in disregarding the significance of the settlement protections negotiated by the states and load serving entities. The RPM Order wrongly allows those who agreed to the state MOPR exemption, presumably in return for other concessions, to claw back what was given up, thereby substantially changing the balance struck in that agreement.[75] Although, as noted in the RPM Order (P 108) the settlement was made subject to modification through a Section 205 filing under the just-and-reasonable standard, not the *Mobile-Sierra* public-interest

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[74] PJM 2006 Settlement Reply Comments at 31-32.

[75] For example, the demand curve adopted in the 2006 settlement was far closer to PJM's initially-proposed curve than it was to the construct previously in place. *See* 2006 RPM Settlement Order PP 80-81. More generally, the Commission appears to have recognized that the MOPR applied to buyer market power was one of the generators' "gets" in the negotiations and that the exception for state-mandated resource procurement was one of their "gives." *See id.* P 86.

standard,[76] the Commission has stated repeatedly that it does not take contract modification lightly even under a just-and-reasonable standard.[77] Absent an unforeseen change in circumstances—and none has been alleged, much less proven—the RPM Order erred in eliminating the state MOPR exemption, which sophisticated parties agreed to as a reasonable compromise of complicated market-design questions. Rights secured through a settlement agreement should not be declared unreasonable simply because an entity makes use of them. The Commission should not transform a FERC-approved settlement into regulatory quicksand, affording ground that appears solid only until one tries to stand on it.

Similarly, absent unforeseen changed circumstances—and none have been proven, the RPM Order finding notwithstanding—there is no basis for reversing the Commission's previous finding, *on the merits*, that the MOPR exception for resources developed in response to state-mandated procurement was just and reasonable. In reviewing the contested settlement, the Commission recognized that "PJM and its members engaged in extensive negotiations to resolve the many difficult questions contained in this Settlement, and went to great lengths to arrive at compromises that were

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[76] *See* Settlement Agreement at 46, Tab 2 of Settlement Agreement and Explanatory Statement of the Settling Parties Resolving All Issues, *PJM Interconnection L.L.C.*, Docket Nos. ER05-1410-000 *et al.* (Sept. 29, 2006), eLibrary No. 20061004-0157 ("Settlement Agreement").

[77] *See PacifiCorp v. Reliant Energy Servs., Inc.*, 99 FERC ¶ 61,381, P 27 & n. 21 (2002), *reh'g granted*, 105 FERC ¶ 61,184 (2003).

> [E]ven under a 'just and reasonable' burden of proof standard, parties who seek to overturn market-based contracts into which they voluntarily entered will bear a heavy burden.
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> By emphasizing that a complainant bears a heavy burden of proof, we state the obvious that the sanctity of contracts is presumed and that the Commission will not lightly undo the terms of existing contracts even under the just and reasonable standard of review.

acceptable to the majority of PJM members."[78] Nonetheless, because the Commission found a need to modify the settlement in certain respects, the Commission could not accept the settlement as a package under the second *Trailblazer* approach, as PJM and the Settling Parties had asked.[79]

For this reason, the Commission "describe[d] and evaluate[d] . . . *each of the contested elements of the Settlement, and [made] a determination whether the provisions are just and reasonable*, taking into account the integrated nature of the capacity market design."[80] With certain exceptions not relevant here, the Commission expressly found that "the Settlement's provisions for market power monitoring and mitigation are reasonable." 2006 RPM Settlement Order P 100. More specifically, the Commission found the negotiated MOPR to be "a reasonable method of assuring that net buyers do not exercise monopsony power by seeking to lower prices through self supply." *Id.* P 104. The Commission further held that "[t]he exception to which PPL/PSEG primarily objects—namely, reliability projects built under state mandate—is reasonable because it enables states to meet their responsibilities to ensure local reliability." *Id.*

Given witness Stoddard and witness Shanker's testimony regarding Connecticut's out of market procurement, the Commission's approval of the MOPR's state-mandated resource exception and rejection of PPL/PSEG's concerns cannot be said to have been

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[78] 2006 RPM Settlement Order P 51 (citing Explanatory Statement and November 9, 2006 Report on Contested Settlement by Settlement Judge).

[79] *Id.* P 57.

[80] *Id.* P 58 (emphasis added). *See also* Answer of PJM Interconnection, L.L.C. to Motion to Vacate Order, Motion for Stay, Requests for Clarification, and Certain Requests for Rehearing at 10, *PJM Interconnection L.L.C.*, Docket Nos. ER05-1410-000, *et al.* (Feb. 6, 2007), eLibrary No. 20070206-5057 ("When the Commission reviews a contested settlement under that approach, it 'renders a binding merits decision on each contested issue' [which] is exactly what it did here.") (footnote omitted).

based on a failure to foresee the possibility of state-mandated procurement programs like New Jersey's LCAPP legislation. Absent unforeseen changed circumstances, which do not exist here, the Commission's reversal is an unadorned rewriting of the 2006 settlement and the Commission's on-the-merits approval of it as just and reasonable. This action is directly at odds both with the Commission's well-established policy in favor of settlements, as well as its emphasis on the importance of ensuring that entities operating in market environments be able to make decisions secure in the knowledge that there is certainty and stability with respect to market rules (and, therefore, anticipated market outcomes).

4. The RPM Order arbitrarily jettisons an exemption to address local reliability concerns and replaces it with a Section 206 process to address the same concerns.

The RPM Order offers confused reasoning in explaining why the state MOPR exemption should be eliminated. According to the Commission, "[i]n the 2006 RPM Settlement Order, the Commission determined that current exemption 'is reasonable because it enables states to meet their responsibilities to ensure local reliability.'" RPM Order P 139 n.75 (quoting 2006 RPM Settlement Order P 104). However, the Commission goes on to state that while it has chosen to do away with this exemption, it has been replaced with the opportunity to file for Section 206 relief "for reliability reasons." *Id.* The Commission's reasons are not consistent: the exemption was authorized to allow states to take actions needed to ensure reliability. It has now been eliminated, in favor of the right to make Section 206 filings, where needed "for reliability reasons." If, as we hope is the case, the Commission remains concerned that states be enabled to "meet their responsibilities to ensure local reliability," then the simplest way to

accomplish this goal was to leave the existing exemption in place. On the other hand, if the Commission has concluded that ensuring that states continue to have this ability is no longer an imperative, then the Commission should state and explain fully the reasons why it has changed course.

F. The RPM Order erred in eliminating the impact screen.

The D.C. Circuit has upheld the Commission's review of ISOs/RTOs' resource-adequacy "requirements" and capacity-deficiency charges as matters affecting wholesale rates.[81] Yet the RPM Order now seeks to proscribe what it deems to be "uneconomic entry" even if the effect on wholesale rates is negligible or non-existent, thereby severing the RPM Order from its jurisdictional foundation. This result interferes impermissibly with the selection by states and LSEs of the generating resources with which they will meet their needs, without any jurisdictional basis.

New Jersey Rate Counsel acknowledged that the MOPR's existing impact screen could be tightened to further limit the incidental impact on RPM prices of states' and LSEs' out-of-market procurement decisions.[82] Specifically, NJ Rate Counsel suggested that the impact thresholds could be reduced from 20-30 percent to 5-10 percent. *Id.*[83] The

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[81] *See Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477, 485 (D.C. Cir. 2009) ("Determination of the ICR affects rates within the Commission's jurisdiction.").

[82] *See* New Jersey Rate Counsel Protest at 49.

[83] Although the RPM Order seems motivated by concern regarding the potential impact of the LCAPP program on RPM prices, the Commission does not mention or rely on any forecasts of the likely impacts of that program on RPM prices—let alone attempt to compare such impacts against the impact screen. Indeed, when P3 filed its complaint and PJM made its Section 205 filing, it would not have been possible to assess such impacts reliably, as the likely LCAPP resources had not been selected yet. The magnitude of the price reduction resulting from out-of-market entry depends on: (a) whether the resource would be deemed economic once mitigated (if so, its entry does not displace any resource or affect the clearing price at all); (b) the capacity value of the resource; and (c) the slope of the supply curve at the relevant points. In segments where the supply curve is relatively flat, even the entry of comparatively large "uneconomic" resources may have little price impact.

RPM Order offers no reasoned basis for rejecting a lowered threshold and instead eliminating the screen altogether.

Eliminating the screen prevents from clearing—and, in practical terms, may foreclose the development of—resources that RPM deems “uneconomic,” even if (a) states and LSEs have determined them to be needed for reliability or to serve other legitimate policies and (b) the “uneconomic” entry of those resources would have “little or no impact” (RPM Order P 104) on RPM prices. The RPM Order advances no valid reason for such interference. The RPM Order argues that “mitigating offers from new resources that would have little or no impact on clearing prices” is appropriate, because “only offers that are demonstrated to be uneconomic will be mitigated” and “[t]he very purpose of the MOPR . . . is to hinder such uneconomic entry.” *Id.* As we showed above, however, the MOPR’s purpose was *not* to hinder all uneconomic entry. Because RPM was to be a residual market through which LSEs could meet their capacity needs remaining after out-of-market procurement, the MOPR was designed to serve a much more limited role and the impact screen was one of the means by which the role was limited. The justification for eliminating the impact screen thus begins from a false and unsupported premise regarding the MOPR’s original purpose.

The RPM Order also suggests that eliminating the impact screen has an “ancillary benefit of simplifying the mitigation process.” *Id.* P 101. The RPM Order does not suggest, however, that this ancillary benefit would be a sufficient basis in itself for eliminating the impact screen. The record contains no evidence demonstrating that application of the impact screen has proved burdensome or difficult. And while the RPM Order discusses a potential weakness of the existing screen, which considers the impact

of offers individually and not cumulatively,[84] the logical response to that concern would be to modify the screen to set a cumulative limit. Eliminating the screen altogether is not a rational response to the identified concern because it is more sweeping than necessary and interferes unduly with State and LSE resource-procurement decisions.[85]

The RPM Order also concludes that eliminating the MOPR's impact screen is appropriate because "there is no parallel screen before mitigation is applied to prevent the exercise of seller market power." *Id.* P 105. But that was true when the MOPR and the impact screen were first adopted. The inclusion of a non-parallel MOPR screen did not render the MOPR unjust and unreasonable when it was adopted, and does not do so now.

More fundamentally, the reasons *why* non-parallelism was appropriate then and is appropriate now have remained the same—and go unaddressed by the RPM Order. Buyers and sellers are not similarly situated for this purpose, and are not similarly affected by seemingly parallel mitigation rules. That is because, on the buyers' side, the submission of price-taker offers for "uneconomic" resources can reflect legitimate business practices rather than the exercise of market power. As Professor Hogan acknowledged:

> Introduction of subsidized investment in generation capacity is not *per se* the exercise of buyer market power. As pointed out by many others in the present matter, there are reasons other than price manipulation for government policies to support certain types of generation capacity. For example, government efforts to promote green technology development may involve initial subsidies to support learning-by-doing and early technology development. Economic development policies could be part of broad

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[84] *Id.* P 106.

[85] It also means that mitigation will be imposed upon relatively tiny resources offered by sponsors with no ability or incentive to suppress capacity prices.

> policy of economic recovery. Long-term contracts beyond the three year horizon of New Jersey's Basic Generation Service could provide economic hedges. There is no disagreement that there can be legitimate public purposes served through various types of government policy support.

