

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

PJM Interconnection, L.L.C. ) Docket No. ER09-1063-004

**COMMENTS OF THE ELECTRIC POWER SUPPLY ASSOCIATION**

Pursuant to Section 212 of the Federal Energy Regulatory Commission's ("FERC" or "the Commission") Rules of Practice and Procedure, 18 C.F.R. § 385.212, the Electric Power Supply Association ("EPSA")<sup>1</sup> respectfully submits supporting comments in the above referenced proceeding. Specifically, on June 18, 2010, PJM Interconnection, L.L.C. ("PJM") filed<sup>2</sup> a proposed package of reforms (the "shortage pricing proposal") to modify its current reserves pricing and scarcity pricing mechanisms and establish just and reasonable pricing for operating reserve shortages to comply with the Commission's shortage pricing directives in Order No. 719<sup>3</sup> and the Commission's December 18, 2009 Order<sup>4</sup> in

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<sup>1</sup> EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the view of any particular member with respect to any specific issue.

<sup>2</sup> PJM Interconnection, L.L.C., Docket No. ER09-1063-004 (filed June 18, 2010) (the "PJM Shortage Pricing Filing").

<sup>3</sup> *Wholesale Competition in Regions with Organized Electric Markets*, Order No. 719, 73 Fed. Reg. 64,100 (October 28, 2008), FERC Stats. & Regs. ¶ 31,281 (2008) ("Order No. 719"), *on reh'g*, Order No. 719-A, FERC Stats. & Reg. ¶ 31, 292 (2009) ("Order No. 719-A"), *on reh'g*, Order No. 719-B, 129 FERC ¶ 61,252 (2009) ("Order No. 719-B").

<sup>4</sup> *PJM Interconnection, L.L.C.*, 129 FERC ¶ 61,250 (2009).

this proceeding.<sup>5</sup> EPSA urges the Commission to approve the PJM shortage pricing proposal with several limited but important modifications as discussed herein on or by November 1, 2010, to allow PJM sufficient time to develop software and other actions necessary to implement its proposal by May 1, 2011.

## **I. COMMUNICATIONS**

All pleadings, correspondence and other communications concerning this proceeding should be directed to:

Nancy Bagot, Vice President of Regulatory Affairs  
Electric Power Supply Association  
1401 New York Avenue, N.W., 11<sup>th</sup> Floor  
Washington, D.C. 20005  
(202) 628-8200  
[NancyB@epsa.org](mailto:NancyB@epsa.org)

## **II. BACKGROUND**

The PJM shortage pricing proposal was filed following more than one year of stakeholder discussions through the Shortage Pricing Working Group (“SPWG”).<sup>6</sup> Although the proposal did not receive the required two-thirds majority sector vote in support, PJM submitted the compliance filing in order to meet its Order No. 719 compliance obligations. PJM states that in addition to its proposal, there were five alternative proposals considered in the stakeholder

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<sup>5</sup> EPSA is a party to this proceeding based on its timely motion to intervene filed on June 26, 2009, regarding PJM’s initial Order No. 719 compliance filing establishing the docket for this proceeding (“PJM Initial Compliance Filing”). See Motion to Intervene And Comments of the Electric Power Supply Association, Docket No. ER09-1063-000 (filed June 26, 2009). The PJM Initial Compliance Filing, filed on April 29, 2009, reported that PJM and its stakeholders were unable to agree on how to comply with Order No. 719’s shortage pricing directives and requested an extension of time to comply with this requirement. The Commission granted this request in its December 18, 2009 Order on Compliance Filing, along with a further PJM extension request, in a January 27, 2010 Notice of Extension of Time in this proceeding, which extended the deadline until June 18, 2010.

