

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

PJM Interconnection, L.L.C.

Docket Nos. ER15-623-000
EL15-29-000
ER15-623-001

**REQUEST FOR REHEARING
OF THE JOINT CONSUMER REPRESENTATIVES**

Pursuant to Section 313 of the Federal Power Act (“FPA”), 16 U.S.C. § 825l(a), and Rule 713 of the Federal Energy Regulatory Commission’s (“Commission’s”) Rules of Practice and Procedure, 18 C.F.R. § 385.713, the New Jersey Board of Public Utilities, the PJM Industrial Customer Coalition, the Delaware Division of the Public Advocate, the West Virginia Consumer Advocate Division, the Maryland Office of People's Counsel, the Delaware Public Service Commission, the Pennsylvania Office of Consumer Advocate, the New Jersey Division of Rate Counsel, the Office of People's Counsel for the District of Columbia, the Public Power Association of New Jersey, and the Duquesne Light Company (collectively “the Joint Consumer Representatives”) hereby respectfully request rehearing of the Capacity Performance Order (“CP Order”) issued on June 9, 2015 in the above-captioned proceeding.¹ The Joint Consumer Representatives respectfully submit that the CP Order errs in several material respects, as discussed below. If the Commission cannot address and correct these errors on rehearing prior to the Transitional Auctions to be held in late July and early August, and prior to the 2015 Base Residual Auction (“BRA”) scheduled for August 10-14, 2015, Joint Consumer Representatives request that the Commission delay the Transitional Auctions and the 2015 BRA until these issues

¹ *PJM Interconnection, L.L.C.*, 151 FERC ¶ 61,208 (“CP Order”)

may be addressed. Delaying the auctions is preferred to conducting the auctions subject to refund.

I. SPECIFICATION OF ERRORS AND STATEMENT OF ISSUES

The Joint Consumer Representatives have identified several errors and issues with the CP Order. These errors and issues will result in unjust, unreasonable, and unduly discriminatory rates in violation of Sections 205 and 206 of the FPA, 16 U.S.C. §§ 824d(a)-(b), 824e(a). These errors and issues also render the CP Order an arbitrary and capricious administrative action, unsupported by substantial evidence. As such, the CP Order violates Section 313 of the FPA, 16 U.S.C. § 825l(b) and the Administrative Procedure Act (“APA”), at 16 U.S.C. §§ 706(2)(A), (E). In accordance with 16 U.S.C. § 825l(a) and 18 C.F.R. § 385.713(c)(2), the Joint Consumer Representatives enumerate these issues and errors as follows:

1. The CP Order is arbitrary and capricious in failing to undertake at least a rudimentary analysis of the incremental costs and benefits associated with adopting the CP Proposal and in explicitly denying consumers' request for such an analysis.²
2. The CP Order is arbitrary and capricious as a result of the failure to properly examine and reach a reasoned decision of the many material issues of fact relative to the design of the Non-Performance Charge, including a failure to consider the alternative employment of a rolling three-year average of actual Performance Assessment Hours (“PAH”) as offered by Joint Consumer Representatives and by PJM.³
3. The CP Order is arbitrary and capricious as a result of the failure to properly examine and reach a reasoned decision regarding the use of Joint Consumer Representatives’ recommended 1.5 divisor of a properly computed number of PAH in the denominator of the Non-Performance Charge, which is necessary to effectuate a negative revenue penalty for complete non-performance of cleared resources.⁴

² See 5 U.S.C. § 701, *et seq.*; *Jersey Central Power & Light v. FERC*, 810 F.2d 1168, 1177-78 (D. C. Cir. 1987); *Michigan v. Env. Prot. Agency*, 576 U.S. ___, slip op. at 12-15 (2015).

³ See *Motor Vehicle Mfrs. Assn. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983); *Elec. Consumers Res. Council v. FERC*, 407 F.3d 1232, 1238-39 (D.C. Cir. 2005); *PSEG Energy Res. & Trade LLC v. FERC*, 665 F.3d 203, 210 (D.C. Cir. 2011); *PPL Wallingford*, 419 F.3d at 1198; and 5 U.S.C. § 701, *et seq.*

⁴ See *id.*

4. The CP Order is arbitrary and capricious in adopting an administratively determined Default Offer Cap of Net CONE*B that negates the value of actual market prices for new entry, disregards endemic structural market power and unjustifiably raises prices on consumers.⁵
5. The CP Order is arbitrary and capricious in accepting PJM's proposed elimination of the Short-Term Resource Procurement Target ("2.5% Holdback" or "Holdback"), to be made effective for the BRA for the 2018-2019 Delivery Year.⁶
6. The Commission's acceptance of PJM's proposed transition mechanisms, as applied to the 2016-2017 and 2017-2018 Delivery Years for which BRAs have already been conducted, constitutes impermissible retroactive ratemaking.⁷

II. REQUEST FOR REHEARING

A. The CP Order Errs by Not Undertaking At Least a Rudimentary Analysis of the Incremental Benefits and Incremental Costs Associated with Adopting the CP Proposal.

Intervenors in this proceeding, including consumers, advocated strongly for the Commission to undertake a cost-benefit analysis of the CP Proposal, in light of serious concerns by consumers that the CP Proposal would increase capacity costs dramatically with minimal additional reliability benefit. The CP Order includes no analysis by the Commission of the potential costs of the CP Proposal, much less a rudimentary cost-benefit analysis. In fact, the CP Order explicitly denies consumers' request that the Commission consider the costs of the CP Proposal relative to potential benefits:

As to intervenors' arguments that PJM's proposal lacks the supportive findings of a cost-benefit analysis, we note, as a threshold matter, that the Commission does not generally require the mathematical specificity of a cost-benefit analysis to support a market rule change. Rather, the Commission considers the proposal in light of the currently effective tariff and comments in support and opposition to reach its determination. Here, on balance and in light of other changes on which we condition our acceptance, we find the proposal to be just and reasonable.⁸

In his dissent, Chairman Bay highlights this deficiency, noting that:

⁵ See *id.*

⁶ See *id.*

⁷ See *infra* Section II.E.

