

121 FERC ¶ 61,173
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

PJM Interconnection, L.L.C.

Docket Nos. ER05-1410-005
EL05-148-005

ORDER DENYING REHEARING

(Issued November 15, 2007)

1. In this order, the Commission denies rehearing of an earlier rehearing order¹ in dealing with a settlement filed by PJM Interconnection, L.L.C. (PJM) and PJM market participants concerning PJM's Reliability Pricing Model (RPM) program. We again affirm our finding that the RPM program produces just and reasonable rates for capacity in PJM.

I. Background

A. Initiation of RPM

2. As discussed extensively in our June 25 Order and prior orders in this proceeding,² based on a section 206 filing by PJM, the Commission found that PJM's capacity market as it existed prior to RPM was unjust and unreasonable, because it failed to procure sufficient capacity in local areas to enable PJM to fulfill its obligation to maintain a reliable transmission system.³ To address this upcoming capacity problem, on August 31, 2005, PJM filed, with many of its customers, a proposed settlement

¹ *PJM Interconnection, L.L.C.*, 119 FERC ¶ 61,318 (2007) (June 25 Order).

² See June 25 Order, 119 FERC ¶ 61,318, at P 5-15; see also *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331 (2006) (December 22 Order) and *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079 at P 9-17 (2006) (April 20 Order).

³ April 20 Order, 115 FERC ¶ 61,079, at P 1-6.

establishing the RPM market mechanism. PJM proposed a capacity market under which capacity sellers would offer, and PJM would purchase, capacity on a multi-year forward basis through an auction mechanism, and that prices for capacity would be derived through these forward auctions. Additionally, the RPM mechanism provided that different locations within PJM might have different prices, if necessary to reflect the amount of capacity that it would be necessary to acquire within each location. Under RPM, the offers submitted into each locally defined market determine a single clearing price for all capacity (*i.e.*, the highest-priced offer accepted by PJM sets the price for all the capacity that PJM purchases).

3. On December 22, 2006, the Commission approved, with certain conditions, the RPM settlement.⁴ Requests for rehearing of the December 22 Order were filed on January 22, 2007. In the December 22 Order, the Commission addressed issues raised by the PJM Industrial Customer Coalition (PJMICC) in its rehearing request, regarding the question of whether RPM constituted a true market. PJMICC stated that "[t]he Commission recognizes that RPM is an administrative mechanism, but inexplicably stops short of providing the customer protections and safeguards required under cost-of-service regulation," and asserted that this "hybrid market/cost-of-service approach to resource adequacy is an unexplained departure from Commission policy in favor of market solutions."⁵ PJMICC further argued that the Commission did not make the necessary findings to justify permitting market-based rates for sales of capacity under RPM, including a finding that RPM would produce a competitive market for capacity. PJMICC stated that:

Unless and until the Commission finds that a competitive market for capacity exists under RPM (which it cannot do under the parameters approved in the December 22 Order), the Commission has no alternative but to align sellers' revenue opportunities with demonstrated, transparent, and actual net costs. Likewise, because a single-clearing price mechanism attains legitimacy only in the context of a demonstrably competitive market, the single-clearing price mechanism has no justification in the RPM context.⁶

⁴ See December 22 Order, 117 FERC ¶ 61,331, at P 1.

⁵ January 22 rehearing petition at 13-14, footnotes omitted.

⁶ *Id.* at 15, footnotes omitted.

4. PJMICC asserted that, if the Commission could not demonstrate that the PJM capacity market was truly competitive, it would be erroneous to permit price-setting mechanisms such as market-based rate authority for sales of capacity, and a single-clearing price mechanism.⁷ PJMICC asserted that, if the Commission could not demonstrate that RPM was a competitive market, it would be required to return to cost-based ratemaking, and that under recent caselaw, the continuation of market-based ratemaking in PJM is unlawful.⁸

5. In its June 25 Order, the Commission responded to several rehearing requests along the same lines as that filed by PJMICC.