Statement of William W. Hogan, Ph.D. at 9:7-15, Ex. 7 to P3 Answer (footnote omitted). As shown above, RPM's original designed depended on the use of self-supply and submission of $0 price offers as the mechanisms by which LSEs could meld their self-built generation or long-term bilateral agreements (including resources encouraged through governmental programs) with market-based procurement to satisfy their residual capacity needs. Such offers were the mechanisms that allowed LSEs to receive the benefit of their resources within RPM and to avoid having to buy more capacity than they need. There is no parallel justification for above-cost offers on the seller side.

The elimination of the impact screen is one of several steps taken by the RPM Order that turns RPM's original design as a residual market—and the original relationship between the MOPR and RPM—on its head. As a result of the RPM Order, states and LSEs may no longer use RPM to procure only their residual capacity needs. Instead, they must use RPM to supply all of their needs or none of them. The only way to procure a resource that RPM deems uneconomic, without opting out of RPM entirely (assuming that were feasible), is to buy and to pay for duplicative capacity. The order thus imposes a steep tax on states pursuing legitimate policies and LSEs making legitimate business decisions: give up competitive markets or pay twice for needed capacity. Putting states and LSEs to such choices is unreasonable and inconsistent with the Commission's prior approval of RPM as a residual market. Putting them to such choices even when the "uneconomic" resources would have a negligible impact on RPM

prices is arbitrary, capricious, and reaches beyond the Commission's jurisdiction over wholesale rates.

G. The RPM Order erred in eliminating the "net-short" requirement.

The RPM Order also errs in approving PJM's proposal to remove the "net-short buyer" requirement from the MOPR. As the Commission described this requirement:

> Capacity offers from a seller and its affiliates who buy substantially more capacity from the RPM auction than they sell into it (*i.e.,* a net-short buyer) are subject to PJM's MOPR, based on the assumption that such a seller may have an incentive to depress market clearing prices below competitive levels.

RPM Order P 75. The Commission went on to explain the rationale for this provision, stating that:

> under the net-short requirement, only entities purchasing substantially more capacity than they sell are subject to the MOPR because only entities in this position would appear to have the desire to artificially lower capacity prices.

Id. P 86.

While approving the elimination of this requirement, the RPM Order does not repudiate the notion that entities who buy more than they sell are those who "would appear to have the desire to artificially lower capacity prices." Instead, the RPM Order credits PJM's concern that there may be other entities with identical desires, but that the net-short requirement will not capture these parties. *Id*. P 88.

In response to this concern, NJ Rate Counsel proposed refinements to the net-short requirement. As explained in witness Wilson's first affidavit:

> The "net buyer" test should be further developed to extend to all circumstances that raise concerns. The definition should be revised to apply to offers by contractual counterparties of net buyers. The definition should also

> recognize that while state programs and policies to encourage new resources generally have legitimate public policy objectives, such policies could also be used with the goal of suppressing capacity market prices, and the resources resulting from any such attempt should be subject to mitigation. While PJM claims that the net buyer test should be eliminated because it is "too easily gamed" (p. 16), if properly revised it would apply to all plausible scenarios.

Wilson Aff. ¶ 89. The RPM Order rejects this suggestion, finding that it would be too difficult to craft a standard that would apply properly in all circumstances, and that the better course was simply to eliminate the net-short test altogether. RPM Order P 90.

We disagree. By eliminating rather than refining the net-short requirement, the Commission abandons a straightforward approach to avoiding the imposition of market power mitigation measures on competitive offers by entities that are net *sellers* and therefore have no incentive to exercise *buyer* market power. We likewise take issue with the finding that the net-short requirement is subject to easy gaming that would be difficult to police. As noted above, NJ Rate Counsel proposed refinements that should address circumstances in which legitimate concerns may be raised. To the extent the refinements are not iron-clad, there is good reason to believe that attempts to evade the requirement would be transparent and would lead to action by either the market monitor or other parties (or both). Even if such efforts are not detected in advance of or during an auction, the Commission has ample tools at its disposal to address behavior that it determines to have been an exercise of market power not prevented by the MOPR.[86]

Moreover, witness Wilson noted that by eliminating the net-short requirement, MOPR mitigation will be applicable to net-sellers, raising a separate set of concerns:

> application of the rule to net sellers could provide a means for a net seller to evade the seller market power mitigation provisions and withhold planned new resources. A net seller could plan new resources (discouraging other, competitive new entry), but effectively withhold the resources from RPM through the MOPR mitigation. This would further magnify the barrier to entry created by the MOPR rule.

Wilson Aff. ¶ 88.

The decision to eliminate the net-short requirement was an error and should be reconsidered and reversed.

H. The RPM Order adopts an unreasonable test for what constitutes "uneconomic" entry.

As explained above, the RPM Order radically changes the MOPR's role in the RPM market design. Instead of serving as a limited check on the potential exercise of buyer-side market power, the MOPR now serves the much expanded function of "hinder[ing]" all "uneconomic" entry (RPM Order P 104)—even if that new entry (a) is not sponsored by an entity with an incentive to suppress prices or anyone affiliated with such an entity; (b) would not in fact meaningfully alter RPM clearing prices; (c) is procured in response to a state legislative or regulatory finding (made following an evidentiary proceeding in which PJM had the opportunity to participate) that the state is capacity deficient; or (d) is procured in response to other legitimate state policies or LSE business decisions. Because the MOPR now is constructed to hinder entry by state- or LSE-preferred resources that the MOPR deems "uneconomic," the accuracy of the MOPR's economic/uneconomic determination takes on added importance. New Jersey Rate Counsel's earlier protest (and the affidavit of James F. Wilson, which was attached

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[86] *See supra* note 14.

thereto) explained why the proposed method of establishing whether a resource is economic was unreasonable.

The RPM Order errs in failing to respond meaningfully to that evidence and in adopting an economically illogical and ill-supported test. The Commission should therefore grant rehearing and revise its determination in two respects. First, it should revise the calculation of the benchmarks against which offers will be screened. Second, and even more important, the Commission should allow market participants to justify individual offers on any just and reasonable basis—not the sole, prescriptive standard set forth in the RPM Order—as Mr. Wilson explains.

1. The RPM Order errs by judging whether offers are economic without considering the present value of future revenue streams or the impact of projected future capacity revenues.

Witness Wilson explained in detail the unreasonableness of PJM's approach to assessing whether an offer was "economic." The RPM Order responds by "reject[ing]," without explanation, "New Jersey Rate Counsel's argument that Net CONE is a poor proxy for a competitive offer price."[87] The RPM Order finds—again, without explanation—that "Net CONE is a reasonable approximation of the cost of new entry less the energy and ancillary services revenues that resources are likely to receive, on average, over the resource's life, and thus Net CONE serves as a reasonable estimate for a competitive offer price." *Id.* And while the RPM Order ostensibly allows individual resources an opportunity to seek to demonstrate that offers below the PJM-calculated benchmark are justified by the resource's unit-specific costs, the RPM Order adopts the

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[87] RPM Order P 43.

same economically-baseless standard for judging individual offers.[88] That approach is demonstrably inconsistent with sound economics, and should be reconsidered and rejected.

As Mr. Wilson explained, under the PJM approach, gross construction costs "are levelized, to place them on an annual basis, and a proxy for long-run average net energy and ancillary services ('E&AS') revenues is netted from this cost."[89] The difference is "Net CONE," which is "assumed to represent a competitive offer for new generation into RPM." *Id.* Mr. Wilson explained that the use of Net CONE in evaluating offers

> deviates from [ ] fundamental economic concept[s] in two significant ways. First, it is a levelized or annual value rather than a present value. Second, future capacity revenues are excluded from the calculation. These characteristics cause a screen based on the Net CONE calculation to be a flawed indicator of a competitive offer price under common circumstances.

Id. ¶ 44.

To prove his point that Net CONE is a poor indicator of competitive-offer levels, Mr. Wilson pointed to the offers and outcomes of the first seven RPM base residual auctions, which neither P3 nor PJM challenged. He showed that "[n]ew power plants, including combined cycle ('CC') and combustion turbine ('CT') plants, have consistently been offered into RPM at prices far below Net CONE." *Id.* ¶ 14. Specifically, he noted:

> For the most recent base residual auction (2013/2014 delivery year), PJM reported that 1,670.4 MW of new

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[88] Id. P 122 ("In conducting an individualized generation review, PJM proposes that: a sell offer would be permissible when such offer is consistent with the competitive, cost-based, fixed, nominal levelized, net cost of new entry were the resource to rely solely on revenues from PJM-administered markets. We find that this standard is appropriate for reviewing such cost estimates and that PJM must include this language in its revised tariff.").

[89] Wilson Aff. ¶ 41.

> generation capacity was offered, and all of it – all 1,670.4 MW – cleared. Most of this capacity (961.1 MW) was offered and cleared in the Rest of RTO region, meaning it was offered at a price no greater than $27.73/MW-day, a small fraction of Net CONE. In the base residual auction that attracted the most offers for new generation (2011/2012; there were thirteen offers for new CTs and CCs, compared to no more than 7 in any other base residual auction), 1,135 MW of new combined cycle capacity was offered. PJM's Independent Market Monitor ("IMM") reported that only 43.5 MW of combined cycle capacity was offered at a price greater than $35/MW-day in this auction, far below the clearing price of $110/MW-year, or Net CONE, which was higher still.

Id. (footnotes omitted). Had the revised MOPR been in place during these auctions, "nearly all of the offers from new power plants into RPM to date would have been deemed 'uneconomically low' by a wide margin." *Id.* ¶ 15. Thus, he concluded, the revised MOPR will interfere with the "normal competitive process by which new resources are brought to the market." *Id.* ¶ 12.

To illustrate the flaws in the Net CONE approach, Mr. Wilson provided an example using a hypothetical resource. In his example, the present value of the sponsor's costs to construct the resource (*i.e.*, gross CONE) was $1,200/MW, the present value of the sponsor's forecast of its energy and ancillary services ("E&AS") revenues was $720/MW, and its forecast of capacity revenues was $540/MW.[90] In that example, the sponsor would expect entry to be profitable because the present value of its projected revenues ($540/MW capacity revenues plus $720/MW E&AS revenue) exceeded the present value of its entry costs ($1,200/MW).[91] Counterfactually, however, the Net

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90 *See* Wilson Aff. ¶¶ 45-47.

91 *Id.* ¶ 47.

CONE calculation would declare entry under these conditions to be uneconomic unless the first-year capacity auction price exceeded $80/MW-year.[92]

Mr. Wilson explained that "because [the Net CONE method] focuses on levelized (annualized) rather than present values and excludes expectations of future capacity revenues, [it] does not accurately estimate an economic or break-even offer price level for a project's first RPM auction, which may be much higher or lower." *Id.* ¶ 48. Mr. Wilson observed that the Net CONE calculation "can be understood to impose the assumption that whatever capacity price is received in the first auction will also be received in all future auctions over the life of the plant, as if RPM offered a long-term commitment, which it does not." *Id.* Thus, he explained:

> The Net CONE calculation can be understood to estimate the long-run average capacity price a facility would need, under the assumed CONE and E&AS values, to break even. But this is an answer to the wrong question. The first auction will only determine the capacity price for the first year of operation, and a new entrant acting competitively will formulate an offer price taking this into account.

Id.

