

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher.

PJM Interconnection, LLC

Docket No. ER04-539-001
ER04-539-002
EL04-121-000

ORDER ON REHEARING AND COMPLIANCE FILING

(Issued August 10, 2004)

1. In this order, the Commission grants in part and denies in part requests for rehearing of an order on market mitigation measures for the Northern Illinois Control Area (NICA) proposed by PJM Interconnection, LLC (PJM),¹ and accepts a compliance filing related to that order. We are also instituting an investigation in Docket No. EL04-121-000 pursuant to section 206 of the Federal Power Act (FPA) to determine whether the existing tariff provision providing for an exemption from mitigation for generators in particular control areas needs to be revised in light of the expansions of the PJM system. This order benefits customers because it ensures the imposition of only those market mitigation measures that are required to prevent the exercise of market power.

I. Background

2. On May 1, 2004, Commonwealth Edison Company (ComEd), located in northern Illinois, transferred operational control of its transmission facilities to PJM. This is part of a process by which the four New PJM Companies (American Electric Power Service Corporation (AEP), Dayton Power and Light Company (DP&L), Dominion Virginia Power (VEPCO or Dominion) and ComEd) will eventually join PJM. ComEd is on the opposite side of "classic PJM" from AEP, and AEP will not integrate its facilities into

¹ PJM Interconnection, LLC, 106 FERC ¶ 61,277 (2004) (March 24 Order).

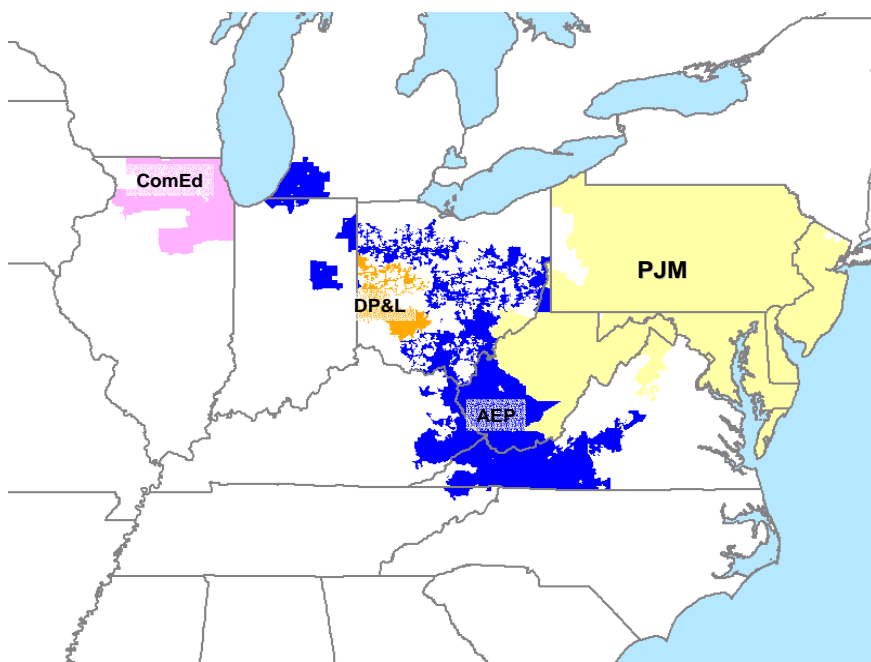
PJM until October 1, 2004.² Thus, until AEP is integrated into PJM, transmission between the ComEd market area (Northern Illinois Control Area or NICA) – *i.e.*, transmission from generators in NICA to customers in PJM, or from generators in PJM to customers in NICA – is taking place by means of a 500 MW transmission reservation pathway across AEP's service territory.

3. On February 5, 2004, PJM submitted revisions to its Open Access Transmission Tariff (OATT) that it alleged were necessary to prevent the exercise of market power in both the NICA energy market and the NICA capacity market.

A. Energy Market Issues

4. PJM stated that its market monitoring unit (MMU) analyzed expected market conditions in NICA after the integration of ComEd into PJM, but before the integration of AEP, and concluded that while under most conditions markets would be competitive, market power concerns could arise under two circumstances. When the pathway from PJM to NICA was constrained, lower-cost generation from PJM could not compete with higher-cost generation in NICA; in that circumstance, higher-priced NICA generation

² See *New PJM Companies*, 107 FERC ¶ 61,271 at P 13, n. 21 (2004):



Source: PowerMap

could set the price in NICA. PJM proposed to use its existing authority under section 6.4 of its market rules to cap, at cost, offers from generating units that must run for reliability (RMR units), or otherwise enter into agreements with generators to mitigate market power.

5. PJM did seek new authority, however, to take action in the second circumstance in which it believed market power could be exercised. When there were extreme market conditions in PJM but not in NICA,³ all of the generation in PJM would be sold locally and not be available to compete with NICA generation; thus, NICA generation could set the price in NICA. PJM proposed to add a new subsection (c) to section 6.4.1 of its Operating Agreement to provide that, when extreme conditions exist in PJM and not in NICA,⁴ marginal units in NICA will be offer-capped at marginal cost plus ten percent. In the event this market mitigation measure was imposed, marginal units would receive the greater of their cost-based bids or the NICA market price. PJM also stated that this provision would go into effect on the date that the ComEd zone is integrated into PJM, and would expire on the date that AEP integrates into PJM.

B. Capacity Market Issues

6. PJM stated that the NICA capacity market would initially be non-competitive because one generator owned or controlled more than 50 percent of total capacity in NICA, and that at least two generation owners would be pivotal in the capacity market. The PJM MMU therefore believed that some generators would be able to exercise market power in the NICA capacity market. PJM proposed to add a new section 7 to its Operating Agreement providing that capacity will be offer-capped at \$30 per MW-day, plus any additional amounts that are shown to the MMU's satisfaction to compensate the seller of capacity for its opportunity costs or any other actual annual avoidable incremental costs of selling its capacity into the PJM Installed Capacity Market.

7. PJM stated that the \$30 offer cap was based on estimates of incremental costs or going-forward costs of three broad categories of generation: peaking plants (combustion turbines), mid-merit plants (combined cycle plants) and baseload units (steam units). PJM further stated that its MMU determined that net revenues would cover going-

³ Such "extreme conditions" in NICA would occur when there were high temperatures in the PJM region but not in the Midwest.

⁴ "Extreme conditions" in PJM would occur when the PJM average hourly Locational Marginal Price (LMP) was \$500/MWh or greater.

forward costs for combined cycle and steam units, but would not cover the going-forward costs of combustion turbines, and that the going-forward costs of a combustion turbine would be \$30 per MW-day; thus, if a combustion turbine was the marginal unit, all units that cleared in the market would receive a price based on the capacity costs for a combustion turbine. PJM's proposal also provided generators with the opportunity to justify additional costs to the MMU to ensure that they would not be under-compensated and that it would not post the clearing prices for the market until the MMU screened all the offers and determined that the market was competitive. If the MMU determined that the market was not competitive, PJM would post new procedures for submitting bids and offers.

