119 FERC ¶ 61,280
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

PJM Interconnection, L.L.C. Docket Nos. ER07-508-000
ER07-508-001

ORDER REJECTING TARIFF AND OPERATING AGREEMENT FILING

(Issued June 15, 2007)

1. On February 2, 2007, PJM Interconnection, L.L.C. (PJM) filed revisions to its Amended and Restated Operating Agreement (Operating Agreement) and Open Access Transmission Tariff (OATT) pursuant to section 205 of the Federal Power Act[1] (FPA). These revisions would eliminate participation by Day-ahead Locational Marginal Price-based contract customers in the Day-ahead Economic Load Response Program. In this order, we reject PJM's revisions because we find that PJM has not sufficiently justified changing its provisions for this year.

Background

2. On June 1, 2002, PJM instituted an Economic Load Response Program (Economic Program) in the Real-time and Day-ahead Energy Markets under which, during periods of high wholesale prices and scarcity, PJM compensates Economic Program participants who voluntarily choose to reduce consumption. The Real-time and Day-ahead Economic Programs provide a mechanism by which qualified Load Serving Entities (LSE) or Curtailment Service Providers[2] (CSP) offer end-use customers the opportunity to commit to a reduction of load in real time or in advance of operations and receive payments based on the Real-time or Day-ahead locational marginal prices (LMP), respectively, for the reductions. The program was to remain in effect until December 1, 2004. In September

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[1] 16 U.S.C. § 824 *et seq.*

[2] A Curtailment Service Provider is a PJM Member that acts on behalf of end-use customers (Non-Members) who wish to participate in PJM Load Response Programs.

of 2004, PJM sought an extension for the Economic Program through December 31, 2007. The Commission granted the request on October 29, 2004.[3]

3. The Economic Program also includes an incentive to end-use customers to enhance the ability and opportunity for reduction of consumption when PJM LMPs are high. When the LMP is lower than $75/MWh, demand responders receive the LMP price net of generation and transmission charges. When the market price is above $75/MWh, demand responders get paid the full LMP (without the reduction for the energy commodity). When the LMP exceeds $75/MWh, the cost of the full LMP payment, or incentive, is socialized among the LSEs within the zone of the Economic Program participant.

4. In 2006, the Commission granted a PJM request to make the Economic Program permanent.[4] In the same proceeding parties challenged the continued use of the incentive. PJM opposed changes to the incentive at that time, saying that retaining the incentive would allow PJM and its stakeholders more effectively to assess the success of the Economic Program; however, the incentive was not included among the permanent provisions of the Economic Program. Currently, under the terms of the PJM OATT and Operating Agreement, the incentive portion of the Economic Program will terminate on December 31, 2007, absent PJM submitting a section 205 filing to extend the duration of the incentive program.

Notice of Filings and Responsive Pleadings

5. Notice of PJM's filing was published in the *Federal Register*, 72 Fed. Reg. 6,558 (2007), and 72 Fed. Reg. 24,284 (2007), with interventions, answers and protests due on or before February 23, 2007. Timely motions to intervene were filed by NRG Companies, ELCON, and Exelon Corporation. A motion to intervene and comments were filed by PJM Industrial Customer Coalition (PJMICC). Motions to intervene and protest were filed by the Steel Manufacturers Association (Steel Manufacturers) and by Gerdau Ameristeel Corporation (Gerdau). Mittal Steel USA, Inc. filed a motion for leave to intervene one day out of time. On March 13, 2007, a motion for leave to answer and answer was filed by PJM. On March 27, 2007, Gerdau filed an answer and limited response.

6. Commission Staff sent PJM a deficiency letter on April 3, 2007, asking for additional information and analysis of the impacts of Day-ahead LMP customers on the Day-ahead Economic Program.

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[3] Unpublished Letter Order issued in Docket No. ER04-1193-000.

[4] *PJM Interconnection, LLC*, 114 FERC ¶ 61,201 (2006).

7. On April 18, 2007, PJM submitted an amendment to the initial filing containing responses to the Commission's requests. Notice of the amendment was published in the *Federal Register*, 72 Fed. Reg. 24,284 (2007), with interventions, answers and protests due on or before May 9, 2007. Gerdau filed a timely supplement to its initial protest.