The RPM Order fails to respond meaningfully to Mr. Wilson's testimony regarding the flaws of the Net CONE approach. This failure cannot be sustained, especially given the calculation's added importance under the expanded MOPR. The Commission should grant rehearing to revise the method by which PJM will establish the

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[92] Mr. Wilson explained that, "[u]nder the financial assumptions used in PJM's Net CONE calculation, levelized (annual) values are about 1/6 of present values, so the corresponding levelized values are $200/MW-year for [gross] CONE [and] $120/MW-year for E&AS." *Id.* ¶ 45 (footnote omitted). Thus, the Net CONE approach would calculate the competitive entry offer for this resource to be $80/MW-year, the difference between the levelized gross CONE and E&AS revenue components. *Id.* ¶¶ 46-47.

MOPR benchmarks and by which it will judge the economics of individual offers supported with unit-specific costs and revenues. As Mr. Wilson explained, even if the benchmarks continue to be calculated using a levelized approach, market participants should be permitted to justify offers to PJM, the IMM, or the Commission using a project-specific net present value calculation that reflects projections of future capacity revenues.[93]

2. The RPM Order errs in requiring the use of a nominal levelized method to calculate benchmarks and to evaluate unit-specific costs and revenues.

The RPM Order accepts PJM's proposed change from a real levelized method of calculating Net CONE to a nominal levelized method. RPM Order P 49. Mr. Wilson explained why requiring the use of a nominal levelized calculation was unreasonable. He explained that, within the gross CONE estimate, costs are assumed to escalate at 2.5 percent per year and that it would be reasonable to assume that net energy, ancillary service and capacity revenues would escalate at similar rates.[94] Using the real levelized approach, annual revenue requirements are calculated using the same rate of inflation—thereby increasing them in nominal terms and holding them steady in real terms. *Id.* Mr. Wilson observed that using this method causes net E&AS revenue and net CONE (*i.e.*, gross CONE minus E&AS revenue) to rise at the same rates and to maintain a consistent relationship. *Id.*

In contrast, the nominal levelized approach holds the revenue requirement steady over the life of a plant in nominal terms (which means it declines in real terms). *Id.* ¶ 78.

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[93] Wilson Aff. ¶¶ 49-52.

[94] Wilson Aff. ¶ 77.

Because E&AS revenue is likely to increase in nominal terms, net CONE calculated in this fashion will decrease over time in nominal terms and decline even more sharply in real terms. *Id*. Stated differently, use of the nominal levelized approach frontloads the Net CONE calculation—artificially increasing the capacity revenue that a resource is assumed to need for "economic" entry in its first auction. *Id.* In effect, using the nominal levelized approach raises a barrier to new economic entry by deeming uneconomic some resources that in fact are economic.

The RPM Order states, without elaboration, that it "agree[s] with PJM, P3, the IMM, and the Pennsylvania Commission that the nominal approach is reasonable here because a first-year offer based upon this methodology is more likely to match the typical cash flow streams associated with financing . . . than the real levelized approach."[95] But Mr. Wilson explained that "[w]hether real or nominal levelization is appropriate has to do not with the financing arrangement, but with the sponsor's expectations about how energy, ancillary services and capacity revenues will change over time." Wilson Aff. ¶ 76. The RPM Order does not respond to Mr. Wilson's testimony on this point.

Nor does the RPM Order respond to Mr. Wilson's observation that, even if the nominal levelized approach is *a* reasonable method, it is not the *only* reasonable method—and it is therefore unreasonable to preclude a market participant's use of the real levelized method if that approach better matches its expectations. *Id.* ¶¶ 83, 85 (quoting PJM and IMM recognition that competitive offers could be based on either approach). Indeed, as Mr. Wilson explained, the IMM has recognized expressly that "an actual competitive offer by a potential entrant could reasonably be based on either

method of levelizing the revenue requirements." *Id.* ¶ 85 (quoting Affidavit of Joseph E. Bowring on Behalf of PJM Interconnection, L.L.C. at 9, August 31, 2005, Docket No. ER05-1410). When choosing an approach to use in the context of establishing the Net CONE value for the demand curve, the IMM recommended use of the higher Net CONE value that results from the nominal levelization approach, in order to avoid excluding entrants that choose the higher offer prices resulting from that approach:

> It is appropriate to base the CONE calculation and therefore the demand curve on the nominal levelized payment stream in order to ensure that the market rules do not exclude reasonable competitive offers. If potential entrants make offers at the real levelized net cost of new entry, they will appropriately win the auction, the clearing price would equal the real levelized net cost of new entry and there will not be an issue. However, if potential entrants determine that a competitive offer is equal to the nominal levelized payment stream then a demand curve based on the nominal levelized payment stream would result in the same price as the demand curve based on the real levelized payment stream, assuming all new entry offers at the same price.

Id. In the context of the MOPR, the same reasoning—the need to avoid excluding competitive offers—compels the opposite result: "use of the lower Net CONE values based on the real levelized approach, in order to not prohibit competitive offers that reflect this assumption." *Id.* ¶ 86. The RPM Order fails to justify its choice of a levelization method that precludes some competitive offers.

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[95] RPM Order P 49.

3. The RPM Order errs in mandating the use of historic E&AS revenue averages to judge the competitiveness of offers that should reflect future revenue expectations.

The RPM Order rejects objections to PJM's use of an "historical estimating method for the energy and ancillary services offset" in lieu of a more forward-looking approach.[96] The use of forecasted E&AS revenues is more appropriate because the offset is used to determine the future capacity revenue (or at least the first year of capacity revenue, on a nominal levelized basis) that would be needed to make entry "economic." The RPM Order dismisses this logic for two reasons, neither of which is persuasive. First, the RPM Order observes that the use of historic E&AS revenue was used to establish the demand curve parameters and that "us[ing] the same approach . . . is reasonable and a sufficient basis" for using this approach. *Id.* P 48. But for the reason discussed above with respect to real versus nominal levelization, the different context rationally leads to different results. In one case (the demand curve) a high Net CONE is needed to avoid pricing some legitimate offers out of the market. In the other case (the MOPR) a low Net CONE is needed to avoid mitigating some legitimate offers out of the market. The RPM Order never grapples with this difference.

Second, the RPM Order states that the Commission has "previously found that it is very difficult to design a forward-looking method and that the continued use of a three-year average of historical revenues from energy and ancillary services markets is appropriate because the cyclical changes in net revenues are likely to average out." *Id.* P 48. But the alleged difficulty of designing a forward-looking method to implement generically should not be relied upon to foreclose market participants from using

forward-looking E&AS revenue estimates to justify offers in specific cases. Moreover, the alleged difficulty does not justify adopting an approach that—contrary to the Commission's claims—is biased systematically. While "cyclical changes in net revenues" may be "likely to average out" over time, new entry is likely *not* to be evenly distributed over time. On the contrary, new entry is to be expected precisely when potential new entrants predict a rising market. Thus, new entry will occur most frequently under exactly the conditions that would cause the use of historical E&AS averages to under-state expectations of future revenues and thus to over-state the capacity revenues needed to make entry "economic."

I. The RPM Order is unreasonable in failing to allow PJM's stakeholders to attempt to develop better solutions than those adopted by PJM on the fly in response to a complaint.

PJM has adopted protocols that contemplate orderly consideration of proposals to amend its tariff, including review and deliberation by stakeholders, providing input through a structured set of committees. For example, PJM's Markets and Reliability Committee is responsible, *inter alia*, for providing

> advice and recommendations concerning issues pertaining to the operation and administration of the PJM markets, including but not limited to amendments to PJM's Operating Agreement, the PJM Tariff, or market rules and procedures as necessary or appropriate to foster competition and assure the fair, reliable and efficient operation and administration of the PJM markets.

PJM Members Handbook at 9 (Jan. 22, 2009) (available at http://pjm.com/~/media/committees-groups/handbook.ashx). Similarly, PJM's Members Committee is charged to

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[96] RPM Order P 48.

> [r]eview all proposals by the Markets and Reliability Committee regarding the following issues and make all such necessary recommendations to the PJM Board for approval of
>
> a. operating principles, policies and guidelines
>
> b. planning principles, policies and procedures as well as expansion plans
>
> c. market practices, procedures, and rules.

Id. at 8.

While seeking amendments to the PJM Tariff, the filings initiating the instant proceedings did not proceed through the committee structure described above. P3 sought expedited consideration of its complaint initiating Docket No. EL11-20-000, claiming that implementation of the New Jersey statute creating the LCAPP would lead to "uneconomic entry," and that because such entry was "imminent" an order should be issued revising the MOPR prior to the next RPM BRA, scheduled for May 2011.[97] PJM's Section 205 filing initiating Docket No. ER11-2875-000, submitted to the Commission in response to the complaint, likewise expressed concern that the Commission act on a hurry-up basis. PJM explained that it

> advised its stakeholders that, given the P3 Complaint's request for action before the May 2011 auction, PJM planned to submit its section 205 filing within a matter of days. PJM does so now, in part to enable the Commission, if it chooses, to act on these Tariff changes before the upcoming auction.

[97] *See* P3 Complaint and Request for Clarification Requesting Fast Track Processing, Docket No. EL11-20-000 (Feb. 1, 2011), eLibrary No. 20110201-5181.

PJM Filing at 4, Docket No. ER11-2875-000 (Feb. 11, 2011), eLibrary No. 20110211-5121. In a nutshell, both PJM and P3 were concerned that resources would be selected through the New Jersey LCAPP on expedited basis, that those resources would bid into the May 2011 BRA, and that they would skew the auction results. For this reason, PJM chose not to conduct a stakeholder process with respect to its proposal to revamp the MOPR. Instead, PJM opted for a single, 270-person conference call. *Id.*

During the pleadings cycle in these dockets and prior to the issuance of the RPM Order, New Jersey moved forward with its LCAPP. In the course of that effort, it became clear that there was no need for an expedited resolution of any MOPR changes prior to the May 2011 BRA, because the New Jersey program would have no impact on its outcome. Specifically, NJ Rate Counsel's April 1, 2011, filing alerted the Commission to the issuance of

> a final Order of the New Jersey Board of Public Utilities (NJ BPU or Board) approving standard offer capacity agreements (SOCAs) for three resources under the New Jersey Long-Term Capacity Agreement Pilot Program (LCAPP). None of the three resources is expected to participate in the May 2011 auction. P3 responded to the LCAPP Agent's recommendation of these resources by observing the absence of a "final finding" on the resources that New Jersey would procure and speculating that "anything can happen between now and the May, 2011 auction." The NJ BPU's Order lays to rest any such concern or speculation.

April 1 Filing at 3 (footnotes omitted). In light of this development, and the significance of the matters at issue, we urged that the Commission take a deliberate approach and not rush to judgment. In support of this position we noted that a P3 witness had made the same observation about the importance of careful consideration of the issues:

> P3 witness Professor Hogan correctly asserts that a "deliberate and comprehensive review" is needed to consider "[m]ost of the issues related to broader RPM design features[.]" Professor Hogan argues that reforming the Minimum Offer Price Rule (MOPR) is "more urgent because of the timing of the next RPM auction and the impact of near-term investment decisions in expectation of future RPM mitigation." [citation omitted] As there is no longer any valid concern that the actions of either New Jersey or Maryland will impact the "next RPM auction," the Commission should address the matters at issue in the "deliberate and comprehensive" manner suggested by witness Hogan, rather than the rush to judgment sought by his clients and PJM.

Id. at 3-4 (footnote omitted).