⁸ CP Order at P 49.

But the question here is not whether to support markets or reliability; rather, it is one of cost relative to the potential benefit and whether the CPP is a just and reasonable way to achieve a higher degree of performance in emergencies. Here, despite the potential multi-billion dollar burden consumers will be asked to bear, there is no analysis, however rudimentary, indicating whether the benefits are at least roughly commensurate with the costs.⁹

By failing to conduct at least a rudimentary cost-benefit analysis, the CP Order is in error. The fundamental premise of the FPA is that customers will be charged just and reasonable rates on an “end result” basis.¹⁰ Courts require the Commission to evaluate rates such as the Capacity Performance penalties in context, to determine that the overall impact of the rates “add up” to an “end result” that is just and reasonable.¹¹ The Commission’s failure to perform an evidentiary-based assessment of the Capacity Performance charges on the ratepayers’ “end result” rates constitutes a failure of reasoned decision making.

Moreover, the Supreme Court recently made clear in *Michigan v. EPA* that the EPA erred in not considering “costs” when adopting a rule pursuant to a statute that required such action to

⁹ *PJM Interconnection, L.L.C.*, Dissent of Chairman Norman C. Bay at 6, Docket Nos. ER15-623-000, *et al.* (June 9, 2015) (hereafter, “Chairman Bay’s Dissent”).

¹⁰ Section 206 of the FPA provides:

Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is **unjust, unreasonable**, unduly discriminatory or preferential, the Commission shall **determine the just and reasonable rate**, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.”

16 USC §824e (2012) (emphasis added).

¹¹ The “end result” standard of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) means that, in reviewing orders of this Commission,

[C]ourts must determine whether or not the end result of that order constitutes a reasonable balancing, based on factual findings, of the investor interest in maintaining financial integrity and access to capital markets and the consumer interest in being charged non-exploitative rates. Moreover, an order cannot be justified simply by a showing that each of the choices underlying it was reasonable; those choices must still add up to a reasonable result.

Jersey Central Power & Light v. FERC, 810 F. 2d 1168, 1177-78 (D. C. Cir. 1987).

be "appropriate and necessary."¹² Not dissimilarly, the "just and reasonable" standard does not allow the Commission to avoid considering "costs" when issuing an order that could impose billions of additional dollars on PJM consumers each year. Yet that is exactly what the CP Order would do. Estimates of the costs of PJM's proposal in some cases exceeded an additional \$2 billion per year. The CP Order does not engage these estimates and does not provide any alternative estimates. By all accounts, consideration of the costs of the CP Proposal were generally absent from the Commission's decision-making. In light of the recent guidance provided by the Supreme Court, the Commission should grant rehearing, engage the evidence concerning the potential costs of the CP Proposal, consider those costs relative to the claimed benefits of the CP Proposal, and incorporate that analysis into its consideration of the justness and reasonableness of the CP Proposal.

B. The CP Order Is Arbitrary and Capricious in Failing To Adopt a Non-Performance Penalty Mechanism Design That Achieves Effective Penalties.

In adopting the essential elements of PJM's proposed Capacity Performance design, the Commission found that the existing Reliability Pricing Model ("RPM") construct has been successful in procuring sufficient capacity resources on a three-year forward basis, but has not been successful in ensuring the actual performance of those resources when called upon.¹³ The first of the three primary cited reasons for this identified failure is RPM's "lack of an adequate penalty structure."¹⁴ The Commission then proceeds to detail the failure of the existing Peak-Hour Period Availability ("PHPA") Charge penalty mechanism by pointing to the excessive 500 peak hours over which actual resource performance is measured against a five-year average, permitting a resource's failure during the most critical hours with minimal revenue consequences

¹² *Michigan v. Env. Prot. Agency*, 576 U.S. ___, slip op. at 12-15.

¹³ *See id.* at P 44.

¹⁴ *Id.*

to the resource owner. During the extreme cold weather of the Polar Vortex period of the 2013-2014 Delivery Year, a paltry \$38.9 million in PHPA Charges were assessed representing only 0.6% of capacity market revenues for that Delivery Year.¹⁵

Joint Consumer Representatives have throughout the course of this proceeding consistently supported PJM's argument that the existing PHPA Charge imposes *de minimis* non-performance penalties and needs to be replaced with an effective design.¹⁶ Joint Consumer Representatives thus concur with the Commission's finding that "[w]ithout more stringent penalties, PJM has shown there is little incentive for a seller to make capital improvements, or increase operating maintenance for the purpose of enhancing the availability of its unit during emergency conditions."¹⁷ Joint Consumer Representatives are further on record that the replacement penalty mechanism should achieve polarity with the maximum annual stop-loss of 1.5 times the appropriate measure of annual capacity market revenue (whether based on Net CONE or the BRA resource clearing price).¹⁸ A non-performance penalty mechanism designed in this manner would achieve PJM's claimed objective, conceptually founded in the Commission-approved *ISO-NE Capacity Performance*,¹⁹ of imposing a negative 150 percent revenue penalty for complete non-performance during the critical system hours.²⁰ As discussed below, however, achievement of this objective has been stymied by the Commission's failure to adopt certain internal-penalty-mechanism design elements that are supported by ample evidence

¹⁵ *Id.* at P 45.

