

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

PJM Interconnection, L.L.C. : ER14-1461-000

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**COMMENTS  
SUBMITTED ON BEHALF OF  
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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**March 31, 2014**

# TABLE OF CONTENTS

	Page
I. INTRODUCTION .....	1
II. BACKGROUND .....	2
III. COMMENTS.....	5
A. By establishing a sell offer that is tied to an actual physical product, PJM will mitigate and reduce speculation. ....	6
B. PJM’s proposed milestones for new generation projects will improve forecasting but need to be more clearly defined and concrete. ....	7
C. PJM’s proposed Replacement Capacity Adjustment Charge and a price floor for IAs will discourage speculative offers that harm reliability. ....	10
D. Revising the timing and purpose of the Incremental Auctions is reasonable. ....	11
E. By reducing the incentive for arbitrage and risk-free speculation, PJM’s proposal allows RPM to send transparent price signals that encourage new entries and prevent premature retirements.....	12
F. While PJM’s proposal is a necessary fix and should be approved, PJM must take a more proactive approach in addressing the RPM construct.....	14
1. Forecasting .....	14
2. Frequent RPM changes should be avoided. ....	16
IV. CONCLUSION.....	17
V. CERTIFICATE OF SERVICE.....	20

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The Public Utilities Commission of Ohio (Ohio Commission) respectfully files these Comments in response to PJM Interconnection, LLC's (PJM) March 10, 2014 proposed revisions, as revised on March 14, 2014, to its Reliability Assurance Agreement among Load Serving Entities in the PJM Region (RAA) and the PJM Open Access Transmission Tariff (Tariff).

**I. INTRODUCTION**

The Ohio Commission is charged with assuring that Ohioans have access to adequate, safe, and reliable public utility services at a fair price. Ohio is a retail choice state for electric generation service. As a state that facilitates competitive electricity markets, we are able to provide a valuable and unique perspective to the Commission.

The decisions PJM makes as the manager of transmission and the operator of wholesale energy and capacity markets, directly impact the reliability of our electric system and the costs necessary to maintain an optimum level of reliability. Approximately

21.4 percent of PJM’s entire load is attributed to Ohio. Consequently, the Ohio Commission is well positioned to evaluate the impact of PJM’s filing.

## **II. BACKGROUND**

In order to meet its reliability objectives and to encourage the development of new capacity resources, PJM depends on its incremental auction construct for members who fail to meet their generation requirement. However, in its filing, PJM maintains that “there are unmistakable indications that Capacity Market Sellers are submitting speculative offers — not disciplined by reasonable expectations of delivery of the specific offered resource — into the BRA and other RPM Auctions.”<sup>1</sup> Submitting an offer that is not tied to a physical capacity resource “is corrosive to RPM’s long-term reliability objectives because it suppresses clearing prices, potentially forcing resources that otherwise would have cleared to leave the market, and discouraging new entry at the true cost of capacity.”<sup>2</sup>

PJM proposes tariff changes to discourage speculative bidding in the reliability markets by imposing measures to thwart the perceived gamesmanship in the Base Residential Action (BRA) and Incremental Auctions (IAs). PJM offers a package of reforms as opposed to a more piecemeal approach that could result in unforeseen loopholes.

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<sup>1</sup> *PJM Interconnection, L.L.C.*, Docket No. ER14-1461-000 (Revisions to the PJM Open Access Transmission Tariff and Reliability Assurance Agreement Among Load Serving Entities in the PJM Region to Limit and Protect Against Speculative Offers Submitted in RPM Auctions at 1) (Mar. 10, 2014) (“ER14-1461-000 Application”).

<sup>2</sup> *Id.* at 2.

Fundamentally, PJM argues that financial arbitrage opportunities are being exploited at a potential cost of reliability. Bidders who lack physical deliverability bid into the BRA at prices that may deter existing and new resources from entering the market. Then, bidders buy out of their commitments in IAs at prices that are significantly less than the amounts they are paid in the BRA. “The average cost to purchase replacement capacity across all IAs conducted to date has been only 30.8% of the value assigned to those capacity commitments by the BRA.” PJM adds, “[f]ocusing on the three Delivery Years for which all three IAs have been conducted (*i.e.*, 2012-13, 2013-14, and 2014-15), the weight-averaged replacement cost (for all areas) has ranged from 16.2% to 28.2% of the BRA value of those capacity commitments.”<sup>3</sup>

Speculative bidders can profit in the BRA without providing electrons. The current system unintentionally creates incentives for BRA sellers to speculate for a financial upside, and they increasingly are taking advantage of it.<sup>4</sup> Accordingly, PJM asks the Commission to approve of the following changes to its tariff and RAA:

**Physicality:** Bidders for the first time would be required to ensure physical delivery of products by the beginning of the Delivery Year.