PJM nonetheless continued to urge expedited consideration of its filing, even though the New Jersey initiative would have no impact on the May 2011 Base Residual (RPM) Auction.[98] In support, PJM counsel asserted that a delay would "simply continue considerable uncertainty in the RPM marketplace." *Id.* at 1. NJ Rate Counsel responded that the claim of uncertainty resulting from delay in addressing MOPR modification was overblown, in that PJM "already is required to conduct significant reviews of RPM this year."[99] We observed that the prospect of a wide-ranging review of RPM created more "uncertainty" regarding future entry and resulting prices than would maintaining the MOPR status quo temporarily, during a period when no LCAPP resource will participate in the auction, so that PJM, its stakeholders, and the Commission could consider the issues raised in this proceeding more deliberately.

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[98] Letter from Paul M. Flynn, Attorney for PJM Interconnection, L.L.C. to Hon. Kimberly D. Bose, Secretary, Federal Energy Regulatory Commission, Docket No. ER11-2875-000 (Mar. 28, 2011), eLibrary No. 20110328-5160.

[99] PJM Answer at 5, Docket No. ER11-2875-000 (Mar. 21, 2011), eLibrary No. 20110321-5174 ("PJM Answer").

Finally, we noted that, in connection with consideration of New England's capacity market (but equally relevant here), Congress had expressly directed the Commission to heed state concerns and give appropriate weight to state interests. In the Energy Policy Act of 2005, Congress "declare[d] that it [was] the sense of Congress that the Federal Energy Regulatory Commission should carefully consider the States' objections" to ISO New England's (ISO-NE's) then-pending capacity market proposal.[100] In response, even though an administrative law judge already had issued an initial decision finding ISO-NE's proposal to be just and reasonable, the Commission convened a lengthy oral argument before the Commission itself to hear the states' claims.[101]

In so doing, the Commission deferred any implementation of the ISO-NE proposal for ten (10) months beyond a previously-announced deadline, recognizing that deliberate and comprehensive review of potential alternatives would be needed before implementing or substantially revising a regional capacity market.[102] Following this action, the Commission—in response to the directive in Section 1236—established settlement talks which culminated in the abandonment of the then-pending ISO-NE proposal and the adoption (by settlement) of the FCM subsequently approved by the Commission. In light of that history, we argued that where (as here) parties urge the wholesale abandonment of Commission-approved settlement terms that are essential

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[100] Pub. L. No. 109-58, § 1236(b)(2), 119 Stat. 594, 961. There, as here, the states were concerned that the wholesale capacity market mechanism "would not provide adequate assurance that necessary electric generation capacity or reliability will be provided." *Id.* § 1236(a)(2)(A).

[101] *Devon Power LLC*, 112 FERC ¶ 61,179, *clarified*, 113 FERC ¶ 61,031 (2005).

[102] *Id.* In that case, the Commission deferred action despite its finding that "the status quo is failing and that generation resources are not being added at a rate necessary to maintain reliability and assure just and reasonable wholesale power prices." *Devon Power LLC*, 113 FERC ¶ 61,075, P 5 (2005). Here, as discussed below, the NJ BPU's LCAPP Order shows that no LCAPP resource will participate in the May 2011 auction, thus eliminating the alleged need for immediate action.

market design components, the Commission should again ensure that all viewpoints are carefully and fairly considered and that the requisite stakeholder processes are invoked, rather than ignored.

The RPM Order pays no heed to these considerations. In support of its precipitous action, the Commission states, first, that "[u]nder Section 205 of the FPA, the Commission must act on PJM's tariff changes within 60 days of the date of filing." RPM Order P 25. While correct that the Commission "must act," within 60 days, there is no obligation on the Commission to resolve the merits of the filing within that timeframe where there are countervailing considerations that suggest doing otherwise. Nothing prevents the Commission from rejecting the PJM filing without prejudice to its being renewed following completion of an appropriate stakeholder process. Nor does anything prevent the Commission from accepting the filing, suspending it, and establishing a hearing to be held in abeyance pending settlement discussions. As the Commission knows, each is a common response to proposed non-exigent ISO/RTO tariff changes that have not been considered adequately by those who will be affected by the changes and who may be able to contribute to a different solution that better meets all parties' needs.

Next, the Commission states that it is "not persuaded that the existing record is deficient on any of the issues presented." *Id.* Similarly, the Commission goes on to note "that the record has been fully developed in support of our findings, regardless of any exigencies that may or may not be attributed to the May 2011 base residual auction." *Id.* P 26. NJ Rate Counsel urges that these findings be reconsidered. There is at least one glaring deficiency in the existing record: PJM's filing does not reflect the outcome of deliberations conducted through a stakeholder process, which might well have resulted

either in refinements to the Section 205 filing, or to the adoption of wholly different, alternative proposals (which might well have not engendered the litigation firestorm that has since ensued). Given the history of the New England stakeholder discussions concerning FCM, the Commission neither can nor should dismiss out of hand the notion that a stakeholder process can yield consensual and creative solutions to disputes that look intractable when they begin in a litigated context.

Next the Commission states, "we agree with parties who argue that it would be beneficial to resolve these issues prior to the May 2011 base residual auction." *Id.* P 26. The Commission does not explain why that is the case. It is not self-evident, in the extant circumstances, that a fast decision that end-runs the stakeholders is necessarily the better course. As shown above, there are substantial reasons to believe that any benefit gained from deciding these issues now was minimal (given that no NJ LCAPP resources nor resources responding to the Maryland RFP would be bidding into the May 2011 BRA), and plenty of reason to conclude that a more deliberate approach was the better course.

The RPM Order also addresses the stakeholder process. While noting that "PJM's specific MOPR revisions have not been considered under the standard stakeholder process," they are nonetheless appropriately before the Commission because PJM

> did convene an expedited process in advance of its filing and answered stakeholder questions raised by PJM's proposal and P3's complaint. We note that PJM's stakeholders are familiar with the instant issues, having addressed MOPR reforms in a recent Commission proceeding.

Id. The characterization of a single, 270-person conference call as a "process" (even an expedited one) is off-base. A stakeholder process involves give-and-take, time and the opportunity to consider and respond meaningfully to what has been proposed, and a

legitimate chance to seek to persuade others that a given stakeholder's perspective is correct and should prevail. PJM's "expedited process" offered none of these opportunities. It was, instead, a status briefing on actions that PJM had already concluded that it was going to undertake.

There should be no question that absent a demonstration of "imminent" harm, the Commission should not consider adopting a PJM proposal that is the result of an end-run of the stakeholder process. Instead, and as it has done in other contexts, the Commission should require that parties seeking changes advance them in accordance with stakeholder procedures. *See*, *e.g.*, *NEPOOL and ISO New England, Inc.*, 105 FERC ¶ 61,211 (2003), in which a demand response provider, NXEGEN, sought to raise before FERC issues that ISO-NE argued should have first been vetted in the stakeholder process. While FERC did not reject NXEGEN's filing, it chastised NXEGEN for its actions:

> The Commission notes that ISO-NE's assertion in its September 12 rehearing request that NXEGEN has inappropriately sought to circumvent the stakeholder process has merit. Rather than coming immediately to the Commission with its complaints, NXEGEN should seek to resolve its difficulties in the first instance by participating in the stakeholder process.

Id. P 20 n.12. The same rule should apply here—especially when those seeking immediate action have failed to demonstrate a legitimate "crisis" justifying precipitous action. The Commission's decision to treat this as a sufficient process is at odds with its general "practice of relying on stakeholder input when appropriate." *E.g., Braintree Elec. Light Dept.,* 128 FERC ¶ 61,008, P 54 (2009) (a proceeding in which the Commission set a matter for hearing, but held the hearing in abeyance *for a full year* to allow for stakeholder consideration of the matters at issue). If the Commission is going to break

with established practice, it should be obliged to provide a reason for its action. FERC's determination here is not properly explained, nor merited by the relevant circumstances. Action on PJM's filing should have been deferred pending the conduct and completion of a PJM-sponsored stakeholder process. Alternatively, the Commission could have accepted the filing, suspended it for five months (which would have had no demonstrated impact on events as the next BRA auction will not occur for another year), set the filing for hearing, and postponed the initiation of any hearing procedures pending the completion of Commission-sponsored settlement discussions. The Commission well knows the drill, but inexplicably chose not to utilize this option in these circumstances.

J. The RPM Order errs in treating the theoretical availability of an FRR option as a real alternative that cures or moots the revised RPM's defects.

The RPM Order asserts that the elimination of the state MOPR exemption is not intended to "interfere" with the efforts of "states or localities that for policy reasons seek to provide assistance for new generation entry if they believe such expenditures are appropriate for their state." RPM Order P 141. However, by modifying the RPM design to make it unlikely that these state resources will clear in the RPM auction, the Commission is doing far more than "interfer[ing]" with state efforts: it is actively impeding them, if not calling them to a complete halt. The RPM Order responds to this concern by asserting that states or localities can avoid such interference by opting out of RPM entirely and procuring all of their capacity needs through reliance on the FRR option. The RPM Order states:

> PJM's tariff also provides an alternative for those load serving entities that wish to bring new generation resources into the PJM capacity market without risk of being

> mitigated under the MOPR. They may avail themselves of the FRR option to satisfy their capacity requirements.

Id. P 192. The Commission goes on to explain that the

> FRR option is the alternative for load serving entities that wish to secure their own capacity resources outside of a competitive market, whether as directed by state-authorized integrated resource plans, or pursuant to other considerations.

Id. P 193.

Contrary to the assertions in the RPM Order, the “FRR option” is not a means through which New Jersey can accomplish the public policy objectives set forth in the LCAPP legislation. New Jersey is not seeking to secure all of its capacity resources outside of the competitive market. Nor does it seem likely that New Jersey could seek to do so effectively, short of reversing the restructuring of its retail electric markets and the state LSEs’ divestiture of their generation facilities. Where generation is no longer owned by vertically-integrated utilities, RPM becomes a price floor for generation resources who would have no incentive to become part of an FRR capacity plan unless they could earn greater profits in such an arrangement. Thus, no matter how unreasonably high RPM prices might get, FRR prices always would be higher. Where RPM serves as a price floor for FRR, the two cannot be treated as real alternatives to one another, and the theoretical availability of an FRR “option” neither cures nor moots RPM’s defects.

In order to evaluate whether FRR was a potentially option viable for New Jersey, NJ Rate Counsel witness James F. Wilson prepared an affidavit (which is attached hereto) in which he has conducted a preliminary evaluation of the Commission’s suggestion that

FRR is a potential alternative through which New Jersey may implement its LCAPP.[103] Mr. Wilson concludes that "FRR is not a viable alternative for meeting the capacity obligations associated with New Jersey loads." Second Wilson Aff. at ¶ 15.

In particular, Mr. Wilson reaches three conclusions, each of which belies the Commission's assertion that FRR is a viable alternative. First, Mr. Wilson notes that "New Jersey FRR Entities would face substantial unmitigated market power in attempting to reach agreements on the capacity resources needed for their FRR Capacity Plans, leading to excessive prices and costs." *Id.* Second, Mr. Wilson finds that even if New Jersey FRR Entities were able to develop adequate FRR Capacity Plans, the entities "would be subject to additional costs and risks, due to various inflexible provisions of the FRR rules and uncertainties about load forecasts and locational resource requirements." *Id.* ¶ 16. Third, Mr. Wilson finds that if New Jersey entities were to elect the FRR alternative and plan to satisfy capacity obligations with new resources such as those the LCAPP was designed to encourage, the effect on *RPM* prices would be the same as if the LCAPP resources had offered *into RPM* at prices that would clear. *Id.* ¶¶ 37-38. Thus, Mr. Wilson concludes, "there is considerable risk that some parties would call for the FRR rules to be changed." *Id.* ¶ 17; *see also id.* ¶ 39.

