UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

FirstEnergy Service Company, Complainant,	)	
v.	)	Docket No. EL14-55-000
PJM Interconnection, L.L.C., Respondent.	)	

ANSWER OF
PJM INTERCONNECTION, L.L.C.
TO COMPLAINT

PJM Interconnection, L.L.C. ("PJM"), pursuant to Rule 213 of the Commission's ("FERC" or "Commission") rules, 18 C.F.R. § 385.213, submits this Answer to the amended complaint of FirstEnergy Service Company ("FirstEnergy") filed in this docket on September 22, 2014.[1]

The Complaint seeks to extend to PJM's capacity market the ruling of the United States Court of Appeals for the District of Columbia Circuit in *Electric Power Supply Ass'n v. FERC*, 753 F.3d 216 (D.C. Cir. 2014) ("*EPSA*").[2] *EPSA* held that the Commission lacked jurisdiction under the Federal Power Act ("FPA") to promulgate the

[1] Unless otherwise expressly stated, PJM's references in this Answer to FirstEnergy's "Complaint" refer to the amended complaint filed on September 22, 2014. Amended Complaint of FirstEnergy Service Company, Docket No., EL14-55-000 (Sept. 22, 2014). It is PJM's understanding that FirstEnergy relies solely on its amended Complaint. In the event that understanding proves incorrect, PJM reserves the right to amend or supplement this Answer to contest any portions of the original complaint that is not repeated or substantively included in the amended complaint.

[2] The court's mandate has been stayed pending the Commission's possible petition for certiorari to the United States Supreme Court. *See Elec. Power Supply Ass'n v. FERC*, No. 11-1486 (D.C. Cir. Oct. 20, 2014) (per curiam) (order granting FERC motion to stay issuance of mandate).

rules established by the Commission's Order Nos. 745 and 745-A.[3] The court vacated the principal regulation created by those orders, which required regional transmission entities, subject to certain conditions, to pay the full locational marginal price ("LMP") to providers of demand response participating in organized wholesale, day-ahead, and real-time energy markets.[4]

The Commission is aware of the wide range of views among electric industry stakeholders regarding the legal reach of the *EPSA* decision. If and when ripe for decision, the instant Complaint will require the Commission to ultimately address that question. Nevertheless, no matter the fate of the holding in *EPSA* as the case continues to be considered by the courts, PJM is concerned also about the risks arising from uncertain market rules and extended litigation over the scope of *EPSA* beyond its specific application to FERC Order No. 745. Specifically, PJM is mindful of the potential for operational and financial disruptions of the three-year forward commitment element of RPM, PJM's capacity market, should there be protracted litigation over the application of *EPSA* to capacity markets—an issue raised directly by the instant Complaint.[5] As a result, PJM focuses much of this Answer on the failure of FirstEnergy's proposed remedies to minimize such risks, and suggests a viable path to continue maximizing the value of load reductions in its markets and operations under market rules consistent with

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3 *Demand Response Compensation in Organized Wholesale Energy Markets*, Order No. 745, III FERC Stats. & Regs., Regs. Preambles ¶ 31,322, *order on reh'g and clarification*, Order No. 745-A, 137 FERC ¶ 61,215 (2011), *reh'g denied*, Order No. 745-B, 138 FERC ¶ 61,148 (2012), *vacated sub nom. Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216 (D.C. Cir. 2014).

4 This rule was codified in a new subsection (v) of section 35.28(g)(1) of the Commission's regulations, 18 C.F.R. § 35.28(g)(1)(v).

5 RPM is PJM's Reliability Pricing Model.

the *EPSA* ruling should that decision become final through a mandate issued to the Commission.[6]

FirstEnergy asks the Commission (1) to nullify immediately all existing terms of the PJM Open Access Transmission Tariff ("PJM Tariff") that provide for participation by demand response resources in PJM's capacity market, and (2) to direct PJM to recalculate the results of its May 2014 Base Residual Auction ("BRA"), which procured capacity commitments for PJM's 2017-2018 Delivery Year. Even if the Commission accepts FirstEnergy's premise that *EPSA* defines the scope of the Commission's jurisdiction over demand response in organized wholesale capacity markets, it need not and should not adopt FirstEnergy's proposed remedies. The relief FirstEnergy seeks is not just and reasonable, and would be extremely damaging to the market certainty that is critical to sustaining investment in electricity infrastructure.

FirstEnergy's request to "recalculate the results" of the 2014 BRA[7] rests on the false assumption there is no demand response in the PJM Region. To the contrary, however, there is, in fact, well-developed peak load reduction capability in the PJM Region, and PJM reasonably and prudently must take that capability into account in both its planning and capacity procurement functions. Because there is no way to recreate how the Commission, states, regional market operators, load serving entities, curtailment

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6 PJM acknowledges that many parties to this proceeding will argue the merits of the scope of *EPSA* to capacity markets and may also challenge the ripeness of FirstEnergy's Complaint. Given PJM's unique responsibility to ensure continued reliability and predictable competitive markets, no matter what the fate of *EPSA* and rulings on its scope, PJM believes it is appropriate for the Commission to focus critically on the impact of the various means of addressing *EPSA*, should the Commission find it applies to the capacity market.

7 Complaint at 4.

service providers, and other market participants would have reflected demand response capability in the absence of demand resource participation in PJM's capacity market, the Commission should apply its remedial discretion, as it consistently does in such situations, to refrain from altering settled market outcomes.

Similarly, under any reasonable interpretation of *EPSA*, the decision does not require abrogating the commitments of the demand response capacity resources that PJM procured in RPM auctions held prior to the court's ruling. Those resources entered into their commitments under, and reasonably relied upon, market rules approved by the Commission in final orders. Accordingly, even assuming *arguendo* the Commission determines that FirstEnergy's Complaint has merit, it nevertheless should recognize that demand response that cleared RPM auctions under rules that were approved in final, unchallenged orders before *EPSA* remain obligated to perform for the RPM Delivery Years for which they have already been committed, and remain eligible to receive compensation for those commitments. This approach is consistent with the Commission's numerous precedents for declining to require regional market operators to re-run settled markets after the fact.[8]

FirstEnergy's proposed approach also improperly fails to distinguish between demand response provided by retail customers, which *EPSA* precludes and commitments by load-serving entities ("LSEs") (i.e., wholesale customers) to reduce their purchases from PJM. The latter addresses transactions that are plainly subject to the Commission's exclusive jurisdiction and that are unaffected by *EPSA*. Under the RPM construct, PJM

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[8] *See Associated Gas Distribs. v. FERC*, 898 F.2d 809, 810 (D.C. Cir. 1990) ("The Commission may not disinter the past merely because experience has belied projections, whether the advantage went to customers or the utility; bygones are bygones.") (Williams, J., concurring in denial of rehearing and rehearing en banc).

procures capacity to meet the demands of LSEs. It would be unreasonable on its face simply to ignore LSEs' actions that reduce their consumption, and shave their peak demands, as PJM determines the amount of capacity resources to procure.

Rather than the unreasonable approach proposed by FirstEnergy, PJM suggests a two-faceted alternative one that would (1) respect markets outcomes and commitments that are already established ,while (2) additionally proposing rules for upcoming auctions to permit demand response participation in PJM's capacity market in a manner firmly grounded in the Commission's jurisdiction. PJM submits that this approach should minimize (if not eliminate) litigation risk for future transactions, until such time as clarity emerges from the *EPSA* litigation.

Accordingly, subject to final PJM review, considering the state of the *EPSA* litigation and any intervening regulatory action taken by the Commission, PJM will submit Tariff changes (expected before the end of 2014 or shortly thereafter) under section 205 of the FPA (and under section 206 as necessary). PJM expects to ask the Commission to accept these changes to serve at least as a "stop gap measure," perhaps to be effective only until such time as the Commission and industry stakeholders have had an opportunity, once jurisdictional questions are finally resolved, to consider and develop generic and more considered options for demand response participation in organized wholesale electricity markets. At the present time, PJM believes it must take this action to avoid the chaos that would likely ensue if requests for Supreme Court review of *EPSA* were denied in the spring of 2015, on the eve of PJM's May 2015 BRA. In broad terms, PJM's expected filing will propose:

- for the May 2015 BRA and potentially for subsequent RPM auctions, rules to that permit LSEs[9] to submit price responsive bids into the auction, as whitepaper that PJM submitted in this proceeding on October 7, 2014;[10]
- to affirm that demand response capacity commitments already made through past RPM auctions, i.e., commitments for the 2014-2015, 2015-2016, 2016-2017, and 2017-2018 Delivery Years, will be honored at their previously established commitment and compensation levels, subject to an orderly, voluntary exit path for capacity demand resources that anticipate losing their energy market compensation as a result of *EPSA*; and
- to make appropriate changes to the capacity market's incremental auction rules to support an orderly—and reliable—transition, including a provision precluding any new demand resource offers in RPM auctions by retail end users or by aggregators of retail customer load reduction capabilities.

