



On May 3, 2019, the Commission issued a Notice of Petition for Declaratory Order, setting June 3, 2019, at 5:00 p.m. as the deadline for filing an intervention or protest regarding the Petition. On May 10, 2019, the PJM Power Providers (“P3”)<sup>4</sup> filed a doc-less Motion to Intervene in this proceeding. The Electric Power Supply Association (“EPSA”)<sup>5</sup> filed a doc-less intervention in this proceeding on May 15, 2019. Pursuant to Rule 211<sup>6</sup> of the Rules of Practice and Procedure of the Commission, P3<sup>7</sup> and EPSA hereby jointly provide these comments with the in response to the Petition.

## **I. BACKGROUND**

Schedule 2 of PJM’s Open Access Transmission Tariff (“Tariff”), entitled “Reactive Supply and Voltage Control from Generation or Other Sources Service” (“Schedule 2”), provides that PJM will compensate owners of generation and non-generation resources for maintaining the capability to provide reactive power to PJM. Specifically, Schedule 2 states that, for each month of Reactive Service provided by generation and non-generation resources in the

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<sup>4</sup> P3 is a nonprofit corporation dedicated to promoting policies that will allow the PJM region to fulfill the promise of its competitive wholesale electricity markets. P3 strongly believes that properly designed and well-functioning competitive markets are the most effective means of ensuring a reliable supply of power to the PJM region, facilitating investments in alternative energy and demand response technology, and promoting prices that will allow consumers to enjoy the benefits of competitive electricity markets. Combined, P3 members own over 87,000 megawatts (“MWs”) of generation assets, own over 51,000 miles of transmission lines, serve nearly 12.2 million customers and employ over 55,000 people in the PJM region – encompassing 13 states and the District of Columbia. For more information see [www.p3powergroup.com](http://www.p3powergroup.com).

<sup>5</sup> Launched over 20 years ago, EPSA is the national trade association representing leading independent power producers and marketers. EPSA members provide reliable and competitively priced electricity from environmentally responsible facilities using a diverse mix of fuels and technologies. Power supplied on a competitive basis collectively accounts for 40 percent of the U.S. installed generating capacity. EPSA seeks to bring the benefits of competition to all power customers.

<sup>6</sup> 18 C.F.R. §§ 385.211 (2018).

<sup>7</sup> The comments contained herein represent the positions of P3 and EPSA as organizations, but not necessarily the views of any particular member with respect to any issue.

PJM region, PJM shall pay each resource owner an amount equal to the resource owner's monthly revenue requirement, as accepted or approved by the Commission.<sup>8</sup>

Petitioners seek clarity and guidance regarding the allowable costs that merchant generators may seek as Commission-approved cost-based compensation for providing reactive power service to the PJM market. As Petitioners note, these costs are not otherwise provided via PJM's energy, capacity, or ancillary services markets.<sup>9</sup> As Petitioners explain in great detail, in terms of cost recovery for reactive power, merchant generators are at a considerable disadvantage to regulated utilities operating in PJM's markets, as regulated utilities historically record costs according to the Uniform System of Accounts ("USofA"), and otherwise recoup their full costs from "captive customers and guaranteed cost recovery and rates of return."<sup>10</sup> Conversely, merchant generators, due to their unique position in the markets, do not record costs according to the USofA, do not have captive customers, and rely on competitive markets to earn revenue.<sup>11</sup>

The discrepancy in cost recovery between merchant and regulated utilities is further compounded by the fact that while PJM's Schedule 2 Tariff allows payment to generators of reactive power, those payment are subject to the "Commission accepted or approved revenue requirement."<sup>12</sup> Yet the current Commission-approved revenue requirement methodology for

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<sup>8</sup> PJM, Intra-PJM Tariff, Schedule 2.

<sup>9</sup> Petition, p. 1.

<sup>10</sup> Borgatti Affidavit, P 16.

<sup>11</sup> *Id.*, PP18-20.