Mr. Wilson notes that "neither the state of New Jersey nor any of its load-serving entities have expressed a desire to withdraw from RPM and manage their own capacity procurement as FRR Entities," and further finds that there is no evidence of any desire on the part of the state to "take on the administrative burden and exposure to various costs

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[103] The "Affidavit of James F. Wilson In Support Of Request For Rehearing Of New Jersey Rate Counsel," is included as an Attachment to this pleading and will be referred to herein as "Second Wilson Aff.."

and risks . . . associated with the FRR alternative." *Id.* ¶ 18. He goes on to note that there is no "evidence that New Jersey wishes to cease relying on the RPM market for its intended purpose, as a capacity spot market balancing residual supply and demand." *Id.* Mr. Wilson notes more generally that "there is there is no historical evidence that FRR is a viable alternative for New Jersey." *Id.* ¶ 19. The FRR alternative has not been used in PJM in a retail access state nor in any "Locational Deliverability Area" in the RTO region. *Id.* ¶¶ 19-20. Instead, he points out that "[t]o date, the FRR alternative has been used by a single large, vertically integrated and capacity-long entity, American Electric Power (AEP), and in fact the FRR alternative was largely designed with this one entity in mind in the settlement process that led to RPM." *Id.* ¶ 19.

In support of the latter assertion, Mr. Wilson refers to the Commission's statement that the FRR option was designed largely at the behest of one utility in the PJM region, AEP, "to provide it with greater certainty and stability in its forward capacity obligations." *Id.* ¶ 19 n.2 (quoting *PJM Interconnection*, 126 FERC ¶ 61,275, P 90 (2009)). As a vertically integrated utility with "enough capacity resources to satisfy the traditional 115 percent state requirement," AEP sought and was granted a mechanism to ensure "greater certainty and stability in its forward capacity obligations."[104] The FRR is neither designed nor capable of allowing New Jersey to effectively meet its public policy needs. The very reason New Jersey adopted its LCAPP program was to address a

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[104] *Id.*; Technical Conference, *Capacity Markets in the PJM* Region, Docket No. PL05-7-000 (June 16, 2005) Technical Conference on June 16, 2005; *See also* Motion to Intervene and Protest of American Electric Power at 8-9, Docket Nos. ER05-1410-000, EL05-148-000 (Oct. 19, 2005), eLibrary No. 100510195073; *PJM Interconnection LLC,* 115 FERC ¶ 61,079, PP 100-101 (2006).

capacity *shortage*; the FRR, in contrast, is premised on an entity already owning or having access to sufficient capacity.

Furthermore, the FRR "option" is not economically suited to the needs of a state like New Jersey which converted to retail electric service over a decade ago.[105] Mr. Wilson explains the "numerous and daunting risks and challenges" that New Jersey would face were it to decide to move forward with the FRR alternative. He explains that implementing an FRR capacity plan in New Jersey would require negotiating under circumstances of "substantial unmitigated market power," and would likely require inclusion in any FRR capacity plan of resources priced above market levels:

> The substantial market power results from the high internal resource requirements of the relevant LDAs (Eastern MAAC, PSEG and PS North); the concentrated ownership of the existing resources within these LDAs; and the presence of little or no excess capacity in these zones. Under these circumstances, attempts to fulfill FRR Capacity Plans would very likely result in prices and costs that reflect substantial market power. While New Jersey FRR Entities could respond to this market power by sponsoring additional new generating resources (in addition to those contemplated in the LCAPP), this would result in duplicative and wasteful investment and the imposition on consumers of excessive costs.

Id. ¶ 22.

In addition, Mr. Wilson's preliminary review reveals other daunting hurdles that would have to be overcome in order to implement the FRR option:

- The FRR alternative is elected for a minimum five year period, and the FRR Capacity Plan submitted each year must identify resources for that five year period. While an FRR Entity is permitted to update its FRR Capacity Plan each year and to identify replacement resources, there are

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[105] Electric Discount and Energy Competition Act (1999), P.L. 2009, ch. 23 (N.J. 2009).

likely to be costs incurred to obtain the rights to include resources in the FRR Capacity Plan and to adjust the plan from year to year. *Id.* ¶ 25.

- The RPM rules recognize that additional short-lead time resources for a delivery year become available after the three-year forward base residual auction by including a 2.5% Short Term Resource Procurement Target that reduces the resources that must be acquired through the base residual auction. The FRR alternative includes no such deduction or flexibility for Year 1 or even for Year 5 of the FRR Capacity Plan. *Id.* ¶ 27.

- The FRR Capacity Plan must identify resources to meet forecast obligations eight years into the future (three years forward for a five year plan)). Load forecasting that far in advance is of course highly uncertain, and this requirement can lead to contracting a substantial quantity of resources that ultimately will not be needed. *Id.* ¶ 28.

- The internal resource requirement is a function of the peak load forecast and also the estimated transmission capacity available to the LDA (Capacity Emergency Transfer Limit, or "CETL"). As the internal resource requirement changes year to year, the FRR Capacity Plan must be adapted accordingly. *Id.* ¶ 29.

- PJM has authority to define additional LDAs that could include portions or all of the New Jersey zones, based on objective tests of transmission constraints or if warranted by other reliability concerns. Were this to happen, effected entities would have only a few weeks to adjust FRR capacity plans to conform. *Id.* ¶ 30.

- PJM can reject an FRR Plan if it is found to not satisfy the entity's capacity obligations; in that case, the entity would be given just five business days to cure the insufficiency. *Id.* ¶ 33.

Witness Wilson goes on to note:

> These and other provisions of the FRR rules impose highly inflexible capacity procurement requirements and substantial penalties for any non-compliance that are not founded on or required by the resource adequacy needs of the system. Many of these provisions reflect the consensus achieved among the parties to the RPM settlement to make the FRR alternative unattractive, and are not necessary to ensure that an FRR entity bears its share of the capacity needs of the system. No capacity-short load-serving entity would acquire commitments to meet 100% of forecast needs eight years in advance, as required by the FRR rules, nor would any state require its load-serving entities to plan that far in advance. The requirement to identify resources to

> meet a forecast peak eight years in advance is especially inefficient under recent circumstances, characterized by slower and increasingly uncertain peak load growth, and an abundance of short lead-time resources, most notably new demand response.

Id. ¶ 35.

In these circumstances, there is no basis for the Commission's conclusion that FRR is a viable option or alternative through which New Jersey can be expected to achieve the goals sought to be met through the LCAPP. Nor is there any basis for concluding, without a detailed factual review, which the RPM Order does not conduct, that FRR would be a viable replacement for RPM in New Jersey's circumstances.

IV. CONCLUSION

WHEREFORE, for the foregoing reasons, NJ Rate Counsel requests that the Commission grant rehearing and take action in accordance with the positions expressed herein.

Respectfully submitted,

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May 12, 2011

Attachment

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

	)	
PJM Power Providers Group	)	Docket No. EL11-20-000
v. PJM Interconnection, L.L.C.	)	
	)	
PJM Interconnection, L.L.C.	)	Docket No. ER11-2875-000
	)	
	)	(not consolidated)
	)	

AFFIDAVIT OF JAMES F. WILSON IN SUPPORT OF REQUEST FOR REHEARING AND FOR EXPEDITED CONSIDERATION OF NEW JERSEY DIVISION OF RATE COUNSEL

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AFFIDAVIT OF JAMES F. WILSON IN SUPPORT OF REQUEST FOR REHEARING AND FOR EXPEDITED CONSIDERATION OF NEW JERSEY DIVISION OF RATE COUNSEL

I. Introduction

1. My name is James F. Wilson. I am an economist and principal of Wilson Energy Economics. My business address is 4800 Hampden Lane Suite 200, Bethesda, MD 20814.

2. My experience, qualifications and past testimony were described in my affidavit filed on March 4, 2011 in this proceeding on behalf of the New Jersey Division of Rate Counsel and in my curriculum vitae, which was attached as Exhibit JFW-1 thereto.

3. This affidavit was also prepared at the request of the New Jersey Division of Rate Counsel. In an order issued April 12, 2011 ("April Order") the Commission accepted most of the revisions proposed by PJM Interconnection, L.L.C. ("PJM") on February 11, 2011 to the Minimum Offer Price Rule ("MOPR") associated with PJM's Reliability Pricing Model ("RPM") capacity construct. The April Order suggested that the Fixed Resource Requirement ("FRR") alternative defined in the PJM Reliability Assurance Agreement ("RAA") provides an alternative for satisfying capacity obligations while accommodating New Jersey policy initiatives. I was asked to evaluate whether FRR is a viable alternative for New Jersey given New Jersey's circumstances and policy initiatives.

II. Background and Scope of Analysis

4. In 2005, PJM proposed to implement the new, locational RPM capacity construct, largely out of concern that no new power plants had been built in New Jersey for several years.[1] Five years later (2010), despite RPM, this situation was largely unchanged, and the state of New Jersey took action by implementing its Long-Term Capacity Agreement Pilot Program ("LCAPP"). The state of Maryland has also considered actions to encourage construction of new capacity in that state. This proceeding largely resulted from concerns about the potential impact

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[1] "PJM has seen few generation additions, but high rates of generation retirements, in some of the same areas in the PJM region where load is growing fastest. As a result of these trends, in particular a spate of actual and announced generation retirements, part of the PJM system – the state of New Jersey – faces violations of reliability criteria in each of the next four years." PJM's RPM Application in Docket No. ER05-1410, August 31, 2005, p. 5.

on RPM prices of these initiatives. The RPM rule changes approved in the April Order would likely thwart the New Jersey and Maryland initiatives by imposing minimum offer prices such that the capacity resulting from the initiatives would be unlikely to clear in RPM's auctions and, therefore, would neither count toward meeting capacity obligations nor receive capacity payments.

5. The April Order recognized that the new rules could cause new resources self-supplied by load-serving entities or assisted through state policy initiatives not to clear in RPM (likely resulting in such resources not being built), but suggested that this result was not too harsh because the FRR alternative could be used to permit construction of the same resources and accomplish the same objectives. The April Order states:

> "PJM's tariff also provides an alternative for those load serving entities that wish to bring new generation resources into the PJM capacity market without risk of being mitigated under the MOPR. They may avail themselves of the FRR option to satisfy their capacity requirements." April Order, P 192
>
> "The FRR option is the alternative for load serving entities that wish to secure their own capacity resources outside of a competitive market, whether as directed by state-authorized integrated resource plans, or pursuant to other considerations." April Order, P 193
>
> "Nor are we persuaded, as intervenors argue, that permitting new self-supply to be rejected at its preferred offer price is too harsh and too costly for ratepayers. First, as noted above, the FRR option is available for those load serving entities that want to secure capacity outside of the RPM market..." April Order, P 195

6. The Complaint and Request for Clarification Requesting Fast Track Processing ("P3 Complaint") filed by the PJM Power Providers Group ("P3") in Docket No. EL11-20-000 also suggested that the mitigation would not be unduly harsh and intrusive because the FRR alternative is available and provides broad flexibility in capacity arrangements that would not be subject to the MOPR:

> "Because FRR Parties are outside the purview of the Minimum Offer Price Rule, they remain free to make arrangements for capacity at any terms otherwise lawful, including at prices above the RPM clearing price, should they so choose. The availability of this option … should be a sufficient answer to any cavil that RPM with the Revised Minimum Offer Price Rule would be unduly harsh and intrusive to parties seeking to self-supply." P3 Complaint, p. 52

7. PJM's Independent Market Monitor also expressed the view that New Jersey could use the FRR alternative to regain control of decisions regarding resource adequacy for the state:

> "New Jersey clearly has the right and the obligation to address its own reliability needs if it does not think they are being adequately addressed through the PJM markets. The most direct option would be for New Jersey to require that LSEs opt out of RPM markets entirely via the Fixed Resource Requirement Alternative ("FRR"). Under FRR, New Jersey's procurement choices would have much less impact on other participants in RPM markets. New Jersey could make its own decisions about how best to reach required reliability levels." Comments of the Independent Market Monitor for PJM, March 4, 2011, p. 10

8. As the April Order noted (at P 137 and footnote 72) various other parties also suggested that FRR is an alternative for New Jersey to pursue its resource adequacy objectives.