PJM's filing will be made well before the next BRA, as prudent contingency planning designed to provide market participants notice and sufficient time to transition to a known set of rules should any mandate issue from the court. PJM is mindful that the stay of the mandate is in force at least until December 16, 2014, at which time the federal government must decide whether or not to request certiorari. Assuming such a request is

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9 The capitalized term "LSE" is used in this Answer for the convenience of the reader. The term has varied meanings in PJM's filed rates and under state law. PJM's use of the term "LSE" in this Answer is not necessarily confined to any particular definition given to the term in other contexts. As explained in PJM"s whitepaper, *see* note 9, *infra*, the important concept for purposes of a path forward is that the entity be "wholesale" in character.

10 *See* PJM Interconnection, L.L.C., *The Evolution of Demand Response in the PJM Wholesale Market* (Oct. 6, 2014) (see Attachment to this Answer).

made, the mandate would not until after the Supreme Court acts on the request. Finally, if the Supreme Court grants the request, the stay would continue until final disposition of the case by the high court. Clearly, this set of possibilities presents a moving target that PJM must consider. But in an ideal case, a set of rules to serve as a contingent "stop gap" would be known and ready to become effective immediately if and when a mandate issues.

Introduction and Summary

FirstEnergy has not justified the relief it seeks because the Complaint demonstrates neither (1) that the PJM Tariff's rules regarding participation of demand resources in PJM's capacity market, nor (2) that the results of PJM's May 2014 BRA, are unjust and unreasonable. Therefore, the Commission should deny FirstEnergy the relief requested in the Complaint.

FirstEnergy attempts to rely solely on the rationale of the *EPSA* decision to satisfy its burden as complainant. However, *EPSA* did not involve capacity markets, and thus neither addresses nor resolves the issues presented in the Complaint. While FirstEnergy argues that *EPSA* necessarily compels the conclusion that demand response is *ultra vires* in the capacity market, the courts have recognized that capacity markets are under the Commission's exclusive jurisdiction to regulate practices affecting sales for resale, and in so doing have expressly noted that capacity is provided *both* by generation facilities

(notwithstanding that the Commission expressly does not have jurisdiction over such facilities[11]) *and* by demand response.[12]

FirstEnergy also has not shown that the capacity payments to generators resulting from the May 2014 BRA—which FirstEnergy seeks to increase after the fact by billions of dollars[13]—are unjust and unreasonable. FirstEnergy asserts that demand resources should not have been allowed to offer in that auction, and that PJM's acceptance of the demand resource offers that cleared in the auction harmed generation owners because the proffered demand reductions led to lower clearing prices than otherwise would have resulted. FirstEnergy disregards, however, that those demand offers were, by explicit PJM Tariff requirement,[14] a reflection of real, physical demand reduction capability that presently exists, or reasonably will exist in the relevant Delivery Year, in the PJM Region. *EPSA* does not eliminate that capability, and contrary to FirstEnergy's view, does not preclude all avenues for considering load reduction commitments in RPM clearing.

The Complaint thus fails to justify the extraordinary disruption of PJM's wholesale capacity market that FirstEnergy advocates, even if the Commission finds the Complaint to have legal merit. In particular, to the extent that FirstEnergy's proposed remedies would (1) encompass demand response resources that are already committed to

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11 FPA section 201(b)(1), U.S.C. § 824(b)(1).

12 *See, e.g.*, *N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74, 100 (3rd Cir. 2014) (describing Commission's finding in RPM market rule proceeding that supply-side market power could "result in less investment in . . . demand-side [capacity] resources"); other cases cited at pages 14-15, *infra*.

13 Complaint at 23-24.

14 *See* PJM Tariff, Attachment DD-1, section A.5.

and bound to perform in PJM's markets, and (2) remove from PJM's capacity market demand response provided by load-serving (wholesale) entities, the relief FirstEnergy seeks is overly broad and unwarranted. Accordingly, should the Commission find any validity to FirstEnergy's jurisdictional argument, it should nonetheless reject FirstEnergy's proposed remedies as unnecessarily broad, unduly disruptive, and unjust and unreasonable.

Among other fatal flaws, FirstEnergy:

- over-reads *EPSA* by seeking to prevent plainly jurisdictional sale-for-resale customers (i.e., LSEs) from committing to reduce their peak purchases in return for credits against or reductions to their capacity obligations;

- invites violation of the ban on retroactive ratemaking by seeking to overturn the results of the 2014 BRA, which PJM conducted under Tariff terms approved by final Commission orders that neither FirstEnergy nor any other party challenged;

- incorrectly seeks to unsettle the 2014 BRA results based on a Tariff provision that, by its terms, applies only when *PJM* discovers an error in an initial posting of BRA results;

- claims not to seek to change the results of the 2011, 2012, or 2013 BRAs, but appears to demand that the Commission ignore the capacity commitments and payment obligations for demand resources resulting from those auctions;

- ignores the Commission's numerous past decisions declining to reopen settled regional transmission organization ("RTO") auctions or markets; and

- misapplies judicial precedent concerning the Commission's authority to give retroactive effect to changes in the law in order to restore the status quo following a legal error (assuming, *arguendo*, there was such an error).

While FirstEnergy has not supported the relief requested in its Complaint, the risk and uncertainty engendered by *EPSA* for PJM's capacity market nonetheless require Commission attention, if the Supreme Court does not review the decision. PJM is

scheduled to conduct its next major capacity auction under RPM in just over six months,[15] and states, end-users, LSEs, curtailment service providers, generation owners, and other stakeholders must know what, if any, market rule changes will be needed in the wake of *EPSA* to protect the results of that auction from ongoing uncertainty.

PJM accordingly urges the Commission to deny the Complaint. In the alternative, if the Commission does not deny the Complaint outright, PJM asks that the Commission:

- set the latest possible refund effective date for the Complaint, i.e., five months from the Complaint's filing on September 22, 2014;
- affirm, consistent with section 206 of the FPA, that any relief granted in this proceeding, including particularly any revision of RPM that would increase clearing prices, will be effective only prospectively from the date of final Commission action in this case; and
- defer any action on the Complaint pending the Commission's review of the Tariff revisions PJM intends to submit to establish new parameters regarding the participation by demand response in PJM's capacity market.

Background

The Complaint includes a chronology of Commission orders since 2005 approving market rules for the participation of demand response in RPM.[16] However, the Complaint does not describe the growth of demand response over that time period, which is a testament to extensive efforts by market participants and regulators to develop the region's peak load reduction capability. As a consequence of those efforts, more than 14,000 MWs of demand response were cleared in the BRA for the current Delivery

[15] In addition, the next incremental auction is in February 2015.

[16] Complaint at 11-18.

Year,[17] and approximately 12,000-14,800 MWs cleared in the BRAs for the 2015-2016 and 2016-2017 Delivery Years.[18]

To help ensure that the demand response participating in RPM reasonably reflects physical capability to reduce load, the Commission recently approved Tariff provisions that require, commencing with the 2014 BRA, each party submitting a demand response offer to submit an officer's certification that the offer is based on existing or reasonably anticipated capability "to physically deliver all megawatts that clear the RPM Auction through Demand Resource registrations by the specified Delivery Year."[19] Sellers' aggregate offers of nearly 11,300 MWs of demand response in that BRA underscore that demand response that clears in RPM auctions is backed by physical load reduction capability.[20]

The Complaint's recitation of the history of demand response in RPM also overlooks the role of LSEs as demand response providers. The Reliability Assurance Agreement ("RAA") specifies the requirements for demand response in RPM, and in that connection refers repeatedly to "Parties" to the RAA (i.e., LSEs) providing and offering

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17 A capacity Delivery Year under RPM begins on June 1 of a calendar year and ends on May 31 of the following calendar year. *See* PJM Tariff, Attachment DD, section 3.2. Although the performance period for most demand response committed as capacity has passed for the current Delivery Year, that capacity demand response is still owed payments over the next seven months, because the payments are spread evenly throughout the Delivery Year.

18 *See* PJM Interconnection, L.L.C., *2017/2018 RPM Base Residual Auction Results* at 2 (May 23, 2014, as rev. June 17, 2014), http://www.pjm.com/~/media/markets-ops/rpm/rpm-auction-info/2017-2018-base-residual-auction-report.ashx ("2014 BRA Results").