In approving new rate design initiatives, the Commission must rely on economic theory and evidence as to how rate designs will perform. In this case, RPM is based on the premise that competition in properly designed geographic markets will produce just and reasonable prices. Since RPM combines locational pricing with the three-year forward procurement and the Variable Resource Requirement, it will improve reliability and lower overall costs to consumers. The evaluation done by [PJM's witness] Dr. Hobbs showed that over the long run overall consumer costs (energy and capacity) would be lower under RPM than under the current vertical demand curve and that reliability would be greater. To ensure that prices remain competitive RPM includes procedures to mitigate the exercise of market power.⁹

6. The Commission noted that the actual prices generated through RPM would depend on market conditions that would differ at different times and in different locations. It acknowledged that:

⁷ *Id.* at 19.

⁸ *Id.* at 20, citing *Farmers Union Cent. Exchange, Inc. v. FERC*, 734 F.2d 1486, 1501-03 (D.C. Cir. 1984), *Interstate Natural Gas Ass'n v. FERC*, 285 F.3d 18, 34 (D.C. Cir. 2002); *Public Utility District No. 1 of Snohomish County v. FERC*, 471 F.3d 1053 (9th Cir. 2006) (*Snohomish PUD*), cert. granted sub nom. *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1*, 76 U.S.L.W. 3154 (U.S. Sept. 25, 2007) (Docket No. 06-1457).

⁹ *Id.*, footnotes omitted.

[F]or some period of time capacity prices in areas with reliability problems and less cost effective generation, such as New Jersey, will be higher than in areas with a surfeit of capacity. But such higher prices reflect the scarcity of capacity in those areas and will provide an incentive for the entry of more cost effective generation, transmission, or demand response resources that will serve to lower price. Indeed, in such capacity constrained areas, energy prices under the current vertical demand curve are likely to be higher, and customers could be subject to paying deficiency charges for failing to procure sufficient capacity or making Reliability Must Run payments to cover the capital costs of retaining inefficient generation that would otherwise retire. Thus, even if capacity prices may increase in capacity constrained areas, those areas will benefit in the long run from increased entry, transmission construction, and demand response.¹⁰

7. Finally, the Commission stated:

We disagree with PJMICC that the Settlement does not include necessary safeguards against market power. As PJM notes, the Settlement includes mitigation measures to protect against the exercise of market power, and it is thus unnecessary to engage in the wholesale revocation of market-based rate authority to PJM sellers that PJMICC seems to suggest. With such mitigation in place, the Commission finds that market-based prices derived from the auctions using a single-clearing price mechanism under the Settlement will be just and reasonable.¹¹

B. July 25 Petition for Rehearing

8. PJMICC, the Maryland Office of the People's Counsel (MD OPC) and the District of Columbia Office of the People's Counsel (DC OPC) (collectively, the PJMICC Group) filed a timely request for rehearing of the June 25 Order.

¹⁰ *Id.* at P 192.

¹¹ *Id.* at P 195.

9. The PJMICC Group states that the June 25 Order "acknowledges, but does not engage"¹² PJMICC's earlier argument that RPM is not a competitive market, and that the Commission's refusal to engage this issue has allowed capacity prices in PJM to increase 20-fold in the preceding three months. The PJMICC Group states:

The heart of the problem continues to be the overlay of market-like functions on physical and practical arrangements that are not capable of supporting dynamic competition. RPM is an administrative revenue-determination mechanism – it is not a competitive market. The Commission should . . . find, as a consequence, that core features of RPM are not just and reasonable.¹³

10. Thus, according to the PJMICC Group, the Commission erred in the June 25 Order by (a) failing to engage the argument that RPM is not a competitive market capable of justifying market-based rate authority for sales through RPM or the use of a single clearing price mechanism, and (b) presuming, without substantial evidence or proof, that RPM is a competitive market and that sellers' market-based rate authority for sales of capacity into the RPM construct is lawful.¹⁴

11. The PJMICC Group argues that the Commission failed to engage its argument that "the Settlement mistakenly presumes that a competitive market will exist,"¹⁵ and therefore, the Commission's rulings in the June 25 Order are not supported by substantial evidence and an explanation between the facts found and the choice made. The PJMICC Group states that, in response to its argument that the Commission must find that RPM is a competitive market before enabling market-based rate authority or a single clearing price mechanism, the June 25 Order stated that "the Settlement includes mitigation

¹² July 25 rehearing petition at 1.

¹³ *Id.*

¹⁴ *Id.* at 7.