9. I was asked to conduct a preliminary evaluation into whether the FRR option is a viable alternative for New Jersey as suggested in the April Order, *i.e.*, to evaluate whether FRR could be used to meet the capacity obligations of New Jersey loads in a manner that would also accommodate pursuit of legitimate state public policy objectives, including the resource adequacy objectives the LCAPP was designed to promote.

10. For my analysis I took as a starting point that the capacity obligations of New Jersey loads are presently satisfied primarily through RPM and at RPM prices. The owners of existing resources would consider RPM prices to be the "opportunity costs" of reaching agreement to provide capacity to a New Jersey FRR Entity for its FRR Capacity Plan. Therefore, without forecasting future RPM prices or evaluating their economic efficiency or reasonableness, I focused on the impact of electing the FRR alternative relative to the RPM status quo.

11. I have also not evaluated the regulatory or political feasibility of the FRR alternative. The RAA includes a "savings clause" that appears to allow a state to require jurisdictional utilities to become FRR Entities. My analysis assumes that most or all of the four electric distribution companies that serve New Jersey, and the various public power entities located within the four utility zones, could become FRR Entities either voluntarily or through state action.

12. My analysis considers the viability of the FRR alternative for all of New Jersey, and, for reasons that are explained, I also consider the possibility of FRR for only two or three of

New Jersey's four utility zones. While the FRR rules also allow FRR service areas that are smaller than a utility zone if certain requirements are met, I do not evaluate smaller FRR service areas. Some of the risks associated with the FRR alternative would be exacerbated by a smaller service area and served load, and the benefits, costs and risks would be concentrated on a smaller group of customers, making this relatively unattractive.

13. Finally, my evaluation assumes the FRR rules as they exist at this time. However, I also briefly discuss the risk that these rules will be changed.

III. Summary of Conclusions

14. The RAA permits an investor-owned utility, public power entity, or electric cooperative to become an FRR Entity and take responsibility for providing the entire capacity obligation for its FRR Service Area. Each FRR Entity must annually submit an FRR Capacity Plan for the five year period beginning three years into the future. An FRR Entity includes in its FRR Capacity Plan resources that it owns or for which it has entered into an agreement that commits the capacity to the FRR Entity. An FRR Entity generally does not participate in RPM base residual or incremental auctions (there is a restricted ability to sell some excess capacity). The RAA imposes many requirements that are similar to those applicable to RPM and various additional requirements specific to FRR status, several of which are further discussed below.

15. Based on my analysis as presented here, I conclude that FRR is not a viable alternative for meeting the capacity obligations associated with New Jersey loads. New Jersey FRR Entities would face substantial unmitigated market power in attempting to reach agreements on the capacity resources needed for their FRR Capacity Plans, leading to excessive prices and costs.

16. In addition, if New Jersey FRR Entities were able to construct the required FRR Capacity Plans, in managing their FRR resource portfolios they would be subject to additional costs and risks, due to various inflexible provisions of the FRR rules and uncertainties about load forecasts and locational resource requirements.

17. Finally, I note that additional new resources have the same impact on RPM prices whether offered into RPM at prices that clear or introduced within an FRR Entity's portfolio. Therefore, if New Jersey entities were to pursue the FRR alternative and plan to satisfy some New Jersey capacity obligations with new resources (such as those the LCAPP was designed to

encourage), there is considerable risk that some parties would call for the FRR rules to be changed.

IV. Evaluation of the FRR Alternative for New Jersey Loads

18. As a preliminary observation, I note that the idea that New Jersey should consider the FRR alternative did not originate with New Jersey or its load-serving entities ("LSEs"). To my knowledge, neither the state of New Jersey nor any of its load-serving entities have expressed a desire to withdraw from RPM and manage their own capacity procurement as FRR Entities. In particular, there is no evidence of a desire to take on the administrative burden and exposure to market power and various other costs and risks (discussed further below) associated with the FRR alternative. I also note that New Jersey and Pennsylvania utilities have benefited from interconnection and reserve-sharing since 1927, and there is no evidence that New Jersey seeks to turn away from the benefits of this arrangement at this time, as would result to some extent from the long-term and inflexible capacity procurement requirements imposed by the FRR rules. Nor is there any evidence that New Jersey wishes to cease relying on the RPM market for its intended purpose, as a residual capacity spot market balancing residual supply and demand.

A. There Is No Evidence the FRR Alternative is Viable Under New Jersey Circumstances

19. The suggestions by various parties that New Jersey should elect FRR are not supported by any history of the alternative being used under New Jersey's circumstances. Nor did any of the parties promoting the FRR alternative provide any discussion or analysis of how the alternative could work for New Jersey entities. To date, the FRR alternative has primarily been used by one large, vertically integrated and capacity-long entity, American Electric Power (AEP), and in fact the FRR alternative was largely designed with this one entity in mind.[2] As a

[2] As the Commission has recognized, the FRR alternative was developed at the behest of AEP to address concerns raised by AEP having to do with its particular circumstances. "As a solution, AEP suggested at the June 16, 2005 technical conference that individual LSEs should be allowed to "opt-out" of the forward procurement auction by identifying – prior to the four-year-ahead auction – enough capacity resources to satisfy the traditional 115 percent state requirement… In response to AEP's suggestion, PJM included in the August 31st Filing draft business rules that could implement an alternative to RPM under which an LSE could provide its own long-term fixed resource requirement." 115 FERC ¶ 61,079 (2006) at PP 100-101. The Commission acknowledged the connection between FRR and AEP three years later, and after two years of RPM operation, stating: "The Fixed Resource Requirement option was developed largely at the behest of AEP to provide it with greater certainty and stability in its forward capacity obligations." 126 FERC ¶ 61,275 (2009) at P 90.

result, the quantity of FRR load has been stable over RPM's eight delivery years, and the planning parameters for the 2014/2015 base residual auction held in May 2011 show FRR load only in the AEP zone (loads associated with procedures to integrate new service areas into PJM are temporarily treated as "FRR" for the purposes of some RPM auctions but are not FRR loads according to the rules in the RAA). Unlike New Jersey, there is only a small amount of retail access in AEP's service territory, and that retail access has resulted in litigation in FERC Docket No. EL11-32 regarding the capacity prices these loads will end up paying.

20. In addition, to date FRR load has existed only in the "Rest of RTO" region; there has never been any FRR load in any Locational Deliverability Area ("LDA") modeled in RPM. (LDAs are PJM-designated sub-regions for which separate RPM prices may be established; RPM prices have been much higher in LDAs than in the Rest of RTO Region.) All New Jersey loads are located in the Mid Atlantic ("MAAC") and Eastern MAAC LDAs, and some New Jersey loads are located in the PSEG and PS North LDAs. Thus, there is no historical evidence that FRR is a viable alternative for New Jersey, a retail access state in which all load is located in LDAs that are modeled in RPM.

B. In Seeking to Develop FRR Capacity Plans, New Jersey FRR Entities Would Face Substantial Unmitigated Market Power

21. New Jersey is a retail access state in which most of the generation formerly owned by utilities was divested or transferred to unregulated affiliates. Consequently, if New Jersey utilities are to become FRR Entities, they will have to reach agreement with the owners of existing or new capacity to fulfill the required, long-range FRR Capacity Plans. In addition, because the New Jersey FRR Service Areas would be located within defined LDAs, they would be subject to a requirement that a high percentage of the resources for the FRR Capacity Plans be located within the LDAs.

22. In an appendix to this Affidavit I review the capacity available to New Jersey FRR Entities to satisfy the requirements of FRR Capacity Plans. My analysis leads to the conclusion that in attempting to reach agreements on capacity resources for their FRR Capacity Plans, New Jersey FRR Entities would face substantial and unmitigated market power. The substantial market power results from the high internal resource requirements of the relevant LDAs (Eastern MAAC, PSEG and PS North); the concentrated ownership of the existing resources within these LDAs; and the presence of little or no excess capacity in these zones.

Under these circumstances, attempts to fulfill FRR Capacity Plans would very likely result in prices and costs that reflect substantial market power. While New Jersey FRR Entities could respond to this market power by sponsoring additional new generating resources (in addition to those contemplated in the LCAPP), this would result in duplicative and wasteful investment and the imposition on consumers of excessive costs.

23. I conclude that because New Jersey FRR Entities would face substantial unmitigated market power (as further developed in the appendix to this Affidavit), FRR is not a viable alternative for New Jersey.

C. Various Inflexible FRR Provisions Would Result in Additional Costs and Risks

24. Assuming New Jersey were nonetheless inclined to pursue the FRR alternative, the state and the participating load-serving entities would face additional costs and risks, primarily due to the inflexibility of the FRR provisions, the complexity of the FRR and RPM rules, and the uncertain market and regulatory environment in which FRR Entities would be obligated to build and manage FRR Capacity Plans. This section identifies several such challenges; a more detailed review would likely identify quite a few more.

25. **Five Year FRR Capacity Plans Submitted Three Years in Advance**. The FRR alternative is elected for a minimum five year period, and the FRR Capacity Plan submitted each year must identify resources for a five year period beginning three years into the future (meaning that an FRR Capacity Plan submitted in April 2012 would have to identify sufficient resources to satisfy capacity obligations for the 2015/2016 through 2019/2020 Delivery Years). While an FRR Entity is permitted to update its FRR Capacity Plan each year and to identify replacement resources, there are likely to be costs incurred to obtain the rights to include resources in the FRR Capacity Plan and to adjust the plan from year to year.

26. **Five Year Minimum Commitment**. An entity electing the FRR alternative commits to a minimum five year term (so an entity electing FRR in 2012 would be committed to it for 2015 through 2019). The only exception from this minimum commitment is in the event of a “State Regulatory Structural Change” that substantially changes the state’s retail access or default service rules.

27. **No Recognition of Short Lead Time Resources**. The RPM rules recognize that additional short-lead time resources for a delivery year become available after the three-year-

forward base residual auction by including a 2.5% Short Term Resource Procurement Target that reduces the resources that must be acquired through the base residual auction. The FRR alternative includes no such deduction or flexibility for Year 1 or even for Year 5 of the FRR Capacity Plan. The RAA specifies that any demand response or energy efficiency on which an FRR Entity intends to rely for a delivery year must be included in the FRR Capacity Plan submitted three years in advance of the delivery year.

28. **Changing Load Forecasts**. The FRR Capacity Plan must identify resources to meet forecast obligations eight years into the future (for a five year plan, three years forward). Load forecasting that far in advance is of course highly uncertain, and this requirement can lead to contracting a substantial quantity of resources that ultimately will not be needed. For example, PJM's forecasts of Eastern MAAC peak loads have been sharply reduced since 2008, and an FRR Capacity Plan in 2008 would have required 7.9% more capacity for 2015 than is now considered needed. PJM Load Forecast Reports, 2008 and 2011, Table B-10.