¹⁶ See *PJM Interconnection, L.L.C.*, Protest of Joint Consumer Representatives at 11-12, Docket Nos. ER15-623-000, *et al.* (Jan. 20, 2015) ("JCR Protest"); PJM Interconnection, L.L.C., Motion for Leave to Answer and Answer of Joint Consumer Representatives at 7, Docket Nos. ER15-623-000, *et al.* (Mar. 11, 2015) ("JCR Answer"); *PJM Interconnection, L.L.C.*, Protest of Joint Consumer Representatives at 13, Docket No. ER15-623-001 (Apr. 24, 2015) ("JCR Deficiency Protest").

¹⁷ CP Order at P 45.

¹⁸ See JCR Protest at 15-17; JCR Answer at 7-10; JCR Deficiency Protest at 13-14.

¹⁹ CP Order at 108 (citing *ISO-NE Capacity Performance Order*, 147 FERC ¶ 61,172 at P 4).

²⁰ See *PJM Interconnection, L.L.C.*, Reforms to the RPM and Related Rules in the PJM Tariff and RAA at 46-47, Docket No. ER15-623-000 (Dec. 12, 2014) ("RAA Filing"); *see also* JCR Protest at 15.

in the record. By failing to conduct evidentiary hearings or otherwise properly examining this evidence necessary to reaching a reasoned decision, Commission has acted arbitrarily and capriciously.

i. The CP Order Failed to Adopt PJM’s Revised Computation of Performance Assessment Hours (“PAH”) Based Upon a Rolling Three-Year Average of Actual PAH

The Commission adopted “PJM’s proposal” to use a fixed 30 hours in the denominator of the new Non-Performance Charge computation.²¹ The proposal by PJM to employ a fixed 30 PAH in the Non-Performance Charge computation appeared in PJM’s *original* December 12, 2014 petition. PJM’s early selection of 30 hours was purportedly based on the 23 actual PAH occurring during the winter events of the 2013-2014 Delivery Year, notably in January 2014.²² Since the time of its original filing, PJM has twice posted changes to the number of actual PAH that occurred during Delivery Year 2013-2014, introducing confusion and an issue of material fact to the selection of a fixed number of PAH for use in the Non-Performance Charge.²³

Fixing the number of PAH in the denominator of the Non-Performance Charge, and fixing it at 30 hours was heavily, criticized by the Joint Consumer Representatives (as well as by PJM’s Independent Market Monitor (“IMM”) and Exelon Corp.) as serving to undermine the intent and effect of the purportedly robust new penalty charge design. As Joint Consumer Representatives detailed in a previous filing, the proposed 30 PAH is 30 percent more hours than

²¹ See CP Order at P 163.

²² See RAA Filing at 43-44.

²³ At the time of its original December 12, 2014 filing, PJM indicated that the number of actual PAH during the Delivery Year 2013-2014 was 23 hours for the RTO. On December 29, 2014, PJM posted data on its website indicating that the number of PAH for the Delivery Year 2013-2014 was 26 hours (*see* <http://www.pjm.com/~media/committees-groups/committees/elc/postings/2013-14-dy-performance-assessment-hours.xls.ashx>). On March 23, 2015, PJM posted yet another document on its website listing PAH events for the delivery years covering 2011-2014, wherein it re-designated the July 18, 2013 “Mid-Atlantic Dominion (MAD) + ATSI” event consisting of four (4) PAH as a “PJM RTO” event; this re-designation served to boost the Delivery Year 2013-2014 number of PAH to exactly 30 hours (*see* <http://www.pjm.com/~media/committees-groups/committees/elc/postings/performance-assessment-hours-2011-2014.xls.ashx>).

what occurred during the historic 2013-2014 Delivery Year, to realize a 1.5 times revenue penalty would require a resource's complete unavailability during a 45-PAH delivery year, effectively *twice* the number of emergency action hours than occurred in Delivery Year 2013-2014. The selection of such a large number of hours, fixed for the foreseeable future in the Non-Performance Charge computation, will not serve to meet the objective of implementing a genuinely effective non-performance penalty. Instead, a fixed 30-PAH design element would reward Sellers whose cleared capacity utterly fails to perform when most needed by guaranteeing that such Sellers will retain a significant portion of their RPM revenue.²⁴

Commission Chairman Bay understands this design flaw precisely. In his dissent, Chairman Bay references the March 23, 2015 iteration of PJM-identified PAH for the three Delivery Years spanning 2011-2014 and the wide variation represented by Delivery Year 2013-2014: 30 PAH for Delivery Year 2013-2014 as compared to 5 and 7 PAH for Delivery Year 2012-2013 and Delivery Year 2011-2012, respectively. Excluding the anomalous Delivery Year 2013-2014 would drop the average to six (6) PAH; including the anomalous Delivery Year 2013-2014 data would raise the average to a mere 14 hours, less than half of the 30 PAH fixed value used in the denominator of the Commission-adopted Non-Performance Charge. Chairman Bay's "carrot-and-stick" analysis of the lack of polarity between the Commission-ordered penalty mechanism and new capacity pricing mechanism is apt:

An estimate of 30 expected performance assessment hours appears to be overly generous and, depending upon the number of actual assessment hours, may result in a partial stick.... A rational profit-maximizing resource could simply seek a capacity award in the auction, fail to perform during each performance assessment hour, and likely pay a penalty less than the carrot it has received. *To put it more bluntly, the resource could be paid for doing nothing during the emergency hours of the year when it is most needed and for which it has been well compensated....* During the delivery year itself, the resource ... can weigh the penalty of failing to perform during each Performance Assessment Hour, as a fraction of one-thirtieth

²⁴ See JCR Protest at 13-14; JCR Answer at 8.

of .85 of Net CONE. *In short, PJM has purchased little certainty for what may be a lot of money.*"²⁵

