

December 1, 2011

***Via Electronic Mail***

Howard Schneider, Esq.  
Chair, PJM Board of Managers  
PJM Interconnection LLC  
955 Jefferson Avenue Norristown, Pennsylvania 19403-2497

**Re: Request for Board Action on RPM Self-Supply and FRR Options**

Dear Mr. Schneider and Members of the PJM Board:

The undersigned write to urge the Board to follow through on PJM's acknowledgement that the MOPR should not apply to "self-supply, that is motivated in good faith and not with the objective of distorting prices" and that the MOPR should not "penalize or discourage good faith resource investment."<sup>1</sup> In light of recent stakeholder activity on the self-supply issue, we seek your favorable consideration to modify PJM's Open Access Transmission Tariff to require that, subject to the exception process, legitimate self-supply must clear so that it is used toward satisfying the capacity obligation for load on whose behalf the investment is made.<sup>2</sup> Additionally, we challenge PJM staff's assertion that no changes to the current FRR rules are acceptable and ask the Board to look beyond staff's insistence that FRR remain unchanged when other aspects of RPM are so significantly revised.

**Self Supply has always been a fundamental component of RPM**

Load interests have actively worked through the recent PJM stakeholder process to preserve legitimate self supply opportunities. As the Board is aware, legitimate self supply is a cornerstone of the business models for cooperative and municipal utilities. Additionally, investor owned utilities in non-choice states must be able to respond to the legitimate mandates of their particular state.

The rules for RPM today are significantly different than the hard-fought compromise that enabled load to agree to a settlement in 2006. And, as you are well aware, the most recent modification eliminating legitimate self supplies' assurance of clearing is incompatible with the business model of your cooperative and municipal members.

From 2006 until the issuance of the April 12, 2011' Order, RPM was a residual construct which procured capacity through a Base Residual Auction only after taking into account self-

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<sup>1</sup> PJM's March 21, 2011 Answer in Docket No. ER11-2875, at page 4.

<sup>2</sup> To be clear, the preference of the cooperative and municipal signatories to this letter is to restore the guaranteed clearing for self-supply which was contained in the 2006 RPM Settlement and the RPM tariff provisions until the April 12 Order which approved PJM's filing in Docket No. ER11-2875. We expect that the Board will not entertain such relief at this time, so have opted for the exception process proposal as an alternative subject to further order from FERC or a court.

supplied resources. Somehow, despite widespread past acknowledgement of this fundamental predicate for RPM by the membership as well as PJM staff, we now hear from PJM and others that RPM itself is not a residual auction design or that the FRR alternative to RPM is now the residual aspect of RPM. Yet, there is a substantial record of FERC and PJM acknowledgement that the RPM capacity construct has been, and must be residual to LSE efforts to self-supply their capacity obligations through bilateral contracts or self-build options.<sup>3</sup> Restoration of the requirement for legitimate self-supply to clear will restore this critical and foundational element of the RPM capacity construct.

### **Consistent with the fundamental FERC-approved RPM design, the Board has an opportunity to restore the clearing assurance for legitimate self-supply obviated by the April 12, 2011 Order**

In its February 11, 2011 filing, PJM rapidly responded to the complaint filed by P3 on February 1, 2011. In the 162 pages of the filing, PJM reacted to the raised concern of monopsony power by proposing to broadly eliminate a number of key provisions in the Tariff. While PJM's rapid response arguably may have addressed the issue, it resulted in unintended consequences clearly not contemplated in the brief ten day period within which PJM developed and submitted its filing.

To PJM and Terry Boston's credit, PJM staff subsequently reviewed this issue carefully and made filings at FERC indicative of the need to accommodate legitimate self supply. In its May 12, 2011 compliance filing, PJM expanded and clarified the MOPR exception provisions (OATT Attachment DD, Section 5.14(h)(5)) to allow use of actual, unit-specific costs and revenues for LSEs with business models that depart from business structures used