¹⁵ *Id.* at 9, *citing* June 25 Order, 119 FERC ¶ 61,318, at P 188.

measures to protect against the exercise of market power."¹⁶ The PJMICC Group argues that it was arbitrary and capricious for the Commission to fail to respond meaningfully to this argument, and that the Commission erred by failing to engage in the necessary fact-finding (including an evidentiary hearing) to determine whether RPM is a competitive market prior to implementing it.

12. The PJMICC Group states that the Commission has recently acknowledged its responsibility to make a two-part finding prior to characterizing new pricing mechanisms as competitive markets and before allowing sellers into that mechanism to submit market-based offers.¹⁷ The PJMICC Group states that, in the June 25 Order, the Commission "characterized RPM as many things, but not as an empirically proven competitive market."¹⁸ The PJMICC Group considers this failure to state that RPM is a competitive market to be inconsistent with the Commission's prior orders, and, in light of recent information that the PJMICC Group claims to show the absence of competitive dynamics in the RPM construct, the PJMICC Group urges the Commission to grant rehearing, find that RPM is not a competitive market, and therefore that core features of RPM are not just and reasonable.

13. The PJMICC Group points to statements by the Commission that, it asserts, show that the Commission itself is not certain that the RPM structure will be competitive, and states that the Commission is unable to state that RPM is a competitive market capable of delivering the benefits to customers that would be expected from a competitive market.¹⁹ The PJMICC Group similarly points to statements in the June 25 Order which, it argues,

¹⁶ July 25 petition for rehearing at 10, *citing* June 25 Order, 119 FERC ¶ 61,318, at P 195.

¹⁷ July 25 petition for rehearing at 11, *citing* *Southwest Power Pool*, 116 FERC ¶ 61,289 (2006) (*SPP*).

¹⁸ July 25 petition for rehearing at 12.

¹⁹ *Id.* at 13, *citing* December 22 Order, 117 FERC ¶ 61,331, at P 101 ("[t]here are a number of market design features within RPM that should [the PJMICC Group stresses that this is *should*, not *will*] operate to limit the potential for the exercise of market power" and "there may still be the potential for the exercise of market power, particularly in small, constrained Locational Delivery Areas") and P 138 ("[i]t is our view that the Settlement will allow market forces to operate to incent new entry of generating capacity more effectively than the current capacity market").

acknowledge that RPM will be subject to numerous administrative fixes, and contradict the presumption that RPM is a competitive market.²⁰

14. The PJMICC Group also seeks, as part of its rehearing request, to introduce additional evidence on the way in which RPM has operated, although it recognizes that submitting new evidence on rehearing is prohibited.

C. PJM's Motion to Dismiss

15. PJM filed a motion to dismiss the PJMICC Group's July 25 petition for rehearing. PJM argues that rehearing of an order denying rehearing does not lie, and that the PJMICC Group has conceded that the June 25 Order already denied the request for rehearing of the same issue that it now seeks to reargue. PJM further asserts that the only permissible grounds to allow a request for rehearing of a rehearing order would be if the Commission changed the result of its prior order in a way that adversely affected the rehearing petitioner,²¹ which is not the case here, where the Commission affirmed its prior orders on the issue raised in the July 25 rehearing petition.

²⁰ July 25 petition for rehearing at 14-15, *citing* June 25 Order, 119 FERC ¶ 61,318, at P 99 ("[t]he sloping demand curve is designed to replicate a true market"); P 109 ("[i]n the hypothetical circumstances in which supply does not intersect the demand curve, we view the approach taken here as a reasonable means of ensuring that generators always have an incentive to submit marginal cost bids"); P 111 ("[t]he derivation of the slope of the demand curve is at least in part subjective"); P 118 ("[t]he demand curve would initially be established, in part, based on an administrative determined estimate of the Cost of New Entry"); P 38 ("[t]he purpose of" the price adjustment for new entry "is to provide a new entrant . . . with some assurance that it can recover its costs"); and P 191 ("we cannot be certain that RPM will procure the needed capacity for New Jersey However . . . we see no compelling evidence that this particular auction process will not have adequate participation" and "RPM provides greater certainty that needed capacity will be procured than the status quo [and] is based on the premise that competition in properly designed geographic markets will produce just and reasonable prices" and "[t]o ensure that prices remain competitive RPM includes procedures to mitigate the exercise of market power").

