REQUEST OF
PJM INTERCONNECTION, L.L.C.
FOR WAIVER, REQUEST FOR 7-DAY COMMENT PERIOD, AND REQUEST FOR
COMMISSION ACTION BY FEBRUARY 10, 2014

Unprecedented market conditions this week have placed certain generators in the region served by PJM Interconnection, L.L.C. (“PJM”) in an untenable situation: they are obliged by one provision of PJM’s Operating Agreement\(^1\) to offer the output of their resources into PJM’s Day-Ahead Energy Market,\(^2\) but they are forbidden by another provision of the Operating Agreement from offering that output at their marginal costs of generating that energy. These provisions were never intended to force generators to sell below their marginal energy costs, but an unprecedented spike in fuel costs this week (setting new natural gas price records in PJM for the second time in just the past two weeks) has yielded exactly that result. With fuel costs this month twice testing or exceeding the level recoverable under the current Operating Agreement, PJM must acknowledge the possibility that these conditions could recur one or more times in the remainder of the winter season. Therefore, while PJM will address with stakeholders appropriate revisions to the Operating Agreement to resolve on a longer-term basis the present conflict in these provisions, the present circumstances demand some form of interim relief. Generators

\(^{1}\) Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., Rate Schedule FERC No. 24.

\(^{2}\) Capitalized Terms used in this pleading that are not otherwise defined herein have the meaning prescribed by the Operating Agreement or by the PJM Open Access Transmission Tariff (“PJM Tariff”), as applicable.
cannot lawfully be required to buy fuel at a cost of many millions of dollars for the purpose of generating power and selling it at a loss. To the contrary, the economic dispatch at the heart of PJM’s energy market critically depends on the assumption that generation offers are economic and reflect the seller’s marginal costs. While tariff authorities, penalty provisions, and various other administrative strictures obligate generators to follow PJM’s dispatch instructions, the dispatch system rests on an understanding that generation offers are consistent with the seller’s marginal costs, and that sellers selected to run will respond to PJM’s dispatch instructions primarily because the dispatch price is economic for that seller. If that fundamental economic precept is discarded, and sellers instead are required to submit offers that are below their marginal costs, and are directed to run at prices that do not recover their marginal costs, then sellers’ economic interests could, for the first time in any meaningful or systemic way, be placed in opposition to PJM’s dispatch instructions. That development would be, to say the least, unhealthy and unsustainable. Consequently, relief is needed this winter from the current market rules that demonstrably impose an untenable requirement for below-cost sales when fuel costs rise to levels already seen this winter.

PJM seeks this relief in two parts. In this filing, PJM seeks a narrowly drawn waiver of the current offer-price cap rule, solely for the remainder of the current winter season, to allow sellers submitting cost-based offers to base those offers on their marginal costs, even if that causes their offer price to exceed the offer-price cap. Because that change to permissible offers would change how PJM clears the market, PJM will await a Commission order on that waiver request before accepting any generation offers that exceed the cap. In the meantime, however, PJM must find some credible means of assuring sellers that they can recover their marginal costs of generation should such costs exceed the cap. In a companion filing also filed today, therefore,
PJM seeks any necessary tariff waivers to permit sellers from generation resources that submitted cost-based energy market offers with costs, as determined in accordance with PJM’s existing energy offer cost calculation guidelines, that exceed the applicable energy market clearing price, to receive a make-whole payment covering the difference between such costs and such clearing price. PJM seeks this waiver only through the end of the current winter season, i.e., through March 31, 2014.\(^3\)

Because this filing seeks waiver of the offer-price cap only prospectively from Commission grant of the waiver, and only through March 31, 2014, PJM asks that the Commission expedite its processing of this request. To that end, PJM asks that the Commission set a shortened, seven-day, comment period for this filing, and that the Commission act on the filing within ten days after the comments are filed, i.e., BY February 10, 2014. This filing, in conjunction with the companion filing, will ensure not only that generators submitting *cost-based* offers can recover their marginal costs of sales into PJM’s energy market, but also that the price in that market will correctly reflect the marginal costs of those sellers when they are needed to serve PJM loads. That principle—basing clearing prices on the costs of cleared sell offers—is fundamental to PJM’s energy market design, and that principle should not be set aside, even for an interim period. To the contrary, it is especially critical to honor that principle at the very times, such as experienced this winter, when seller costs are high. There is no question that fuel costs are a legitimate marginal cost of generation, and there also is no question that generators that have had to purchase natural gas on the spot market this winter have at times faced

\(^3\) Moreover, favorable Commission action on the waiver requested in this docket, which would authorize the preferred approach of reflecting seller costs in clearing prices rather than in uplift of make-whole payments, will supersede the make-whole and uplift relief requested in the companion filing.
extremely high costs for that gas. Consequently, there is no sound basis for energy prices to ignore those costs. For these reasons, PJM asks that the Commission approve this waiver request on an expedited basis during the present winter season so that the PJM energy market can operate as intended and set prices based on seller marginal costs.