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<sup>3</sup> See e.g., the definition of Base Residual Auctions in the RPM provisions, which are defined as "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*." (PJM Tariff Attachment DD, Section 1(a)(emphasis added)); *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 (2006). In its order on PJM's initial proposal to create RPM, the FERC "conclude[d] 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.*" 115 FERC at P 71 (emphasis added). FERC also explicitly recognized that, **under the pre-RPM construct**, "an LSE is required under PJM's RAA to maintain an IRM of 15 percent above its load. *It does so by self-supplying generating capacity or entering into bilateral contracts with capacity suppliers, and meets the rest of its capacity obligation through the daily and monthly capacity credits markets operated by PJM.* *Id.* at P 53 (emphasis added). Then, in its order on approving the RPM Settlement, FERC explicitly acknowledged that RPM preserved the fundamental self-supply element of the pre-RPM design, explaining that "[T]o 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, LLC*, 117 FERC ¶ 61,331 at P 13 (2006)(emphasis added). Cf. *PJM Interconnection, LLC*, 95 FERC ¶ 61,175 at 61,563 (2001) (describing the pre-RPM capacity market structure as follows: "A load serving entity can satisfy its obligation by reliance on: (1) self-supply, (2) acquisition in bilateral markets, or (3) acquisition of Capacity Credits in the PJM Capacity Credit market. Load serving entities typically satisfy approximately 95 percent of their capacity obligations through self-supply and bilateral contracts. The remaining 5% is traded on the Capacity Credit market") In that order, FERC also noted that "The purpose of the capacity deficiency charge [in the pre-RPM capacity construct] is to provide an incentive for load serving entities to obtain, through construction or by contract, adequate supplies to meet their peak requirements." *Id.* at 61,568 (emphasis added).

to finance merchant generator projects. However, this filing did not fully deal with the fact that some participants make investment decisions on a multi-year basis rather than based solely on a single year and the associated clearing risk.

Among other rulings, FERC's November 17, 2011 order accepted PJM's compliance filing and explicitly recognized the need for PJM and/or the IMM to account for different business models in the RPM exception review. The November 17, 2011 order concluded that PJM's proposal for a unit-specific review process would recognize long-standing business models and practices used for developing resources outside of the RPM construct. Beyond the exception process, the November 17, 2011 Order leaves LSEs with two problematic alternatives to RPM – the currently problematic FRR option or the filing of an FPA Section 206 complaint.

Although FERC was clear that there shall be no blanket exemption for new self- supply resources,<sup>4</sup> FERC did not preclude restoring the clearing assurance for self supply after the rigorous assessment of the exception process.

The immediate self-supply proposal that resulted from the stakeholder process and is now before the Board received supermajority support at the MRC of 3.41 and a simple majority at the next week's MC of 3.02. While disappointed to not carry a supermajority in both forums, the undersigned believe that these votes nonetheless are informative to the independent Board as it considers further modifications to the OATT under its FPA Section 205 authority.

## **Components of the Self Supply Proposal**

The self-supply proposal has seven components, summarized below. The first two fit easily within the MOPR exception process as accepted by the Commission's November 17, 2011 Order. The remaining five components listed below are exemptions that we request the Board also consider for inclusion in a filing under FPA Section 205.

### **1. Exception: Allow self supply if economic on a multi-year view to offer so it clears**

Some market participants such as cooperatives and municipalities make investment decisions on a multi-year basis rather than solely a single-year test. The suggested language recognizes the difference in decision horizons in a manner consistent with an entity's business model as utilized under the approved unit specific review process and addresses the associated clearing risk.

Attachment 1 provides recommended modifications to Attachment DD, 5.14.h.5(iii) and 5.14.h.6.

### **2. Exception: Allow for exceptions based on a predetermined high percentage of the entity's obligation being fulfilled with its own generation or under contract**

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<sup>4</sup> November 17 Order at P 205.

Other market participants such as investor-owned utilities in non-choice states must be able to respond to the legitimate mandates of their particular state. Limiting this exception to those that currently satisfy the bulk of their own obligations prevents the provision from being utilized by entities where the investment is driven by a secondary portfolio benefit.

FERC was clear that there should be no blanket exemptions for self supply. However, the Commission did recognize there are types of investments not suitable for manipulating capacity prices for a secondary portfolio benefit. And the Commission also recognized that the unit-specific review process does place a burden on a potential capacity market seller. The tariff provides for explicit MOPR exemptions for nuclear, coal, Integrated Gasification Combined Cycle, hydroelectric, wind or solar facilities. We ask that the Board consider restoring or adding the exemptions enumerated below<sup>5</sup> as these exemptions are not suitable vehicles for seeking a secondary portfolio benefit and these types of investments do not warrant the administrative burden inherent in the unit-specific review process.