²¹ PJM motion to dismiss at 5, *citing* *Town of Norwood v. FERC*, 906 F.2d 772, 775 (D.C. Cir. 1990).

16. PJM further asserts that the PJMICC Group has ignored the absolute bar on submitting new evidence after rehearing.

D. The PJMICC Group's Answer

17. The PJMICC Group filed an answer to PJM's motion to dismiss, asserting that the Commission's tolling order demonstrates that this proceeding is not over as a matter of law.²² It also reiterates its view that, since the Commission did not engage with the issue raised by PJMICC's original petition for rehearing, the Commission's ruling in the June 25 Order is not the product of a reasoned decision-making process.

II. Discussion

18. The Commission denies PJM's motion to dismiss and will deny PJMICC Group's July 25 petition for rehearing. While the Commission did address PJMICC's rehearing request in the June 25 rehearing order, we did so as part of responding to other similar, but perhaps not identical, rehearing requests. We will therefore use this opportunity to respond more specifically to the issues raised by PJMICC. As discussed below, however, the Commission will not address any of the post-record evidence introduced by PJMICC, because such evidence goes beyond the scope of legitimate rehearing.

A. Rehearing Request Regarding Competitive Markets

19. The crux of the PJMICC Group's argument is that the Commission must find that RPM creates a competitive market for capacity in order to approve the RPM settlement. The PJMICC Group argues that the Commission did not rely on substantial evidence that (a) RPM is a competitive market and (b) sellers' market-based rate authority for sales of capacity into the RPM construct is lawful. As discussed below, we disagree that the RPM settlement will result in rates that are not just and reasonable.

20. Under the Federal Power Act (FPA), the Commission is not bound to a particular ratemaking methodology in setting rates as long as rates fall within a zone of reasonableness,²³ *i.e.*, the rates are neither less than compensatory to the seller nor

²² On August 24, 2007, the Commission issued an order granting rehearing for the purpose of further consideration.

²³ *FPC v. Hope Natural Gas*, 320 U.S. 591, 602 (1944) ("[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling"); *Permian Basin Area Rate Cases*, 390 U.S. 747, 776-777 (1968) (*Permian Basin*) ("rate-making agencies are not bound to the service of any single regulatory

excessive to the consumer.²⁴ In addition, the “zone of reasonableness” may take into account all relevant public interests, both existing and foreseeable.²⁵ These public interests may appropriately include non-cost factors, such as the need to stimulate additional investment.²⁶

formula; they are permitted, unless their statutory authority otherwise plainly indicates, 'to make the pragmatic adjustments which may be called for by particular circumstances,'" citing *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)).

²⁴ *Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 692-93 (1923) (“[a] public utility is entitled to such rates as will permit it to earn a return . . . equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties”).

²⁵ *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1501 (D.C. Cir. 1984) (*Farmers Union*) (“Congress delegated ratemaking authority to FERC in broad terms. Accordingly, ‘the breadth and complexity of the Commission’s responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties’” *Permian Basin Area Rate Cases*, 390 U.S. [at 790]. In arriving at a just and reasonable rate, “no single method need be followed.” *Wisconsin v. FPC*, 373 U.S. 294, 309, 10 L. Ed. 2d 357, 83 S. Ct. 1266 (1963). Indeed, and more specifically, FERC is not required “to adhere ‘rigidly to a cost-based determination of rates, much less to one that base[s] each producer’s rates on his own costs.’” *FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 517, 58 L. Ed. 2d 773, 99 S. Ct. 765 [(*Pennzoil Producing Co.*)] (1979) (quoting *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 308, 41 L. Ed. 2d 72, 94 S. Ct. 2328 [(*Mobil Oil*)] (1974))”).

²⁶ While the court in *Farmers Union* found that the Commission had failed to demonstrate that its ruling in the underlying orders would, in fact, stimulate new investment, the court acknowledged that such “non-cost factors may legitimate a departure from a rigid cost-based approach.” *Farmers Union*, 734 F.2d at 1502, citing *Pennzoil Producing Co.*, 439 U.S. at 518; *Mobil Oil*, 417 U.S. at 308.