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<sup>3</sup> ER14-1461-000 Application at 11.

<sup>4</sup> Monitoring Analytics, *Analysis of Replacement Capacity for RPM Commitments: June 1, 2007 to June 1, 2013*, The Independent Market Monitor for PJM (Sep. 23, 2013), [http://www.monitoringanalytics.com/reports/Reports/2013/IMM\\_Report\\_on\\_Capacity\\_Replacement\\_Activity](http://www.monitoringanalytics.com/reports/Reports/2013/IMM_Report_on_Capacity_Replacement_Activity).

**Planned Resources Development:** Sellers who base their offers on a Planned Generation Capacity Resource greater than 20 MW would submit to PJM a Facilities Study Agreement, including a Project Development Schedule.

**Planned Generation Sanctions for Failure to Deliver:** A planned generation resource that is not in service at the start of the Delivery Year for which it was committed may be prohibited from participating in future auctions.

**Deliverability Assurances:** Bidders would submit Non-Diversion Agreements that ensure they will not replace capacity committed in RPM to sell it to another market. External resources would secure letters of non-recallability endorsed by their host balancing authority to ensure deliverability.

**Capacity Resource Deficiency Charge:** To create a greater deterrent, PJM would increase the existing charge to the greater of 1.5 times the BRA Resource Clearing Price or \$50. Correspondingly, PJM would increase the RPM Auction Credit Rate for Planned Resources by 150 percent.

**Replacement Capacity Adjustment Charge:** PJM would institute a charge equal to the difference between the BRA price and the IA price, assessed to any transaction in an IA.

**Incremental Auctions:** PJM would eliminate two of three existing IAs, unless a significant revision is made to reliability requirements. Prices in the IA would be floored at the BRA clearing price.

### **III. COMMENTS**

The Ohio Commission recommends that the Commission approve PJM's proposed tariff revisions as a package. Taken as a whole, PJM's revisions will discourage speculative offers in the BRA and IAs by emphasizing the physical nature of the RPM construct. Reliability will improve as entities will be required to identify actual physical resources in conjunction with their offers in the BRA. Further, more accurate price signals will be able to emerge, encouraging new entries into the market. Transparent price signals will also prevent unnecessary and premature generation retirements. The Ohio Commission opines that while this proposal should be approved, it also highlights the need for PJM to review its forecasting methodologies and consider foreseeable consequences that may arise through its continuous RPM tariff revisions.

**A. By establishing a sell offer that is tied to an actual physical product, PJM will mitigate and reduce speculation.**

The Ohio Commission agrees that RPM was originally structured, premised and dependent on commitments of physical capacity resources that must make themselves physically available to PJM dispatch either by producing megawatts of energy or reducing consumption of energy during peak or emergency conditions.<sup>5</sup> The rationale behind this requirement is not only to ensure reliability but also to reduce the risk of resource inadequacy by providing verifiable and quantifiable capacity resources that meet the reliability needs of PJM's member loads.<sup>6</sup>

In its original construct, RPM appropriately provided a limited opportunity for a capacity market seller to be excused from its capacity commitment based upon unforeseen or "force majeure" circumstances that prohibited the supplier from delivering its cleared megawatts for the applicable delivery year. However, there has been an increase in speculative bidding in the BRA that is not based on intended delivery of actual capacity in a delivery year, but rather reflects the fact that the RPM clearing price has typically been higher than the clearing prices in the IAs.<sup>7</sup> This price separation allows for a capacity market seller to offer a speculative resource into the BRA knowing that it can buy out

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<sup>5</sup> ER14-1461-000 Application at 6.

