



utilize and exhaust all market approaches to procuring the capacity necessary to ensure reliable service in the PJM Region before resorting to out-of-market solutions. The proposed out-of-market approach, if necessary at all after all market approaches have been utilized, must be limited in its use and specifically and clearly confined to the 2015/2016 Delivery Year.

## **I. BACKGROUND**

As outlined in the PJM Filing, recent developments have raised concerns to PJM regarding the level of secured capacity resource commitments it has procured for the 2015/2016 Delivery Year (“15/16 Delivery Year”). In part, the RTO’s concerns are based on the level of capacity consisting of Demand Resources (“DR”) due to risks posed by the 2014 federal appellate court decision in *Electric Power Supply Association v FERC*<sup>3</sup> (“*EPSA v FERC*” or “*EPSA*”), which precludes the participation of supply-side DR in the wholesale energy market as DR is a retail product that is outside of FERC’s jurisdiction over wholesale markets. Mr. Michael J. Kormos, PJM Executive Vice President – Operations states, “[g]iven where we are today, the potential adverse impacts of *EPSA* on Demand Resources simply falls in the category of foreseeable risk,”<sup>4</sup> and that regardless of disagreements over whether or how the *EPSA* decision may be implemented, PJM must address this foreseeable risk. In addition to the concerns over DR, PJM cites expected or announced generation retirements in the 2015/2016 Delivery Year, largely related to environmental regulations that are expected to take effect in 2015. These retirements compound the concern that it will be

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<sup>3</sup> 753 F.3d 216 (D.C. Cir. 2014) (“*EPSA*” or “*EPSA v FERC*”).

<sup>4</sup> PJM Tariff Revisions Filing at P 3.

challenging if not difficult to replace committed capacity resources that may not be available for the 2015/2016 Delivery Year.

Therefore, in light of resource adequacy uncertainties for the 2015/2016 Delivery Year, PJM proposes to revise its tariff, for the 2015/2016 Delivery Year only, as follows:

PJM proposes to add to RPM a provision that recognizes that PJM can enter into out-of-market agreements for targeted capacity commitments for all or part of that Delivery Year, and to establish the costs of such agreements will be recovered from Load Serving Entities – in essentially the same way that out-of-market “make whole” payments to Capacity Market Sellers are currently recovered from Load Serving Entities. Each such agreement will be subject to review and approval by the Commission, but to streamline that process, PJM suggests tariff language to memorialize the standards and considerations for approval of such agreements.<sup>5</sup>

## II. COMMENTS

While resource adequacy concerns and the assurance of the reliable delivery of electricity is a paramount concern, it is also imperative that the system operator of the nation’s largest competitive wholesale power market explore and exhaust all market approaches at its disposal, even in unique situations. According to its Tariff Filing, PJM believes that resource adequacy for the 2015/2016 Delivery Year represents just such a unique situation. PJM recounts several factors going in to the 2015/2016 Delivery Year that have created or added to this concern, including the *EPSA v FERC* decision and its impact on demand resources as participants in wholesale markets. As has been addressed in several recent proceedings before the Commission, the *EPSA v FERC* decision vacates Order No. 745,<sup>6</sup> a rule that had required independent system

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<sup>5</sup> PJM Tariff Revisions Filing at P 4.

<sup>6</sup> *Demand Response Compensation in Organized Wholesale Energy Mkts.*, Order No. 745, FERC Stats. & Regs. ¶ 31,322 (“Order No. 745”), *on reh’g*, Order No. 745-A, 137 FERC ¶ 61,215 (2011), *reh’g denied*, Order No. 745-B, 138 FERC ¶ 61,148 (2012).

operators and regional transmission organizations to pay demand response providers for energy at the full locational marginal price (“LMP”), with no offset for the avoided cost of the retail energy purchase. Based on the reasoning of the U.S. Court of Appeals for the D.C. Circuit in the *EPSA v FERC* decision<sup>7</sup> FirstEnergy Service Company filed a complaint with the Commission arguing that the decision applies with equal force to RPM and other capacity markets as it does to energy markets.<sup>8</sup> EPSA agrees that the legal rationale for the finding that the Commission lacks jurisdiction over compensation for DR in energy markets applies with equal or greater weight in capacity markets.<sup>9</sup>

In this context, and without presuming or prejudging the outcome of either the pending appeals of *EPSA v FERC* or the disposition of the related FirstEnergy Complaint, PJM has acknowledged the “foreseeable” risk that DR resources going forward will be legally and rightfully barred from participating in wholesale energy and capacity markets. Mr. Kormos explained,

The possibility for the *EPSA* court’s mandate to issue this spring, with ensuing developments at the Commission both on *the FirstEnergy Complaint* and on remand from *EPSA*, could at a minimum create considerable uncertainty in the market on the status of those Demand Resources, and their ultimate ability to obtain compensation, and in the