21. In permitting market-based rates in its regulation of electric markets, there are two approaches the Commission has used to ensure that rates are just and reasonable: either a finding that an individual seller and its affiliates lack or have mitigated market power in a particular market; or a finding that a particular market is competitive or yields competitive results. Since the mid-1980's, the Commission's approach in the electric area has been primarily to rely on an analysis of individual seller market power and this approach was recently affirmed in the Commission's 2007 market-based rate rule.²⁷ In addition, with regard to rates for sales within Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs), even if sellers have been found to lack market power on an individual seller basis, the Commission has relied on a blend of market and cost-based elements, e.g., some form of cost cap or mitigated bids, to ensure just and reasonable rates.²⁸

22. The Commission has previously considered a similar argument (that the Commission must find that a market is competitive before it can permit market-based

²⁷ *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252 (2007).

²⁸ See Order No. 697 at P 952, footnotes omitted ("[i]n the market-based rate program adopted in this rule and through other Commission actions, . . . the Commission is not relying solely on the market, without adequate regulatory oversight, to set rates. . . . In addition, for sellers in RTO/ISO organized markets, Commission-approved tariffs contain specific market rules designed to prevent or mitigate exercises of market power"). At the time the Commission approved the tariffs for ISO New England, the New York Independent System Operator, and PJM, it applied mitigation procedures in markets administered by those organizations, and incorporated those procedures in the RTO/ISO tariffs so as to apply to all sellers in the RTO/ISO administered markets. See *New England Power Pool*, 85 FERC ¶ 61,379 (1998); *Central Hudson Electric & Gas Corp.*, 86 FERC ¶ 61,062 (1999); *Atlantic City Electric Co.*, 86 FERC ¶ 61,248 (1999).

See also *AEP Power Marketing, Inc.*, 109 FERC P 61,276 (2004), *reh'g denied*, 112 FERC P 61,320 at P 23 (2005) (after finding that AEP passed the generation market power screening test in PJM, the Commission also noted that "RTOs such as PJM with Commission-approved market monitoring and mitigation provide a check on the exercise of generation market power"), *aff'd sub nom. Industrial Energy Users-Ohio v. FERC*, No. 05-1435, 2007 U.S. App. LEXIS 3661, at *2 (D.C. Cir. Feb. 16, 2007) (noting that "the Commission adequately considered and responded to petitioner's arguments") (unpublished).

rates) with regard to the Midwest Independent Transmission System Operator (MISO), and rejected it. We stated:

The Commission rejects MISO Industrial Customers' argument that, as a prerequisite to reliance upon market-based rate pricing to produce just and reasonable rates, the Commission must, in addition to finding that applicants lack or have adequately mitigated market power, make a separate and independent finding that a competitive market exists. . . . We . . . incorporate by reference the Commission's discussion in its final rule on market-based rates (Order No. 697 [at P 943-71]) of the legality of its approach to market-based rates. The Commission's long-established approach involves assessing whether a seller lacks market power, which includes an assessment of seller-specific market power. This approach, combined with the Commission's filing requirements and ongoing monitoring, allows the Commission to ensure that market-based rates remain just and reasonable. Additionally, for sellers in RTO/ISO organized markets, the Commission has in place market monitoring and mitigation rules to mitigate the exercise of market power, including price caps where appropriate, and the Commission also uses RTO/ISO market monitors to help oversee market behavior and market conditions.

. . . .

With regard to MISO Industrial Customers' argument that the Midwest ISO is required to submit "empirical" proof that the [ancillary services market] will constitute a competitive market as required by *Farmers Union*, we deny rehearing on this issue. MISO Industrial Customers misread *Farmers Union*. This case holds that the Commission may rely on non-cost factors in setting just and reasonable rates but that the Commission may not rely on largely undocumented market forces as the principal means of rate regulation. Further, *Farmers Union* holds that the Commission must have in place sufficient monitoring to ensure that rates remain within a zone of reasonableness. The Commission's market-based rate program does not rely on undocumented market forces, nor does it lack monitoring. . . . Sellers are also subject to market power mitigation rules approved by the Commission. In addition, market monitoring by both the RTO/ISO market monitors and by the Commission help ensure that rates remain within a zone of

reasonableness. Thus, the Commission's market-based rate program is fully consistent with *Farmers Union*.²⁹