Joint Consumer Representatives indicated that this evident design flaw could be fixed through the employment of a number of PAH "reflecting no more than an actual number of historically-experienced number of PAH in a single year *or the average of the PAH for a recent number of delivery years.*"²⁶ To its credit, PJM responded to this criticism in its February 13, 2015 Answer, conceding that Delivery Year 2013-2014 "had an unusually high number of emergency hours, and thus may be a poor source for a number of Performance Assessment Hours to fix in the denominator of the rate calculation."²⁷ PJM then offered to "revise the Tariff to state that the denominator will contain a number of hours equal to the annual average of the [PAH] in the three calendar years preceding PJM's posting of parameters for the BRA for a Delivery Year."²⁸ Joint Consumer Representatives welcomed the new proposal from PJM (while also pointing out that it represented but one essential fix to the computation of the penalty charge), which represents a simple yet substantive fix of an evident problem in the mathematics of the Non-Performance Charge.²⁹

While not completely correcting the adopted design of the Non-Performance Charge, employing the three-year rolling average actual PAH in the denominator will *better* correct for historical anomalies across delivery years and render a more effective and stable non-performance penalty charge than the static design adopted by the Commission. Utilizing PJM's March 2015 data covering the most recent three delivery years, a three-year rolling average of annual Regional Transmission Organization ("RTO") PAH would result in 14 PAH in the

²⁵Chairman Bay's Dissent at 3-4(emphasis supplied).

²⁶JCR Protest at 16.(emphasis supplied)

²⁷*PJM Interconnection, L.L.C.*, Answer of PJM Interconnection L.L.C. at 64-65, Docket No. ER15-623-000 (Feb. 13, 2015) ("PJM Answer").

²⁸*Id.*

²⁹JCR Answer at 8-9.

denominator of the charge.³⁰ Assuming complete unavailability of a resource during all PAH in the delivery year, penalties hypothetically assessed over the past three delivery years using the 14-PAH denominator would have been imposed as follows: Delivery Year 2013-2014 exhibited either 26 or 30 PAH, either of which would have produced a cap on the penalty at the 1.5 times Net CONE; Delivery Year 2012-2013 exhibited 5 PAH, which would have generated an annual penalty of 36% of Net CONE (5 actual PAH/14 PAH); and Delivery Year 2011-2012, which had 7 PAH, would have imposed a penalty of 50% of Net CONE (7 actual PAH/14 PAH) for complete non-performance. Revising the penalty computation in this manner would address anomalous, high PAH years better than a fixed 30 PAH denominator due to the functioning of the annual stop-loss of 1.5-times Net CONE, but would still leave lower PAH delivery years with a substantial delivery disincentive during the most critical hours. The results, however, compare favorably to complete non-performance outcomes assuming a fixed 30-PAH denominator, which would have rendered a Delivery Year 2013-2014 penalty of either 87% (26 actual PAH/30 fixed PAH) or 100% (30 actual PAH/30 fixed PAH); Delivery Year 2012-2013 penalty of 17% of Net CONE (5 actual PAH/30 fixed PAH); and a Delivery Year 2011-2012 penalty of 23% of Net CONE (7 actual PAH /30 fixed PAH). These results are half the level of penalty that would have been imposed for non-performance assuming use of the three-year rolling average PAH approach.³¹

The CP Order, however, sidestepped this easily-implemented design solution and instead reverted to PJM's original December 12, 2014 proposal to fix the PAH at 30 hours. Beyond a mere description, the CP Order failed to qualitatively consider the benefits of the three-year

³⁰ The average of 42 total PAH over three delivery years. See CP Order at P 317. See also <http://www.pjm.com/~media/committees-groups/committees/elc/postings/performance-assessment-hours-2011-2014-xls.ashx>.

³¹ Further correction of insufficient penalties during low PAH years are easily corrected through employment of the 1.5 PAH divisor discussed in the immediately following section.

rolling average proposal offered by PJM relative to the fixed 30 PAH denominator.³² Rather than address this obvious design flaw and the evidentiary record demonstrating it, the Commission instead directed PJM to make *informational filings* at the conclusion of each of the next five delivery years regarding actual net capacity revenues and revenue levels assuming greater than and less than 30 PAH.³³ The Commission concluded its narrow consideration and disposition of the PAH issue with a mere *suggestion* of potential future changes to the PAH: “We also *encourage* PJM to reassess the assumed number of [PAH] after it has gained more experience with Capacity Performance and submit a filing if it finds a revision is warranted.”³⁴ It appears that the Commission missed that portion of PJM’s February 2015 Answer wherein the RTO conceded – prior to and without the need for “more experience with Capacity Performance” - that fixing the PAH at 30, on the basis of the worst performing year on record plus “an adder for the possibility that even more Emergency Action hours may occur,”³⁵ was a deficient design element. In the estimation of PJM, as of its February Answer, and Joint Consumer Representatives, the ability to reference actual emergency action hours over a rolling three-year period provides a far superior method of computing a penalty charge so fundamental to this most fundamental redesign of the capacity market.

The CP Order's failure to examine this acknowledged design flaw of using a fixed 30-PAH denominator in the Non-Performance Charge and the CP Order's failure to consider an elaborated and PJM-supported alternative constitutes arbitrary and capricious decision-making contradicting substantial record evidence to the contrary. The Commission should accordingly order review of this issue via rehearing.

³² CP Order at PP 135,163.

³³ *See id.* at P 163.

³⁴ *Id.* (emphasis supplied)

³⁵ *Id.*

ii. By Failing To Consider and Adopt Joint Consumer Representatives' Recommended 1.5 Divisor of a Properly Determined PAH, the CP Order Failed To Make the Second Correction Needed To Produce an Effective Non-Performance Penalty Design.