19 *PJM Interconnection, L.LC.*, 146 FERC ¶ 61,150, at P 5 n.10 (2014) (quoting RAA, Schedule 6, section 6.A.2.b).

20 2014 BRA Results at 14.

demand resources.[21] Implementing this authority, LSEs in fact offer and clear demand response in RPM, although the level of that participation is undoubtedly lower than it otherwise would be, given that the current rules also allow end-users and curtailment service providers ("CSPs") to offer demand response directly.

In accordance with the PJM Tariff, PJM secured capacity commitments for the 2017-2018 Delivery Year in the BRA held from May 12 to May 16, 2014. PJM initially published a report of the results of the auction on May 23, 2014.

Also on May 23, 2014, the court issued the *EPSA* decision, vacating Order Nos. 745 and 745-A and remanding them to the Commission. On the same day, after the court announced its decision in *EPSA*, FirstEnergy filed its original complaint in this docket.[22] FirstEnergy requested an order of the Commission:

- "requiring PJM to delay the release of its [2017-18 Delivery Year] auction results pending rehearing" of the *EPSA* decision.[23]
- "direct[ing] PJM to remove all portions of its tariff allowing or requiring the inclusion of demand response as suppliers in PJM's capacity market," to be effective on the date of the Original Complaint's filing, May 23, 2014.[24]

On June 5, 2014, FirstEnergy submitted a motion for an extension of the time for answers to its complaint.[25] FirstEnergy stated that it intended to amend its complaint, and requested an order extending the time for answers and other pleadings until 30 days after

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21 RAA, Schedule 6, section 6.A-1.1.c(iv).

22 Complaint of FirstEnergy Service Company, Docket No. EL14-55-000 (May 23, 2014) ("Original Complaint").

23 *Id*. at 2.

24 *Id*.

25 Motion of FirstEnergy Service Company Requesting Extension of Comment Date, Docket No. EL14-55-000 (June 5, 2014).

the filing of the amended complaint. By notice issued on June 11, 2014, the Commission granted the requested extension of time.[26]

FirstEnergy filed the Complaint on September 22, 2014, seeking the following relief:

- "removal of all provisions in PJM's tariff, agreements, and business manuals that authorize or require PJM to compensate demand resources as capacity suppliers,"[27] and
- re-calculation of the results of the BRA for the 2017-2018 Delivery Year "by (i) removing demand response resources from the PJM capacity supply pool, (ii) leaving the offers of actual capacity suppliers unchanged, and then (iii) determining which capacity suppliers clear the auction on the basis of the offers they submitted consistent with the existing tariff once the unlawful demand response resources have been removed."[28]

Argument

Section 206 of the FPA requires a party that brings a complaint to demonstrate that the existing tariff, rate, or practice it challenges is unlawful. If the complainant meets that requirement, any replacement provisions must be supported as just and reasonable,

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26 *See FirstEnergy Serv. Co. v. PJM Interconnection, L.L.C.*, Notice Extending Due Date for Answers, Interventions, and Protests, Docket No. EL14-55-000 (June 11, 2014).

27 Complaint at 4. Elsewhere in the Complaint, FirstEnergy describes this portion of its proposed relief as "an order directing the removal of all PJM Tariff provisions that allow or require demand response to be included in the PJM capacity market." *Id.* at 35.

28 *Id.* at 4. FirstEnergy states that the Complaint does not contest the results of RPM auctions held prior to May 23, 2014, but FirstEnergy "reserves the right to redress that jurisdictional error in other proceedings." *Id.*

although the burden of establishing new, just and reasonable rates or terms ultimately rests with the Commission.[29]

Here, FirstEnergy has not demonstrated that *EPSA* dictates the conclusion that participation in RPM by reductions in LSE consumption which lower PJM's aggregate capacity procurement is beyond the Commission's jurisdiction. Because capacity procurement must match supply and demand, FirstEnergy's invitation for the Commission to ignore load serving entities' actions that reduce their capacity obligations is on its face unjust and unreasonable, and far beyond any reasonable reading of *EPSA*. Moreover, even if FirstEnergy had satisfied its initial burden, the remedies it proposes are not just and reasonable.

I. FirstEnergy Has Not Shown that *EPSA* Compels the Elimination of all Demand Response from the Capacity Market.

FirstEnergy argues that, because *EPSA* found that the Commission does not have jurisdiction to set compensation for demand response in the energy market, it has no jurisdiction to permit demand response to participate in PJM's capacity market. While debate as to the extent of *EPSA*'s reach is understandable—indeed, there is no question that *EPSA* has fostered great uncertainty regarding the status of demand response in wholesale markets—it does not compel the conclusion that FirstEnergy draws from it.

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[29] *See, e.g.*, *FirstEnergy Servs. Co. v. FERC*, 758 F.3d 346, 353 (D.C. Cir. 2014) ("[I]t is only FERC who is required to shoulder the 'dual burden' [of showing the existing tariff to be unjust and unreasonable and demonstrating a just and reasonable replacement] when it institutes a section 206 proceeding.") *Md. Pub. Serv. Comm'n v. FERC*, 632 F.3d 1283, 1285 n.1 (D.C. Cir. 2011) ("It is the Commission's job—not the petitioner's—to find a just and reasonable rate.").

A. Courts Have Affirmed Commission Jurisdiction Over Capacity Markets Notwithstanding Avowed Demand Response Participation.

EPSA reviewed and vacated only the compensation prescribed by Order No. 745 for economic demand response that is offered as a source of supply in energy markets. The decision does not address capacity markets at all, much less RPM in particular. Indeed, Order No. 745 expressly did not address "programs that RTOs and ISOs administer for reliability or emergency conditions, such as . . . PJM's Emergency Load Response Program,"[30] i.e., the program by which demand response resources honor and implement their capacity commitments to PJM. Therefore, demand response as capacity was not at issue in the *EPSA* litigation.

EPSA's silence on capacity is significant because courts have upheld Commission jurisdiction over capacity as a distinct practice related to the sale for resale of electricity, and in so doing have noted that capacity requirements are addressed in part through demand response. *See, e.g., N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d at 100 (describing the Commission's finding that supply-side market power could "result in less investment in . . . demand-side [capacity] resources"); *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 526 (D.C. Cir. 2010) ("'Resource adequacy is the availability of an adequate supply of generation or demand responsive resources to support safe and reliable operation of the transmission grid.'"); *Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477, 482 (D.C. Cir. 2009) (LSEs "may also seek capacity from interconnected utilities outside the New England power system or 'demand response' contracts where users are compensated for committing to use less electricity during shortages."); *ELCON v. FERC*, 407 F.3d 1232, 1241 (D.C. Cir. 2005) (deferring to the Commission's finding

30 Order No. 745 at P 2 n.4.

that demand resources are compatible with the New York Independent System Operator's demand curve for clearing its capacity market). *See also Cal. Indep. Sys. Operator*, 149 FERC ¶ 61,042, at PP 18, 102 n.128 (2014) (approving, after rehearing *en banc* of *EPSA* was denied, an ISO's proposal for a "flexible capacity" product, defined to include "the capacity of a resource that is operationally able to respond to Dispatch Instructions to manage variations in load," with a "super-peak category" to accommodate, *inter alia*, "demand response").

B. Wholesale Capacity Procurement Under RPM Is Within the Commission's Jurisdiction; Therefore, Ignoring LSEs' Efforts to Reduce Their Capacity Obligations Would Lead to Unjust and Unreasonable Results.

FirstEnergy also overlooks the roles of LSEs in utilizing demand response to reduce their capacity obligations. As noted above, RPM's demand response rules expressly contemplate LSE provision of demand response, and LSEs do in fact provide demand response in RPM. Indeed, for years before RPM, PJM's capacity rules allowed LSEs to obtain credit against their capacity obligation by demonstrating a peak load reduction capability known as "Active Load Management" or "ALM."[31] The demand resource product that was established at the initiation of RPM was, in effect, a carbon copy of the ALM capacity credit product as it existed at that time.