29. **Changing Internal Resource Requirements**. New Jersey FRR Service Areas would be located within defined LDAs and, therefore, subject to a requirement that a high percentage of the resources for the FRR Capacity Plan must be located within the LDA. The internal resource requirement is a function of the peak load forecast and also the estimated transmission capacity available to the LDA (Capacity Emergency Transfer Limit, or "CETL"). Both the load forecast and the CETL values have been volatile in recent years, causing large swings in the minimum internal resource values. Over the past three RPM base residual auctions, the minimum internal resource requirement for Eastern MAAC has ranged from 84.2 percent to 89.9 percent. As the internal resource requirement changes from year to year the FRR Capacity Plan must be adjusted accordingly, and such adjustments will likely result in additional costs.

30. **Changing LDAs and New LDA Internal Resource Requirements**. PJM has authority to define additional LDAs that could include portions or all of the New Jersey zones, based on tests reflecting transmission constraints or "if warranted by other reliability concerns consistent with the Reliability Principles and Standards." RAA Schedule 10.1. PJM has authority to include LDAs in RPM auctions if "such LDA is determined in a preliminary analysis by the Office of the Interconnection to be likely to have a Locational Price Adder, based on historic offer price levels", or if PJM finds that including the LDA "is required to achieve an

acceptable level of reliability consistent with the Reliability Principles and Standards." PJM Tariff Attachment DD section 5.10.ii.C. The fact that a zone was entirely served by an FRR Entity would presumably not change this authority. If PJM chooses to model an additional LDA in RPM, it must notify the market of the new LDA and of the corresponding FRR minimum internal resource requirement by March 31 before the base residual auction. This would give an FRR Entity only a few weeks to adjust its FRR Capacity Plan, due one month before the base residual auction, to conform to the new minimum internal resource requirements.

31. **Restrictions on Sale of Excess Capacity**. An FRR Entity must either carry a "threshold amount" of excess capacity above the obligation based on forecast peak load, or commit to not selling any excess capacity into RPM auctions. This may not be a problem under the circumstances contemplated here, because the FRR Entity would likely simply release any excess resources from contractual obligations, although arranging and exercising this flexibility would likely entail additional cost.

32. **FRR and Retail Access**. New Jersey's retail competition program sets prices for the coming three years, so it dovetails with RPM that set prices more than three years forward. As FRR operates on the same three-year-forward schedule as RPM, the timing would not seem to introduce any additional issues. Under the FRR rules, a state can define its own rules for allocation of capacity costs as customers switch between load-serving entities (alternatively, the FRR rules describe a default plan if the state does not have one). However, as noted above, the one major FRR entity at this time has filed a complaint concerning the treatment of capacity costs for its small amount of retail access load. Use of the FRR option in a state with substantial retail access load, such as New Jersey, would likely surface additional unanticipated issues.

33. **Possible Rejection of FRR Plan**. The RAA states that PJM can reject an FRR Plan if it is found to not satisfy the FRR Entity's capacity obligations, and the FRR Entity would be given five business days to cure the insufficiency. If the FRR Entity is unable to cure the insufficiency, it would be subject to an FRR Commitment Insufficiency Charge equal to two times the Cost of New Entry for the relevant location (currently $379.85/MW-day), times the shortfall in MW, "for the remaining term of such plan." RAA Schedule 8.1, section D.7.

34. **Various Penalties for Non-Compliance or Resource Non-Performance**. The RAA specifies various penalties for non-compliance with the FRR requirements or non-performance of the resources used to meet the FRR obligations, rendering any failure to

accurately manage the portfolio of resources used to fulfill the FRR capacity obligations costly. FRR Entities might choose to carry excess capacity (at additional cost) to mitigate the risk of the various penalties.

35. These and other provisions of the FRR rules impose highly inflexible capacity procurement requirements and substantial penalties for any non-compliance that are not founded on or required by the resource adequacy needs of the system. Many of these provisions reflect the consensus achieved among the parties to the RPM settlement to make the FRR alternative unattractive, and are not necessary to ensure that an FRR Entity bears its share of the capacity needs of the system. No capacity-short load-serving entity would acquire commitments to meet 100% of forecast needs eight years in advance, as required by the FRR rules, nor would any state require its load-serving entities to do so. This requirement is especially inefficient under current circumstances, characterized by slower and increasingly uncertain peak load growth and an abundance of short lead-time new resources, most notably demand response.

D. If New Jersey Tried To Use FRR, There Is Substantial Regulatory Risk That the Rules Would Be Changed

36. In its March 4, 2011 filing in this proceeding, the PJM market monitor stated that "Under FRR, New Jersey's procurement choices would have much less impact on other participants in RPM markets." I disagree. The impact of the LCAPP resources (or any other new resources) on RPM prices would be the same if introduced through an FRR Capacity Plan as they would be if offered directly into RPM at prices low enough to clear.

37. When a load-serving entity elects the FRR alternative, both its capacity obligation (based on its peak load), and the capacity identified in its FRR Capacity Plan to meet that capacity obligation, are removed from RPM's base residual auctions. Assuming the capacity chosen for the FRR Capacity Plan would have cleared if offered into RPM, the RPM price for the region in which this load is located will be unchanged by the FRR election. Removing an amount of load and a corresponding quantity of cleared capacity from an RPM auction shifts the supply and demand curves the same amount, with the clearing price unaffected.

38. Similarly, when a new resource is offered and clears in RPM, the clearing price will generally be lower than it would have been had the new resource not been offered, because the supply curve shifts while the demand curve is unchanged. And if a new resource is included

in an FRR Capacity Plan, it has exactly the same impact on RPM prices as would occur if the resource was offered directly into RPM at a price that clears, because the other supply displaced from the FRR Capacity Plan by the new resource will likely be offered into RPM.

39. Consequently, while the April Order states that the FRR alternative allows bringing new resources into the market "without risk of being mitigated under the MOPR" (P 192), if New Jersey were to pursue the FRR alternative and plan to satisfy some New Jersey capacity obligations with new resources chosen based on public policy objectives such as those behind the LCAPP, there is risk that some parties would again respond by seeking changes to the rules. And, as this proceeding has demonstrated, the RPM rules can be changed very quickly.

40. The regulatory risk surrounding an RTO's resource adequacy rules, and the impact of the April Order on this perceived risk, was recognized recently in comments of the staff of the Organization of Midwest States ("OMS") in a Midwest ISO ("MISO") context:

> "At the [MISO Supply Adequacy Working Group] meeting on April 7th and 8th, 2011, the Midwest ISO acknowledged a need for those LSEs that own their resources to be able to self-supply in a manner that holds their load harmless. Our continued concern stems from: (1) a sense that the Midwest ISO lacks the authority to realize such assurances; (2) the recent FERC Order on the minimum offer pricing rules in PJM; and (3) draft tariff language provided by the Midwest ISO's Independent Market Monitor (IMM). These instances highlight the fact that a regional transmission organization's planned market design might end up being substantially modified by the Federal Energy Regulatory Commission, either on its own volition or in response to the comments of the Midwest ISO's IMM or other Midwest ISO stakeholders. In other words, whatever the intentions of the Midwest ISO's planned approach, a different approach might end up being imposed, in order to better serve different policy ends than those contemplated here." (Comments of OMS Staff on Midwest ISO's Presentation Materials from the April 7 & 8, 2011 MISO Supply Adequacy Working Group meeting, p. 1-2)

41. The complexity of the FRR and RPM rules, the fact that FRR has never been elected for loads in an LDA modeled in RPM or by a large, capacity-short entity, and that the only intersection of FRR and retail access has led to litigation, provide additional reasons for concern that FRR election by New Jersey entities would reveal additional shortcomings in the rules or consequences considered unintended or undesirable by some interested parties. To note just one issue that would likely lead to a change in the FRR rules, the RAA calls for the percentage internal resources required for each LDA to be calculated in a manner that does not necessarily result in a value less than 100% (this is because LDA Reliability Requirements are considerably larger than the sum of capacity obligations). In fact, for the 2013/2014 delivery

year, the value for the Mid Atlantic zone, calculated using the formula in the RAA, was 101.5%, although PJM chose to override the formula and set the value to 100% in the planning parameters for this auction. However, if this arose in an LDA with FRR load, PJM would undoubtedly propose some change to the rules, as allowing the FRR Entities to only provide 100%, when a greater quantity is necessary to meet the Reliability Requirement, would jeopardize reliability.

42. While pursuing the FRR alternative would likely entail substantial administrative cost due to its many requirements and inflexibility, and substantial market costs due primarily to market power, there is also considerable risk that the rules will be changed to impose additional onerous requirements or costs after an FRR Entity has elected FRR and become committed to its minimum five year term.

Appendix: Availability of Resources for Inclusion in New Jersey FRR Capacity Plans

43. An FRR Entity is required to file an FRR Capacity Plan one month before each RPM base residual auction, showing qualified resources sufficient to meet the capacity obligations of the FRR Service Area for a five year period beginning with the RPM delivery year three years forward. This appendix discusses the resources that would be needed and that would be available for FRR Capacity Plans to serve New Jersey loads.

44. The greatest challenge that would be faced by a New Jersey FRR Entity would be obtaining agreements with the owners of existing resources and sponsors of new resources sufficient to meet the RAA requirements for the FRR Capacity Plan. The RAA requires that the FRR Capacity Plan identify unforced resources equal to the forecast peak load of the FRR Service Area times the Forecast Pool Requirement ("FPR"; 1.0809 for the 2014/2015 delivery year). If any part of the FRR Service Area is located within an LDA modeled in RPM's auctions, there is an additional requirement that a minimum percentage of the resources must be located within the LDA.

A. Capacity Demand and Supply in Eastern MAAC and New Jersey LDAs

45. Table 1 shows the peak loads of the New Jersey and other Eastern MAAC zones based on the forecast for 2014/2015. The New Jersey zones represent 61.3% of the load in Eastern MAAC. If all New Jersey zones become part of FRR Service Areas (including both

investor-owned utilities and public power entities), this percentage of the Eastern MAAC load would be served under FRR and a corresponding quantity of capacity resources would be required to develop acceptable FRR Capacity Plans.

46. An FRR Capacity Plan can include existing generation, demand response, and planned resources (generally the same resources that are eligible to offer into RPM base residual auctions). However, to meet the capacity requirements of the Eastern MAAC zone, whether they are satisfied through RPM, FRR, or some combination of both, recent RPM results show that virtually all available capacity would be required.

Table 1: Peak Loads and FRR Obligations, 2014/2015
(New Jersey and Eastern MAAC Zones)

Zone *(subzonal LDA)*	Peak Load 2014 (MW)	FRR Obligation (peak x FPR)	Percent of Eastern MAAC	Percent of New Jersey
Public Service Electric and Gas Co. (PSEG)	10,901	11,783	32.4%	52.8%
of which, PS North LDA	*4,960*	*5,361*	*14.7%*	*24.0%*
Jersey Central Power and Light Co. (JCPL)	6,539	7,068	19.4%	31.7%
Atlantic Electric Co. (AEC)	2,773	2,997	8.2%	13.4%
Rockland Electric Co. (RE)	433	468	1.3%	2.1%
PECO Energy Co. (PECO)	8,911	9,632	26.5%	
Delmarva Power and Light Co. (DPL)	4,121	4,454	12.2%	
of which, DPL South LDA	*2,369*	*2,561*	*7.0%*	
Total, Eastern MAAC	33,678	36,403	100%	
Total, New Jersey	20,646	22,316	61.3%	100%
Total, New Jersey excluding PSEG Zone	9,745	10,533	28.9%	47.2%

FPR = Forecast Pool Requirement, for 2014/2015, 1.0809. PS North = PSEG zone north of Linden Station. DPL South = DPL zone south of Chesapeake and Delaware Canal.