I. BACKGROUND

The Operating Agreement, at Schedule 1, section 1.10.1A(d), provides that Market Sellers owning or controlling the output of all Generation Capacity Resources in the PJM Region that have been committed as capacity for PJM shall submit offers into the Day-Ahead Energy Market for the available capacity of their resources. But the Operating Agreement also provides that offers from Generation Capacity Resources into the Day-Ahead Energy Market shall not exceed an energy offer price of $1,000/Mwh. These provisions have not previously come into conflict: to PJM’s knowledge, sellers with generation resources offering into PJM’s energy market have not had marginal costs in excess of $1,000/Mwh, certainly not on any systemic basis, or that they have brought to PJM’s attention.

That changed this week. Published natural gas prices to two key citygates in the PJM Region, for trades on January 21 and delivery on January 22, averaged over $120/MMbtu, and included high prices for the day of up to $140/MMbtu. These gas prices are record-setting for the PJM Region (if not for the nation), shattering even the records set just earlier this month.

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4 Id. at section 1.10.1A(d)(viii).

5 Natural gas prices for January 21 trade and January 22 delivery to the Transco Z-5 zone averaged $120.275/MMbtu; prices for delivery to the Transco Z-6 (non-NY) zone averaged $123.50/MMbtu, with high prices for the day ranging up to $135/MMbtu and $140/MMbtu, respectively. In addition, prices for January 21 trade and January 22 delivery to the TETco M-3 zone averaged $71.81/MMbtu, with high prices ranging up to $95/MMbtu.
during the “polar vortex” extreme cold weather event. These Transco citygate gas prices would equate to a marginal energy cost for a simple-cycle combustion turbine (“CT”) generator, of a type that PJM would likely need in high-demand conditions, of approximately $1,200/Mwh. Indeed, PJM observed approximately 5,000 MWs of energy market offers in Tuesday’s day-ahead market at a price of $999/Mwh, implying that the costs for those resources was above $1,000/MWh but their offers were constrained by the offer cap. Approximately 4,000 MWs of these offers were called upon by PJM to operate; the remaining 1,000 MWs were available for PJM to call in real-time if needed.

Consequently, a large amount of generation has been offered into, and cleared, PJM’s energy market at prices likely below the generators’ costs of producing that energy. The Operating Agreement’s “must-offer” and “offer-cap” provisions mean that the sellers were required to offer the available capacity of their generation resources below their marginal costs.

This is untenable. It is patently unfair to the affected generators, who should be permitted to recover their costs of generating the energy that they are required to offer into the PJM energy market. And it is contrary to the marginal-cost clearing price principle that is the

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6 The gas price spikes during the “polar vortex” event raised significant concerns at PJM that the $1,000/MWh offer cap might pose a problem for cost-based offers. Less than two weeks later, that fear has been realized. The occurrence of these events less than two weeks apart, with ten weeks remaining in the winter season, in a context of continued below-average temperatures in parts of the PJM Region and continued pressure on natural gas storage inventories (and thus continued natural gas price volatility), underscores the need for Commission action to resolve this problem for the current winter season.

7 Since a representative CT heat rate is approximately 10 MMbtu/Mwh, see, e.g., PJM Tariff, Attachment DD, section 2.58 (defining CT “Reference Resource” for PJM’s capacity market to include a heat rate of 10.096 MMbtu/Mwh), the equivalent power-cost calculation is very straightforward: $120/MMbtu times 10 MMbtu/Mwh equals $1,200/Mwh.
essential feature of the PJM energy market, as repeatedly endorsed by the Commission. If a seller legitimately must pay $120/MMbtu to obtain the natural gas required to generate the energy needed to clear the PJM energy market, then that seller’s offer, and the PJM market clearing price, should reflect that legitimate cost.

Given the published natural gas prices, their likely impact on energy costs, and multiple inquiries to PJM from market participants that were required to submit generation offers into PJM’s day-ahead market on Tuesday (January 21), PJM considered this matter and posted a notice on its website (as shown in attachment A to this filing), affirming that the available capacity from Generation Capacity Resources must still be offered into the Day-Ahead market, and advising that PJM would file as soon as practical with the Commission to seek the tariff waivers needed to ‘make whole’ generation capacity resources that are required to offer into PJM’s day-ahead market for their costs that exceed the market clearing price, and recover those costs through an uplift charge; and seek a temporary waiver of the offer cap rule as applied to cost-based offers from generation capacity resources through the end of the current winter season.

II. REQUESTED WAIVER

To provide interim and immediate relief to the present untenable situation, PJM requests a waiver of the $1,000/Mwh offer cap, effective from a Commission order granting that waiver, for Generation Capacity Resources that have legitimate costs above that level.