EPSA did not address purchase reduction commitments by LSEs that are parties to the sale-for-resale transactions that the Commission exclusively regulates. Such

[31] *See* PJM Tariff, Attachment K-Appendix, section 8.

commitments to PJM by LSEs fall well within the Commission's authority to set the rates, terms, conditions, and practices affecting such jurisdictional transactions.[32]

EPSA holds simply that FERC's "affecting" authority under FPA sections 205 and 206 cannot be more expansive than the scope of its jurisdiction as delineated by other provisions of the statute. In *EPSA*, the key was section 201(a)'s provision that federal regulation under the FPA "extend[s] only to those matters which are not subject to regulation by the states,"[33] such as retail sales and the retail market for electricity. The court repeatedly emphasized that the "demand response" challenged by the *EPSA* petitioners,[34] concerned "retail electricity consumption."[35]

This reading of *EPSA* is reinforced by the D.C. Circuit's decision a few weeks later in *New England Power Generators Ass'n v. FERC*, 757 F.3d 283 (D.C. Cir. 2014). There, a different panel of the D.C. Circuit (but including Judge Brown, who authored the *EPSA* majority opinion) held that an RTO's rules mitigating buyer market power in a wholesale capacity market are within the Commission's jurisdiction because: (1) the rules prescribe acceptable offers into a wholesale capacity market, and therefore are a matter "affecting" wholesale rates that FERC can regulate under sections 205 and 206; and (2) the rules do not contravene the FPA's express limits on Commission authority, i.e., they

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32 *See, e.g.*, *Cal. Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 403 (D.C. Cir. 2004); *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985); *Municipalities of Groton v. FERC*, 587 F.2d 1296, 1302 (D.C. Cir. 1978).

33 *EPSA* at 221 (alteration in original) (quoting 16 U.S.C. § 824(a)).

34 *See* Order No. 745 at P 2 n.2 (citing 18 C.F.R. § 35.28(b)(4)).

35 *EPSA* at 223.

do not run afoul of section 201(a), because they "do not entail direct regulation of facilities, a matter within the exclusive control of the states." *Id.* at 290.

In short, *EPSA* struck down Order No. 745 because it attempted to prescribe compensation for a retail customer's decision to purchase less electricity at retail—a matter subject to regulation by the states.[36] Accordingly, *EPSA*'s jurisdictional holding does not affect the provision of demand response in wholesale markets by wholesale entities seeking to manage their capacity obligations through the use of demand response programs.

A wholesale customer's decision to purchase less power for resale can affect the clearing price in PJM's single-clearing-price wholesale market; indeed, that reduction in wholesale market demand will often directly affect the wholesale price. Unlike the end user demand response at issue in *EPSA*, however, the wholesale customer's decision to purchase less power at wholesale, and thereby reduce demand in the wholesale market, is within the Commission's authority in ensuring that the RTO is procuring the capacity required to meet reliability standards. Thus, while end user demand response and wholesale-customer demand response both can directly affect the wholesale price, the former, according to *EPSA*, requires FERC to intrude impermissibly in the retail market that is the exclusive province of the states, while the latter does not.

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[36] *Accord S. Carolina Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 52 n.4 (D.C. Cir. 2014) (describing *EPSA* as a case "where this court struck down a Commission attempt to regulate an aspect of retail electricity sales").

FirstEnergy, therefore, cannot justify its claim that *EPSA* precludes all participation by demand response in PJM's capacity market.[37] At the very least, wholesale market participants, i.e., LSEs and others that purchase power for resale, may lawfully provide demand response from the loads for which they are responsible, i.e., the loads that define how much they must buy at wholesale.

II. Even Assuming, *Arguendo*, that *EPSA* Requires Changes to Demand Response in RPM, FirstEnergy's Proposal to Preclude Participation by Any of the Region's Actual Load Reduction Capability Is Unreasonable.

As shown above, FirstEnergy has not demonstrated that *EPSA*, as a legal matter, requires changes to demand response in the capacity market. Even assuming, for the sake of argument, that such a showing had been made, the Complaint's proposed remedies are not just and reasonable. Specifically, FirstEnergy's proposal to recalculate the 2014 BRA results with no consideration of the region's actual load reduction capability is unreasonable. Similarly, FirstEnergy's proposed removal of all PJM Tariff provisions related to demand response participation in RPM is overly broad, and to the extent it would abrogate existing capacity commitments for the current and upcoming Delivery Years, impermissibly retroactive in effect. Accordingly, whatever other action the Commission takes in this proceeding, it unquestionably should reject FirstEnergy's proposed relief.

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[37] FirstEnergy also argues that the PJM Tariff is unlawful because it provides for PJM to pay the same price to demand response capacity resources as to generation capacity, even though generation is subject to different performance obligations and incurs costs that demand response does not. Complaint at 22-23. PJM does not respond specifically to this claim because it is irrelevant, since FirstEnergy proposes no changes to PJM's pricing terms, and instead seeks to exclude outright all demand response from the PJM capacity market.

A. Contrary to FirstEnergy's Claim, the PJM Tariff Does Not Sanction Reopening RPM Auction Results Simply Because a Complaint Is Filed with the Commission.

According to FirstEnergy, section 5.11(f) of Attachment DD of the PJM Tariff provides that the filing of its Original Complaint on May 23, 2014, was sufficient to remove finality from the BRA results that PJM posted on the same day. *See* Complaint at 24-25. FirstEnergy is mistaken.

FirstEnergy relies on the last sentence of section 5.11(f), which states that auction results will not be deemed final in the event they are "under publicly noticed review by the FERC." FirstEnergy establishes no foundation for its assertion that the "most reasonable interpretation of 'notice' under this provision is that it refers to FERC's electronic acknowledgment of a filing."[38]

In accordance with PJM's Commission-approved Tariff, offers in the BRA were submitted during May 12-16, 2014. Also in accordance with its Tariff, PJM calculated and confirmed the results of the auction immediately thereafter, and before FirstEnergy filed its Original Complaint. The May 23 posting of the auction results is a ministerial act that informs market participants of the results *already determined* by the approved RPM rules in place when PJM conducted the auction.

FirstEnergy also fails to mention that the portion of section 5.11(f) on which it relies, begins with the caveat that its provisions apply only "[i]f PJM discovers an error in the initial posting of auction results." PJM discovered no errors in its May 23, 2014 posting of the results of the May 2014 BRA for the 2017-2018 Delivery Year. In particular, the conduct of the May 2014 BRA in accordance with the approved Tariff,

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38 Complaint at 24.

including the participation of demand response, was not an "error." By its terms, therefore, the subject paragraph of section 5.11(f) simply does not apply in this instance. Accordingly, section 5.11(f) provides no support for FirstEnergy's extraordinary request for recalculation of the results of the 2014 BRA.

Though unnecessary to conclude that FirstEnergy's claim is unsupported, the history of section 5.11(f) also undercuts FirstEnergy's position. The indicated sentence was added to the Tariff in 2010 as part of changes PJM made at the request of its independent market monitor ("IMM") for the purpose of providing a transparent process for advising market participants when there are errors in market results, and to establish a fixed window of time within which errors will be corrected, or if no corrections are made, market prices will be deemed final.[39] Nothing in the provision suggests that the mere filing of a complaint with the Commission is enough to supersede the market transparency and price certainty that RPM as a whole is intended to provide. Indeed, FirstEnergy's suggestion that simply filing a complaint is sufficient to make auction results subject to modification would undercut the market stability that section 5.11(f) is intended to foster. Thus, the context in which the sentence was created makes clear, contrary to FirstEnergy's interpretation, that it refers to notice of an IMM referral to the Commission of flawed auction results. FirstEnergy, therefore, has established no foundation, in the PJM Tariff or otherwise, for its proposed recalculation of the results of BRA of May 2014.

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39 *See PJM Interconnection, L.L.C.*, Letter Order, Docket No. ER10-1137-000, at 1 (June 21, 2010); Submittal of PJM Interconnection, L.L.C., Docket No. ER10-1137-000, at 1-2 (Apr. 29, 2010). The current section 5.11(f) was originally designated as section 5.11(e) of Attachment DD. The final sentence of the provision is unchanged from when it was first added to the PJM Tariff in 2010.

B. Even if the Tariff Permitted It, Changing the Results of the 2014 BRA Would Be Unreasonable.

Even if the Tariff permitted such disruption (which it does not, as shown above), the Commission should not change the results of the 2014 BRA. The Commission repeatedly has made clear that, when exercising its remedial discretion to correct tariff or other violations, its policy is not to change settled markets, and the rationale for not changing such market outcomes fully applies here.

As the Commission has explained, "we generally exercise our discretion over remedies and do not order refunds that require re-running a market. . . . Even if PJM could recalculate prices . . . , it cannot retroactively change the output of plants or easily adjust for the differences in cost and output that would result."[40] Similarly, the Commission has expressed its hesitation "to retroactively undo the decisions of market participants. [Retroactive measures] would necessarily be inaccurate because they cannot take into account the changes in behavior that those market participants would have made" if the market error had not occurred.[41]

Here, in FirstEnergy's view, the Commission's "legal error" apparently was to allow demand response to submit offers into RPM. But if that "error" had never been made, and the Commission had never approved rules for end users, CSPs, or others to offer demand response into PJM's wholesale capacity market, the Commission undoubtedly would have taken other measures, consistent with expressed national policy

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40 *Md. Pub. Serv. Comm'n v. PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,169, at P 49, *order on reh'g*, 125 FERC ¶ 61,340 (2008).