8. In the event of scarcity conditions (namely, when available capacity in the ComEd zone is less than or equal to 1.01 times the Interim Installed Capacity Requirement, or total load plus reserves in the ComEd zone), PJM proposed to raise the offer cap to \$160 per MW-day. The MMU would also screen capacity offers in the NICA capacity credit markets to ensure that the NICA capacity markets are competitive. PJM proposed to make the capacity market mitigation measures effective beginning on the date that the ComEd zone was integrated into PJM, and concluding on May 31, 2005.

C. Commission's March 24 Order

9. The Commission rejected PJM's filing, as follows.

1. Energy Market Mitigation Proposal

10. We found that the PJM proposal for mitigation in the NICA energy market when the 500 MW pathway from PJM to NICA is constrained did not consider the impact that imports from neighboring regions could have in mitigating market power in NICA. We noted that the 500 MW capacity of this pathway was small relative to the peak load in NICA, which exceeds 20,000 MW, and that PJM did not sufficiently consider the effects on competition in NICA of the much larger transmission capabilities between NICA and its immediate neighbors. PJM failed to support its position that imports provide inadequate competitive discipline, not because they are unavailable, but because they are more costly than energy produced by mid-merit resources within NICA. PJM did not specify the size of the cost difference between imports and NICA's resources. We stated that, while we might agree with PJM that imports provide inadequate competitive

discipline if the supply curve is steep and imports are significantly more expensive than internal NICA generation, imports could provide reasonable competitive discipline if the supply curve was relatively flat and imports were only slightly more costly than internal NICA generation.⁵

11. Also, we found that PJM's analysis of the effects of contracts on competition in the spot market was incomplete. PJM proposed measures to mitigate market power in its spot energy market, but we noted that the incentive of generators to exercise market power in the spot market is reduced or eliminated to the extent that the generators are owned by or contractually committed to buyers outside the spot market. PJM stated that it considered the effects of contracts between ComEd and Edison Mission Energy, *et al.* (the EME Companies) in calculating Herfindahl-Hirschman Index (HHI) concentration statistics, but it was not clear to us how the HHI statistics were calculated, or what portion of the market is covered by these statistics, or how PJM took into account the fact that ComEd, as a buyer, owns generation resources. Thus, we found that the proposed mitigation measures did not adequately consider the competitive effects of (i) generation from adjoining utilities and their ability to mitigate the exercise of market power, and (ii) ownership of, or contracts with, generators by buyers, when the 500 MW pathway is constrained from PJM to NICA. PJM had stated that it would not invoke market mitigation "when the market monitor determines that there are adequate external resources to otherwise mitigate market power,"⁶ but we found that this proposal gave the MMU too much discretion in determining when mitigation measures would apply. We therefore rejected PJM's seller-specific bid cap proposal for extreme conditions without prejudice to a future proposal that either: (1) provided adequate justification for the triggering mechanism proposed in this docket, or (2) proposed a different triggering mechanism for the bid caps and provides an adequate justification for that mechanism.⁷

12. Additionally, PJM had proposed to use the existing provisions of section 6.4 of its tariff to cost-cap units that are dispatched out of economic merit to maintain system reliability as a result of limits on transmission capability. We pointed out that PJM's existing tariff contains an exception to this tariff provision under which units are not

⁵ March 24 Order at PP 28-29.

⁶ Transmittal letter, PJM Application, at 6.

⁷ March 24 Order at PP30-32.

subject to cost-capping for constraints to relieve the Western, Central, and Eastern reactive limits in the PJM control area. We required PJM to file an explanation of why the competitive situation in NICA did not warrant a similar exception from cost capping. We also required PJM to explain whether the cost cap of 110 percent would provide adequate scarcity pricing within NICA.⁸

2. Capacity Market Mitigation Proposal

13. For the period after ComEd's integration into PJM but before AEP's integration, PJM proposed to limit capacity offers to \$30 per megawatt day (except in scarcity conditions, when a \$160 per megawatt day limit would apply), "plus such additional amounts as are shown to the satisfaction of the Market Monitoring Unit to compensate the seller of Capacity Credits for its opportunity costs or any other actual annual avoidable incremental costs of selling Capacity Credits from its Capacity Resource in the PJM Installed Capacity Credit Market."⁹ We found that PJM's proposed rules for the capacity offer cap were not sufficiently clear with regard to the additional amounts added to the initial \$30 per megawatt day cap. We stated that this proposal gave the MMU excessive discretion in determining the level of individual offer caps. Additionally, we found that PJM's proposal to allow the MMU to void the results of the NICA capacity market, if after screening the capacity offers it deemed the capacity market to be non-competitive, similarly gave the MMU excessive discretion.¹⁰

14. Finally, we found that PJM had not persuaded us that its proposed offer cap of \$160 per megawatt day during scarcity periods was reasonable. We noted that while a cap reflecting average costs might be reasonable if it were available to generators in all periods, this proposed cap would be available only during periods of capacity scarcity, and could therefore be too low. We additionally found that, in finding that the capacity market was highly concentrated and capacity sellers would therefore have market power, PJM again did not adequately consider the possibility of importing generation from other control areas as a factor that might prevent the exercise of market power. We rejected PJM's proposal for mitigation of the capacity markets, without prejudice to a future filing that provided adequate support, including an analysis of the effects on competition of all potential sources of capacity.

⁸ March 24 Order at PP33-34.

⁹ PJM Transmittal Letter in Docket No. ER04-539-000 at p. 11.

¹⁰ March 24 Order at PP 35-36.

D. Requests for Rehearing**1. PJM's Request for Rehearing**

15. PJM, in its request for rehearing, requests that the Commission reconsider its decision and permit temporary mitigation of market power in the NICA capacity market. Specifically, PJM asserts that the Commission erred in (1) rejecting PJM's finding that the NICA capacity market is highly concentrated and thus sellers would have market power; and (2) rejecting PJM's proposed \$30/MW-day offer cap, plus appropriate adders. PJM's initial proposal for the NICA capacity market was proposed in a February 5, 2004 filing.

16. PJM argues that its MMU was correct in concluding that the capacity market in NICA was not competitive. PJM argues that use of indicative screens described in a Commission order issued April 14, 2004¹¹ confirms the MMU's conclusion. The PJM market monitor utilized two screens – an uncommitted pivotal supplier analysis and an uncommitted market share analysis – to analyze the competitiveness of the NICA capacity market. PJM asserts that the results of the pivotal supplier analysis showed that no supplier is pivotal in the capacity markets, but the results of the market-share analysis demonstrate that one generation supplier in NICA has more than a 20 percent market share of the NICA capacity market. PJM concludes that this supplier is assumed to have market power, and thus the NICA capacity market is presumptively non-competitive.