Filings and Protests

A. PJM's Filing

8. PJM proposes to eliminate from participation in the Day-ahead Economic Program those customers holding Day-ahead LMP-based contracts,[5] citing approval from stakeholders who endorsed the proposal. PJM states that it makes the instant filing to address the problem of entities engaging in activity using PJM's Demand Response market access to benefit without providing the demand reduction benefits that the program was designed to produce. PJM alleges that CSPs are submitting Day-ahead demand reduction bids on behalf of Day-ahead LMP customers solely to obtain the incentive paid when the Day-ahead LMP equals or exceeds $75/MWh, whether or not they intend to consume energy. PJM believes this behavior is inconsistent with the purpose of the Economic Program.

9. PJM states that Day-ahead LMP customers should not receive the incentive payment, because these customers already receive the proper signal to reduce load from the LMP price. PJM contends that there would be no reason for these customers to participate in the Day-ahead Economic Program absent the incentive payment for LMPs above $75/MWh. PJM states that these customers already have access to and receive the LMP, and that consequently allowing the incentive for these types of transactions constitutes a double payment.

B. Comments and Protests

10. Gerdau alleges that PJM's proposal to eliminate participation by Day-ahead LMP customers is not just and reasonable, and is an overly broad remedy to an unsubstantiated problem. Gerdau contends that PJM overlooks reliability and cost savings benefits, including more efficient dispatch and scheduling of less generation on a day-ahead basis. Gerdau states that its participation in the Economic Program allows it to lower the strike price at which it would curtail, and this has LMP-lowering benefits for other customers. Gerdau also maintains that the Economic Program provides large industrial Day-ahead LMP customers such as itself with the ability to link hours for a continuous curtailment or payment for a load reduction, thereby improving day-ahead planning for production, and making curtailment cost effective by facilitating shut-downs lasting more than one

[5] PJM states that Day-ahead LMP customers would still be able to participate as self-scheduled or PJM-dispatched demand resources in the Real-time Energy Market.

hour at a time. This in turn, according to Gerdau, obviates the need to respond to real-time pricing, which reduces efficiency and imposes additional costs on participants.

11. Gerdau maintains that PJM's proposal is fundamentally unfair to Day-ahead LMP customers currently participating in the Economic Program. Gerdau relates that in February, 2006 it negotiated, along with its CSP and at considerable cost of time and resources, amendments to the agreements governing its participation in the Economic Program. The terms of the agreement, according to Gerdau, concerned how Gerdau would submit reduction bids into the Day-ahead Market on behalf of its New Jersey load. Gerdau alleges that preclusion of its participation under the agreements as currently structured would be unfair, would likely shake customer confidence in PJM's commitment to demand response, and have an adverse effect on investment and participation in demand response programs.

12. ELCON and the PJMICC express support for Gerdau's protest in the proceedings. ELCON, PJMICC and the Steel Manufacturers take issue with PJM's characterization of the stakeholder process leading to adoption of PJM's proposal. They argue that certain PJM Members opposed the proposal to restrict Day-ahead LMP customer participation. ELCON and the Steel Manufacturers join Gerdau in claiming that ten end-use customer sector representatives objected to the proposed revisions at the September 28, 2006 Members Committee Meeting.

13. Gerdau is joined by PJMICC in urging the Commission to reject the "double recovery" argument, as the Commission has found that the value of load reductions during peak periods would have significant impacts on LMP prices in PJM. Gerdau and PJMICC state that the value of system benefits created by load reduction may significantly exceed the value of the incentive payments. PJMICC contends this finding was validated during the heat wave of August, 2006, when demand responders received $5 million in compensation in exchange for $650 million in energy cost savings.

14. ELCON maintains that PJM's proposal does not treat demand response symmetrically with other resources, which should be priced on the same basis as a generator. ELCON objects to PJM's inference that some industrials might game the Economic Program by making offers in the Day-ahead Energy Market but not following through in the Real-time Market. ELCON states that PJM ignores the fact that the PJM Market Monitor is charged with monitoring such behavior.

15. The Steel Manufacturers maintain that PJM's premise for the proposal is faulty, and revisions to the Economic Program should not be approved. The Steel Manufacturers believe that PJM's theoretical argument that customers receiving the day ahead hourly LMP require no further incentive to reduce load misses the point. The Steel Manufacturers state that PJM is once again raising concerns that current rules permit demand reduction bids whether or not the parties intend to consume energy. The Steel

Manufacturers contend that to the extent any load revises or adapts planned down time to correspond better to high LMPs, the load is engaging in the type of price-responsive behavior the Economic Program was designed to promote.