41 *Ameren Servs. Co. v. Midwest Indep. Transmission Sys. Operator, Inc.*, 127 FERC ¶ 61,121, at P 157 (2009).

favoring elimination of barriers to demand response participation in wholesale markets,[42] to allow peak load reduction capabilities to be reflected in wholesale capacity procurement decisions *in some other way.* There is no question that "changes in behavior" of the same type that concerned the Commission in *Ameren* would have occurred, because demand response *does in fact exist*, and therefore, even under FirstEnergy's "legal error" scenario, that demand response capability *would have found expression*, one way or another, in PJM's procurement of capacity for the region.

There is no way now to predict how the Commission, the states, market operators, and market participants would have acted to reflect peak load reduction capabilities in wholesale capacity procurement under different RPM rules. Nonetheless, we can say with certainty that such load reduction capability *would not have been ignored*. Consequently, the proper course is for the Commission to do what it has consistently done when confronted with such situations in the past, and exercise its remedial discretion *not* to upset settled markets.

C. FirstEnergy Has Not Justified Its Proposed Immediate Removal of All Demand Response, Including Resources Committed to Meet Regional Reliability Requirements for the Next Two-and-a-Half Years, from PJM's Capacity Market.

In addition to the capacity committed in the 2014 BRA for the 2017-2018 Delivery Year, numerous demand response providers have cleared in past RPM auctions, and thus are obligated to provide load reductions during the current (i.e., 2014-2015)

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[42] The Energy Policy Act of 2005 states that it is "the policy of the United States that . . . unnecessary barriers to demand response participation in energy, *capacity* and ancillary services markets," and requires the Commission to publish annually a report to identify and review, *inter alia*, "steps taken to ensure that, in regional transmission planning *and operations*, demand resources are provided equitable treatment as a quantifiable, reliable resource." Energy Policy Act of 2005, Pub. L. No. 109-58, § 1252(e)(3)(E), 1252(f), 119 Stat. 594 (2005) (emphasis added).

Delivery Year and during the two ensuing Delivery Years (i.e., 2015-2016 and 2016-2017).

FirstEnergy claims that it does not seek to change the outcomes of the capacity auctions for those Delivery Years,[43] but it demands that the Commission remove from the Tariff all provisions by which the commitments made in those auctions would be fulfilled and compensated.[44] FirstEnergy's proposal to remove all demand response from PJM's capacity market is, taken at face value,[45] unlawfully retroactive, and would unnecessarily disrupt PJM's market operations.

FirstEnergy's proposal undeniably would give retroactive effect to *EPSA*'s ruling. Such an outcome would preclude PJM from relying in its market operations on demand response resources that are already committed for the current Delivery Year and the two ensuing Delivery Years. Not only would such a prohibition abrogate the commitments of such resources, but it also would undermine PJM's reliance on demand response to ensure reliability of service.

Even if FirstEnergy is right that the logic of *EPSA* extends to demand resource compensation in capacity markets, the decision should not apply retroactively to commitments made under PJM's Commission-approved Tariff *prior* to the *EPSA* decision. As an initial matter, the Commission "has no power under [FPA] § 206 to order

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43 Complaint at 4.

44 *Id.* at 23-25.

45 If PJM misreads the Complaint, and FirstEnergy's statements that it does not seek to change the outcome of those other RPM auctions means that it does not seek to rescind the commitments of demand resources resulting from those auctions for the current, and two subsequent, Delivery Years, then FirstEnergy should make that intent clear, and thereby moot this aspect of PJM's Answer.

reparations for excessive rates collected in the past,"[46] and therefore its orders generally have very limited retroactive effect. This limitation is expressly reflected in the portion of section 206 that directs the Commission, when it grants relief in a proceeding instituted on complaint, to establish an effective date for any refunds that is *no earlier than* the date of filing of the complaint.[47]

The Commission's establishment of a refund effective date does not control the date upon which any tariff changes would in fact become effective or allow for the retroactive imposition of rate increases or surcharges. While the FPA directs the Commission to establish a refund effective date in each section 206 proceeding, the mere establishment of such a date does not mean that the Commission will impose a rate increase or rate surcharge on transactions that take place between the refund effective date and any final order in the proceeding. Rather, as courts have found, the refund effective date is only used to *lower* rates that have been paid by customers, directing *refunds* back to the refund effective date only when necessary to remedy unjust and unreasonable over-collections.[48]

Further, the cases FirstEnergy cites in support of its claim that "there is no retroactive ratemaking issue"[49] are inapposite to FirstEnergy's claim. In each of those cases, the Commission committed legal error, the unlawful order never became final, a

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46 *Elec. Dis. No. 1 v. FERC*, 774 F.2d 490, 494 (D.C. Cir. 1985).

47 16 U.S.C. § 824e(b).

48 *See City of Anaheim v. FERC*, 558 F.3d 521, 524 (D.C. Cir. 2009) (Section 206(b) "applies in cases where the complainant a *purchaser* alleging that the rates it paid were too high. That provision permits FERC-ordered refunds '*of any amounts paid . . . in excess of* those which would have been paid under the just and reasonable rate.'") (alteration in original) (quoting 16 U.S.C. § 824e(b)).

49 Complaint at 29.

reviewing court overturned (or remanded) the unlawful order, and the Commission made whole the parties involved in the relevant proceeding.[50] In none of the cases on which FirstEnergy relies did the Commission do what FirstEnergy would have it do here: retroactively modify tariff provisions that were approved years ago by final Commission orders, and which expressly established enforceable obligations, merely because an appellate decision on review of *other* Commission orders called into question the basis on which the now-contested orders were issued.

Moreover, contrary to FirstEnergy's assertion,[51] its requested relief is not consistent with the rule against retroactive ratemaking. Retroactive effect is appropriate only "for 'new applications of *existing* law, clarifications, and additions.'"[52] Accordingly, the "governing principle is that when there is a substitution of new law for old law that

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50 *See, e.g.*, *Exxon Co., U.S.A. v. FERC*, 182 F.3d 20, 49-50 (D.C. Cir 1999) (directing relief back to date in the proceeding when a new allocation method was adopted and not on a prospective-only basis); *Pub. Serv. of Colo. v. FERC*, 91 F.3d 1478, 1488 (D.C. Cir. 1996) (directing FERC to permit pipeline (and its customers) to recover charges from natural gas producers in excess of statutory permissible rate back to date of notice that such rate component was at issue); *Pub. Utils. Comm'n of Cal. v. FERC*, 988 F.2d 154, 168 (D.C. Cir. 1993) (rejecting challenge that FERC order allowing pipeline to change methods for recovering certain costs constituted impermissible retroactive ratemaking); c*f. United Gas Improvement Co., v. Callery Properties*, 283 U.S. 223, 229 (1965) (stating that FERC's authority to order refunds under the Natural Gas Act is limited by its power to fix rates under section 5 on a prospective-only basis, but "it is not so restricted where its order, which never became final, has been overturned by a reviewing court").

51 Complaint at 29-30.

52 *Pub. Serv. Co. of Colo. v. FERC*, 91 F.3d at 1488 (alteration in original) (emphasis added) (quoting *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1554 (D.C. Cir. 1993)).

was reasonably clear, the new law may justifiably be given prospective-only-effect in order to protect the settled expectations of those who had relied on the preexisting rule."[53]

Courts have repeatedly acknowledged the participation of demand response resources in organized wholesale capacity markets similar to RPM without even a hint of jurisdictional objection.[54] PJM's Tariff rules permitting demand response resources to participate in the capacity market have been a recognized part of RPM since the Commission's first order on RPM in 2005,[55] and neither FirstEnergy nor any other market participant previously has challenged the Commission's jurisdiction to authorize such activity.

Thus, PJM market participants have relied in their decision-making for years, since RPM's very inception, on Commission-approved rules and auction parameters providing for demand resource participation in PJM's capacity market. Reliance on those rules was and remained reasonable at least until parties were put on notice of a specific legal challenge to demand response participation in RPM. The first notice of any such challenge was the Commission's notice of FirstEnergy's Original Complaint in this proceeding on May 23, 2014, *after* the auctions that established the capacity commitments upon which the PJM Region will depend for the next two-and-a-half years.

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53 *Pub. Serv. Co. of Colo. v. FERC*, 91 F.3d at 1488 (quoting *Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1554 (D.C. Cir. 1993)) (internal quotation marks omitted).

54 *See* the precedents cited on pages 14—15 affirming Commission jurisdiction over capacity programs that were described as including demand response participation.