If the objective of the Non-Performance Charge is to impose *negative* revenue penalties for complete resource non-performance, then it is insufficient to merely achieve a good approximation of PAH in the coming delivery year. Even if the number of PAH in the coming delivery year could be foreseen *with exact precision*, the use of that number of PAH in the denominator of the Non-Performance Charge would at best impose a 100% of Net CONE revenue reimbursement on a resource that was completely unavailable in each of those PAH. Precision in estimating the number of PAH is thus not enough: to ensure implementation of a “stick” of sufficient size and mass to match the substantially increased clearing price “carrot” implied in the Commission’s approved default offer cap, the penalty mechanism requires a second fix. This second mathematical device, briefed by Joint Consumer Representatives in previous filings in this proceeding, involves the division of a properly determined estimation of PAH by 1.5.³⁶ In conjunction with a three-year rolling average of actual PAH, the use of this 1.5 divisor will lend greater polarity between the carrot and the stick of PJM’s pay-for-performance construct, imposing *actual* negative revenue penalties for complete non-performance that are more consistent with the level of penalties implied in the 1.5-times annual stop-loss provision.

The effect of employing the 1.5 divisor to the properly determined PAH is illustrated in the hypothetical implementation over the past three delivery years, as discussed above. Utilizing again PJM’s March 2015 listing of PAH for the three delivery years commencing June 2011 through May 2014, a three-year rolling average of PAH generates a 14-PAH denominator employed in the Non-Performance Charge. This 14-PAH value, when divided by 1.5, produces a

³⁶ See JCR Protest at 15-16; ; JCR Answer at 9-10; JCR DeficiencyProtest at 13-14.

value of 9.33 PAH, rounded to 9 PAH for use as the final denominator value in the Charge computation. Hypothetical implementation of this design to a resource completely unavailable during all 26 or 30 hours of Delivery Year 2013-2014 would reach its maximum 150% of Net CONE stop-loss penalty at 14 emergency action hours. In Delivery Year 2012-2013, which experienced 5 PAH, a completely unavailable resource would be penalized revenue equal to 56% of Net CONE (5 actual PAH/9 PAH). In Delivery Year 2011-2012, which experienced 7 PAH, complete non-performance would be penalized at a rate of 78% of Net CONE (7 actual PAH /9 PAH).

Utilization of the 1.5 divisor in conjunction with a rolling three-year average of actual PAH thus increases the levels of penalties implemented for non-performance relative to fixing the denominator at 30 PAH. The 150% of Net CONE annual stop-loss cap is actually achieved under this design and presents the proper disincentive for non-performing resources during relatively high PAH years; during relatively low PAH delivery years, the resulting penalties are substantially increased over those imposed under a fixed 30-PAH design. The combined use of a three-year rolling PAH divided by 1.5 as the denominator in the Non-Performance Charge represents a much improved approach that deserves consideration by the Commission.

While evidence of the failure to employ a 1.5 divisor in the PAH computation was on the record in three Joint Consumer Representatives filings, the CP Order did not address the evidence nor did the CP Order address the simple mathematical critiques of PJM's original design offered by Joint Consumer Representatives and other parties. By neglecting to appropriately examine this evidence, the CP Order is arbitrary and capricious in ordering the implementation of a deficient penalty mechanism that will, in the words of Chairman Bay, cause

customers to “purchas[e] little certainty for what may be a lot of money.”³⁷ The two Non-Performance Charge design improvements offered by Joint Consumer Representative in evidence in the record should be re-examined in the context of a Commission-ordered rehearing.

C. The CP Order is Arbitrary and Capricious in Adopting an Administratively-Determined Default Offer Cap of Net CONE*B That Negates the Value of Actual Market Prices for New Entry, Disregards Endemic Structural Market Power, and Unjustifiably Raises Prices on Consumers.

The fundamental problem with the RPM construct, argued by PJM and upheld by the Commission, is its failed and ineffectual penalty structure.³⁸ The identified failure to ensure resource performance when called upon during the most critical hours is resolved through a genuinely effective disincentive for non-performance, *i.e.*, a robust penalty mechanism. That task is achievable with the requested reconsideration and adoption of the two mathematical revisions to the Non-Performance Charge offered by Joint Consumer Representatives, as detailed above.

The Commission acknowledges that RPM which has successfully garnered sufficient capacity resources to ensure reliability.³⁹ The Commission also acknowledges that RPM has done so in the midst of a structurally concentrated market, under rules that have effectively capped offer prices at the unit-specific Net Avoidable Cost Rate (“Net ACR”), mimicking competitive *market* fundamentals and competitive *market* behavior, and that it has cleared new and existing capacity at prices consistently deemed competitive by the IMM.⁴⁰ Yet the Commission has ordered that the RPM pricing mechanism be dispensed with entirely and replaced with an *administratively-determined* value that bears little resemblance to real-world

³⁷ Chairman Bay’s Dissent at 4.

³⁸ See CP Order at PP 24-25, 44.

³⁹ See *id.* at P 44.

⁴⁰ See *id.* at P 325.

new entry.⁴¹ Net CONE times the Balancing Ratio (“Net CONE*B”), with Net CONE reflecting *assumed* combustion turbine capacity, will replace substantially lower market clearing prices reflecting the *actual* avoidable costs of *actual* new combined cycle capacity offered in by *actual* resource owners.⁴² Offers up to the level of Net CONE*B will receive neither review nor mitigation for market power abuse, effectively abandoning the economic principle that competitive markets clear at the marginal cost of production and opening the door to market power abuse.⁴³

The Commission-adopted default offer cap of Net CONE*B will ostensibly address two claimed “primary” failures of the current RPM construct that were raised by PJM and affirmed by the Commission: 1) RPM’s present design skews reliability investments toward capital investment and away from fuel security measures such as firm natural gas contracts; and 2) it encourages resource owners to avoid capital improvements and trim operating budgets in order to remain competitive with zero-offer price-takers in the auctions.⁴⁴ The claimed resulting incentive for less reliable resources offering and clearing the RPM auctions represents, according to this perspective, a substantial concern given the reliability impacts implied in the future potential for extreme weather and the near-term retirement of over 26 GW of coal and oil capacity.⁴⁵

These two claimed design failures on the pricing side of the RPM construct are, however, easily resolvable through modification of current Net ACR-based offer rules and through the implementation of a robust penalty mechanism. As Joint Consumer Representatives have argued, the present tariff limitations proscribing the inclusion of firm gas transportation and other fuel

⁴¹ See JCR Deficiency Protest at 10.