<sup>6</sup> PJM Shortage Pricing Filing at 6.

process (one from the PJM Independent Market Monitor and four stakeholder proposals); however, none of these proposals received the required majority support and PJM asserts these alternate proposals are non-compliant with FERC's Order No. 719 shortage pricing criteria and should not be adopted.<sup>7</sup> PJM proposes an effective date of May 1, 2011, for the proposed revisions and requests Commission approval by November 1, 2010, to allow for an orderly implementation of the significant changes involved, "which will affect not only emergency conditions but also the dispatch and pricing of energy, reserves, and Regulation during normal operations."<sup>8</sup>

Specifically, the PJM shortage pricing proposal includes the following:<sup>9</sup> (1) a cost-based, Non-synchronized Reserve Market to clear all ten-minute reserves to ensure pricing supports the system's short-term reliability needs; (2) jointly optimized dispatch of energy and reserves every five minutes; (3) Reserve Penalty Factors, which effectively serve as distinct price caps on synchronized and total ten-minute reserves, consistent with the reserve shortage pricing approach the Commission has previously approved for the ISO New England ("ISO-NE") and the New York Independent System Operator ("NYISO"); (4) an overall cap of \$2,700 MWh on combined energy and reserve prices that is in line with price caps approved for the ISO-NE, NYISO, and Midwest Independent System Operator ("Midwest ISO"); (5) demand-curve pricing (a sanctioned Order

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<sup>7</sup> *Id.* at 7 and 42-49.

<sup>8</sup> *Id.* at 2.

<sup>9</sup> *Id.* at 2-3.

No. 719 approach)<sup>10</sup> utilizing the Reserve Penalty Factors and jointly optimized dispatch and pricing of energy and reserves to enable a gradual and transparent rise in market-clearing prices as shortage conditions approach; (6) new rules that allow emergency demand response to set market-clearing prices during emergencies; (7) retention of all existing applicable market power mitigation rules; and, (8) continued reliance on the existing Energy and Ancillary Services (“E&AS”) revenue offset methodology for the Reliability Pricing Model (“RPM”), which deducts the E&AS revenues earned by the reference unit from the fixed costs of the reference resource to calculate the net cost of new entry (“Net CONE”) used to establish the downward sloping demand curve in the RPM auctions; and, (9) Regulation service priced every five minutes consistent with the five-minute optimization of energy and reserves. Further, PJM recommends a four-year transition period that gradually raises the Reserve Penalty Factors and combined energy-reserves price cap.

### **III. COMMENTS**

In the Order No. 719 rulemaking process, EPSA strongly advocated for price reforms applicable to all organized wholesale electric markets and supported the Commission’s proposals to allow market-clearing prices to accurately reflect the value of energy during periods of operating reserve shortage, noting among other things, that this would produce more efficient price signals for plant operation, investment and consumption and allow demand to

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<sup>10</sup> Order No. 719 at P 208.

respond to price when most needed and valuable for the reliability of the grid.<sup>11</sup> EPSA commends the significant effort by PJM to develop its shortage pricing proposal. EPSA generally supports the filed proposal, and believes that, with certain limited but important modifications specified herein, the proposal will meet both the Commission's requirements and PJM's goals for compliance.

To that end, EPSA and its members have reviewed, and EPSA hereby states its support for, the comments and limited protest filed by the PJM Power Providers Group ("P3 Comments") in this proceeding. The P3 Comments support, with certain modifications, the PJM shortage pricing proposal, as detailed in the accompanying affidavit of Dr. Roy J. Shanker ("Shanker Affidavit").

The P3 Comments and Shanker Affidavit recommend the following:

- (1) Modifications to the calculation of the E&AS Offset to Net CONE to ensure that Net CONE is not reduced by scarcity rents that generators have not, and cannot, receive;
- (2) Adjustments to reference prices for mitigated units committed in the Day Ahead market to properly reflect increased outage risks associated with the modified shortage pricing design, in particular, the Reserve Penalty Factors and the ability of emergency resources to set prices; and,
- (3) Clarification that the ability of all resources, including emergency demand response, to set the market-clearing price should apply at all times when emergency actions are taken, and not just during periods of operating reserve shortage.

With these enhancements, EPSA agrees the PJM proposal will comply with the Order No. 719 guidance on shortage pricing mechanisms, intended to facilitate, among other things, more accurate pricing, enhanced reliability, new

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<sup>11</sup> See Wholesale Competition in Regions with Organized Electric Markets, *Comments Of The Electric Power Supply Association* at 2-10, Docket Nos. RM07-19-000 and AD07-7-000 (filed April 21, 2008) and *Comments Of the Electric Power Supply Association* at 2-3 and 6-36, Docket Nos. RM07-19-000 and AD07-7-000 (filed September 14, 2007).

entry of both generation and demand resources, investment in demand response technologies, and ensuring market power is mitigated during periods of operating reserve shortages.<sup>12</sup> Further, the PJM shortage pricing proposal is consistent with approaches the Commission has previously accepted for several other ISOs/RTOs.