Sources: RAA, Planning Parameters for the 2014/2015 Base Residual Auction.

47. The Eastern MAAC supply curve for the RPM base residual auction for the 2012/2013 delivery year (the last delivery year for which a meaningful supply curve has been provided) showed that only 600 MW was offered at prices between $230/MW-day and $420/MW-day. This suggests that in the 2013/2014 base residual auction, in which the clearing

price in Eastern MAAC was $245/MW-day, virtually all available capacity cleared. The market monitor's report on this auction identified 0 MW of unoffered capacity and 196 MW of uncleared installed capacity in Eastern MAAC. Monitoring Analytics, *Analysis of the 2013/2014 RPM Base Residual Auction, Revised and Updated*, September 20, 2010, p. 42.

48. An owner of Eastern MAAC generation that lacks market power (that is, that controls only a very small amount of Eastern MAAC generation) might be expected to offer its capacity to an FRR Entity at prices similar to those the owner anticipates from the corresponding future RPM base residual auctions. Therefore, but for market power, an FRR Entity could expect to pay prices for capacity agreements similar to anticipated RPM clearing prices. Unfortunately, however, as PJM's market monitor has consistently concluded, market power is "endemic" in the PJM capacity market. The 2010 State of the Market Report for PJM (p. 361) states:

> "Given the basic features of market structure in the PJM Capacity Market, including significant market structure issues, inelastic demand, tight supply-demand conditions, the relatively small number of nonaffiliated LSEs and supplier knowledge of aggregate market demand, the MMU concludes that the potential for the exercise of market power continues to be high. Market power is and will remain endemic to the existing structure of the PJM Capacity Market."

49. In applying market structure screens for each RPM base residual auction, PJM's market monitor has consistently found that even in the very large RTO and MAAC regions, there is a single supplier who is "pivotal", that is, who owns enough capacity that the total demand for capacity cannot be met without some portion of this supplier's resources. Monitoring Analytics, *Preliminary Market Structure Screen for the 2014/2015 Delivery Year*, p. 2.

50. Table 2 provides statistics on the ownership of generation in New Jersey and Eastern MAAC. Ownership of generation in Eastern MAAC is quite concentrated, with the largest entity (combined with affiliated entities) controlling one third of the generation. The PSEG and PS North LDAs exhibit especially concentrated ownership of generation, with the largest entity controlling 89.4% of the generation in the PSEG LDA and 88.2% of the generation in the PS North LDA.

51. Table 2 also shows that an FRR Entity would be required to supply over 60% of its capacity obligations in the PSEG and PS North LDAs with resources located within these LDAs. Consequently, a substantial quantity of the resources from the entity that owns 88 or 89

percent of the generation resources in these LDAs would be required for any FRR Capacity Plan for these LDAs. The alternative would be for the FRR Entity to incur the additional (and wasteful) cost of sufficient new resources to displace the existing resources.

Table 2: Generation Market Shares in the New Jersey and Eastern MAAC Zones

Zone (subzonal LDA)	Highest Market Share	HHI	FRR Internal Resource Requirement	
			Percent	MW UCAP
Public Service Electric and Gas Co. (PSEG)	89.4%	8027	62.6%	7,376
of which, PS North LDA	88.2%	7825	71.6%	3,839
Eastern MAAC	33.1%	1966	87.4%	31,816
MAAC	17.6%	1038	99.7%	66,491

Source: Monitoring Analytics, Preliminary Market Structure Screen for the 2014/2015 delivery year, p. 2; Planning Parameters for the 2014/2015 Base Residual Auction.

B. Capacity Demand and Supply in New Jersey Excluding the PSEG Zone

52. The remainder of this Appendix evaluates capacity supply and demand for New Jersey excluding the PSEG zone (including only the JCP&L, Atlantic Electric, and Rockland Electric zones). Because the Rockland Electric zone is small (the FRR obligation for 2014/2015 would be 468 MW) this analysis is roughly the same with or without the Rockland Electric zone. Similarly, New Jersey's public power entities serve relatively small loads and the analysis does not depend on whether they are assumed to elect the FRR alternative.

53. These three zones are located in the Eastern MAAC LDA, and smaller LDAs including part or all of these zones have to date not been modeled in RPM's auctions. Assuming no additional LDAs will be modeled, the evaluation can focus on Eastern MAAC. The three New Jersey zones would have an obligation of 10,533 MW based on the 2014/2015 forecast peak, and would represent just under half of the New Jersey load and just under 30% of the Eastern MAAC load (as shown in Table 1). Of the 10,533 MW, 87.4%, or 9,206 MW, would have to be met with Eastern MAAC resources. An FRR Capacity Plan for these loads could at least theoretically be satisfied without the resources of the PSEG companies, or those of the other very large Eastern MAAC capacity seller, Exelon. Exelon has roughly a 25% share of Eastern

MAAC generating capacity. As a very large seller whose resources are mainly located outside New Jersey, but with a large market share in Eastern MAAC, Exelon possesses substantial market power and can be considered unlikely to offer capacity to a New Jersey FRR entity at competitive prices.

54. PSEG and Exelon control 58% of the generating capacity in Eastern MAAC, leaving roughly 14,000 MW of installed generating capacity owned by other entities, based on PJM's most recent public generation data reported to the Energy Information Administration (form EIA-411). An Eastern MAAC FRR obligation of 9,206 MW could be met with the demand response and energy efficiency resources located in these zones and new Planned Resources, in addition to these existing resources. Table 3 outlines how an FRR Capacity Plan could at least theoretically be fulfilled for these three zones. This outline would of course be affected by capacity changes over time, including new generation or demand response, retirements, or exports out of New Jersey to New York or Long Island.

Table 3: FRR Capacity Plan Parameters for New Jersey Excluding PSEG Zone

FRR Capacity Plan Element	***MW***
Peak load of JCP&L, AE, RE zones (2014/2015)	9,745
FRR Unforced Capacity Obligation (peak x FPR)	10,533
Minimum internal (Eastern MAAC) resource requirement, percent	87.4%
Resources that can be sourced from outside Eastern MAAC	1,327
Minimum internal (Eastern MAAC) resource requirement	9,206
Demand response and energy efficiency resources (2013/2014 values)	446
New Planned Resources (based on LCAPP and 5% EFORd)	1,900
Remaining Eastern MAAC unforced capacity need	6,860
Approx. existing Eastern MAAC capacity, excl. PSEG, Exelon	13,100

Sources: Planning Parameters for 2013/2014 RPM base residual auction; Results report for 2013/2014 base residual auction; PJM's most recent EIA-411 filing. The assumed 1,900 MW of new planned resources is based on the 2,000 MW value under the LCAPP program, reduced 5% for an estimated unforced capacity value.

55. Under this scenario, the FRR entities would still have to reach agreement and include in their FRR Capacity Plans about half of the non-PSEG, non-Exelon generating capacity

in Eastern MAAC. The majority of this other capacity is also held by entities with sizable portfolios of 1,000 MW or more in Eastern MAAC, so the FRR entities could expect their negotiations with capacity sellers to reflect the incentives that result from market power.

C. Capacity Demand and Supply: Conclusions

56. This analysis leads to the following observations regarding efforts to acquire resources for FRR Capacity Plans to satisfy New Jersey capacity obligations.

57. The high internal resource requirements of the Eastern MAAC, PSEG, and PS North LDAs, the concentrated ownership of the existing resources in these zones, and the absence of excess capacity in these zones result in substantial market power. Attempting to fulfill an FRR Capacity Plan for these areas would, therefore, likely result in prices and costs that reflect this market power.

58. While market power mitigation applies to the offers from existing generation into RPM auctions, FRR Capacity Plans are developed on a bilateral basis through negotiations between an FRR Entity and potential suppliers, and no market power mitigation applies.

59. Entities with market power will have strong incentives to demand prices for capacity well above resources' net avoidable costs (the competitive level); indeed, entities with market power will have strong incentives to demand prices above anticipated RPM clearing prices. There is no reason to expect capacity owners to offer their capacity to an FRR Entity for prices less than they would expect to receive through RPM, and for entities with market power, it must be expected that prices in excess of anticipated RPM prices will be required.

60. With regard to the PSEG and PS North LDAs, the entity that owns nearly 90% of the resources in these LDAs, PSEG Power (with affiliates), would have enormous market power in negotiations with an FRR Entity seeking to enter into agreements to meet the capacity requirements of FRR loads.

61. While the market power problem is not as severe under the assumption that only the JCP&L and Atlantic Electric zones (with or without Rockland Electric and the New Jersey public power entities) pursue the FRR alternative, the FRR Entities would still face substantial market power and would likely have to pay prices that reflect such market power to complete their FRR Capacity Plans.

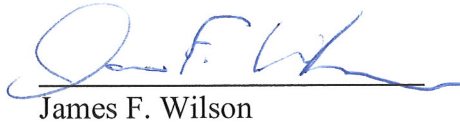
62. As in any market, a buyer facing market power can turn to new resources. The physical or economic withholding of existing resources due to market power makes new resources more attractive; in this way, the exercise of market power often leads to uneconomic entry. To fulfill FRR Capacity Plans, New Jersey FRR Entities might need to sponsor additional new resources that are needed and attractive in part due to the withholding of existing resources. Thus, pursuing the FRR alternative for New Jersey would likely lead to exercise of market power and uneconomic entry, an inefficient result.

63. This completes my affidavit.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Power Providers Group v. PJM Interconnection, L.L.C.	))))	Docket No. EL11-20-000
PJM Interconnection, L.L.C.	))))	Docket No. ER11-2875-000 (not consolidated)

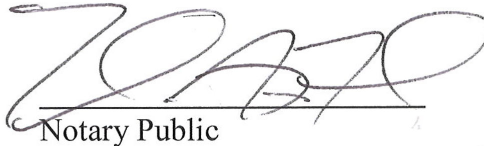
James F. Wilson, being first duly sworn, states he is the same James F. Wilson whose Affidavit In Support Of Request For Rehearing and for Expedited Consideration of New Jersey Division of Rate Counsel accompanies this affidavit; and that the facts set forth therein are true and correct to the best of his knowledge, information, and belief.



James F. Wilson

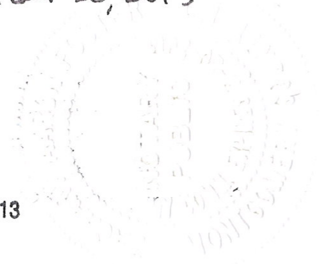
Subscribed and sworn before me, a Notary Public in and for the State of Maryland

this 12 day of MAY, 2011.



Notary Public
My Commission expires: November 20, 2013

ZACHARY AARON FOSTER
NOTARY PUBLIC
MONTGOMERY COUNTY
MARYLAND
MY COMMISSION EXPIRES NOVEMBER 20, 2013



CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated on this 12th day of May, 2011.

/s/ Jeffrey A. Schwarz
Jeffrey A. Schwarz

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