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8 See note 13, infra.

9 It is possible for the PJM energy market to clear at a price above $1,000/MWh, based on offers from Demand Resources (which are not capped at $1,000/MWh) or application of shortage pricing rules. If that occurs, and the clearing price is above the generator’s costs (including its elevated fuel costs), then the seller will clear and recover its costs from the market. But the seller required to offer into PJM’s market cannot control demand response offers or shortage pricing triggers, and there is no guarantee that those conditions will arise.
A. The Requested Waiver.

Specifically, PJM requests waiver of Operating Agreement, Schedule 1, section 1.10.1A(d), the equivalent Tariff section of Attachment K-Appendix, and any other related Operating Agreement and Tariff provisions as necessary to permit sellers from Generation Capacity Resources to submit offers in PJM’s energy market that are based on their marginal costs, notwithstanding that such offers exceed an offer price of $1,000/MWh.\(^\text{10}\)

Such seller’s costs would be document and determined in accordance with as determined in accordance with the Cost Development Guidelines in Manual 15.\(^\text{12}\) Specifically, section 2.3 of Manual 15 sets forth the “Fuel Cost Guidelines,” which PJM will apply unchanged to the sellers subject to the requested waiver. The substance of the proper determination of cost-based offers for such a seller would not change—all that would change is that the result of the calculation of those cost-based offers would not be arbitrarily cut off at $1,000/MWh.

While the waiver requested in the companion filing would keep sellers whole for their marginal costs, it would not reflect those legitimate marginal costs in the market-clearing price. But that approach falls short of Commission policy, and PJM’s fundamental market design, that

\(^{10}\) The substance of this waiver applies only to cost-based offers. However, the mechanics of the system by which market sellers submit generation offers to PJM requires in most circumstances a market-based offer to be submitted as well. Because the PJM market clearing algorithms are programmed to select the market-based offer when the resource is not offer-capped pursuant to PJM’s market power mitigation rules, and when a resource that is mitigated is scheduled on the basis of the cheaper of its market-based or cost-based offers, a seller submitting a cost-based offer above $1,000 MWh will also need to submit a market-based offer that is equal to its cost-based offer. Otherwise, if the seller were not permitted to also submit a market-based offer at the level of its cost-based offer when such cost-based offer is above $1,000/MWh, then the seller would still be limited to the lower market-based offer.

\(^{11}\) PJM clarifies, however, that if Shortage Pricing is triggered for a time that this waiver has resulted in an energy price over $1,000/MWh, then the shortage pricing reserve penalty factors will nonetheless be applied to an energy price no higher than $1,000/MWh.

clearing prices should reflect the marginal costs of the last resource needed to clear the market.\textsuperscript{13} Handling those legitimate costs through uplift costs is disfavored, because, as the Commission has recognized, “[p]ayments made only to individual resources and recovered in uplift fail to send clear market signals.”\textsuperscript{14} Those resource costs instead “should be reflected in transparent market prices whenever possible.”\textsuperscript{15}

Moreover, to ensure that PJM energy market prices this winter reflect, as has always been intended, the marginal costs of producing that energy, PJM asks that the Commission act on this waiver request on an expedited basis, as described above. Since allowing cost-based offers to exceed the offer cap can affect the calculation of clearing prices, PJM prudently will await the Commission’s response to this filing before accepting such offers. And as PJM proposes that this time-limited waiver expire in any event on March 31, 2014, applying the requested waiver during any substantial part of the remaining winter season will require expedited Commission action.

B. Waiver Is Appropriate in These Circumstances.

The Commission will grant waiver of a tariff provision for good cause, and considers several factors to make that determination. For example, the Commission has granted waiver requests where: (1) the underlying error (assuming one is made) was made in good faith; (2) the

\textsuperscript{13} See, e.g., \textit{PJM Interconnection, L.L.C.}, 117 FERC ¶ 61,331, at 62,876, n.101 (2006). See also \textit{Town of Norwood v. FERC}, 962 F.2d 20, 23 (D.C. Cir. 1992) (upholding Commission marginal cost pricing order and describing in detail academic and scholarly support for marginal cost pricing). In addition, PJM notes that when market power mitigation is triggered in the energy market, the Operating Agreement (at Schedule 1, section 6.4.2(a)(1)) sets marginal (a/k/a “incremental”) costs as the key component of a permissible energy price offer.

\textsuperscript{14} \textit{PJM Interconnection, L.L.C.}, 139 FERC ¶ 61,057, at ¶ 78, n. 72, reh’g denied, 141 FERC ¶ 61,096 (2012).