EPSA offers these additional comments in support of the PJM proposal.

**A. The PJM Shortage Pricing Proposal Reflects Compromise**

In assessing the inevitable arguments that the PJM proposal did not receive the requisite stakeholder support, the Commission should fully consider the extensive, focused effort by PJM to develop a consensus proposal in the stakeholder process. Not only did PJM hold twenty-four meetings of the SPWG from April 22, 2009 to April 30, 2010 to discuss and develop a shortage pricing proposal,<sup>13</sup> but numerous stakeholder meetings<sup>13</sup> were held in the six-month period prior to that to develop the comprehensive PJM Initial Compliance Filing. These earlier stakeholder deliberations included detailed consideration of various options for a revised shortage pricing mechanism and associated changes.<sup>14</sup> Due to the complexity of this issue and lack of final agreement, a final proposal was not included in PJM's Initial Compliance Filing. In its Initial Compliance Filing, PJM provided to the Commission a general overview of the guiding principles and revisions PJM and its stakeholders had identified to be necessary

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<sup>12</sup> Order No. 719 at P 247.

<sup>13</sup> PJM Shortage Pricing Filing at 6.

<sup>14</sup> PJM Initial Compliance Filing at 21-30.

for the pricing criteria PJM committed to work to establish. Additionally, PJM explained that agreement had been reached that the preferred approach for compliance would focus on implementation of an operating reserve demand curve, an option suggested by the Commission.<sup>15</sup> In other words, by the time the SPWG began its intensive effort, PJM had already considered diverse views and input on the appropriate pricing mechanism for the region.

The final package of proposed reforms submitted in the shortage pricing proposal results from this deliberative process. PJM has carefully considered inputs and options intended to satisfy the mandates of Order No. 719. The reforms proposed by PJM do not all reflect optimal market design elements that were advocated by various EPSA members that participated in the SPWG. For example, EPSA members compromised on the ultimate acceptable Reserve Penalty Factor cap,<sup>16</sup> compromised on the means for hedging risk of real time unavailability of generators cleared in the Day Ahead market,<sup>17</sup> and compromised on implementing a phased implementation of the proposed shortage pricing rules.<sup>18</sup> Despite these and other “gives,” EPSA members

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<sup>15</sup> *Id.* at 28-29.

<sup>16</sup> See, generally, *Id.* at 24-25 (Explaining that the total \$2,700 cap is to “protect load,” is “below the estimate of the value to consumers of lost load during reserve shortage conditions,” and is below the \$4,400 reserve and energy price that the proposed rules could yield under the most extreme shortage conditions). See also, *Id.*, Attachment C, Affidavit of Dr. Paul Sotkiewicz, Ph.D., on behalf of PJM Interconnection, L.L.C. at 26 (Explaining that PJM is “worried about the political sustainability of prices that could potentially rise to \$4400/MWh” and that some stakeholders expressed the opinion that prices are “too high”).

<sup>17</sup> *Id.* at 40.

<sup>18</sup> *Id.* at 32 (Explaining that the transition period was implemented “based on feedback during the stakeholder process”).

concur with PJM that the proposed package of reforms will establish just and reasonable pricing for operating reserve shortages in the PJM region.

Furthermore, EPSA agrees that PJM, as a public utility subject to the Commission's jurisdiction, had an obligation to file within a reasonable period of time to comply with the directives and requirements of Order No. 719.

**B. Co-Optimizing the Energy And Ancillary Services Market Provides Further Transparency And Efficient Pricing**

EPSA also urges the Commission to consider the additional benefits that will be derived through PJM's proposed co-optimization of the E&AS markets. Specifically, this co-optimization will provide further market transparency and lead to more robust, efficient pricing through the single stack for dispatch. The co-optimization will also more accurately reflect the costs of ensuring reliability for the PJM system as a whole.