⁴² See CP Order at PP 336, 341.

⁴³ See *id.* at P 325; see also JCR Answer at 16-18; JCR Protest at 20-21.

⁴⁴ See CP Order at PP 44, 46-47.

⁴⁵ See *id.* at PP 42-43.

security measures not presently recoverable in Net ACR price offers could be easily changed to accommodate those identified fuel security expenses.⁴⁶ The second concern, that less reliable resources clearing RPM auctions as price takers are displacing investment in more reliable resources, is explicitly and properly addressed via the Non-Performance Charge; that is, lower reliability resources will henceforth be substantially penalized for non-performance, an eventuality that will compel resource owners either to make sufficient investments to ensure performance or exit the market altogether. The Commission's two concerns with the existing RPM pricing design are thus not problematic and do not warrant total replacement of the RPM pricing mechanism; a stiff penalty mechanism and relatively simple incremental tariff language modifications would fix them. These remedies, however, received no critical consideration by the Commission in its rush to implement the costly new default offer cap. Furthermore, Joint Consumer Representatives maintain that while the Commission's two identified concerns with RPM may merit attention and remediation, the claimed adverse impacts on resource adequacy are patently overblown.

Chairman Bay concurs with Joint Consumer Representatives in his succinct, empirical assessment of the present efficacy of RPM: “[T]he Reliability Pricing Model (RPM), has worked tolerably well” and has demonstrated its capability to incentivize new capacity to date and to ensure sufficient reserve margins despite significant generation retirements.⁴⁷ Chairman Bay points to PJM's own assertions that RPM has garnered 35,000 MW of new generation capacity since its introduction - 6,000 MW of which alone cleared in the May 2014 BRA for Delivery Year 2017/2018 - and that RPM “has worked effectively to spur new investment to replace the 26,000 megawatts (MWs) of retiring generation since 2008, and projecting forward to 2019 and

⁴⁶ JCR Protest, April 24, 2015 at 8.

⁴⁷ Chairman Bay's Dissent at 1.

[to] ensure forward reliability in a period of unprecedented turnover of a large portion of the generation fleet.”⁴⁸ Chairman Bay further notes the various incremental efforts on PJM’s part since the winter 2014 weather events to ensure better gas-electric coordination, winter unit preparations and winterization that have served to significantly drive down forced outages during a record winter peak-setting 2015 that was nearly as cold as 2014.⁴⁹ The finding in the CP Order, then, that RPM’s pricing mechanism is so flawed as to justify a complete replacement with a structure that promises to foist onto consumers upwards of \$4 billion in additional costs, simply cannot be justified.⁵⁰ As Chairman Bay bluntly states, “it is important to emphasize what the CPP is *not* about: it is not about the need to incent the development of new capacity”⁵¹

Substantial upward pressure on prices clearing under a default offer cap of Net CONE*B can be rationally expected as a consequence of the explicit removal of any review or mitigation of price offers up to that level coupled with the presence of endemic structural market power in the capacity market. Joint Consumer Representatives raised this significant concern throughout their filings.⁵² Chairman Bay as well notes the evident problem of dropping an unmitigated Net CONE*B default offer price into the midst of a structurally non-competitive market.⁵³ The CP Order, however, attempts to resolve this substantial market power problem and artificial price inflation with the convenient proposition that price offers up to Net CONE*B are, *by definition*, competitive and thus not in need of scrutiny for consistency with actual unit marginal costs or mitigation to curb market power abuse.⁵⁴ In coming to this finding, however, the CP Order relies on the insular, circular, and flawed logic of PJM’s default offer cap proposal.

⁴⁸ *Id.* at n.1.

⁴⁹ *See id.* at 2-3.

⁵⁰ *See id.* at 6.

⁵¹ *Id.* at 1.

⁵² *See, e.g.*, CP Order at P 325.

⁵³ Chairman Bay’s Dissent at 4-5.

⁵⁴ *See* CP Order at 340.

The logic of PJM’s NET CONE*B default offer cap pivots entirely on the concept of the exposure to opportunity costs by resources with low avoidable costs. The default offer cap “reflects the amount that a competitive resource with low avoidable costs (“Low ACR Resource”) would accept in the capacity market.”⁵⁵ A Low ACR Resource, presumably an efficient resource, is one that stands to earn in excess of its avoidable costs through the receipt of Performance Bonus Payments for energy deliveries made during performance assessment hours, assuming that the resource does not take on a Capacity Performance capacity obligation and thus serves as an energy-only resource. “That resource, therefore, will be *willing* to take on a capacity obligation as long as the amount it can earn for capacity (including both capacity auction revenues as well as Performance Bonus Payments) exceeds the amount it can earn in Performance Bonus Payments *by participating in the energy market only*.”⁵⁶ By taking on a capacity obligation, meaning that the unit offers into and clears the BRA as a Capacity Performance resource, the Low ACR Resource foregoes the opportunity to earn big Performance Bonus Payments because, as a Capacity Performance resource, such Performance Bonus Payments would only be made for energy deliveries above the Expected Performance level determined by the resource’s share of the Balancing Ratio.⁵⁷

The issue presented by the opportunity cost implied in serving as a Capacity Performance resource must somehow be overcome; otherwise the Low ACR Resource would simply sit out the auction and continue on as an energy-only resource. Following this logic, the problem then is how to *entice* the resource owner to make the commitment to offer in as a Capacity Performance resource. PJM solves this conundrum by identifying an offer price cap (and attendant capacity payment) that exceeds the opportunity cost, an amount equal to the Performance Bonus Payment

⁵⁵ *Id.* at P 336.