55 *See PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, at P 84 (2006) ("We are encouraged by PJM's proposal for considering generation, transmission, and demand response together in the Base Residual Auction. . . . The inclusion of these resources is consistent with Commission policy . . . .").

FirstEnergy nevertheless asserts that reliance on the PJM Tariff's long-standing provisions for demand response participation in RPM "cannot exist" when the Commission's jurisdiction is challenged in another proceeding on a related issue.[56] FirstEnergy offers no precedent for its position, nor could it. The Commission's orders approving PJM's capacity market rules have long been final. Parties always may reasonably rely on final Commission orders that are not subject to judicial review. Indeed, the FPA itself contemplates and encourages such reliance. The statute precludes judicial challenges to final Commission action more than 60 days after an order on rehearing.

FirstEnergy could have challenged the RPM auctions in which the capacity commitments of demand resources that it now contests were made, but it failed to do so. Thus, FirstEnergy's position is, in fact, an impermissible collateral attack on the Commission's long-final orders that approved the RPM rules under which those capacity commitments were cleared. As discussed, the FPA permits changes to Commission-approved tariffs to become effective only prospectively, and does not allow reparations for past legal errors. Therefore, even if FirstEnergy is right that *EPSA* precludes retail end users' participation in RPM as demand response resources, the Commission still should reject, as unlawful under the FPA, FirstEnergy's attempt to apply that limitation to past, settled RPM auctions and existing capacity commitments.

Even if persuaded by FirstEnergy's jurisdictional argument regarding demand response in capacity markets, the Commission is certainly not compelled to adopt the

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56 Complaint at 29.

remedy advanced in the Complaint.[57] Should the Commission find that a remedy is required in this case, the more reasoned approach, balancing competing interests favoring settled outcomes and the harm resulting from retroactive intervention, would be to facilitate permissible demand response by LSEs in PJM's wholesale market, and to put in place a mechanism to provide current demand resource commitments by retail entities (and their agents/aggregators) an option to convert or terminate their existing commitments or continue to assume their curtailment performance obligations without receipt of possible energy market revenues in future RPM Delivery Years. PJM describes such an approach in the following section. Enabling such a transition would be consistent with the Commission's findings in Docket No. ER11-3322 that changes to the manner of measuring a demand resource's capacity performance would not be just and reasonable absent an interim mitigation mechanism ending "coincident with the last delivery year for which a base residual capacity auction has been held" so as to "protect[] the reasonable reliance expectations of DR suppliers through the 2014-2015 delivery year."[58]

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57 It is well established that "the breadth of [the Commission's] discretion is, if anything, at zenith when the action assailed relates primarily . . . to the fashioning of policies, remedies and sanctions." *Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir 1967); *see also La. Pub. Serv. Comm'n v. FERC*, 522 F.3d 378, 393 (D.C. Cir. 2008) (The Commission has "ample discretion" in fashioning remedies.); *Ariz. Corp. Comm'n v. FERC*, 397 F.3d 952, 956 (D.C. Cir. 2005) (noting that the Commission "wields maximum discretion" when choosing a remedy).

58 *PJM Interconnection, L.L.C.*, 137 FERC ¶ 61,108, at P 81 (2011); *but see Pepco Energy Servs., Inc. v. PJM Interconnection, L.L.C.*, 128 FERC ¶ 61,051, at P 27 (2009) (making RPM penalty provisions effective as of the complaint's refund effective date because parties "were on notice from the date of the complaint" of the relief sought).

D. In the Event the Commission Does Not Simply Deny the Complaint, It Should Order Additional Procedures in This Docket.

In the event the Commission does not deny the Complaint outright, it should investigate narrower and less disruptive approaches than the relief that FirstEnergy has proposed. As noted at the beginning of this Answer, PJM anticipates submitting (subject to internal approval and the status of the *EPSA* litigation) its own proposals under section 205 (and if necessary section 206) to bring needed certainty to this area before the next BRA. That BRA is scheduled for May 2015, and the present uncertainties about the status of demand response offers in that auction must be resolved sufficiently before that time to allow LSEs, CSPs, and others to prepare for that auction.

To resolve this uncertainty, PJM contemplates filing RPM modifications to establish that demand response henceforth would bid into RPM auctions as a commitment to curtail by wholesale market LSEs, including competitive LSE's in retail choice states. Under this approach, wholesale load would participate on the demand side of the capacity market, and would be modeled as a reduction in the associated LSE's capacity obligation. Such resources would bid a curtailment commitment into the capacity auction at a chosen price. The curtailment commitment bid would affect the demand curve, could set the capacity price, and if cleared, the LSE would avoid paying the clearing price for the amount of curtailed load. Cleared curtailment bids would result in PJM reducing its procurement of capacity for the LSE by the quantity of the entity's cleared curtailment bid(s), plus the applicable reserve margin, and all other things being equal, reduce the clearing price for capacity in the applicable local deliverability area.

To facilitate such wholesale demand response participation, PJM would define in its Tariff the eligibility requirements for a curtailment commitment, and would establish

other requirements as necessary to ensure performance and compliance with market rules. Cleared curtailment commitments would require the LSE to reduce its wholesale demand at PJM's request during the established compliance period. If the demand response resource were called to perform (reduce wholesale load) in the energy market, it would receive no additional payment, but would avoid paying the energy market price for the quantity of reduced load.

PJM also contemplates filing a transition mechanism to minimize disruption to market participants other than LSEs that have already committed demand resources in RPM for Delivery Years 2015-2016, 2016-2017, and 2017-2018. The transition mechanism PJM suggests could be structured as follows:

- There would be an affirmation that demand response capacity commitments already made would be honored. The party that submitted the cleared offer (or that already committed the demand resource in a bilateral transaction) would fulfill that commitment, and would be paid, in accordance with the current capacity market rules.
- PJM would establish procedures under which demand response resources with existing capacity commitments that face the possible loss of energy market revenues as a result of *EPSA* could be released from their RPM capacity commitments. Such resources would receive no capacity credit for a released commitment, and would retain no obligation to perform as demand response in the pertinent Delivery Year(s).[59]
- PJM would take into account the quantity of released demand response resources in setting parameters for the remaining incremental auctions for the three transition Delivery Years, and if necessary would purchase capacity (potentially including wholesale demand response/curtailment commitments) to replace the released demand response commitments.

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[59] The need for a specific filing to cover this option will be examined in light of the level of demand response that otherwise invokes the transition mechanism already filed by PJM in Docket No. ER15-135-000, as well as the extent of CSPs' utilization of the PJM Tariff's existing replacement capacity provisions. *See* Submittal of PJM Interconnection, L.L.C., Docket No. ER14-135-000 (Oct. 20, 2014).

- The demand resource product rules (limited, extended summer, and annual) established for particular Delivery Years would remain in effect for those Delivery Years.

Any such filing by PJM obviously would have implications for this proceeding. Therefore, the Commission should take no action in this docket pending PJM's submission of its filing. PJM is not seeking to delay this matter. Its section 205 filing will seek an effective date prior to the 2015 BRA.

The Commission should not act on the Complaint prior to the issuance of the *EPSA* mandate, which the court has stayed. Obviously, Supreme Court review of *EPSA* could significantly affect this matter. To facilitate coordinated Commission consideration of the filings, PJM requests that, if the Commission does not deny the Complaint, it should:

- set the latest possible refund effective date for the Complaint, i.e., five months from the Complaint's filing on September 22, 2014;
- affirm, consistent with section 206 of the FPA, that any relief granted in this proceeding that would increase RPM prices will be effective only prospectively from the date of final Commission action in this case;[60]
- defer action on the complaint pending PJM's submission of its sections 205/206 filing; and
- if necessary following PJM's filing, establish appropriate further procedures to address the issues raised in this docket.

Admissions and Denials

In accordance with Rule 213(c)(2) of the Commission's Rules of Practice and Procedure,[61] to the extent practicable and to the best of PJM's knowledge and belief at

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60 *See City of Anaheim v. FERC*, 558 F.3d at 524-25 (holding that rate increases imposed under section 206 must have prospective effect only).

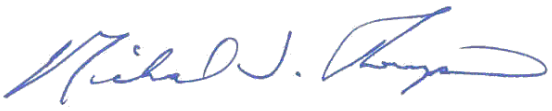
61 18 C.F.R. § 385.213(c)(2).

this time, PJM states that, to the extent that any fact or allegation in the Complaint is not specifically admitted in this Answer, it is denied.

Conclusion

Wherefore, PJM respectfully urges the Commission to deny the Complaint and its requested relief as described above in this Answer.