<sup>12</sup> Schedule 2, Payment to Generation or Other Source Owners.

merchant generators, referred to as the “AEP Methodology,”<sup>13</sup> was established in 1999. There have been no uniformly accepted or approved revenue requirement options for reactive power in PJM over the past 20 years. Merchant generators, instead, have been forced to undertake piecemeal litigation of their reactive power costs through the Commission’s regulatory process, proving a cumbersome, expensive route to achieve just and reasonable recoupment of their costs for supplying this important power in the PJM market. Petitioners, therefore, seek updated guidance and Commission-accepted revenue requirements that may be used by a merchant generator for reactive power, including:

- The use of PJM’s Commission-approved Cost of New Entry (“CONE”) for capital structure and capital cost;
- The inclusion of fixed fuel transportation costs in a reactive power revenue requirement;
- The use of an Engineering, Procurement, and Construction (“EPC”) Contractor’s spreadsheet apportioning project costs among the relevant major equipment categories for merchant generators that acquire a plant from an EPC Contractor;
- The particular itemized indirect cost items accepted in *Chehalis*<sup>14</sup> and *Bluegrass*<sup>15</sup> are recoverable indirect costs under the AEP Methodology;
- The recovery of a reactive power annual revenue requirement based on a generator’s full reactive capability; and
- The use of actual plant load, rather than engineering judgment, to determine the accessory equipment allocation factor.<sup>16</sup>

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<sup>13</sup> *Am. Elec. Power Serv. Corp.*, 88 FERC ¶ 61,141 (1999) (“AEP Methodology”).

<sup>14</sup> *Chehalis Power Generating, L.P.*, 123 FERC ¶ 61,038 (2008) (“Chehalis”).

<sup>15</sup> *Bluegrass Generation Company, L.L.C.*, 121 FERC ¶ 61,018 (2007).

<sup>16</sup> Petition, pp. 1-33.

P3's and EPSA's members include merchant generators that would benefit from the guidance and clarity sought by the Petitioners. Thus, for the reasons stated herein, P3 and EPSA support the Petition and urge the Commission to update the allowable reactive power cost structure for merchant generators.

## II. COMMENTS

P3 and EPSA support the Petitioners' request for guidance and clarity from the Commission on merchant generators' allowable cost recovery for reactive power for several reasons. As an initial matter, providing the requested guidance and clarity is both timely – given that the current reactive power cost recovery guidance for PJM was established 20 years ago – and appropriate, as such guidance supports the Commission's goals in meeting regulatory efficiency for all interested parties subject to the Commission's regulations. Thus, the Commission has recently explained its focus on meeting its goal of ensuring that “rates, terms, and conditions of jurisdictional services are just, reasonable, and not unduly discriminatory or preferential,” by stating that:

One of the Commission's fundamental statutory responsibilities is to ensure that rates, terms, and conditions for wholesale sales and transmission of electric energy and natural gas are just, reasonable, and not unduly discriminatory or preferential. The Commission uses a combination of regulatory and market means to achieve this goal. When competitive markets exist and there are assurances against the exercise of market power, FERC leverages competitive market forces to promote efficiency for consumers. When competitive market conditions do not exist and competitive forces are inadequate to protect consumers, FERC relies on traditional rate-setting authority and tools such as cost-of-service ratemaking. FERC determines the appropriate approach, balancing two important interests: protecting consumers against excessive rates, and providing an opportunity for regulated entities to recover their costs and earn a reasonable return on their investments. Regardless of the approach, the Commission ensures that interested stakeholders have the opportunity to provide their views and that the Commission's ultimate decisions are adequately supported by the evidentiary record.<sup>17</sup>

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<sup>17</sup> *Fiscal Year 2018 Fiscal Agency Report*, November, 2018, Chairman Neil Chatterjee, Federal Energy Regulatory Commission, dated November 6, 2018, p. 5 (emphasis added).

As previously noted, generators are not compensated through PJM’s energy, capacity, or ancillary services markets for providing reactive power. Merchant generators also do not have the ability to recover their costs from state regulators. Therefore, merchant generators are truly dependent upon the Commission setting just, reasonable and updated cost-of-service methodologies for reactive power in PJM’s market. By doing so, the Commission will significantly reduce the piecemeal reactive power litigation inherent upon merchant generators in PJM, but will also ensure that rates are not otherwise “discriminatory”<sup>18</sup> between merchant and state-regulated generators that operate in PJM’s wholesale markets. P3 and EPSA also appreciate that the Petitioners are not requesting a “one-size fits all” cost recovery scheme, similar to that currently available through ISO New England.<sup>19</sup>