17. PJM further argues that the results of the recent NICA capacity auctions were not "characterized by competitive behavior." On April 13, 2004 PJM administered the first capacity auction for the period June 1, 2004 through May 31, 2005. The auction cleared 300 MW at a price of \$24.84/MW-day, below the proposed \$30/MW-day offer cap. The PJM market monitor states that suppliers offered only 11 percent of available uncommitted capacity into the auction, the HHI was high and there were one or more pivotal suppliers in the auction.

18. On April 15, 2004, the second NICA capacity auction was conducted for the period from June 1, 2004 through December 31, 2004. The auction cleared 75 MW at \$29.25/MW-day. PJM states that suppliers offered 7 percent of available non-committed capacity into the auction, the HHI was high and there were one or more pivotal suppliers in the auction.

¹¹ AEP Power Marketing, Inc., 107 FERC ¶ 61,018 (2004) (Market Power Policy Order).

19. On April 20, 2004 the third NICA capacity auction was conducted for the period from June 1, 2004 through September 30, 2004. PJM states that 6 percent of the available capacity was offered into the market, the HHI was even higher than the first two auctions and there was at least one pivotal supplier in the auction. PJM submits that unlike the first two auctions, the third auction cleared above the proposed \$30 offer cap (\$37 per MW-day).

20. PJM argues that the analysis using the indicative screens of the Market Policy Order, which indicates that the NICA capacity market is presumptively non-competitive, and the three NICA capacity auctions, shows that the Commission should accept the proposal to implement a \$30 per MW-day (plus appropriate adders) offer cap as a market mitigation measure for the NICA capacity market.

21. In the March 24 Order, the Commission found that PJM's proposed capacity offer cap was not sufficiently clear, specifically as to any additional amounts added to the initial \$30/MW-day offer cap, and the proposed rules accorded the market monitor excessive discretion in determining the level of individual offer caps. PJM argues on rehearing that rather than rejecting PJM's offer cap proposal, the Commission should have required PJM to make a compliance filing setting forth the costs that could be appropriately added to the \$30/MW-day offer cap. PJM states that participants in the NICA market should have the opportunity to demonstrate that the cost of capacity for specific units is greater than \$30 per MW-day. To address the Commission's concerns about excessive discretion, PJM includes a list of the categories of costs the MMU believes a participant should be permitted to use to demonstrate that its total costs for a particular unit exceed the proposed offer cap. PJM states that the list of costs could be incorporated into the PJM manuals or into the PJM Operating Agreement, through a compliance filing, if the Commission so ordered.

2. Responses to PJM's Rehearing Request

22. The EME Companies; Peoples Energy Services Corp. (Peoples Energy); NRG Power Marketing, Inc., Indian River Power LLC, Vienna Power LLC, Keystone Power LLC, Conemaugh Power LLC, NRG Energy Center Dover LLC, NRG Rockford LLC, NRG Rockford II LLC, and LSP-Kendall Energy LLC (collectively, NRG); Duke Energy North America, LLC and Duke Energy Trading and Marketing, LLC (collectively, Duke); and the Electric Power Supply Association (EPSA) filed responses to PJM's request for rehearing.

23. Peoples Energy urges the Commission to grant PJM's rehearing request. Peoples Energy is primarily concerned with the need for the MMU to impose mitigation in the capacity market. Peoples Energy asserts that the potential for market power abuse is real and should be addressed. Parties also raised the following issues.

a. Market Power Policy Order

24. Duke and EPSA assert that the Market Power Policy Order screens are designed to evaluate whether an individual applicant for market-based rates has market power, and thus the Market Power Policy Order does not support PJM's conclusion that when one supplier is presumed to have market power, the capacity market as a whole is presumptively non-competitive. Duke asserts that any mitigation should be limited to those participants who failed the screens, not the entire market.

b. Auction Results

25. Duke argues that there is no indication that the capacity not made available in the NICA capacity auctions provided any monopoly rents to the entities that did not offer that supply. Duke argues that, at most, the auction results show a consistent differential between the NICA auction and the PJM auction, and that such price movements may be influenced by many factors (*e.g.*, summer prices are higher than twelve month prices). EPSA argues that PJM's capacity proposal could encourage load to fulfill capacity obligations largely or solely on a monthly basis, as load will have the protection of an annual cost-of-service rate during summer months, and will rely on market forces only during the non-summer intervals when capacity is relatively more abundant.

26. The EME Companies argue that PJM's proposed \$30/MW-day offer cap is unnecessary because PJM has already conducted several annual capacity auctions clearing below \$30, indicating competitive behavior. EPSA argues that the NICA auctions held so far demonstrate that buyers are willing to pay in excess of \$30/MW-day during summer months, which EPSA believes reflects buyers' expectations of lower capacity prices in the non-summer months and their willingness to pay higher summer interval prices to compensate. The EME Companies argues that the application of one offer cap across an entire year without regard to seasonal surpluses or deficits in capacity is inappropriate. The EME Companies also disagree with PJM's suggestion that there may have been withholding in the first three NICA capacity auctions. The EME Companies state that there are several other possible reasons for the low participation, including that a significant amount of demand in NICA has traditionally been met through bilateral contracts and, therefore, it is not reasonable to assume great activity in the capacity auction.

c. Continued Discretion

27. Duke and the EME Companies assert that PJM's rehearing continues to grant its MMU far too much discretion in unilaterally determining whether a market participant may benefit from an adder to the \$30/MW-day offer cap. Duke argues that although PJM provides more detail on the cost data that sellers should provide, PJM continues to seek the discretion to administratively determine limit prices. The EME Companies assert that, because PJM excludes costs such as property taxes or costs reflecting operating risk, a participant could never demonstrate its true "to go" costs. The EME Companies also argue that because PJM shifts the burden to participants to demonstrate that the offer cap is too low, PJM's MMU still has unilateral discretion to decide when a participant has made a satisfactory showing.

d. RTO/ISO Membership As a Mitigating Factor

28. EPSA asserts that because of extensive monitoring in RTO/ISO markets, and the Commission's Market Behavior Rules, membership in an RTO/ISO would be a structural remedy to address market power concerns. EPSA also argues that if the MMU suspects anti-competitive behavior such as withholding, it is able to investigate quickly and promptly to determine any reasons for this seemingly irrational behavior.

e. Proposed Offer Cap

29. EPSA, NRG and the EME Companies argue that PJM's \$30/MW-day proposed offer cap does not reflect the competitive market rate, and that PJM does not explain the origin of cost information it used to derive the proposed offer cap. Moreover, in using data derived from recently constructed combustion turbine, PJM excludes data from older peaking units with potentially higher marginal "to go" costs. The EME Companies further argue that, although PJM provides a table of the costs included in its offer cap calculation, it does not include certain essential variable costs that increase generators' "to go" costs – such as property taxes or an additional cost factor reflecting operating risk. The EME Companies state that incorporating such costs into the offer cap almost doubles the appropriate offer to approximately \$54.80/MW-day. Finally, the EME Companies argue that PJM's proposed market design is based on short-term marginal cost caps for long-term capital goods, which, as their witness explains, will make it impossible over the long term for a party to recover its long run marginal costs. Duke adds that should the Commission determine that some form of cost-based mitigation is appropriate for NICA capacity markets, the Commission should not allow a cap below \$160 per MW-day.