23. In the case before us, the Commission is faced with the non-cost factor of ensuring that sufficient capacity is procured and reliability is maintained in the PJM region. Further, not only is every jurisdictional seller in the capacity market required to have individual seller market-based rate authorization (based on a demonstration that it lacks horizontal and vertical market power), but it is also subject to mitigated bids and market monitoring to ensure that rates in PJM remain within a zone of reasonableness. This is in full accord with the Commission's statutory obligation.³⁰ Under the RPM mechanism, PJM holds an auction in which generators submit bids to supply capacity in local areas. PJM uses those bids to create a supply curve that is overlaid onto a sloped demand curve (also known as a Variable Resource Requirement, or VRR, curve) to determine the price of capacity. As discussed in the December 22 Order, RPM enhances competition as compared with the existing capacity market used in PJM.³¹ RPM encourages new entry of generation resources, because the generator will know three years in advance the prices it will receive for capacity, and therefore assisting its ability to obtain financing. RPM also enhances the capacity market by allowing transmission and demand response to participate in the capacity market, thus further increasing the number of suppliers.

24. We conclude that prices in RPM will be just and reasonable because mitigation measures will constrain sellers to submit bids that prevent the exercise of market power, with the result that prices will approximate those of a competitive market. In evaluating RPM, neither PJM and the stakeholders, nor the Commission, relied on competition alone

²⁹ *Midwest Independent Transmission System Operator, Inc.*, 120 FERC ¶ 61,202 at P 9, 12 (2007), *appeal pending sub nom.*, *Coalition of Midwest Transmission Customers v. FERC*, 7th Cir. No. 07-3592 (filed Oct. 26, 2007).

³⁰ *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) ("when there is a competitive market the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable' result").

³¹ December 22 Order, 117 FERC ¶ 61,331 at P 6, footnotes omitted ("The Settlement includes a number of design features that discourage the exercise of market power and market manipulation generally. Specific mitigation rules and increased competition from new entry are the most important design elements in this regard. Additionally, since this market design is anticipated to decrease price spikes, it is likely to provide fewer incentives for sellers to exercise market power by withholding supply from the market").

to ensure that the rates created by RPM were just and reasonable. Rather, RPM contains a variety of measures to mitigate bids in circumstances in which there is the potential for the exercise of market power by generators. The VRR curve that is used to set prices creates a price ceiling at 1.5 times the cost of new entry. But even further, RPM employs the three pivotal supplier test (already accepted in the energy market) to determine for each geographic area in each auction whether market power can be exercised.³² If this screen is failed, the PJM market rules apply bid caps based on the seller's avoidable cost, which is the bid level that would be expected from a seller that lacks market power. Thus, the bid caps ensure that market power cannot be exercised. Additionally, whenever the market power screens are failed, bids of new generation capacity that exceed specified levels, and that are not justified to the satisfaction of the PJM Market Monitoring Unit (MMU) and the Commission, are excluded from the auction. Thus, contrary to the claim by the PJMICC Group, the market power tests and mitigation measures contained within RPM will ensure that offers are mitigated to prevent the exercise of market power. Mitigation ensures competitive market results, and thus, just and reasonable prices.

25. The Commission notes that PJM already provides on its website significant information to assist stakeholders in assessing the competitiveness of the market, including the results of each Base Residual Auction for each Delivery Year and updates from the following incremental auctions, the supply curves for each Locational Deliverability Area (without revealing the identity of any individual bidder), the amount of new generation that cleared the auctions, an estimate of the amount of capacity that postponed retirement as a result of the auctions, and information regarding participation by demand response and transmission participation, the PJM entities that chose the Fixed Resource Requirement, and the total the amount of capacity procured.³³ See, for

³² The three pivotal supplier test examines whether competition exists in a load pocket defined by transmission constraints. PJM defines a "pivotal supplier" as one whose output is required to meet relevant load. A pivotal generator may exercise market power, because its output is essential for PJM to meet capacity requirements in that transmission limited area. A generation resource's offers are not capped when its offers combined with the two largest other generation suppliers are not pivotal. PJM tariff, Attachment K-Appendix, section 6.4.1(e). Further, more than one supplier can be pivotal at any given time, if the output of any supplier or combination of suppliers is required to meet load affected by that transmission limit. Four or more jointly pivotal suppliers are considered competitive, as are zero pivotal suppliers. See *PJM Interconnection, LLC*, 119 FERC ¶ 61,318, at P 135 n.129 (2007).