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<sup>7</sup> In relevant part, the decision found that the Commission lacks jurisdiction to regulate “demand response.” (*EPSA*, 753 F.3d at 220) Noting that the Commission’s regulations set forth just a “single definition of ‘demand response’” (*Id.* citing 18 C.F.R. § 35.28(b)(4) (2012)), the D.C. Circuit rejected the notion that reductions in consumption can be considered “wholesale sales” and thus subject to the Commission’s jurisdiction (*Id.* at 220-224). The D.C. Circuit held that “[d]emand response – simply put – is part of the retail market. It involves *retail* customers, their decision whether to purchase *at retail*, and the levels of *retail* electricity consumption.” (*Id.* at 223 (emphasis in original)) While the Commission enjoys broad discretion to regulate “practices affecting the wholesale market,” the D.C. Circuit explained, it may “not directly regulat[e] a matter subject to state control, such as the retail market.” (*Id.* at 222. *See also id.* at 224 (“Because [Order No. 745] entails direct regulation of the retail market – a matter exclusively within state control – it exceeds the Commission’s authority.”))

<sup>8</sup> *See FirstEnergy Service Co. v. PJM Interconnection, L.L.C.*, Docket No. EL14-55-000, Complaint of FirstEnergy Service Company, (May 23, 2014); Amended Complaint of FirstEnergy Service Company, (September 22, 2014) (filed in the same proceeding) (“FirstEnergy Complaint”).

<sup>9</sup> Comments of the Electric Power Supply Association, *FirstEnergy Service Co. v. PJM Interconnection, L.L.C.*, Docket No. EL14-55-000 (filed October 22, 2014), available at [www.epsa.org](http://www.epsa.org).

worst case could effectively nullify that compensation and the associated commitments during all or part of the summer when those resources are most needed.<sup>10</sup>

As that outcome is possible if not likely, PJM has developed contingency measures and approaches to account for possible or foreseeable changes to their DR resource commitments.<sup>11</sup> Doing so is both prudent and necessary, as only just last week (January 15, 2015) the U.S. Solicitor General filed a petition for writ of *certiorari* with the United States Supreme Court asking it to review aspects of the *EPSA v FERC* decision. Supreme Court review of the case is discretionary and by no means assured. On the expected schedule, the Court is likely to decide whether or not to take the case before the beginning of the 15/16 Delivery Year.

PJM cites several factors as creating uncertainty about certain committed capacity resources going into the 2015/2016 Delivery Year. EPSA does not intend to question PJM's assessment. Based on that premise, the tariff revisions proposed are in part another contingency tool developed by PJM to address short term resource adequacy uncertainties - those related to *EPSA v FERC* as well as several others, as described in the filing (including expected environmental regulations and resultant retirements).

Notably, the proposed tariff changes have been offered concurrently with a request for waiver submitted by PJM on the same day as the instant filing which seeks to waive (solely as to the upcoming Third Incremental Auction ("IA") for the 2015/2016

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<sup>10</sup> PJM Tariff Revisions Filing at P 2.

<sup>11</sup> See for example PJM white paper, "The Evolution of Demand Response in the PJM Wholesale Market," issued October 6, 2014, available: <http://www.pjm.com/~media/documents/reports/20141007-pjm-whitepaper-on-the-evolution-of-demand-response-in-the-pjm-wholesale-market.ashx>.

Delivery Year) provisions of its OATT that require PJM to release prior capacity commitments in the IA based on reductions to the Reliability Requirement for the PJM Region due to a decrease in the final peak load forecast for that Delivery Year (“Waiver Filing”).<sup>12</sup> The waiver of its tariff would allow the RTO to retain rather than release approximately 2,000 MW of previously committed capacity, which PJM states is needed based on the same resource adequacy uncertainties enumerated in the instant proceeding. As indicated in its separate comments on the Waiver Filing, EPSA does not oppose that approach as a short term and limited tool with less market distorting effects than the instant tariff revisions which allow out-of-market contracts.<sup>13</sup> While both proposals submitted by PJM are intended to be short term, time limited approaches to address foreseeable risks to the level of available committed capacity for the 2015/2016 Delivery Year, the instant out-of-market capacity contract approach raises far greater concerns and in the least should only be considered if and when *first* all market mechanisms and approaches have been used, and *second* the aforementioned waiver allowing the retention of 2,000 MWs has been utilized. It is not clear from the Tariff Filing whether that is (or will be) the case; any filing from PJM for approval of an out-of-market contract pursuant to the instant tariff provisions should demonstrate that these other tools have been utilized and exhausted. Further, if the Waiver Filing is approved and PJM has been allowed to retain nearly 2,000 MWs of capacity which is over and above its Reliability Requirement based on a lower final peak load forecast for 2015/2016, that must be taken in to account when PJM assesses the need to seek or

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<sup>12</sup> *PJM Interconnection, L.L.C.*, Docket No. ER15-738-000 (filed December 24, 2014) (“PJM Waiver Filing”), at P 5.