- 3. Exemption (restore): Allow for upgrades, such as a process upgrade, at existing units without limitation.**
- 4. Exemption (restore with modifications): Allow for unit additions at existing plant up to a pre-defined threshold.**
- 5. Exemption (expand existing category): Allow all renewable projects (e.g., landfill, biomass, etc.).**
- 6. Exemption (addition): Allow for unit replacement generation at existing site.**
- 7. Exemption (addition): Allow exception for certain MW amount tied to the size of the LDA**

The undersigned request the Board to direct PJM staff to prepare an additional Section 205 filing to incorporate the above revisions. As the Commission noted throughout the November 17, 2011 Order, PJM has the sole right to make tariff revisions under FPA Section 205, which gives PJM the authority to make reasonable Tariff modifications such as those requested above.

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<sup>5</sup> See detail posted for November 22 Members Committee at <http://www.pjm.com/~-/media/committees-groups/committees/mc/20111122/20111122-item-03-self-supply-package-2-additional-documentation.ashx>

## **Modifications to FRR were not adequately addressed during the Stakeholder process**

In its April 12, 2011 and November 17, 2011 Orders, FERC has been exceptionally clear that entities wishing to self supply should avail themselves of the FRR component within RPM. Per paragraph 100 of the November 17, 2011 Order:

“Some parties argue that the FRR alternative may not be a viable substitute for many RPM participants. But this is an individual determination to be made by each state and distribution company. PJM’s tariff provides this alternative method of satisfying resource requirements while preserving wholesale market prices, and states and distribution companies can make this choice based on their individual circumstances.”

In its Triennial Review, Brattle noted the immediate concerns of states as well as the need to address the self supply issue. And the Board is well aware that a number of states and PJM stakeholders continue to wrestle with the Federal/State jurisdictional issue of resource adequacy. Despite the Commission’s recent order, we do not expect this issue to go away and ask the Board to challenge PJM staff’s refusal to consider even modest changes to FRR.

Of all the modifications made to the original RPM settlement in 2006, very few modifications have been made to the FRR rules. These rules were developed to accommodate a unique situation and constructed so that primarily only one entity could economically use the FRR alternative. Yet over time, FRR has been held out as the only option for any LSE who must be able to use its resources obtained outside of RPM to meet its capacity obligation. With the significant modifications to RPM, including the elimination of the state exemption, it is time to meaningfully revisit the design of the FRR alternative, including the prohibition on partial procurement of capacity through RPM and the disproportionately steeper penalties for capacity deficiencies. While some would prefer to have the majority of capacity procured through the RPM construct, the modification to the original RPM design that eliminated the assurance of clearing for self-supply effectively makes RPM an untenable option for LSEs whose business models prefer to continue to exercise self-build options in conjunction with RPM purchases.

We remind the Board that PJM has exclusive FPA Section 205 filing rights regarding all aspects of RPM. As such, we ask the Board to challenge PJM staff regarding the market design issues surrounding modifications to FRR. We also ask the Board to explore with staff what, if any, technological hurdles would remain for a partial FRR option, including tracking of obligations and measurement and verification, given the possible implementation of Price Responsive Demand and Residual Zone Pricing.

As a closing note, we wish to commend Adrien Ford of your staff for an exemplary job in facilitating the recent RPM stakeholder process. She did an excellent job in implementing the GAST Phase IIA process regarding this matter. Because of her extraordinary efforts, the PJM stakeholders and ultimately you the Board have been able to process a tremendous amount of complicated information in an orderly and informed fashion.

Sincerely,

/s/ Chris Norton  
Director of Market Regulatory Affairs  
**AMP Partners**

/s/ Duane S. Dahlquist  
General Manager  
**Blue Ridge Power Agency**

/s/ John Michael Adragna  
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On Behalf of the  
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/s/ Patrick E. McCullar  
President & CEO  
**Delaware Municipal Electric Corporation**

/s/ Greg Morgan  
Managing Director Fossil & Hydro  
Regulated Operations  
Virginia Electric & Power Company  
**d/b/a Dominion Virginia Power**

/s/ Michael Spiker  
Director of Utilities  
**City of Hagerstown**

/s/ George E. Owens  
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On Behalf of Dennis Monn, Council  
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**Borough of Park Ridge**  
**Borough of Pemberton**  
**Borough of Seaside Heights**  
**Borough of South River**

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**Town of Thurmont, Pennsylvania**

/s/ Gary A. Jack  
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