³³ See June 25 Order at P 209.

example, <http://www.pjm.com/markets/rpm/downloads/2009-2010-base-residual-auction-results.pdf>. Additionally, PJM's market monitor analyzes the structure and performance of RPM capacity markets through its State of the Market Report (the first of which will be issued in 2008), as well as through market structure screens posted on PJM website: <http://www.pjm.com/markets/rpm/downloads/20071001-pmss-results-2010-2011.pdf>.

26. The PJMICC Group complains that RPM may lead to higher prices in local areas. It is true, as the Commission recognized, that "for some period of time capacity prices in areas with reliability problems and less cost effective generation . . . will be higher than in areas with a surfeit of capacity."³⁴ But this short-term outcome "reflect[s] the scarcity of capacity in those areas and . . . provide[s] an incentive for the entry of more cost effective generation, transmission, or demand response resources that will serve to lower price" in the longer term.³⁵ The existence of high prices due to scarcity does not establish that generators are exercising market power or that prices are unjust and unreasonable. As discussed above, the mitigation measures in RPM are designed to protect against the exercise of market power and to help assure reasonable prices.

27. The PJMICC Group maintains that the Commission's action in approving RPM is inconsistent with its decision in *SPP*³⁶ where the Commission made a finding that the market was competitive before approving market-based rates for an energy imbalance service. In *SPP*, the Commission found that the SPP imbalance market is competitive in the absence of transmission constraints, and that SPP's mitigation measures and monitoring plan are sufficient to protect customers from the exercise of market power that might occur in the energy imbalance market when transmission constraints bind.³⁷

28. But *SPP* is not inconsistent with our holding in RPM. In RPM, the Commission did not perform an analysis of competition "in the absence of transmission constraints," because RPM mitigates the effects of transmission constraints in determining capacity prices. The three pivotal supplier test included in RPM is a competitive market analysis

³⁴ June 25 Order, 119 FERC ¶ 61,318, at P 192.

³⁵ *Id.*

³⁶ *Southwest Power Pool*, 116 FERC ¶ 61,289 (2006).

³⁷ *Id.* at P 30.

that examines whether market power potentially exists when transmission constraints are taken into account.³⁸

29. Moreover, as the Commission found in *SPP*, the Commission finds that the PJM monitoring and mitigation procedures are sufficient to protect customers from the exercise of market power. As the Commission stated in *SPP*:

the Commission's obligation is to assure that rates are just and reasonable for buyers and sellers. The mitigation measures, as well as the monitoring plan, are key to enhancing the competitive structure of the market and assuring that prices are properly reflective of supply and demand conditions in the short-term and long-term. The Commission must find the appropriate balance between over-mitigation and under-mitigation in mitigating offers into the imbalance market. While under-mitigation may result in some exercise of market power that is not mitigated, over-mitigation means more frequent intervention in the market, and some competitive markets will be mitigated. We find that *SPP*'s mitigation measures, as supported by the monitoring plan, strike an appropriate balance that will result in just and reasonable rates and enable reliable provision of imbalance service.³⁹

30. Similarly here, the Commission finds that RPM is just and reasonable, because of the presence of market mitigation mechanisms that will enable the Commission and the PJM MMU to ascertain when offer prices are the result of market power, mitigate those offers as appropriate, and protect customers from the exercise of market power.

31. PJMICC argued on rehearing of the December 22 Order, and the PJMICC Group argues in this rehearing, that until the Commission finds that a competitive market for capacity exists under RPM, the Commission has no alternative but to align sellers' revenue opportunities with demonstrated, transparent, and actual net costs. But the Federal Power Act does not require that prices be set through cost of service regulation, rather than through a single-pricing clearing mechanism. The Supreme Court has held that "Far from binding the Commission, the "just and reasonable" requirement accords it broad ratemaking authority" ..., and "the just and reasonable standard does not compel

³⁸ See fn. 28, *supra*.