<sup>13</sup> Comments of the Electric Power Supply Association, *PJM Interconnection, L.L.C.*, Docket No. ER15-738-000 (filed January 14, 2015), available at [www.epsa.org](http://www.epsa.org).

sign out-of-market contracts, and the Commission considers approval of such contracts, to fill in as capacity going in to the Delivery Year.

Should the contemplated out-of-market contracts be utilized, and separately approved by the Commission on a contract-by-contract basis, PJM should ensure that those out-of-market capacity resources offer in to the energy market on an emergency basis so that they are dispatched last and set a market price reflective of a shortage or scarcity situation. These resources, which have not and did not plan to participate as capacity resources for the 2015/2016 Delivery Year, are resources that would be relied upon to forestall shortage or scarcity conditions. Therefore they must be priced as such so that they do not artificially suppress energy prices for all other resources. Ensuring these units are properly priced is critical to the integrity of the market and energy price formation, as has been emphasized during the Commission's examination of these very issues in wholesale energy and ancillary services markets over three detailed workshops last fall.<sup>14</sup> As the Commission considers broad action or reforms pursuant to that examination, it must also ensure that individual proceedings support these price formation principles and in particular do not interfere with or artificially suppress needed price signals in wholesale energy markets.

To that end, these out-of-market resources should be priced at scarcity levels and set the market price when functioning in that role.<sup>15</sup> These pricing concerns raise

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<sup>14</sup> *Price Formation in Energy and Ancillary Services Markets Operated by Regional Transmission Organizations and Independent System Operators*, Docket No. AD14-14-00); Uplift Workshop, held September 8, 2014; Shortage Pricing, Offer Price Mitigation, and Offer Price Caps Workshop, held October 28, 2014; and Operator Actions Workshop, held December 9, 2014. See [www.ferc.gov](http://www.ferc.gov).

<sup>15</sup> *Staff Analysis of Shortage Pricing in RTO and ISO Markets*, FERC staff paper issued in Docket No. AD14-14-000, October 2014, "A failure to properly reflect in market prices the value of reliability to consumers and operator actions taken to ensure reliability can lead to inefficient prices in the energy and ancillary services markets leading to inefficient system utilization, and muted investment signals," at P 1, <http://www.ferc.gov/legal/staff-reports/2014/AD14-14-pricing-rto-iso-markets.pdf>.

complicated questions regarding PJM's proposed tariff revisions and whether it is a viable or workable approach to procuring capacity for the imminent Delivery Year. Again, these generators did not plan to stand ready as capacity resources, and many did not intend to be supplying energy going into the 2015/2016 Delivery Year. Therefore, what costs will be recoverable in energy market offers? Will it be sufficient to utilize these resources? Can after the fact cost assessments akin to that which occurs for Reliability Must Run ("RMR") contracts develop prices that sufficiently compensate these units? Importantly, the out-of-market contracts that are the subject of this proceeding differ from RMR contracts in that they will function as bulk system resource adequacy resources, whereas RMR arrangements address local reliability problems and therefore may be subject to different pricing approaches. There is a host of questions that should be addressed before market participants can be confident that this out-of-market approach is workable, much less not distortive to the competitive market.

More broadly on the impacts to the competitive market, EPSA and many others, including the Commission, have noted in other proceedings that out-of-market contracts distort the wholesale competitive market and suppress overall prices paid to needed generation resources.<sup>16</sup> Such effects are presented even in circumstances in which a system operator has deemed some type of RMR contract necessary in light of local reliability concerns. In certain situations, however, near term reliability concerns have warranted such short term contracts to ensure local reliability.

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<sup>16</sup> *Bridgeport Energy, LLC*, 118 FERC ¶ 61,243 at P 41 (2007) (stating that RMR mechanisms RMR-type agreements should be used only as a "last resort," because they "suppress market-clearing prices and deter investment in new generation"); *Midwest Indep. Transmission Sys. Operator, Inc.*, 109 FERC ¶ 61,157 at P 291 (2004) (approving an RMR-type mechanism as "a limited, last-resort measure").