<sup>6</sup> *Id.*

<sup>7</sup> See ER14-1461-000 Application at 4 (citing to *Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477, 479 (D.C. Cir. 2009) ("Cooperation may be necessary to avoid a free rider problem, where some utilities count on the capacity they expect others to buy in order to support their own reliability."); *PJM Interconnection, L.L.C.*, Docket. No. ER13-2108-000 (Answer of the Independent Market Monitor at 1) (Sep. 13, 2013).



of its position in subsequent IAs, thereby creating an increased supply of capacity offers in the BRA.<sup>8</sup> Speculative offers artificially suppress prices for all capacity resources bidding into RPM.<sup>9</sup> The Ohio Commission is extremely concerned that continued price suppression may lead to premature and uneconomic retirements, and could discourage suppliers from making economic investments in new resources in the region.<sup>10</sup>

By approving PJM's proposed revision to require that sell offers be tied to an actual physical product, PJM will mitigate and reduce speculation and the current tendency for capacity market sellers to overestimate megawatts.<sup>11</sup>

**B. PJM's proposed milestones for new generation projects will improve forecasting but need to be more clearly defined and concrete.**

PJM proposes a Project Development Schedule that is a projection of achievement dates for key milestones anticipated by a planned generation capacity resource greater than 20 MW in size.<sup>12</sup> By implementing project milestones, PJM will be able to more accurately predict the impact of planned generation and reduce the likelihood of an

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<sup>8</sup> ER14-1461-000 Application at 8 (noting that the current tariff allows sellers of capacity to buy out of their positions).

<sup>9</sup> *Id.* at 7.

<sup>10</sup> *See id.*

<sup>11</sup> *See PJM Interconnection, L.L.C.*, Docket. No. ER13-2108-000 (Answer of the Independent Market Monitor at 8) (Sep. 13, 2013) ("The enforcement of an obligation to both identify and deliver a physical resource, combined with appropriate penalties for noncompliance, would eliminate the buy out strategy.").

<sup>12</sup> ER14-1461-000 Application at 28.

offered planned resource clearing the BRA under overly optimistic forecasts of the actual deliverability of the resource.

The Ohio Commission supports PJM's proposal to include a schedule of specific project development milestones for planned generation. However, the proposed guidelines are unclear on what the milestones actually entail and provide no guidance as to how PJM will determine the reasonableness of each schedule. Rather, the proposal superficially reflects that dates of seven critical development milestones should be submitted to PJM within 30 days of the BRA, with no requirements for periodic updates or review of the original submission.<sup>13</sup>

PJM's proposal reflects an oversimplification of a planning process that requires years of research, development and financing. For example, ascertaining the completion date of item "(iv) securing of all necessary federal state and local permits associated with siting, air emissions, and water use and discharge"<sup>14</sup> would be impossible to determine with any certainty until closer to the delivery date and would necessarily require guessing on the part of suppliers. If the planned generation fails to provide the committed resource, PJM proposes to prohibit that resource from offering into any subsequent RPM auction, absent the showing of extenuating circumstances. This result would render moot any milestone schedule provided three years earlier by the planned unit, and therefore, the schedule would serve no purpose as currently proposed by PJM. This is extremely

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<sup>13</sup> ER14-1461-000 Application at 28.

<sup>14</sup> *Id.*

concerning, because without clear guidelines to provide certainty and guidance to new market participants, new entrants might avoid entering the market. It is imperative that PJM's milestones be more clearly defined and concrete, and they should not simply defer all discretion to PJM for a game time decision.

The Ohio Commission recommends several improvements to PJM's proposal regarding milestones. Suppliers should update the information on a periodic basis prior to the applicable delivery year. PJM should incorporate a specific process to account for scenarios that may occur when planned generation fails to meet specific milestones. PJM needs to refine its waiver process to avoid punishing newly planned generation for setbacks beyond the control of the developer and to allow for new generation to enter RPM as soon as possible.

PJM should not restrict a new entrant from offering into an auction for subsequent delivery years unless PJM receives unresponsive or extremely inaccurate information when gathering milestone data and progress reports. Rather than providing ultimate deference to PJM for determinations regarding this matter, the Ohio Commission recommends that the Independent Market Monitor (IMM) review the milestone and waiver information provided by planned generation.

In sum, the Ohio Commission supports PJM's proposal to require milestones. However, the process and guidelines should be clarified in order to avoid future confusion. As it is foreseeable that disputes may arise without any clear guidelines, we recommend that the Commission address this issue in this docket. With clearly defined

guidelines, PJM will not only reduce the risk for planned generation but also will improve reliability by increasing the certainty of when new generation will be available.