\textsuperscript{15} \textit{Id.}

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waiver request is of limited scope; (3) a concrete problem needs to be remedied; and (4) the waiver did not have undesirable circumstances, such as harming third parties.\footnote{See N. Y. Indep. Sys. Operator, Inc., 125 FERC ¶ 61,005 (2008) (citing ISO New England, Inc. 117 FERC ¶61,171, at P 21 (2006)); see also PJM Interconnection, L.L.C., 125 FERC 61,279, at P 8 (2008).}

Those considerations warrant granting the waivers requested here. PJM has not made any errors and is proceeding in good faith. PJM has not previously filed a tariff change in this area simply because generation resource energy offer costs have not, prior to this month, appeared to seriously threaten exceeding the $1,000/MWh offer cap. PJM could not in good faith have anticipated this week’s record-high natural gas prices over $100/MMBtu. But now that it is clear that these elevated fuel costs can occur, PJM is proceeding in good faith to seek prompt interim relief to counteract the plainly evident adverse effects resulting from the interaction of the existing offer-price cap with those unprecedented fuel costs.

The waiver request here also is of limited scope, both in time period (limited to, at most, the remainder of this winter season) and in nature (limited to Generation Capacity Resources that have legitimate costs over $1,000/MWh).

The requested waiver also resolves a concrete problem, i.e., the conflict between the must-offer requirement and the offer cap, precipitated by this week’s elevated natural gas prices.

Finally, no market participants can claim any legitimate harm because the PJM market always has been premised on seller recovery of marginal costs, and on clearing prices based on marginal costs. There is no good reason why cost-based offers that have legitimate costs, of the same type always allowed to support generation offers, simply because those costs are above the arbitrary level of $1,000/MWh. Moreover, sellers are entitled to the proposed cost recovery only
for their cost-based offers that are cleared, and that therefore are necessary to the reliable operation of the PJM Region.

III. CORRESPONDENCE

The following individuals are designated for inclusion on the official service list in this proceeding and for receipt of any communications regarding this filing:

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IV. SERVICE

PJM has served a copy of this filing on all PJM members and on all state utility regulatory commissions in the PJM Region by posting this filing electronically. In accordance with the Commission’s regulations,\textsuperscript{17} PJM will post a copy of this filing to the FERC filings section of its internet site, located at the following link: \url{http://www.pjm.com/documents/ferc-manuals/ferc-filings.aspx} with a specific link to the newly-filed document, and will send an e-mail on the same date as this filing to all PJM members and all state utility regulatory commissions in the PJM Region\textsuperscript{18} alerting them that this filing has been made by PJM and is available by following such link. PJM also serves the parties listed on the Commission’s official service list for this docket. If the document is not immediately available by using the referenced link, the document will be available through the referenced link within 24 hours of the filing. Also, a copy of this filing will be available on the FERC’s eLibrary website located at the following link: \url{http://www.ferc.gov/docs-filing/elibrary.asp} in accordance with the Commission’s regulations and Order No. 714.

\textsuperscript{17}See 18 C.F.R. §§ 35.2(e) and 385.2010(f)(3).

\textsuperscript{18}PJM already maintains, updates and regularly uses e-mail lists for all PJM members and affected state commissions.
V. CONCLUSION

Accordingly, PJM requests that the Commission grant the waivers requested herein.

Respectfully submitted,

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January 23, 2014
Cost Based Offers Into the Day-ahead Energy Market on January 21, 2014

Notice To Market Participants: Please be advised that capacity resources under PJM's rules are required to offer into the PJM Day-ahead energy market. Both price and cost-based offers from generation capacity resources are presently subject under the rules to a $1000 system offer cap. PJM is actively in the process of seeking a waiver from the FERC of the system offer cap rule as applied only to cost-based offers from generation capacity resources. The basis for such a waiver is documented and widespread escalation of natural gas prices in significant parts of the PJM region to prices. However, the request for such a waiver cannot be filed with FERC today because the agency is closed due to the weather.

Accordingly, please be advised:

1. All generation capacity resources that do not qualify to take a forced outage under PJM's rules are required to submit an offer into the Day-ahead market subject to the system offer cap rule (i.e., an offer no greater than $1000).

2. Non-capacity resources, whose costs cannot be reimbursed without submitting an offer in excess of $1000, may submit "emergency offers" in excess of the system offer price cap.

3. PJM will file as soon as practical to seek a retroactive waiver of its system offer cap rule to "make whole" generation capacity resources to their documented costs to the extent such costs exceed the system offer cap. The waiver would seek permission to reimburse affected generation resources through an "uplift" payment. While we appreciate this predicament leaves some PJM generation capacity resources in an uncertain state, PJM has consulted with counsel and believes the anticipated retroactive waiver request will likely be accepted by the FERC.

4. Along with the above-described retroactive waiver, PJM will seek a temporary waiver of the system offer cap rule as applied to cost-based offers from generation capacity resources through March 1, 2014.