An aspect of the petition that P3 and EPSA believe warrants particular focus is return on equity (“ROE”) methodology for reactive power providers. As Petitioners note, because a merchant generator faces significantly greater risk than a transmission owner—which the Commission has acknowledged<sup>20</sup>—a merchant generator requires a different capital structure with a higher cost of debt and a greater ROE than transmission owners. As the Sotkiewicz Affidavit outlines, the use of the Capital Asset Pricing Model (“CAPM”) to generate the ROE and capital structure would be an appropriate way to address this issue, as many owners of merchant generators are not publicly traded and do not pay dividends. Unlike the Discounted Cash Flow (“DCF”) methodology, the CAPM model does not require dividend payments to determine the

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<sup>18</sup> 16 U.S.C. §824d (a)(b).

<sup>19</sup> Reactive Power Requirements for Non-Synchronous Generation, Docket No. RM16-1-000; Order No. 827, Issued June 16, 2016, 155 FERC ¶ 61,277.

<sup>20</sup> *Chehalis*, at P 167.

ROE.<sup>21</sup> As Dr. Sotkiewicz provides, “use of CAPM... offers a better comparison of risk-adjusted ROEs and choices the owners of capital face when deciding to make investments than the DCF methodology of looking at small proxy group of companies within the electric utility sector.”<sup>22</sup>

Merchant generators, similar to state-regulated generators operating in PJM’s markets, are each unique, and their cost recovery will largely be dependent upon the unique specifications and requirements for each specific unit. The Commission has historically recognized generators’ unique needs, and thus, for example, recognized in Order No. 2003-A that the pro forma Large Generator Interconnection Agreement was “designed around the needs of large synchronous generators and that generators relying on newer technologies may find that either a specific requirement is inapplicable or that it calls for a slightly different approach” because such generators “may have unique electrical characteristics.”<sup>23</sup>

P3 and EPSA seek similar allowances in regard to the type of reactive power cost recovery that may be sought. Thus, a certain merchant generator may find that all six of the suggested revenue requirements and cost-based rates sought by Petitioners are necessary to adequately recover their reactive power costs. Or, conversely, a merchant generator may only need to rely upon CONE for its capital cost and structure, as well as fixed fuel transportation costs.<sup>24</sup> The key is that the Petitioners’ seek clarification and direction from the Commission on each of these six

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<sup>21</sup> Affidavit of Dr. Paul Sotkiewicz P. 14.

<sup>22</sup> *Id.* at P.25.

<sup>23</sup> Order No. 2003-A, FERC Stats. & Regs. ¶ 31,160 at P 407 and n.85.

<sup>24</sup> For instance, certain generators need to be able to include natural gas firm transportation costs in fixed operations and maintenance expenses for reactive power purposes. This is an expense that is generally independent of power output but, for plants where dual fuel capability isn’t feasible, it is a required arrangement and expense in providing reactive power service.

requested cost recovery items, any or all of which may be used by a merchant generator. P3 and EPSA support the Petition.

### III. CONCLUSION

For the foregoing reasons, P3 and EPSA request that the Commission consider its comments and provide the requested declarations as contained in the above-referenced Petition.

Respectfully submitted,

On behalf of the PJM Power Providers Group

By: Glen Thomas

Glen Thomas  
GT Power Group  
101 Lindenwood Drive, Suite 225  
Malvern, PA 19355  
[gthomas@gtpowergroup.com](mailto:gthomas@gtpowergroup.com)  
610-768-8080

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Nancy Bagot

Nancy Bagot  
Senior Vice President  
Electric Power Supply Association  
1401 New York Ave, NW, Suite 950  
Washington, DC 20005  
[Nbagot@epsa.org](mailto:Nbagot@epsa.org)  
202-628-8200



**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document on each person designated on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

Dated at Washington DC, this 3<sup>rd</sup> day of June, 2019.

On behalf of the PJM Power Providers Group

By: Laura Chappelle  
Laura Chappelle  
GT Power Group  
101 Lindenwood Drive, Suite 225  
Malvern, PA 19355  
[gthomas@gtpowergroup.com](mailto:gthomas@gtpowergroup.com)  
610-768-8080