C. PJM Answer

16. PJM responds that its proposal is just and reasonable, and not discriminatory. PJM argues that participation in the Day-ahead Economic Program by Day-ahead LMP customers is both inefficient and inequitable and should be prohibited because their participation distorts and games the market in a “manner akin to paying subsidies for wash trading.” PJM points to the testimony of its Market Monitor to support this allegation. PJM maintains that “the success, continuing evolution and support of its demand response programs depend on the integrity of the programs which contain subsidization and socialization elements that must be effective and free from criticism that such programs amount to corporate welfare.” PJM states that it has the majority support of its stakeholders in this view, and further risks losing support for the demand response program if the incentive is allowed to continue.

17. PJM counters arguments that the Commission in the past rejected PJM’s rationale for prohibiting LMP customers from participating in the Economic Program. PJM states that the Commission agreed with PJM’s justifications, but found countervailing factors that warranted allowing LMP customer participation under limited circumstances. PJM argues that it is implicit that should the factors no longer control, thus making participation unfeasible, PJM should be able to prohibit Day-ahead LMP customer participation.

18. PJM also responds to Gerdau’s argument that access to the day-ahead component of the Economic Program incentive enhances its ability to mitigate business risks. PJM argues that the structure of Gerdau’s retail rate already provides the necessary economic incentive to adjust its operations.

19. PJM states that Gerdau should have been aware of its ongoing efforts to eliminate the loophole in the market rules. PJM maintains that prior to the discussions with Gerdau to amend its agreements, the issue was generally known and was made clear in the stakeholder meetings, as were PJM’s intentions to file rule changes to prohibit the activity. PJM states that given the rules at that time, however, it nevertheless entered into negotiations with Gerdau. PJM again states that the proposal was fully vetted in the stakeholder process, and that the objections of ten end-use Customer Sector representatives could not have affected the endorsement by a majority. PJM urges the Commission not to discount the outcome of the stakeholder process.

D. Gerdau Answer

20. Gerdau contends that PJM makes assertions regarding customer behavior that are not supported by the record. In its answer Gerdau argues that what PJM alleges to be a "loophole" is in fact an established component of demand response programs in the New York Independent System Operator (NYISO) and the Independent System Operator of New England (ISO-NE). Gerdau contends that NYISO places no limitation on LMP-based contract customer participation in the Day-ahead Market. Gerdau likewise alleges that ISO-NE allows any participant in real-time programs to participate in day-ahead programs.

E. Deficiency Letter

21. On April 3, 2007, the Commission issued a Deficiency Letter requesting further support for several of PJM's assertions, including, (1) clarification of the claim that there is no demand benefit if the Day-ahead LMP customers submitted demand reduction bids in the Day-ahead Energy Market; (2) the difference between incentive payments for the Day-ahead and Real-time Energy Markets; and (3) substantiation for the implication that Day-ahead LMP customers were gaming the system.

22. PJM responds to the Commission's information requests by reiterating its view that load reductions that are not based on the economics of a situation provide no benefits to the system and result in double payments. PJM acknowledges that the customer does curtail as a result of an accepted demand reduction bid and that there may be less load on the system, but insists there is no net load reduction and no net demand response. PJM then explains that it only considers demand response benefits to be those that result from "economically rational" demand response, and behavior resulting from the inducement of an incentive is "economically irrational," and thereby distorts efficient price signals and undermines efficient market activity and investment.

23. PJM provides information in response to the Commission's request for a cost/benefit analysis of incentive payments and reliability or market benefits. PJM's information scrutinized ten days out of thirty-nine between March and August of 2006 when Day-ahead LMP customers' bids were accepted in the Day-ahead Economic Program. PJM took no position on absolute cost/benefit outcomes, but rather continues to argue that economically irrational demand response provides no benefits. The filing also provides detailed explanations of how the Economic Program works when third parties act on behalf of entities that are not members of PJM, when bilateral agreements govern participation and methods of settlement.

24. Gerdau faults PJM's response to the deficiency letter as incomplete. Gerdau asserts that PJM has overlooked real-time benefits flowing from Day-ahead LMP customer participation, as well as environmental benefits. Gerdau states that PJM only focused on single-zone impacts and ignored potential benefits outside a particular zone.