Respectfully submitted,



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October 22, 2014

ATTACHMENT

The Evolution of Demand Response in the PJM Wholesale Market

PJM Interconnection

October 6, 2014

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Introduction

In any market, the participation of consumer response to price is essential to healthy and competitive market outcomes. This axiom holds true for wholesale electric markets as with any other market. The more that demand actively participates in our wholesale electricity markets, the more competitive and robust the market. Additionally, demand response, if visible and dependable, can and has proven to be an operational tool that assists in maintaining reliability, both in regards to real-time security and long-term resource adequacy. For these reasons, PJM Interconnection remains committed to finding ways to preserve the value that demand response provides to both our system and market operations. PJM also notes our market experience has demonstrated the value of competition among service providers, which has fostered demand response innovations. The market would benefit by preserving this competitive dynamic.

Since the May 2014 decision by the D.C. Circuit Court of Appeals (the "*EPSA*" decision), PJM has considered alternative approaches that would permit demand response to continue to participate in our markets in a manner consistent with the division of jurisdictional responsibility between the states and the Federal Energy Regulatory Commission described in the panel decision. This paper presents PJM's thoughts and rationale to support an approach that would meet these objectives and do so without exposing PJM and its members to unacceptable litigation risk and uncertainty as to settled market outcomes.

Different approaches, other than the approach PJM advances in this paper, are conceptually possible under the *EPSA* decision. Moreover, stakeholders hold differing views generally as to (1) the value of demand response to PJM's markets and operations and (2) its lawful participation in wholesale electricity markets. Indeed, at least one group of PJM stakeholders, and perhaps the FERC itself, will request appeal of the *EPSA* decision to the U.S. Supreme Court, leaving open the possibility of a return to the status quo before the *EPSA* decision. PJM offers this paper to illustrate a viable path forward to evolve demand response in light of the *EPSA* decision, should the FERC decide, after considering its options under the *EPSA* decision (including possible further appeal), that such a path is needed. Ultimately, any path forward will be subject to stakeholder comment and critique and acceptance by the FERC and state regulators. PJM is committed to working with state regulators to develop strategies to monetize the benefits of consumer demand response in the wholesale markets.

Where We Have Come from – a Thumbnail Sketch

Demand response has come to mean many things. Therefore, offering some precise definitional terms helps to promote a shared understanding of options. Currently, curtailment participates most commonly in PJM as a "demand resource." By this (and despite what may appear to be a contradiction in terms) we mean demand resources offer into the PJM markets and are paid as "supply-side" resources. As such, demand resources are expected to perform (more or less) comparably to traditional supply-side resources (generation). In this paper, the term "demand *resource*" describes the supply-side participation of demand, and the term "demand *response*" describes demand (as load) making a curtailment commitment and, in so doing, avoiding costs and charges it otherwise would incur. Peak shaving, active load management and PJM's "price responsive demand" rules are examples of "demand response."

While PJM market rules offer both "demand resource" and "demand response" opportunities, most activity in recent years has taken the form of "demand resource" (i.e. supply-side) participation. There are logical and policy arguments on both sides of the "demand resource" paradigm.[1] The path forward advanced in this paper does not reflect a preference on the part of PJM between these competing economic and policy arguments. Rather, the proposal is informed by the law and analysis represented by *EPSA* and by practicalities which favor an approach that would reduce lengthy litigation risk and the potential for disrupting settled transactions – particularly in the context of the three-year "forward" capacity market administered by PJM.

The Law Following the *EPSA* Decision and Practicalities

The reach of the *EPSA* decision is subject to debate. Technically, the decision vacated FERC Order No. 745, which was confined only to the payment of demand resources in the wholesale energy market. However, the jurisdictional analysis applied by the majority to reach the *vacatur* suggests a precedent that could apply, when litigated, to PJM's Reliability Pricing Model capacity market. The FERC will need to confront this question; indeed, it has been put in play by FirstEnergy's May 23, 2014, filing of a complaint with the FERC seeking to remove demand resources from the 2014 RPM Base Residual Auction. PJM will answer this complaint on or about October 22, 2014. Suffice to note here, PJM's answer will oppose FirstEnergy's complaint and its requested relief.

In considering the implications of *EPSA* to PJM's capacity market, we once again face the question of what is capacity? Arguments can be offered that, unlike energy, capacity is a product (albeit abstract in nature) that can be sold for resale. Whether a product or service, capacity is a uniquely wholesale market concept – one not subject to state regulation and one over which the FERC exercises expansive jurisdictional authority as evidenced by recent decisions out of the Third and Fourth Circuit Courts of Appeal. While PJM acknowledges arguments of this nature, they are uncertain and untested.

Moreover, the linkage between the capacity and energy markets is undeniably strong. After all, the theory underlying the purpose of capacity markets is the recognition that energy markets alone are impeded in providing sufficient compensation to supply – due in part to the suppressing effect of offer caps, reserve margins and other features giving rise to a "missing money" problem that capacity markets are designed to solve. PJM's unfolding capacity performance initiative more explicitly defines capacity in reference to a resource's performance in the energy markets, further suggesting that capacity is simply a form of inchoate energy or a call on energy. The derivative and interdependent nature of the capacity market vis-a-vis the energy market raises the question under *EPSA* whether a commitment to curtail in the capacity market (a demand resource) is functionally any different than a commitment to curtail in the energy market.

The *EPSA* decision is more explicit in focusing on curtailment as the action defining a demand resource and further regarding this action as within the jurisdiction of the states and not the FERC. Yet, PJM does not believe the *EPSA* court squarely addressed the notion of "wholesale curtailment." PJM recognizes this notion. Load serving entities, in partnership with their customers (often under state programs), can manage their wholesale consumption, lower their forecast demand

[1] A thorough treatment of these positions can be found in the comments and the FERC decision finalizing Order No. 719.

requirements and actively manage their consumption of energy at the peaks to lower their capacity obligations. PJM can and does account for these actions in making planning and procurement decisions in the wholesale market. Nothing in the *EPSA* decision prevents PJM from taking such actions to recognize wholesale curtailment actions. In PJM's view, the jurisdictional divide between wholesale and retail under the *EPSA* reasoning allows PJM to account for curtailment only to the extent it reflects the action of a wholesale entity, such as a load-serving entity or competitive retail service provider, and only to the extent such curtailment reflects that entity's own wholesale load.

Finally, PJM will be the first to agree that the *EPSA* decision, both in regards to its scope and its division of state and federal responsibilities, raises numerous unanswered questions and is open to various differing, reasonable interpretations. Accordingly, as noted earlier, one could propose different paths forward and argue such approaches are consistent with or distinguishable from *EPSA*. In arriving at its proposed path forward, PJM sought first to maximize the continuing value of demand in its markets and operations and, second, to do so in a manner compatible with a reasonable interpretation of *EPSA*.

But a third consideration deserves equal weight: risk. Litigation risk can upset market and settlement outcomes as evident from appellate court decisions in recent years remanding transmission cost allocation methodologies and marginal loss surplus allocations. These disruptions, often many years into the future, would upset what were thought to be settled market and billing outcomes and could lead to default and default allocations to members. PJM is particularly mindful of this risk when considering its capacity market. The three-year-forward commitment feature in PJM's capacity market raises a host of complications when it comes to resettling auction outcomes. The amount of money subject to disgorgement can be considerable, and the change in clearing prices given the sensitivity of the supply and demand curves in the auction can be dramatic.

Demand resources participate today in PJM's energy markets under pre-*EPSA* rules. PJM will be clearing capacity auctions in 2015, including the Base Residual Auction in May 2015. The form by which demand is eligible to participate in these auctions ideally would be known before conducting such auctions. Pursuing creative but untested notions of demand as a demand resource in upcoming capacity market auctions and thus facing the prospect of several years of uncertain administrative and judicial litigation serves to undermine completely the very purpose of the capacity market – namely, to provide a certain stream of forward revenues to assist capital formation for resource investment.

In considering PJM's market and operational objectives in maximizing demand participation along with the law and practicalities (including risks) associated with the *EPSA* ruling, PJM proposes an approach to have demand participate in PJM's energy and capacity markets under the following broad terms:

1. As demand response (i.e. demand side). PJM's markets would not separately compensate demand as a supply-side resource. The economics and incentives in having demand participate would result from avoided costs and obligations. State programs, of course, could offer added incentives to both wholesale and retail market participants.

2. Through load-serving entities. PJM would base planning and procurement decisions on commitments bid into PJM's markets by wholesale market entities. These entities, by definition, have control over, or an obligation to serve, specified retail load and can commit to reduce their wholesale load based on curtailment commitments or alternate supply (behind the meter) which they arrange with their end-use retail load. We envision that in many states third-party curtailment service providers will serve a continuing and important function by partnering with load-serving entities to provide their customer management expertise.