³⁹ 116 FERC ¶ 61,289 at P 17.

the Commission to use any single pricing formula”⁴⁰ In *Federal Power Commission v. Texaco, Inc.*, the Court held “that every rate of every natural gas company must be just and reasonable does not require that the cost of each company be ascertained and its rates fixed with respect to its own costs.”⁴¹

32. The purpose of the single price auction accepted in RPM is to produce rates that parallel those of a competitive market and the mitigation requirements for bids ensure that such rates are just and reasonable. In the December 22 Order, the Commission stated that:

We disagree with New Jersey Rate Counsel, whose argument in essence seeks a return to cost-based ratemaking under which the price each resource receives is solely a function of its costs. In a competitive market, prices do not differ for new and old plants or for efficient and inefficient plants; commodity markets clear at prices based on location and timing of delivery, not the vintage of the production plants used to produce the commodity. Such competitive market mechanisms provide important economic advantages to electricity customers in comparison with cost of service regulation. For example, a competitive market with a single, market-clearing price creates incentives for sellers to minimize their costs, because cost-reductions increase a seller’s profits. And when many sellers work to minimize their costs, competition among them keeps prices as low as possible. While an efficient seller may, at times, receive revenues that are above its average total costs, the revenues to an inefficient seller may be below its average total costs and it may be driven out of business. This market result benefits customers, because over time it results in an industry with more efficient sellers and lower prices. By contrast, sellers have far weaker incentives to minimize costs under cost-of-service, because regulation forces a seller to reduce its prices when the seller reduces its cost.⁴²

⁴⁰ *Mobil Oil Exploration v. United Distribution Co.*, 498 U.S. 211, 224 (1991).

⁴¹ 417 U.S. 380, 387 (1974)

⁴² December 22 Order, 117 FERC ¶ 61,331 at P 141.

33. Thus, the market design used in RPM will result in just and reasonable prices that approximate those resulting from a competitive market, while at the same time protecting against the potential exercise of market power.

B. Introduction of New Evidence

34. The Commission rejects the PJMICC Group's rehearing request based on new evidence outside the scope of the record in this proceeding. Relying on evidence outside the record is inappropriate, because it denies to other parties the due process rights to address that evidence. As the Commission has made clear, allowing new evidence on rehearing presents a moving target and eliminates the need for finality to proceedings.⁴³ As the Supreme Court has stated:

If upon the coming down of the order litigants might demand rehearings as a matter of law because some new circumstance has arisen, some new trend has been observed, or some new fact discovered, there would be little hope that the administrative process could ever be consummated in an order that would not be subject to reopening.⁴⁴

35. Although the PJMICC Group cites to two Commission decisions accepting new evidence in rehearing requests, those cases are not in the same procedural posture as this case and are inapposite.⁴⁵ Both of the orders to which the PJMICC Group cites involved a situation where PJM had included additional evidence in its first rehearing request. In these cases, the Commission had not yet put into place a regulatory framework for a

⁴³ See *New York Independent System Operator*, 112 FERC ¶ 61,283 at P 35 n. 20 ("parties are not permitted to raise new evidence on rehearing. To allow such evidence would allow impermissible moving targets"), citing *Entergy Nuclear Operations, Inc., Entergy Nuclear Indian Point 2, L.L.C., Entergy Nuclear Indian Point 3, L.L.C. v. Consolidated Edison Company of New York, Inc.*, 112 FERC ¶ 61,117 at P 39 (2005)); see similarly *Ocean State Power II*, 69 FERC ¶ 61,146 at 61,548 n. 64 (1994) ("The Commission generally will not consider new evidence on rehearing, as we cannot resolve issues finally and with any efficiency if parties attempt to have us chase a moving target").

⁴⁴ *ICC v. Jersey City*, 322 U.S. 503, 514 (1944).

⁴⁵ *PJM Interconnection, LLC*, 108 FERC ¶ 61,187 at P 50 (2004); *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,105 (2004).

particular market (in that case, the market created by the entry of Commonwealth Edison Company into PJM). Further, in these cases, the new evidence was proffered in the first request for rehearing, and the Commission reopened the proceeding to permit other parties an opportunity to respond to that evidence. Indeed, the Commission recognized that admitting new evidence even on a first rehearing was “exceptional,” and rejected attempts to introduce further evidence in filings subsequent to the first rehearing request.⁴⁶

36. For these reasons, we find it inappropriate to reopen this proceeding to consider the additional evidence put forward by the PJMICC Group.

The Commission orders:

The PJMICC Group's request for rehearing is denied.

By the Commission

(S E A L)

Kimberly D. Bose,
Secretary.

⁴⁶ 108 FERC ¶ 61,187 at P 50-52.