Gerdau also states that PJM did not respond to the Commission's questions on reliability and market benefits in the deficiency letter. Finally, Gerdau states that PJM's examples in the deficiency letter response are confusing, and no example directly captures the Gerdau arrangement.

25. Gerdau rejects PJM's assertion that Day-ahead LMP customers provide no benefit in the Economic Program. It continues to reject PJM's proposal as elevating economic theory over reality, and denies that Day-ahead LMP customers' sole motivation to participate in the program is due to the incentive or that there is double payment. Gerdau insists there are additional benefits to the system resulting from its participation, including providing demand response and the associated benefits in a more predictable way, in particular as it relates to hourly pricing.

Discussion

A. Procedural Matters

26. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Given the early stage of this proceeding, the absence of any undue prejudice or delay, and their interest in this proceeding, we grant the untimely, unopposed motion to intervene. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to an answer or protest unless otherwise ordered by the decisional authority. We will accept the answers filed by PJM and Gerdau as they have assisted us in the decision-making process.

B. Commission Determination

27. We reject PJM's OATT and Operating Agreement revisions that would exclude Day-ahead LMP customer participation in the Day-ahead Economic Program. We find that PJM has not provided sufficient support to terminate the incentive program at this time for one set of customers that made financial arrangements based on the expectation that this program would continue.

28. As the parties argue, they had a reasonable expectation under the tariff to make arrangements for demand response at least up until December 31, and relied on that fact in expending time and resources to negotiate new agreements. PJM has not sufficiently justified terminating the program early for only this one set of customers, the Day-ahead LMP customers.

29. PJM conceded in its answer to the deficiency letter that its proposal was not based on the failure of customers to perform under the program. PJM has acknowledged that

Day-ahead LMP customer demand bids do reduce consumption, and therefore assist in taking energy off the system at peak periods.

30. Finally, we recognize that the incentive program is scheduled to expire at the end of this year. If PJM and its stakeholders wish to continue the incentive program beyond 2007, they will have the burden of justifying its justness and reasonableness. At that time, we will review any such filing based on the merits and evidence presented in that proceeding.

31. For the foregoing reasons, we find that PJM has not sufficiently justified its filing and we reject it.

<u>The Commission orders:</u>

The revisions are hereby rejected.

By the Commission. Commissioner Moeller concurring with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
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PJM Interconnection, L.L.C. Docket Nos. ER07-508-000
ER07-508-001

(Issued June 15, 2007)

MOELLER, Commissioner, concurring:

Upon review of the record, I am concerned that PJM's Economic Load Response Program ("ELRP") has not been operating as intended. As described by PJM in its filings, and supported by its Market Monitor, Dr. Joseph E. Bowring in his written testimony, the ability of certain customers to execute complementary transactions in the same day-ahead energy market may result in these participants collecting a load response incentive payment that is not deserved.

As a strong supporter of competitive markets and demand response programs, I believe that the ultimate goal of a properly functioning demand response program is to replicate the price signal to the customer that would exist if the customer was fully exposed to the locational marginal price ("LMP"). However, until demand response programs in the electricity markets mature to a stage where customers will make rational economic decisions to reduce load based on the LMP, I agree with the PJM Market Monitor's testimony that "the success, continuing evolution and support of [PJM's] demand response programs depend on the integrity of the programs which contain subsidization and socialization elements that must be effective and free from criticism that such programs amount to corporate welfare."

Under PJM's existing program, LMP customers do not necessarily require an incentive payment since their decision to reduce load can be based on the hourly LMP. However, customers with fixed price contracts who are insulated from the wholesale price, may need (and deserve) the encouragement of an ELRP incentive payment to reduce its load. As such, I question the design of programs that allow for certain customers who are exposed to the LMP to receive such incentives – because ultimately, it is other customers and LSEs who bear the cost of these incentive payments.

In my deliberation of this record, I considered the fact that PJM's filing received substantial support of its stakeholders, and I am respectful of the stakeholder process. However, despite my reservations concerning the continuance of the ELRP in its current form, I also recognize that certain customers have made financial arrangements based on the expectation that this program would run until its expiration on December 31, 2007. As such, in balancing the equities, I reluctantly conclude that the ELRP should be permitted to continue for the duration of this year so as not to upset the reliance placed by the majority of customers who are using the ELRP in an appropriate manner.

For these reasons, I respectfully concur with the Commission's order.

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Philip D. Moeller
Commissioner