**C. PJM’s proposed Replacement Capacity Adjustment Charge and a price floor for IAs will discourage speculative offers that harm reliability.**

The Ohio Commission agrees with PJM that no meaningful efficiencies or benefits are lost by removing the profit incentive that currently exists with replacement capacity in RPM.<sup>15</sup> The BRA clearing price should be the primary indicator of capacity revenues available from RPM. As stated by PJM, “market-clearing prices should reflect the marginal seller’s cost, and not the marginal seller’s costs less an RPM speculative profit.”<sup>16</sup> Therefore, the Ohio Commission generally supports PJM’s proposal to assess a Replacement Capacity Adjustment Charge<sup>17</sup> on every replacement transaction and to implement a price floor in the IAs equal to the BRA price for that delivery year.

The Ohio Commission notes that this single proposal goes the furthest to remove speculative offers from RPM.<sup>18</sup> While the Ohio Commission agrees that these specific details will eliminate speculative offers, we recognize that the replacement capacity

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<sup>15</sup> ER14-1461-000 Application at 35.

<sup>16</sup> *Id.*

<sup>17</sup> The Capacity Adjustment charge is equal to the difference between the BRA price and the IA price, assessed anytime the BRA price is higher than the IA price.

<sup>18</sup> See *PJM Interconnection, L.L.C.*, Docket No. AD13-7-000 (Comments of the Independent Market Monitor for PJM at 5) (Jan. 9, 2014) (noting that in the PJM capacity market, performance incentives are inadequate because they provide overpayment for underperformance).

charge and the BRA price floor are merely artificial price mechanisms rather than efficient market signals, and may serve to punish those with a legitimate need to replace physical capacity in an IA. Nonetheless, we agree with PJM that under the RPM administrative construct, replacement capacity was designed simply to preserve capacity at committed levels or to procure additional capacity to meet reliability needs.<sup>19</sup> The opportunity to profit, a function of true markets, is not appropriate under this construct, and, therefore, the Ohio Commission supports these aspects of PJM's proposed package of revisions.

**D. Revising the timing and purpose of the Incremental Auctions is reasonable.**

Currently, PJM's RPM construct provides parties an opportunity in each of its IAs to buy out of their capacity commitments.<sup>20</sup> The Ohio Commission agrees with PJM that the current three-IA structure "permits a seller to engage in repeated capacity sales and buy-backs over the course of four auctions for a delivery year; [this potentially allows sellers to] reap multiple profits on the same MWs for [that] delivery year."<sup>21</sup> Thus, reducing the IAs from three to one and allowing for conditional auctions will limit this behavior while also allowing PJM to more accurately determine, closer to the delivery

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<sup>19</sup> ER14-1461-000 Application at 35.

<sup>20</sup> See *PJM Interconnection, L.L.C.*, Docket No. ER13-2108-000 (Answer of the Independent Market Monitor at 3) (Sept. 13, 2013) (explaining that the fact that there are three incremental auctions in which parties can buy out of their capacity commitments creates significant problems).

<sup>21</sup> ER14-1461-000 Application at 37.

year, whether it has procured the appropriate level of capacity needed to secure the region's reliability needs.

**E. By reducing the incentive for arbitrage and risk-free speculation, PJM's proposal allows RPM to send transparent price signals that encourage new entries and prevent premature retirements.**

The Ohio Commission agrees with PJM that by increasing the financial consequences associated with non-delivery of committed capacity, capacity market sellers will offer only those resources that they reasonably believe will be available and deliverable in the relevant delivery year.<sup>22</sup> By reducing speculative actions and removing incentives through financial means, actions by capacity market sellers that are artificially suppressing prices in the BRA should be mitigated.<sup>23</sup>

Furthermore, by removing unrealistic resource assessments in the BRA, prices will be based on actual resources that are physically deliverable, and will discourage market sellers from overestimating the physical capability of their resources. This will lead to a more accurate assessment of resource adequacy in PJM, resulting in informed decision-making by both planned and existing generation.<sup>24</sup> Existing generators may delay plant

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<sup>22</sup> ER14-1461-000 Application at 43.

<sup>23</sup> ER13-2108-000 (Answer of the Independent Market Monitor at 5) (Sep. 13, 2013) (providing an example of arbitrage).

<sup>24</sup> See *id.* at 1-2 ("The tariff requirement that all capacity resources...be physical is a necessary but not sufficient condition to ensure the efficient and competitive operation of the PJM capacity market.").

retirements and planned generation may have a greater incentive to build additional facilities in the PJM region.