EPSA asserts that, in addition to the data PJM offered in support of its proposed pricing levels, PJM's proposed reforms to the Reserve Penalty Factors and combined energy-reserves cap are consistent with reserve shortage pricing elements already approved for the NYISO, ISO-NE and the Midwest ISO.<sup>19</sup> Of note, Potomac Economics stated in its Order No. 719 Report on Shortage Pricing that:

[I]t is important to recognize that operating reserve demand curves are most effectively implemented in the context of jointly-optimized energy and ancillary services markets. New York ISO and ISO-New England both have jointly-optimized markets and the Midwest ISO is in the process of implementing jointly-optimized markets. In summary regarding approach 3 [Reserve Demand Curves], therefore, it is our opinion that effective

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<sup>19</sup> PJM Shortage Pricing Filing at 19-26 and Attachment C, Affidavit of Dr. Paul Sotkiewicz, Ph.D. on behalf of PJM Interconnection, L.L.C. at 11-27.

shortage pricing requires jointly-optimized markets with operating reserve demand curves set at levels that reflect the value of the reliability they provide to consumers. None of the other approaches proposed by the Commission will set efficient shortage prices when the ISO or RTO must sacrifice its operating reserves to satisfy the energy demands of the system.<sup>20</sup>

Given the broader market efficiencies that would result through this consistency, and the fact that these elements have been approved for neighboring ISOs/RTOs, and are therefore just and reasonable, EPSA asserts that they are therefore “within scope” and FERC should approve PJM’s proposed reforms.

### **C. Shortage Pricing Plays A Beneficial Role In Wholesale Electric Markets**

In both the Initial Compliance Filing and the Shortage Pricing Proposal, PJM explained that its currently effective reserves and scarcity pricing rules are not just and reasonable and do not comply with Order No. 719. PJM explains that the current design is inflexible, lacks transparency, and has yielded “unintuitive” pricing that fails to reflect true operating constraints as PJM goes into shortage conditions. To PJM’s credit, reserve shortage events have been very limited occurrences in PJM;<sup>21</sup> however, the data reflects severe design flaws including relatively low, or even zero, clearing prices for Synchronized Reserves in the face of a reserve shortage that otherwise is marked by high energy prices, and high out-of-market opportunity cost payments for

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<sup>20</sup> *Report on Shortage Pricing of Potomac Economics, Ltd.*, Independent Market Advisor for the New York ISO at 7-8, Docket Nos. RM07-19-000 and AD 07-7-000, (filed May 15, 2009) . Potomac Economics is also the External or Independent Market Monitor for the ISO-NE, Midwest ISO and Electric Reliability Council of Texas (“ERCOT”).

<sup>21</sup> PJM Shortage Pricing Filing at 9-17 and Attachment C at 11-16.

Synchronized Reserves,<sup>22</sup> among other things. EPSA believes the PJM package of shortage pricing reforms, with the modifications recommended by P3, will play a critical role in: (1) helping to defray the ongoing costs of high-cost generators that run just a few hours of the year, yet are critical to grid reliability during those few hours; (2) providing the proper economic signal necessary to motivate demand response; (3) establishing efficient incentives for new investment in the best location; and, (4) mitigating market power.

EPSA has previously called for timely implementation of an enhanced shortage pricing mechanism in PJM, as well as for all ISOs/RTOs, and does so here again because it is one of the key components needed to achieve truly price responsive demand.<sup>23</sup> By approving the comprehensive and thoughtfully structured mechanism proposed by PJM, the Commission is facilitating implementation of a more transparent price signal under peak conditions that will allow resources of all types to respond more efficiently and consequently, improve reliability. Such enhancements will benefit all market participants and ultimately, consumers.

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<sup>22</sup> *Id.* at 13.

<sup>23</sup> EPSA Comments on PJM Initial Compliance Filing at 7.

#### **IV. CONCLUSION**

WHEREFORE, EPSA respectfully requests that the Commission consider the comments herein in rendering its decision in this proceeding. Further, EPSA urges the Commission to adopt the modifications to the PJM shortage pricing proposal recommended in the P3 Comments and accompanying affidavit of Dr. Roy J. Shanker.

Respectfully submitted,



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Nancy Bagot, Vice President of Regulatory Affairs  
Sharon Theodore, Director of Regulatory Affairs  
Electric Power Supply Association  
1401 New York Ave, N.W.  
11<sup>th</sup> Floor  
Washington, D.C. 20005

July 30, 2010

#### **CERTIFICATE OF SERVICE**

I hereby certify that I have served a copy of the comments via email, upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., July 30, 2010.



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Nancy Bagot, VP Regulatory Affairs