That said, the out-of-market contracts negotiated pursuant to the proposed tariff provisions pose concerns for all market participants as they will rely on uplift payments to the out-of-market resources. As explained in the filing,

[N]ew [tariff] section 5.14(b-1) states that the costs of any payments made pursuant to such agreements shall be collected pro rata from all LSEs, based on such LSEs' Daily Unforced Capacity Obligations.... This cost recovery for "out-of-market" resource costs also tracks the cost recovery presently allowed under section 5.14 for other "out-of-market" payments, such as make-whole payments for certain Capacity Resources.<sup>17</sup>

The negative impact of uplift payments has been well documented before the Commission, both in presentations at the September 8, 2015 workshop "Uplift in Energy and Ancillary Services Markets Workshop,"<sup>18</sup> and in the Commission's white paper on the issue, the August 2014 "Staff Analysis of Uplift in RTO and ISO Markets."<sup>19</sup>

These numerous concerns in mind, the possibility that out-of-market approaches or mechanisms could creep beyond the 2015/2016 Delivery Year is unpalatable. In this circumstance, the proposed contracting approach may be deemed to address a short term and unique situation. Since issuance of the *EPSA v FERC* decision, PJM has considered possible impacts and their timing pursuant to the expected outcome of the ongoing litigation. EPSC is confident that the *EPSA v FERC* decision will be upheld and

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<sup>17</sup> PJM Tariff Revisions Filing at P 11.

<sup>18</sup> Uplift in Energy and Ancillary Services Markets Workshop, Docket No. AD14-14-000, September 8, 2014, transcript and presentations available: <http://www.ferc.gov/EventCalendar/EventDetails.aspx?ID=7424&CalType=%20&CalendarID=116&Date=09/08/2014&View=Listview>.

<sup>19</sup> *Staff Analysis of Uplift in RTO and ISO Markets*, FERC staff paper issued in Docket No. AD14-14-000, August 2014, "Regardless of the underlying causes of uplift, a failure to make the causes transparent and to price them into the energy and ancillary services markets can undermine the effectiveness of price signals and efficient system utilization, and mute investment signals. Volatile uplift charges may also create financial uncertainty for customers, depress liquidity and reduce market efficiency," staff paper at P 2, <http://www.ferc.gov/legal/staff-reports/2014/08-13-14-uplift.pdf>

that the court's jurisdictional reasoning precludes DR from participating as a supply-side resource in capacity markets. PJM, therefore, is correctly developing contingency plans for that outcome, regardless of its perspective on the decision, as Mr. Kormos explains,

We can reasonably foresee a scenario in which the Supreme Court decides this spring not to review *EPSA*, and FERC concludes, in light of *EPSA*, that it also lacks authority to order compensation for end-users that commit through the wholesale market to reduce peak electricity consumption.... And if that scenario does unfold, then the important point from a resource adequacy perspective is that it could effectively negate or nullify the Demand Resource commitments on which the PJM Region is now depending to ensure reliable service to loads beginning in just over five months.<sup>20</sup>

As *EPSA* noted in a previous proceeding in which PJM moved forward with transition provisions for certain demand resources affected by previously approved RPM changes,<sup>21</sup> both PJM and the Commission should continue to develop contingency plans for demand response participation in order to prepare markets for possible outcomes from the *EPSA v FERC* litigation. That said, the final details of any such contingency plans matter greatly. First and foremost such plans must be workable and consistent with the economic integrity of competitive wholesale markets.

Should there be a finding that the instant out-of-market contracting approach is a necessary last resort to deal with short term resource concerns in the 2015/2016 Delivery Year, *EPSA* urges the Commission to explicitly and definitively confine the tariff revisions, as well as the related waiver request, to that time period. Even though each out-of-market contract developed pursuant to these tariff provisions will be filed with FERC for comment by interested parties and assessment by the Commission to ensure

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<sup>20</sup> PJM Tariff Revisions Filing at P 3.

<sup>21</sup> Comments of the Electric Power Supply Association, *PJM Interconnection, L.L.C.*, Docket No. ER15-135-000 (filed October 22, 2014), available at [www.epsa.org](http://www.epsa.org).

that they are just and reasonable and have been arranged pursuant to the tariff, as PJM notes, the tariff language itself has been proposed to streamline the out-of-market contracting mechanism. Such tariff language cannot proliferate beyond the defined time period which presents concerns affecting previously committed Capacity Resources and the ability to replace them. Further, acceptance of the requested tariff revisions in this proceeding should not set a precedent or expectation that the tariff rules dictating capacity procurement or capacity release parameters are fungible based on varying resource conditions year to year.

### III. CONCLUSION

**WHEREFORE**, for the foregoing reasons, EPSA respectfully requests that the Commission consider these comments in developing its Order on the PJM Filing.

Respectfully submitted,



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Dated: January 20, 2015

**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., January 20, 2015.

A handwritten signature in cursive script, appearing to read "N. Bagot", is positioned above a horizontal line.

Nancy Bagot, VP of Regulatory Affairs