f. Demand Curve

30. NRG submits that throughout the country, conditions of oversupply are leading to the rapid and economically rational retirement of facilities. NRG argues that limiting capacity prices to PJM proposed levels would send a continuous signal for capacity to exit the market until reserve shortage conditions are experienced. By contrast, either a higher offer cap, or a deficiency price that gradually declines as available capacity exceeds the minimum requirement, would reduce the incentives for inordinate levels of retirement. NRG contends that a capacity demand curve similar to the New York model would remedy PJM's market power concerns. NRG argues that the demand curve can be designed to support positive cash flow for capacity resources at moderate levels of oversupply and to produce levels of net income for needed resources when the minimum reserve requirement is met. Additionally, NRG argues that the demand curve approach offers far better incentives regarding retirement, investment, and maintenance than that proposed in PJM's rehearing request.

g. \$160/MW-day Offer Cap

31. The EME Companies request confirmation that PJM will not apply a \$160/MW-day offer cap during scarcity conditions. The EME Companies submit that, given the MMU's acknowledgement that scarcity is not an issue for the limited duration of the proposed rules, it appears that PJM in its request for rehearing has sensibly abandoned its earlier \$160/MW-day offer cap proposal. The EME Companies argue that the Commission should accept that representation as binding on PJM.

3. PJM's Answer

32. PJM filed an answer to the responses to its rehearing request, which included new information. As discussed later in the order, the Commission rejects PJM's reply to responses to its rehearing request.

4. Illinois Commerce Commission's (Illinois Commission's) Request for Rehearing

33. The Illinois Commission claims that the Commission made six errors in the March 24 Order. First, it argues that the Commission erred in stating that PJM's market power mitigation trigger is based "solely" on whether the 500 MW pathway from PJM to NICA is congested. The Illinois Commission states that, rather, PJM would not apply market power mitigation only when the 500 MW pathway is congested but rather, PJM would also monitor whether the availability of energy from other control areas adequately disciplines market power. The Illinois Commission also states that the Commission erred

in rejecting PJM's proposal for market power mitigation for NICA under "extreme conditions" in the PJM energy market. The Illinois Commission urges PJM to provide a more detailed analysis of how imports may affect the need for market power mitigation measures within NICA and the types of market power mitigation measures that may be appropriate within NICA. However, the Illinois Commission argues that rather than rejecting PJM's proposed extreme conditions market power mitigation proposal without prejudice, the Commission should have accepted PJM's mitigation measures, subject to replacement, should the additional analysis of imports to be provided by PJM show the initially proposed measures to be inappropriate or unneeded.

34. The Illinois Commission further argues that the Commission erred in its evaluation of energy import capability into NICA. The Commission's order stated that PJM "chose not to consider the impact" that energy imports could have on the NICA market; however, according to the Illinois Commission, PJM's MMU stated that it tested the expected role of imports into NICA. Accordingly, the Illinois Commission requests rehearing of the Commission's statement. The Illinois Commission also requests that the Commission reverse its reliance on the import data provided by the EME Companies' witness, Dr. Shanker, which led the Commission to an inappropriate rejection of all proposed energy market mitigation measures

35. With regard to capacity market issues, the Illinois Commission urges the Commission to either reinstate the rejected capacity market mitigation measures or direct PJM to submit replacement measures to become effective prior to ComEd's integration into the PJM. The Illinois Commission also requests clarification of the statement in footnote 4 of the March 24 Order, which states that PJM and MISO will not be able to begin operating their joint and common market until 2005 at the earliest. The Illinois Commission asserts that the Commission cites no source to support its statement and argues that PJM and MISO would be able to begin implementing the common market starting on the date that MISO initiates market operations (currently expected for December 1, 2004) regardless of whether or not AEP is integrated into PJM's market by that date. The Illinois Commission recommends that the Commission withdraw this statement in the March 24 Order and urges the Commission to direct PJM and MISO to initiate joint and common market elements as soon as MISO's day-ahead and real-time energy markets start up.¹²

¹² The Illinois Commission also states that the March 24 Order and PJM's February 5 filing incorrectly state that the opening of NICA's capacity market is currently scheduled for June 4, 2004. Both of these dates conflict with footnote 20 of PJM's February 5 filing, which states that the anticipated opening of the capacity markets

36. Finally, the Illinois Commission asserts that, based on statements made in the March 24 Order, the Commission is apparently willing to rely on bilateral contracting to reduce the incentives of power sellers in NICA. The Illinois Commission argues that such an expectation is not supported by market conditions. Illinois Commission states that there may not be many generation supply alternatives for ComEd, given the limited transmission import capability into ComEd's service territory, the high concentration of generation ownership/control, and ComEd's sole supplier arrangement with its affiliate Exelon Generation (ExGen). The Illinois Commission states it may not possess sufficient regulatory authority at the retail level to prevent the exercise of market power at the wholesale level as energy purchases made through bilateral contracts are passed through to ultimate customers via bundled retail rates. Thus, by expecting that bilateral contracting will reduce incentives for power sellers in NICA to exercise wholesale market power, the Commission fails to perform its statutory obligation to ensure just and reasonable rates. The Illinois Commission, therefore, requests rehearing of the Commission's finding that wholesale contracting will reduce or eliminate the incentives of generators in NICA to exercise market power.

E. PJM's Compliance Filing

37. In the March 24 Order, the Commission directed PJM to explain why an exception should not be added to section 6.4 of PJM's OATT when the pathway between PJM and NICA is constrained from east to west. The Commission further directed PJM to explain whether the cost cap of 110 percent will provide adequate scarcity pricing within NICA. In its explanation and response to both of the above directives, PJM states, as in its initial filing, that the NICA energy market is characterized by market power and that under certain circumstances application of measures under section 6.4 of Schedule 1 to the PJM Operating Agreement are warranted in NICA. PJM asserts that the integration with PJM resolves the market power issues for 95 percent of the hours of the year but that mitigation is necessary for the remaining 5 percent of the hours, when the pathway is constrained from east to west.