⁵⁶ *Id.* (emphasis supplied)

⁵⁷ *See id.* at P 337.

rate times the Balancing Ratio times the number of Performance Assessment Hours (PAH) – all algebraically reduced to Net CONE*B.⁵⁸ That, PJM assures, is the price that “a competitive resource *would require*” to “*accept a capacity obligation.*”⁵⁹ High ACR Resources, “whose avoidable costs exceed the amount *it can earn as an energy-only resource,*” would offer in above the default offer cap at their Net ACR plus a risk premium, with such offers reviewed by the IMM and PJM and mitigated if necessary.⁶⁰ With the exception of the additional risk premium recognized in High ACR Resource offers, such resources remain subject to the review and mitigation regime presently in place to ensure against anti-competitive bidding practices and artificial price inflation.

Joint Consumer Representatives are confounded by the CP Order's acceptance of PJM's rationalization for the default offer cap. Specifically, Joint Consumer Representatives highlight the existing must-offer rule that requires capacity resources to offer into the BRA and the role that rule should play in the purported economic rationale for the new offer cap. The Commission accepted PJM's proposal to retain the present must-offer requirement as part of the CP paradigm: “The use of a must-offer requirement is both consistent with established capacity market practice and necessary to safeguard against manipulation in the PJM market.”⁶¹ With a must-offer requirement in place, a Low ACR Resource cannot opt to sit out the BRA and continue on as an energy-only resource, earning big revenues on Performance Bonus Payments during emergency action hours with no obligation to deliver energy when called. With a must-offer requirement in place, a Low ACR Resource need not “require” license to offer in a mitigation-free price exceeding its net avoidable cost. In short, with a must-offer requirement in place, a Low ACR

⁵⁸ See *id.* at P 338.

⁵⁹ *Id.* (emphasis supplied)

⁶⁰ *Id.* at PP 339-40. (emphasis supplied)

⁶¹ *Id.* at P 354.

Resource is not presented with a voluntary choice to either demur or “accept a capacity obligation.”

The opportunity cost conundrum facing a Low ACR Resource does not in fact exist when a must-offer rule requires that the resource bid in as a capacity resource. The CP Order's justification for abandoning Net ACR based offers for such resources is thus not merely academic, but is moot, and to entertain it is to engage in arbitrary and capricious decision-making. But that is precisely what the CP Order has done in ordering the dissolution of unit-specific resource offers capped at Net ACR, reviewable and subject to mitigation by the IMM, for all offers up the level of Net CONE*B. Outside of the insular logic of PJM's rationale, which pays no regard to the must-offer rule, the Commission fails to explain and justify why Net CONE*B now represents the competitive price in a market that has to date cleared more than sufficient capacity pursuant to the traditional economic concept that clearing price reflects the marginal cost of production, *i.e.*, net avoidable costs. The Commission's finding for the new default offer price should be re-examined in the context of a rehearing of all the evidence in the record, including all applicable rules that would require capacity resources to participate in the capacity auction.

D. The CP Order Erred in Allowing PJM To Eliminate the 2.5% Holdback Beginning with the BRA for the 2018-2019 Delivery Year.

The CP Order is arbitrary and capricious in accepting PJM's proposal to eliminate the 2.5% Holdback effective for the BRA for the 2018-2019 Delivery Year.⁶² The primary benefit of the 2.5% Holdback in the current workings of RPM is to offset the persistent load over-forecasting that drives higher-than-necessary Reliability Requirement levels in the BRAs. Contrary to the Commission's findings, retention of the 2.5% Holdback is critical to address

⁶² See *id.* at P 394.

PJM's continual load forecasting errors under the current RPM construct. Absent the Holdback, "the historical overstatements experienced to date are . . . likely to recur at a level that requires mitigation" at least through the 2018-2019 Delivery Year given PJM's stated intent to use its current Peak Load forecasting model for the BRA scheduled to occur in August 2015.⁶³ The Commission should therefore grant rehearing and reinstate the 2.5% Holdback to prevent harm to consumers through the unjust and unreasonable over-procurement of Capacity Resources for the 2018-2019 Delivery Year.

When first proposed, the 2.5% Holdback was intended to provide an opportunity for shorter-term resources – like demand response resources that could become available in closer proximity to the Delivery Year – to qualify as Capacity Resources and help meet the Reliability Requirement.⁶⁴ While that original intent justified the Holdback at its inception, the Holdback remains just and reasonable for another reason. As demonstrated in Joint Consumer Representatives' Protest, in each and every BRA since the inception of RPM, PJM's load forecast at the time of the BRA has been substantially overstated.⁶⁵ The historical average load over-forecasting level in the years for which a comparison is possible – 6.25% -- is more than double the level of the Holdback – 2.5%. Consequently, the Holdback should not be eliminated; it actually be increased – to 6.25% – in order to prevent the systemic over-procurement of capacity that has been occurring by virtue of persistent load over-forecasting. At a minimum, the historical analysis demonstrates that the current Holdback remains just and reasonable, particularly given PJM's intention to continue use of its current load forecasting model through the BRA for the 2018-2019 Delivery Year, because it is necessary as a correction mechanism

⁶³ *Id.* at P 396; *see also* *Joint Consumer Representatives v. PJM Interconnection L.L.C.*, Complaint of the Joint Consumer Representatives Requesting Fast-Track Processing at 3, Docket No. EL15-83-000 (June 30, 2015).