As a part of PJM's package of reforms to address replacement capacity issues, PJM is proposing to increase the current Capacity Resource Deficiency Charge.<sup>25</sup> The charge is assessed when a committed capacity resource is unavailable or unable to deliver its committed capacity for a relevant delivery year. PJM is proposing to increase this charge so that a capacity market seller will be required to pay a 50% penalty (or if higher, \$50/MW-day) in addition to paying back an amount equal to the capacity payments it has received to date as a result of clearing the BRA.<sup>26</sup> The Ohio Commission believes the proposed Capacity Resource Deficiency Charge is reasonable and should be approved.

PJM states that its "proposed change to the deficiency charge necessitates a conforming change to the credit requirements for participation in RPM auctions"<sup>27</sup> as currently contained in its Tariff. According to PJM, the calculations used to determine the new credit requirements are the same, except that the revised deficiency charge has been incorporated into the existing calculation. The Ohio Commission avers that PJM's proposed increase to its credit requirement will appropriately protect other PJM members from the exposure of a capacity market seller's default as a result of the higher deficiency rate. It is reasonable to place the burden of protecting against this exposure on the RPM

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<sup>25</sup> ER14-1461-000 Application at 41.

<sup>26</sup> *Id.* at 43.

<sup>27</sup> *Id.*

participant taking the action that gives rise to the risk. PJM's new credit requirements are also reasonable and should be approved.

**F. While PJM's proposal is a necessary fix and should be approved, PJM must take a more proactive approach in addressing the RPM construct.**

The Ohio Commission recommends that the Commission order PJM to undertake a comprehensive review of its current forecasting methodology. PJM should also take more proactive steps to ensure it does not fall into the trap of constantly revising its tariffs without consideration of foreseeable consequences that constant changes may have on state policy decisions and private investments.

**1. Forecasting**

PJM notes that even after accounting for and addressing market design rules that may lead to IA prices clearing below the corresponding BRA prices, features inherent to any resource adequacy construct, including conservative forecast estimates, may still bias the IA results towards lower clearing prices. PJM notes that forecasting used in reliability planning is inherently conservative as it seeks to protect against the failure of the system to serve loads. PJM observes the following about its RPM forecasts:

PJM has carefully reviewed its load forecast changes for the relevant delivery year and has found that those forecasts were for the most part accurate, that changes in the load forecast were largely due to changes in expected econometric forecasts, and that many independent economic forecasts over-



estimated the pace of the nation's economic recovery during the relative time period.”<sup>28</sup>

The Ohio Commission recommends that the Commission order PJM to undertake a comprehensive review of its forecasting models in RPM. Accurate load forecasting is an important underpinning to procuring adequate resources to serve load.<sup>29</sup> Over-procurement does not serve any purpose except to suppress prices and present the observed opportunities for arbitrage. Further, the Ohio Commission does not agree that the pace of economic recovery is an adequate reason to dismiss inaccurate forecasting.

It is worth noting that the IMM recently called for a review of PJM's forecasting processes as well.<sup>30</sup> In comments to the Commission regarding centralized capacity markets, the IMM stated that it would be appropriate to review existing methods for determining resource adequacy requirements including a review of forecasting methods to ensure that forecasts are reasonable and consistent.<sup>31</sup> The Ohio Commission could not agree more. Accurate forecasts not only foreclose opportunities for arbitrage for certain capacity market sellers but they provide a more precise picture of the need for pool-wide generation resources and serve to remove risks for sellers participating in RPM.

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<sup>28</sup> ER14-1461-000 Application at 17, n. 25.

<sup>29</sup> *Centralized Capacity Market Design Elements*, Docket No. AD13-7-000 (Commission Staff Report) (Aug. 23, 2013) (“More accurate forecasts lead to more accurate procurements of capacity, helping to mitigate economic and resource adequacy risk for customers.”).

<sup>30</sup> See *Centralized Capacity Markets in Regional Transmission Organizations and Independent System Operators*, Docket No. AD13-7-000 (Comments of the Independent Market Monitor for PJM at 11) (Jan. 9, 2012).