38. With regard to the question of an exception to section 6.4, the PJM MMU submits a further market power analysis based on the Commission's Market Power Policy Order, which was issued after the March 24 Order. PJM argues that this additional analysis confirms the MMU's original conclusion that two entities have market power in NICA energy markets and thus it would be a mistake to not apply mitigation measures during

was June 1, 2004. The Illinois Commission urges the Commission to clarify this inadvertent error.

that constraint. The PJM MMU conducted two analyses – a pivotal supplier screen and a market share screen. The MMU further applied a delivered price test to rebut or confirm the results. PJM states that the pivotal supplier test indicated that no supplier was pivotal in the NICA market for the period analyzed, but the market share screen indicated the presence of market power and the delivered price test confirmed that finding. PJM further states that the results of the MMU's analysis establish that two companies presumptively have sufficient market power that mitigation measures are required, because the current structural characteristics of NICA's energy market require mitigation measures and mitigation authority when the pathway is constrained. Thus, PJM argues, the Commission should not impose an exception to section 6.4 with respect to east to west (PJM to NICA) constraints on the pathway. PJM argues that exceptions to mitigation authority were established for the three internal PJM interfaces identified in section 6.4 because the market areas defined by the internal constraints were found to be structurally competitive. However, where markets defined by transmission constraints are characterized by market power, such as NICA, an exception for a constraint would be counterproductive. PJM also notes that these mitigation rules are needed for only 5 months.

39. In response to the Commission's directive to explain whether the cost cap of 110 percent will provide adequate scarcity pricing within NICA, PJM states that scarcity is not an issue in NICA, at least during the short time period these rules would be in effect. PJM asserts that the competitive issues arise from market concentration and the resulting abilities to set prices. As market power in NICA does not arise from scarcity, PJM argues that cost plus ten percent will provide adequate revenue to generators.

1. Protests

40. Duke and the EME Companies submit that the market share analysis and delivered price test presented by the PJM MMU do not accurately capture the level of competition in the NICA energy market and do not support the broad mitigation proposed.

41. Duke argues that the Market Power Policy Order tests are designed to evaluate whether an individual applicant for market-based rates has generation market power; thus, PJM's conclusion that the entire NICA energy market is presumptively non-competitive because a particular supplier is presumed to have market power is not supported by the Market Power Policy Order. The EME Companies and Duke assert that should a supplier fail a test, that supplier alone, and not the entire market, is subject to possible mitigation.

42. The EME Companies submit that PJM's market share test included a number of generating units owned or controlled by Midwest Generation (MWGen) that are currently in either suspended operational or decommissioned status. The EME Companies argue that none of these units should be included in the summer 2004 market power analysis. The EME Companies state that in calculating the market share screen without these units, "the EME Companies market share drops significantly to approximately for the summer period and, thus, the EME Companies do not fail either of the indicative screens." Thus, EME Companies continue, no delivered price test is required.¹³

43. The EME Companies also submit that the Commission has, in previous orders, recognized that analysis must consider varying supply and demand conditions. In contrast, the EME Companies argue the MMU's delivered price test observes only average market prices during the fall, spring, summer and winter: average prices for these four broad categories cannot provide the detail required to make the delivered price test a useful tool in analyzing potential market power concerns, and without such detail the analysis becomes too crude to produce useful information.

44. Duke argues that PJM's delivered price test fails to account for generation that cannot offer energy at prices within 105 percent of historical market clearing prices, which excludes a "very large number of suppliers located within NICA," as well as generation from neighboring supply regions. Duke argues that PJM would consider a market with concentrated ownership of low cost generating resources and diverse ownership of high cost generating resources to be non-competitive when demand levels require production only from low cost resources.

45. The EME Companies argue that the fact that they passed both the pivotal supplier and market share tests indicates that they does not possess market power in generation and thus a delivered price test is not necessary. Based on this analysis, the EME Companies argues that they should not be subject to mitigation in the NICA energy markets.

46. The EME Companies propose a trigger for invoking the MMU's mitigation authority, should the Commission believe some form of mitigation to be necessary for the less than five month period (assuming AEP joins PJM on October 1). The EME Companies suggest granting the MMU authority to invoke its authority to impose mitigation measures on NICA generation resources only when (1) the generation transfer pathway is constrained in the direction from the PJM Control Area to the Northern

¹³ Comments of the EME Companies at p. 8.

Illinois Control Area; and (2) the constraint on the generation transfer pathway exceeds thirty minutes in duration. The EME Companies believe that their proposed trigger recognizes that imports may be available into NICA to relieve constraints on the generation transfer pathway once the constraint arises, as well as the fact that such imports generally would not be able to respond for thirty minutes due to PJM's fifteen minute scheduling increments and NERC's requirement that tags be submitted at least twenty minutes before the schedule starts.

2. PJM's Reply to Protests

47. PJM filed a reply to the protests, stating that it is appropriate to use the screens contained in the Market Power Policy Order in this context, since it addresses many of the same concerns that were raised by the Commission in its March 24 Order. PJM reiterates that, when a market is structurally non-competitive, all offers into that market should be mitigated, and that this proposal is consistent with PJM's current method for mitigating market power in load pockets. PJM further reasserts that its MMU's conclusions, based on the use of the screens in the Market Power Policy Order demonstrate the presence, are valid.

II. DISCUSSION

A. Procedural Issues

48. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2003), prohibits an answer to a request for rehearing, an answer, or a protest unless otherwise ordered by the decisional authority. We will accept PJM's reply to the responses to its rehearing request and the EME Companies' response to that reply, and PJM's response to the protests, because they have provided information that assisted us in our decision-making process.

49. Parties seeking rehearing of Commission orders are not permitted to include additional evidence in support of their position, particularly when such evidence is available at the time of the initial filing.¹⁴ The initial filing must include all material

¹⁴ Section 385.713(c)(3) provides that parties may set forth new matters in a rehearing request only when rehearing is "based on matters not available for consideration by the Commission at the time of the final decision or final order." *See*, Central Maine Power Co., 90 FERC ¶ 61,198 at 61,641 and n. 8 (2000).

needed to establish the utility's case-in-chief.¹⁵ The rule limiting new matter raised on rehearing particularly important, since answers to rehearing requests are not permitted and other parties, therefore, will not have an opportunity to respond to newly submitted information.

50. In its rehearing petition, PJM relied upon an affidavit by Mr. Bowring that included new evidence filed as confidential. Because of the importance of this matter, and because the Commission had articulated revised standards for evaluating generator market power in the Market Power Policy Order after the issuance of the initial order in this proceeding, the Commission made a special exception and established procedures for providing access to the material under a protective order and for comment on the new evidence. But this was done on an exceptional basis, and PJM as well as other parties, should not expect that such new evidence will be permitted to be filed at the rehearing stage of Commission proceedings.

51. EME Companies have also moved to strike PJM's reply to the responses filed by parties to PJM's rehearing request. EME asserts that at the time PJM filed its rehearing request, it had in its possession the material it now presents in its reply, and that, by presenting this material now rather than sooner, PJM is in essence making a new request for rehearing, in contravention to section 313(a) of the FPA, which requires any person seeking rehearing of a Commission order to do so within thirty days of the issuance of the order.