⁶⁴ *See PJM Interconnection, L.L.C.*, 126 FERC ¶ 61,275 (2009).

⁶⁵ *See* JCR Protest at 29.

and at least a partial offset to the inherent load over-forecasting that has been occurring in BRAs. Whether due to the three-year forward nature of RPM, fundamental changes in energy consumption, or otherwise, there is, in fact, a significant upward bias in the PJM load forecast on a three-year forward basis, and the Holdback remains necessary as a partial cure to this problem.

Although the CP Order acknowledges PJM's chronic load over-forecasting problem, the CP Order erred in granting PJM's proposal to eliminate the 2.5% Holdback based on PJM's assurance that "PJM's stakeholders have discussed these issues, including proposed modeling changes, with load forecast adjustments recently adopted by PJM."⁶⁶ Importantly, as PJM itself acknowledges, the recent change imposed to the 2015 load forecast was a one-year interim adjustment.⁶⁷ Given that PJM continues to develop a revised load forecasting model, and has indicated it will not implement any permanent model changes to its load forecast assessment before November 2015, it is arbitrary and capricious to allow PJM to eliminate the Holdback at this time. Accordingly, 2.5% Holdback should remain in place, at a minimum, to address the likelihood of capacity over-procurement during the August 2015 BRA.

E. The Commission's Acceptance of PJM's Proposed Transition Mechanism, as Applied to the 2016-2017 and 2017-2018 Delivery Years, Constitutes Impermissible Retroactive Ratemaking.

The Commission's conclusion that PJM's transition mechanism does not impermissibly revise the already-cleared BRAs for the 2016-2017 and 2017-2018 Delivery Years is arbitrary and capricious. Adding capacity costs for the 2016-2017 and 2017-2018 Delivery Years, for which BRAs have already been conducted, does not result in "prospective changes only and

⁶⁶ CP Order at P 396.

⁶⁷ See PJM Load Forecast Report at 1 ("PJM introduced this change as a short-term solution as it pursues its announced intention to better reflect usage trends such as adoption of more energy efficient end uses and behind the meter generation which are not currently captured in the forecast model.").

provides ratepayers with sufficient notice that PJM proposed to change its tariff on file."⁶⁸

Rather, paying higher Capacity Resource clearing prices in PJM's proposed Transition Auctions to resources that already cleared in a prior BRA is retroactive ratemaking because it alters the obligations imposed on such resources at the time they cleared the BRA. The Commission should therefore grant rehearing to reconsider this issue and ensure that the CP Order does not violate the prohibition on retroactive ratemaking.

The retroactive ratemaking doctrine provides that "a utility cannot retroactively increase the rate charged a customer to a level higher than the rate on file."⁶⁹ The Commission itself also has no power to alter a rate retroactively.⁷⁰ This rule bars "the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate."⁷¹ The CP Order violates the retroactive ratemaking doctrine because obligations that attached to cleared Generation Capacity Resources at the time of their clearing in the BRA for the 2016-2017 or 2017-2018 Delivery Years, pursuant to the PJM Operating Agreement and Tariff effective at the time such resources cleared, are now being rescinded, to the benefit of generators and to the detriment of consumers. Contrary to the Commission's findings in the CP Order, these Tariff provisions are not prospective; rather, these *post hoc* actions are unjust and unreasonable because they require consumers to pay additional capacity prices for Capacity Performance Resources. Capacity costs had already attached to these resources (known as "Cleared Capacity Resources" under the current RPM construct) at the time they cleared the BRA. As such, customers and generators have already undertaken capacity commitments to meet the Reliability Requirement (with any updates under current rules relative to Incremental Auctions). Customers would now

⁶⁸ CP Order at P 261.

⁶⁹ *Cities of Anaheim, et al. v. California Independent System Operator Corporation*, 102 FERC ¶ 61,274 at P 40-41 (2003).

⁷⁰ *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981).

⁷¹ *See City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979).

be subject to additional capacity costs for meeting the same Reliability Requirement (with any updates under current rules relative to Incremental Auctions) under the PJM transition mechanisms.

The transition mechanism proposal set forth in the CP Filing requires going back to the time that Generation Capacity Resources cleared the BRA for either the 2016-2017 or 2017-2018 Delivery Years and retroactively changing the rules of the auction to the disadvantage of consumers. Clearing a BRA for a particular Delivery Year entitles a Generation Capacity Resource to receive capacity payments, as set by the auction clearing price, in exchange for performance.⁷² Consumers pay billions of dollars each year in the form of capacity payments in exchange for this obligation.

The CP Order fundamentally restructures these obligations well after they were undertaken. Under the transition mechanism, Capacity Performance Resources that clear the Transitional Auctions are relieved of their consumer-funded obligations that were set at the time of clearing the BRA for the 2016-2017 and 2017-2018 Delivery Years. There is no question that the CP Order constitutes a substantial rate-increasing rule change, and there is no question that the CP Order effectuates a rule change well after the obligations were undertaken. This is the essence of impermissible retroactive ratemaking.

⁷² See PJM Operating Agreement, Schedule 1, section 1.10.1A(d), available at <http://pjm.com/~media/documents/agreements/oa.ashx>.

III. CONCLUSION

WHEREFORE, Joint Consumer Representatives respectfully request that the Commission grant this request for rehearing.

Respectfully submitted,

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Dated: July 9, 2015

CERTIFICATE OF SERVICE

I hereby certify that I have this day served, via first-class mail, electronic transmission, or hand-delivery the foregoing upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, DC this 9th day of July, 2015.

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