

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

January 27, 2006

In Reply Refer To:
Docket Nos. ER04-539-005
ER04-539-006
ER04-539-007

Attention:
Barry S. Spector, Esq.
Carrie L. Bumgarner, Esq.
Wright & Talisman, P.C.
1200 G Street, N.W.
Suite 600
Washington, D.C. 20005

Dear Mr. Spector and Ms. Bumgarner:

1. PJM Interconnection, LLC (PJM)'s Operating Agreement (Operating Agreement) and Open Access Transmission Tariff (OATT) currently enable PJM to mitigate the market power of certain generators by capping their offers to sell energy under particular conditions. If PJM determines that, due to limits on transmission capacity, a generating unit may be dispatched out of economic merit order, that generator's offers are capped.¹ However, the Operating Agreement and OATT also provide that when generators are dispatched out of economic merit order due to constraints on particular transmission interfaces (the Western, Central and Eastern reactive limits in the classic PJM control area), they are not offer capped, on the basis that sufficient competition exists on each side of these constraints to prevent any generator from acquiring market power when the constraint develops.

2. Following PJM's recent expansion, the Commission instituted an investigation in Docket No. EL04-121-000 under section 206 of the Federal Power Act to determine "whether PJM has identified the appropriate triggers for offer[] capping mitigation in the control areas of" the new PJM members, and required PJM to provide an analysis of whether "constraints on the major transmission interfaces into and/or out of Allegheny Power (Allegheny), Commonwealth Edison (ComEd), American Electric Power (AEP),

¹ PJM Operating Agreement, section 6.4 and PJM OATT, section 6.4.

Dayton Power and Light Company (DP&L) and others, such as Dominion Virginia Power (VEPCO) should also trigger offer capping as those companies move into PJM."² In the same August 10 Order, the Commission found that there was sufficient competition to justify a temporary exemption from offer capping for the ComEd control area when the 500 MW pathway between the Northern Illinois Control Area (NICA) and PJM was constrained from west to east, and directed PJM to amend its Operating Agreement and OATT accordingly.³

3. On September 9, 2004, in Docket No. ER04-539-005, PJM submitted for filing amendments to its Operating Agreement and OATT to include an exception to PJM's offer-capping rules for the aforementioned NICA pathway when the pathway is constrained from west to east. The Commission will accept this filing as compliant with the August 10 Order.

4. On October 26, 2004, in Docket No. ER04-539-006, PJM filed a request to eliminate offer capping for the NICA pathway, explaining that the pathway no longer exists due to the integration of AEP into PJM and that the need for offer capping due to constraints on the pathway has now become moot. In the same filing, in compliance with the Commission's August 10 order, PJM submitted a report of the PJM Market Monitor regarding offer capping of major transmission constraints, and amendments to its Operating Agreement to revise its offer capping rules to provide that (a) PJM will exempt the APS South interface⁴ from its offer capping rules, and (b) PJM will conduct annual analyses of transmission constraints and, if warranted, will include additional exemptions from its offer capping rules.

5. On February 4, 2005, in Docket No. ER04-539-007, PJM submitted responses to questions provided to it by the Commission by letter dated January 15, 2005, with regard to its October 26, 2004 filing.

6. By order dated April 18, 2005, the Commission established a hearing into the issues raised in these filings in Docket No. EL04-121-000.⁵ The Commission stated in the April 18 Order that it could not determine whether the provisions in PJM's tariff for mitigation of out-of-merit calls on generation for reliability in the control areas of the new PJM companies were just and reasonable. The Commission directed the Presiding Judge to hold resolution of the three-pivotal supplier test in abeyance in Docket No.

² *PJM Interconnection, LLC*, 108 FERC ¶ 61,187 (2004) (August 10 Order) at P 72.

³ August 10 Order at P 66.

⁴ The APS South interface lies between pre-expansion PJM and the Allegheny Power control area.

⁵ *PJM Interconnection, LLC*, 111 FERC ¶ 61,066 (2005) (April 18 Order).

EL04-121-000 until it had determined how to proceed on that issue in another proceeding, Docket No. EL03-236-006. In a July 5, 2005 Order, the Commission consolidated and set for hearing Docket No. EL03-236-006 with the ongoing hearing in EL04-121-000.⁶ This hearing resulted in a settlement agreement filed by PJM on November 17, 2005.

7. In an order issued concurrently with this order (PJM Interconnection LLC, Docket Nos. EL03-236-006 and EL04-121-000 (Settlement Order)), the Commission is accepting an uncontested settlement which includes revisions to the OATT and Operating Agreement which, *inter alia*, provides that (a) in addition to exempting from offer capping the Western, Central, and Eastern reactive limits now effective in the Mid-Atlantic Area Council (MAAC) Control Zone, PJM will exempt the APS South Interface from offer capping; (b) on a quarterly basis, the PJM Market Monitoring Unit will evaluate whether additional interfaces should also be exempt and whether existing interface exemptions should be terminated; (c) to make this determination, the PJM Market Monitoring Unit shall use an analysis no less stringent than the three pivotal supplier test; and (d) any change in the exempt status of the interface shall become effective upon acceptance by the Commission.

8. Because the issues addressed by the PJM filings in Docket Nos. ER04-539-006 and ER04-539-007 have been resolved by the Settlement Order, the Commission will reject the tariff sheets filed by PJM in Docket No. ER04-539-006 and dismiss the proceedings in Docket Nos. ER04-539-006 and ER04-539-007 as moot.

By direction of the Commission.

Magalie R. Salas,
Secretary.

cc: All Parties

⁶ *PJM Interconnection, LLC*, 112 FERC ¶ 61,031 (2005).