52. We agree with EME that PJM's filing of new material in its reply to responses to its rehearing request violates section 313(a), and is prohibited. As the Commission has stated,

if we were to consider [a party's] late-filed supplement [to its rehearing request] and its allegedly newly discovered evidence, we would run afoul of the express language of the Federal Power Act requiring all requests for rehearing to be filed within 30 days. We would also set a very dangerous precedent: we would sanction parties behaving with less than due diligence and their filing of endless supplements. The effect on our orderly processes, and on our ability to resolve disputes – while admittedly difficult to quantify in absolute terms – would be significant. An adjudicatory proceeding, be it a judicial proceeding or an

¹⁵ 18 C.F.R. § 35.13 (e)(2) (2003).

administrative proceeding, requires that there be some date at which argument and presentation of evidence must end so that the decision maker can decide.¹⁶

Therefore, PJM's reply will be rejected.

53. We will also grant EPSA's late-filed motion to intervene. Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2003) allows the decisional authority to accept late motions to intervene if, among other things, the movant had good cause for failing to file the motion within the time prescribed. EPSA states that PJM's rehearing request presented factual material and policy arguments which were not before the Commission or the parties before the issuance of the March 24 Order – *i.e.*, during the period of time prescribed to intervene in this proceeding. We therefore find that good cause exists for EPSA's failure to intervene timely.

B. Capacity Market Mitigation

1. Rehearing requests

a. Capacity Market Issues

54. The Commission will reject PJM's and the Illinois Commission's rehearing requests related to mitigation for the capacity market. There is disagreement among PJM and the other commenting parties regarding the level of competition in the capacity market and the resulting need for mitigation. However, PJM's existing rules effectively cap the prices for capacity in NICA, and thus provide some mitigation of any market power that may exist. This cap arises because of the \$160/MW-day deficiency charge, which is the charge imposed on LSEs for failure to satisfy their capacity requirement. The deficiency charge sets a cap on capacity payments, because a customer will not pay more than the \$160/MW-day deficiency charge to procure capacity.

55. The record does not support a finding that the potential for market power in the NICA capacity market warrants adopting the additional mitigation proposed by PJM, that is, the proposed \$30/MW-day offer cap during periods of capacity surplus. The results of pivotal supplier test conducted by PJM's MMU show that no supplier was pivotal in the capacity market for the period analyzed. And while the results of market share analysis

¹⁶ Commonwealth Elec. Co. v. Boston Edison Co., 47 FERC ¶ 61,118 at 61,349 (1989).

showed that there was one participant whose market share rose above 20 percent, the NICA capacity market has considerable surplus capacity. Mr. Fox-Penner, representing the EME Companies, reports that capacity within NICA exceeds peak load by about 8,000 MW., *i.e.*, by 31 percent, and that if the simultaneous import capacity of 4700 MW is also considered, available capacity exceeds peak load by 53 percent.¹⁷ The existence of significant surplus capacity is likely to dilute any market power that a generator with a high market share would otherwise have, because customers have more capacity options available to them.

56. Our conclusions are supported by the results of the capacity auctions that have been held in NICA since the issuance of our March 24 Order (when the \$30/MW-day offer cap was not in place). In its rehearing request, PJM references the results of the first three capacity auctions in NICA. In only one of those auctions was the clearing price above \$30/MW-day—the auction cleared 457 MW at \$37.00/MW-day.¹⁸ According to capacity auction results listed on the PJM website¹⁹, PJM has administered twenty capacity auctions through July 1, 2004 for NICA. Of those 20 auctions, six have cleared above PJM’s proposed \$30/MW-day cap; the highest clearing price was \$60, far below the \$160 deficiency charge. Ten auctions cleared below the proposed offer cap and four auctions did not clear any megawatts, despite the fact that capacity was offered into these 4 auctions for prices as low as \$7.99/kW-month. An auction that clears zero MW implies that buyers were not compelled at that time to purchase the offered capacity and presumably were able to procure capacity elsewhere. Moreover, the Commission

¹⁷ Affidavit of Peter Fox-Penner re: PJM Market Mitigation in NICA, attached as Exhibit A to Comments of Edison Mission Energy, *et al.*, ER04-539-002, May 26, 2004, page 5.

¹⁸ PJM administered three auctions prior to its rehearing request. The first auction was run for the twelve-month period from June 1, 2004 to May 31, 2005. It cleared 300 MW at \$24.84/MW-day. The second auction covered the period from June 1, 2004 to December 31, 2004. It cleared 75 MW at \$29.25/MW-day. The third auction covered the period June 1, 2004 to September 30, 2004. It cleared 457 MW at \$37.00/MW-day.

¹⁹ See NICA Installed Capacity Credit Market Results [ftp://ftp.pjm.com/pub/capacity_credit_market/results/nica/ccmmonthly-nica.csv] accessed July 2, 2004.

believes that the number of megawatts cleared in the capacity auctions seems low relative to peak load in NICA, which exceeds 20,000 MW.²⁰ The auction results thus far seem to indicate that there are sufficient alternative sources to the PJM-administered capacity auctions, thus offering a form of mitigation without a mandated offer cap.

57. Rejecting PJM's rehearing request in this docket would also be consistent with the ruling the Commission recently made in an order on locational installed capacity in ISO-NE (LICAP Order).²¹ In deferring implementation of a locational installed capacity market until January 1, 2006 in New England, the Commission extended the current capacity market mechanism. Under that mechanism, the only form of mitigation in place with regard to capacity is the deficiency charge, currently set at \$6.66/kW-month. Participants in areas of New England that exhibit high levels of supplier concentration (*e.g.* Southwest Connecticut and Northeast Massachusetts/Boston) are subject to the deficiency charge. Despite concentration levels similar to those in NICA, the Commission did not find it necessary to install an offer cap in New England during the period until January 1, 2006. In fact, the deficiency charge in PJM markets is somewhat lower than that in New England, \$4.87/kW-month compared with \$6.66/kw-month, so the PJM deficiency charge will serve as an equally effective cap. The Commission, therefore, finds that rejecting the \$30/MW-day offer cap and relying on the deficiency rate provides adequate mitigation to the NICA capacity market until May 31, 2005.

58. The Commission, in regard to the EME Companies request, confirms that PJM is not seeking rehearing of the Commission's rejection of its proposal to apply a \$160/MW-day offer cap during scarcity condition. In a footnote to its request for rehearing, PJM states:

...in the March 24 Order, the Commission also rejected PJM's proposals (1) to permit the PJM market monitor to void the results of NICA capacity auctions that it determines are non-competitive, and (2) to set a \$160 per MW-day offer cap during periods of scarcity. March 24 Order at PP 36-37. PJM does not seek rehearing of these determinations.²²

²⁰ Five auctions cleared more than 100 MWs, with 457 MW representing the greatest number cleared. Eleven auctions cleared fewer than 100 MWs; four auctions cleared no MWs.

²¹ See *New England Power Pool and ISO New England, Inc.*, 105 FERC ¶ 61,300 (2004).