Demand Response in Specific Markets Going Forward

Capacity Market

Consistent with the foregoing, PJM describes below a modified approach to demand response participation in the capacity market and, in addition, proposes a transition mechanism to address the question of cleared demand resource bids from past base and incremental capacity auctions.

Wholesale demand response would bid into the capacity auction as a commitment to curtail by wholesale market entities (load serving entities, including competitive retail providers). This alternative would enable wholesale (load-serving entity-based) load to participate on the demand side of the capacity market as "demand response" and would be modeled as a reduction in capacity obligation. The demand would bid a curtailment commitment into the capacity auction at a price. This curtailment commitment bid would affect the demand curve, could set the capacity price and, if cleared, would avoid paying the capacity clearing price. This cleared curtailment would result in PJM procuring less capacity for that load-serving entity in the same amount as the cleared curtailment bid quantity. Under this approach, PJM would define the eligibility characteristics of a curtailment commitment and would establish measurement, verification, penalty and credit requirements as necessary to ensure performance and compliance. The curtailment commitment is essentially a commitment by the load-serving entity to reduce its wholesale demand at PJM's request during the established compliance period. If the demand response curtailment commitment is called to perform in the energy market, it may receive no additional energy market payment,[2] but would avoid an energy payment for the demand reduced.

PJM believes a transition mechanism can be developed based on this alternate approach to minimize disruption to participation by wholesale demand response that is already committed through a capacity auction for delivery years 2015/16, 2016/17 and 2017/18. The proposed transition mechanism is as follows:

- PJM would review demand resource commitments to determine which are load-serving-entity-based and can be directly converted to demand response curtailment commitments.

[2] In implementing *EPSA*, the FERC will decide whether the court decision leaves open any room for the FERC to direct PJM to offer affirmative payments for wholesale curtailment. PJM would have concern with any theory upon which such FERC authority is based, should such a theory be "creative" and subject to the uncertainty of credible and protracted litigation.

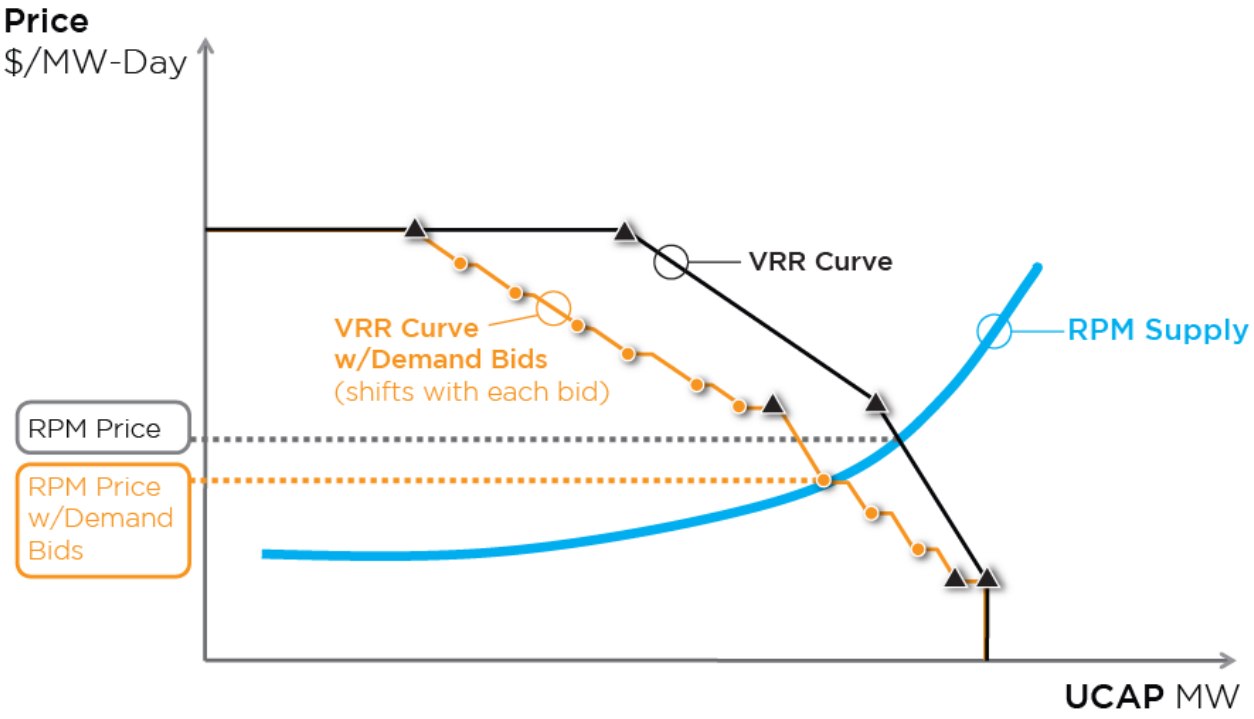
- PJM would develop a mechanism to work with curtailment service providers, states and load-serving entities to explore how demand resource commitments may be transitioned to load-serving entity-based curtailment commitments through assignment arrangements and the like.

- PJM would establish procedures for demand resources that cannot be converted to release them from their capacity commitment. Such resources would receive no capacity credit for their released commitment and retain no curtailment obligation in the delivery year.

- Similar to the pending rules transitioning demand resources affected by the new 30-minute notification requirement, PJM would account for the quantity of released demand resources in the remaining incremental auctions for the three transition delivery years and, if necessary, purchase additional capacity to replace the released demand resources. Additionally, load-serving-entity-based demand response would be eligible to bid into the incremental auctions as demand-side participants.

- The terms of the curtailment commitment in the energy market for each type of demand resource (limited, extended summer and annual) would be preserved during the transition.

Figure 1: Integration of Demand Response Bids with RPM Demand Curve



Shown based on existing PJM Variable Resource Requirement Curve.
PJM has proposed an alternative demand curve as part of the triennial review process.

Energy Market

Depending on the FERC's decisions for demand response compensation, demand reduction in the PJM energy markets may not receive direct compensation from the wholesale market. The PJM Day-Ahead Energy Market permits price responsive demand bids in which load-serving entities can specify a price at which they choose not to consume energy rather than pay energy market clearing prices. The PJM Tariff also includes provisions for Price-Responsive Demand in the Real-Time Energy Market. Under these provisions, a load-serving entity can provide a forecast of aggregated price responsive demand which PJM will model in the regional dispatch to avoid dispatch of generating resources in anticipation of price responsive demand reduction.

Ancillary Service Markets

The participation of demand in PJM's ancillary service markets in light of *EPSA* strikes PJM as presenting a different legal argument than participation by demand in capacity and energy markets. While we would regard any legal basis allowing demand to continue to participate in energy and capacity markets as a demand resource as an intolerably uncertain, PJM believes ancillary service markets might be different. Ancillary services are well-defined wholesale products and services closely tied to the FERC's federal authority over interstate transmission service. They were defined as required elements of open access transmission service in FERC Orders Nos. 888 and 889. Ancillary services are not directly bought or sold at retail by, or from, end users. As such, they are not matters historically under state purview. While ancillary services support the consumption and delivery of electric energy, they are discretely recognized and not, by PJM's way of thinking, so closely linked as capacity might be to energy.

At this time, PJM would propose to pay demand that is eligible to provide frequency regulation and synchronized reserve, as a resource in the markets that PJM operates for those services. Under PJM's construct, demand resource offers in the frequency regulation and synchronized reserve markets could continue to be submitted by both load-serving and non-load-serving entities.

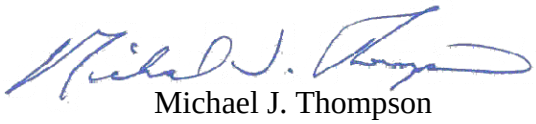
Conclusion

PJM sets forth this approach for consideration by regulators and stakeholders and will address these ideas further in responding to the FirstEnergy complaint. PJM believes it appropriate at this critical time to lay out this "road map" for continued participation by demand in wholesale markets – one that fits within reasonable interpretation of *EPSA*. We do so with the hope that it advances our stakeholder and regulator's consideration of options to restore confidence and certainty in the PJM markets. PJM respects and seeks to understand other views and suggested options. Given the day-to-day continuing operation of our markets and our reliance on these markets to fulfill important aspects of PJM's larger mission (notably, ensuring adequate resources in the face of a changing fuel mix of generation resources), we admittedly will place a premium on policy approaches that can be quickly implemented and that bring certainty, with a minimum risk of protracted litigation or threat of judicial disruption.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 22nd day of October, 2014.



Michael J. Thompson