<sup>31</sup> *Id.*

Specifically, in addition to continuing existing efforts to refine the load forecasting model, the Ohio Commission recommends that PJM continue to expand the documentation and explanation of its updated load forecasts to state commissions and stakeholders.<sup>32</sup> Consistent with the Brattle Group's assessment of RPM, we also recommend that any and all forecast changes, including any perceived forecast uncertainty, be provided in a detailed and timely manner to state commissions and stakeholders.<sup>33</sup> The Ohio Commission maintains that this will allow state commissions and stakeholders to have a better sense of the forecasting process and how it affects PJM.<sup>34</sup>

## **2. Frequent RPM changes should be avoided.**

While the Ohio Commission strongly supports PJM's proposal as a package, the continuous trend of rewriting RPM rules and changing market parameters is troubling and may discourage investments in PJM's territory. State policy decisions and private investment decisions, including the planning for new generation units and consideration by operators to retire existing units, are dependent on certainty and stability in PJM's auction processes. Without regulatory certainty, PJM may face longer term reliability issues if its RPM construct is not given an appropriate opportunity to evolve without constant changes.

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<sup>32</sup> The Brattle Group, *Second Performance Assessment of PJM's Reliability Pricing Model*, at 128-131 (Aug. 26, 2011).

<sup>33</sup> *Id.* at 130.

<sup>34</sup> *Id.*

The Ohio Commission commends PJM for making necessary changes by removing the incentive to speculate on its BRA and IAs, but the physical nature of the RPM construct should have been set forth back during the IA updates made in 2009, and not raised for the first time in this proceeding.<sup>35</sup> The Commission should encourage PJM not only to evaluate its internal forecasting measures, but also should implore PJM to look beyond just a Band-Aid approach of fixing short-term problems to consider the foreseeable long-term consequences that may result from its continuous tariff revisions.

#### **IV. CONCLUSION**

The current RPM has led to artificially low prices that could deter existing generators from participating in the capacity market and lacks incentive for new generation to be built within PJM. Over time, we have seen an increase in price separation from the BRA to the subsequent IAs and a rise in speculative bidding that is not backed by any assurance of physical delivery. Although the circumstances have not yet led to a reliability problem within PJM, the Ohio Commission shares PJM's concern that remedies are needed.

Specifically, the Ohio Commission supports the imposition of requirements to assure physical delivery, and, with modifications, its establishment of milestones for planned generation through a project development schedule requirement. We also support the concept of a Replacement Capacity Adjustment Charge and flooring IA bids at the BRA price to eliminate financial arbitrage, even as we are concerned that those

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<sup>35</sup>

*PJM Interconnection, L.L.C.*, 126 FERC ¶ 61,090 (2009).

mechanisms may punish those who have a legitimate need to replace capacity. Cutting back to one IA, under most circumstances, is an effective way to reduce opportunities for bidders to buy out of their capacity commitments, as PJM suggests. Combined, those changes are likely to raise auction bids to a point where they may encourage existing generators to forego plant retirements and new generation to be built. The Ohio Commission also agrees that raising the Capacity Resource Deficiency Charge and its related Auction Credit Rate would raise the stakes on suppliers whose defaults can damage reliability.

Absent from PJM's proposal but of concern to the Ohio Commission is the mismatch between PJM's forecasts and the actual reliability needs of the RTO. If the forecasts had been more accurate, bidders would have had fewer opportunities to use the BRA and IAs to their financial advantage and to create the reliability concerns that PJM's filing attempts to rectify. As PJM's objective is to arrive at an accurate determination of demand so that capacity market sellers can respond appropriately, a review of PJM's forecasting methodologies is necessary and should be ordered by the Commission. With those caveats, the Ohio Commission supports the PJM filing. Accordingly, as PJM's proposal is just and reasonable, consistent with Rule 205, the Ohio Commission respectfully requests that the Commission approves PJM's tariff revisions, incorporating the Ohio Commission's recommendations set forth herein.

Respectfully submitted,

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**On behalf of  
The Public Utilities Commission of Ohio**

**V. CERTIFICATE OF SERVICE**

I hereby certify that the foregoing have been served in accordance with 18 C.F.R. Sec. 385.2010 upon each person designated on the official service list compiled by the Secretary in this proceeding.

*Thomas W. McNamee*

**Thomas W. McNamee**

Dated at Columbus, Ohio this March 31, 2014.

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Filing Party/Contacts	Filing Party	Signer (Representative)	Other Contacts (Principal)
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Summary: Comments submitted by Assistant Attorney General Thomas McNamee to the Federal Energy Regulatory Commission on behalf the Public Utilities Commission of Ohio to be filed in FERC Docket No. ER14-1461-000, In re PJM Interconnection, LLC. electronically filed by Kimberly L Keeton on behalf of Public Utilities Commission of Ohio