²² PJM Request for Rehearing in Docket No. ER04-539-001 at fn 4.

59. The Commission will not direct PJM to develop a demand curve approach to capacity prices, as requested by NRG. Since the Commission is rejecting the \$30 cap proposed by PJM, there is no need to consider an alternative mitigation approach to that proposal.

b. Energy Market Issues

60. The Commission denies the Illinois Commission's rehearing request that PJM be given the authority to impose mitigation when extreme conditions prevail in PJM.²³ The Commission found in the March 24 Order that PJM had failed to show that imports would not provide sufficient market discipline to make this mitigation measure unnecessary.²⁴ The Illinois Commission has provided no new information to show that the analysis on which the Commission relied is erroneous, merely making a declarative statement that its own "examination of the evidence . . . shows that the question of import capability into NIA is, at best, a disputed issue of material fact, [but] it appears that [PJM] has the stronger argument." This does not provide a sufficient basis to grant rehearing. PJM has the burden of justifying its proposal, and we continue to find that PJM failed to provide sufficient evidence that imports would not be sufficient to provide market discipline during periods of extreme conditions in PJM.

61. The Commission disagrees with the Illinois Commission's argument that the Commission is relying inappropriately on bilateral contracting to reduce the incentive of power sellers in NICA to exercise market power in the energy spot markets. The Illinois Commission alleges that, because ComEd has entered into a sole supplier relationship with its affiliate ExGen, contracts between ComEd and ExGen will not impose competitive discipline on the energy spot markets.

62. In our March 24 Order, we did not rely on contractual agreements, as alleged by the Illinois Commission to establish a lack of market power, we found that PJM had failed in its application for special mitigation to appropriately evaluate contractual provisions that can reduce market power, and eliminate the need for mitigation. Given

²³ Since the Commission is here accepting PJM's explanation as to why it requires the ability to mitigate market power in NICA when the 500 MW pathway from PJM to NICA is congested, there is no need to address the Illinois Commission's request for rehearing on this point.

²⁴ March 24 Order at P 28-31.

PJM's failure to provide sufficient information on imports, as discussed above, we would have rejected PJM's filing even if the analysis had shown that contracts did not limit the potential to exercise market power.

63. Moreover, the Illinois Commission has still not provided a sufficient analysis of the outstanding contracts to show that they would not be sufficient to mitigate market power, particularly since, PJM asked for such mitigation only until AEP integrates into PJM on October 1, 2004. The Illinois Commission simply refers to the sole supplier relationship without stating any details of the contracts between ComEd and ExGen, including the amount of MW involved relative to the total amount of MW in NICA, and the prices to be charged for energy under those contracts. The Illinois Commission's concern about the possible pass-through of wholesale prices also does not speak to the question of whether existing bilateral contracts for energy in NICA will or will not exercise competitive discipline on the energy spot market.²⁵

2. PJM's Compliance Filing

64. We will accept PJM's April 26, 2004 compliance filing. With respect to granting an exception to the offer capping provisions of section 6.4, we agree with PJM that there is sufficient competition within the PJM MidAtlantic Region on a standalone basis to grant an exception when the 500 MW pathway is constrained from west to east. Indeed, we have previously relied on the existence of competition in the PJM MidAtlantic Region as a basis for granting the existing exceptions for the three major internal PJM. Therefore, we direct PJM to amend its Operating Agreement within 30 days of the date of this filing to provide for an exception to the offer capping provisions of section 6.4 when the 500 MW pathway is constrained from west to east.

²⁵ The Illinois Commission also asks the Commission to correct statements made in the March 24, 2004 Order concerning the date on which the MISO/PJM common market will be operational, and ComEd's ownership of generation resources. The Commission clarifies that it did not intend to prejudge the date that the PJM and MISO joint and common market will be operational. However, we note that, in an order dated May 26, 2004, the Commission moved the date for implementation of MISO's energy markets to March 1, 2005. Midwest Independent Transmission System Operator, Inc., 107 FERC ¶ 61,191 (2004). The Commission also clarifies that it is ComEd's affiliate, not ComEd, that owns generation resources.

65. PJM opposes granting an exception when the 500 pathway is constrained from east to west, and the Commission will not require it to do so. Granting an exception would involve a change in PJM's existing Operating Agreement, and thus, would require the Commission to find that the existing provisions are unjust and unreasonable under section 206 of the FPA. The evidence currently suggests that mitigation in the NICA area would be appropriate, although as discussed below, such mitigation could appropriately be limited to the largest generators in NICA, who provide most of the supply in that market area. We will not institute a section 206 proceeding to require PJM to so limit its mitigation at this point, because such mitigation will only apply until October 1, 2004. However, we are concerned about whether PJM's tariff provisions regarding mitigation exemption are being applied, as new control areas, are added to PJM, and are instituting a section 206 proceeding in Docket No. EL04-121-000, to examine whether changes to mitigation need to be made to accommodate new areas entering PJM.

66. The Commission recently identified the methodology that it would use, at least on an interim basis, for evaluating the extent of generation competition in the Market Power Policy Order. That methodology relies on two indicative screens, a pivotal supplier test and a market share threshold of 20 percent. In following this methodology, the evidence in this docket is mixed regarding the extent of competition in the NICA energy market when the 500 MW pathway is constrained from east to west. While the analysis of the PJM MMU indicates that no individual generator would be pivotal in the energy market, the analysis found that at least one generator has a market share above 20 percent.²⁶ This suggests that at least one generator may have the potential to exercise market power when the 500 MW pathway is constrained from east to west. Therefore, we find that mitigation during east to west constraints is appropriate.

67. However, PJM proposed to mitigate all generators in NICA, but it does not appear that mitigation needs to be so widely applied. Duke and the EME Companies state that the Market Power Policy Order tests are designed to evaluate whether an individual seller

²⁶ EME states that PJM's analysis overstated EME's market share because PJM attributed some capacity to EME that was, in fact, taken out of service. (*See* Comments of EME Companies [public version] in Docket No. ER04-539-002, May 26, 2004, at page 2.) PJM subsequently revised its analysis to exclude those units. However, PJM states that it also became aware of a generator's control over certain generating units under a power purchase agreement. When all of these factors were taken into account, PJM's analysis concluded that the energy market shares of at least one generator continued to exceed 20 percent.

has market power. They argue that only those suppliers that fail the market power test should be subject to mitigation, and that sellers that pass the test should be exempt from mitigation.

68. We agree in principle. No evidence has been presented in this record to demonstrate that a seller who is not pivotal and whose market share is below 20 percent in the NICA energy market is able to exercise market power in the NICA energy market solely as a result of a constraint on the 500 MW pathway.²⁷

69. PJM argues that when even a single seller has market power, the market is structurally non-competitive, and all offers into that market should be mitigated. PJM states that mitigating only one or two dominant generation owners could create opportunities for mitigated and non-mitigated participants to cooperate either tactily or explicitly to exercise market power. For example, PJM suggests that the dominant, mitigated generators could enter into bilateral arrangements with non-mitigated participants; the mitigated participants would turn over control the bidding of its resources to non-mitigated participants who would offer the resources at non-mitigated prices and set the market price. However, we are not persuaded that the solution to PJM's concerns is to impose mitigation on sellers that lack market power and that choose not to participate in such collusive behavior. Rather, the solution is to require sellers to report promptly to PJM and the Commission any significant changes in their control over resources in the NICA market, and for mitigation to be applied in the future to any additional sellers who acquires bidding control over significant portions of generation capacity in NICA. We already impose similar reporting requirements on sellers with market-based rate authority. Under our current policy, any seller obtaining market-based rate authority must report to the Commission any material changes in the structural or other conditions that originally justified its market-based rate authority. However, as noted by the PJM MMU in his April 26 affidavit, the 500 MW pathway will effectively disappear and the combined PJM, AEP and NICA regions can be evaluated as a single market for energy market power purposes when AEP integrates into PJM. In view of the brief period of time before AEP will integrate with PJM, we will not require any changes to PJM's Tariff or Operating Agreement at this time to exempt any generators in NICA from PJM's offering capping provisions triggered by constraints on the 500 MW pathway. We conclude that the burden of making such changes would not be worth the benefits in light of the brief time that they would be in effect.

²⁷ However, we are not disagreeing here with the justification for PJM to offer cap generators when other transmission constraints within NICA require PJM to accept the offers of generators out-of-merit for reliability reasons.

70. We reject the other protests regarding the application of any mitigation to the NICA area. We do not agree with those arguing that the offer capping provisions unreasonably limit the compensation of generators in NICA. The provisions allow the seller to recover more than (i.e., at least 110 percent of) its variable costs of production. And the offer caps are not expected to be applied often – less than 5 percent of the time, and only until AEP integrates with PJM. Finally, we are persuaded that the offer caps are not likely to prevent prices from rising to ration legitimately scarce supplies (i.e., supply not rendered scarce by withholding) during the limited period when they will be in existence; supply scarcity is unlikely to arise during this time, since there is currently a substantial capacity surplus in the NICA region.

71. We will not require PJM to adopt the alternate proposal by the EME Companies for triggering offer capping. Under that proposal, offer capping would not be triggered unless the 500 MW pathway is constrained for more than 30 minutes. EME states that imports could respond to higher prices resulting from the pathway constraints, but that imports require some time to respond in order to acquire NERC tags and ramp reservations. We agree with PJM that the EME Companies' proposal would allow generators in NICA to exercise market power for up to 30 minutes at a time. This could produce unnecessary energy price volatility. It could also result in additional uplift payments to cover the start-up and minimum run time costs of high-priced NICA generators that are initially dispatched and then turned off when imports enter the market.

72. However, we are concerned that PJM's current tariff is no longer appropriate in determining whether generators in new areas should be exempt from mitigation and are instituting a procedure under section 206 of the FPA to determine whether PJM has identified the appropriate triggers for offering capping mitigation in the control areas of those companies that have recently joined it and/or are in the process of joining it: Allegheny Power, ComEd, AEP, DP&L and VEPCO, and that will join in the future.

73. PJM's tariff generally provides for mitigation whenever a generator is called out of merit due to a transmission constraint. However, section 6.4(d) of PJM's tariff provides an exception from such mitigation:

Price caps shall not be applicable to generation resources used to relieve the Western, Central and Eastern reactive limits in the PJM Control Area. In addition, price caps shall not be applicable to generation resources used to relieve any other transmission limit as to which the FERC has authorized the used of market based rates.

74. Under this provision, generators are not offer capped when the constraint is due to transmission constraints on these three transmission interfaces. The rationale for the exceptions is that sufficient competition exists on each side of these constraints to prevent any generator from acquiring market power when the constraint develops.

75. We are concerned that as PJM expands, there is not in place a mechanism for determining whether other major transmission constraints into and/or out of the newly integrated areas should also be exempted from triggering mitigation of some or all generators called out of merit. Currently, the burden is placed on individual generators to seek an exception to PJM's mitigation procedures, or they will, by default, be subject to mitigation. It is our view that, as new members join PJM and new control areas come under PJM's control, the onus should be on PJM to demonstrate why generators in those control areas should be mitigated when constraints on the major transmission interfaces into the control area arise. We therefore will require PJM to respond within 60 days of the date of this order to justify its current provision or to propose a revision to that provision that will require PJM to perform the competitive analysis to determine whether an exemption from mitigation is appropriate when new control areas are added to PJM. Because of the concerns with respect to the offer capping of all units, as discussed above, we will require PJM to address in its response whether offer capping should be limited to those generators that fail the market power test.

76. In addition, such an analysis has not been submitted for the new areas that have already been accepted as members of PJM or have such applications pending. Therefore, pursuant to sections 206, 304, and 307 of the FPA, the Commission will require PJM to provide, within 60 days of this order, a competitive analysis of whether constraints on the major transmission interfaces into and/or out of AEP, DP&L, and VEPCO should also trigger offer capping as those companies move into PJM.

77. Pursuant to section 206(b) of the FPA, the Commission must establish a refund effective date that is no earlier than 60 days after the publication of notice of the Commission's intent to institute a proceeding, and no later than five months subsequent to the expiration of the 60-day period. The Commission will establish a refund effective date of 60 days from publication of notice of this investigation. The Commission is also required by section 206 to indicate when it expects to issue a final order. The Commission expects to issue a final order in this section 206 investigation within 180 days of the date this order issues.

The Commission orders:

(A) The parties' requests for rehearing and clarification are denied in part and granted in part, as discussed above.

(B) PJM's compliance filing is accepted, as discussed above.

(C) PJM is directed to revise its tariff and Operating Agreement, within 30 days of the date of this order, to exempt sellers from offer capping when the 500 MW pathway is constrained from east-to-west.

(D) PJM is hereby directed to file in Docket No. EL04-121-000 its response regarding limitations on mitigation, and the analysis required for the Allegheny, ComEd, AEP, DP&L and VEPCO control areas within 60 days from the date of the issuance of this order. Parties will be given an opportunity to comment or protest in accordance with the provisions of section 35.8(a) of the Commission's regulations (18 C.F.R. § 35.8(a)).

(E) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly section 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), a public hearing shall be held in Docket No. EL04-121-000 concerning the allocation of ARRs and FTRs, as discussed in the body of this order.

(F) Any interested person desiring to be heard in the proceedings in Docket No. EL04-121-000 should file a notice of intervention or motion to intervene with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C., 20426, in accordance with Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214) within 21 days of the date PJM makes the filing directed in Paragraph (D) above.

(G) The Secretary is directed to publish a notice of this section 206 proceeding in the *Federal Register*.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Acting Secretary.