

Problem Statement:

Definition of Variable Operation and Maintenance Costs

Issue:

The PJM Operating Agreement Schedule 2 (b) provides for generators to include the following short run incremental costs in cost-based energy offers:

- Incremental fuel cost;
- Incremental maintenance cost;
- Incremental labor cost; and
- Other incremental operating costs.

The current definition of incremental or short run marginal costs, in Manual 15 “Cost Development Guidelines” does not clearly specify the components of variable operations and maintenance (VOM) that are incremental and includable in cost-based energy offers. Some components of VOM may currently not be includable in cost-based offers in the appropriate market (capacity market or energy market).

There also has been a considerable amount of CDS discussion on the administrative cost of calculating components in Manual 15 due to the lack of standardized cost accounting methods. Additionally, the historical FERC based calculation process does not address all units, such as those units not required to account under FERC derived accounting definitions and Long-Term Service Agreement (LTSA) units. Another area of concern is how to account properly for VOM costs for immature units.

Issue Source:

The MMU initially brought this issue forward for consideration by the Cost Development Subcommittee (CDS). After receiving questions from generation owners regarding what costs are includable in the Avoidable Cost Rate in the RPM Capacity Market, the MMU concluded that the definition in Manual 15 needs clarification. Other market participants brought forward related VOM issues.

Background

Manual 15 details the standards recognized by PJM for determining cost components for markets where products or services are provided to PJM at cost-based rates, as referenced in Schedule 1, Section 6 of the Operating Agreement of PJM Interconnection, L.L.C. Generation Owners use Manual 15 to develop their cost based offers.

Assignment of Responsibility:

Governance of Manual 15 is the primary scope of responsibility for the CDS and is therefore the appropriate stakeholder body to address this issue. This lies directly within the existing CDS

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charter and no charter modifications are needed. Further as CDS is a standing Subcommittee, no charge is required from the Markets and Reliability Committee (MRC).

Objectives and Expected Activity:

1. Using the proposal matrix developed by the CDS members (Appendix 1, Proposal Matrix), the CDS will create a preferred, clear definition of the components of variable operations and maintenance costs to be included in energy cost offers.
2. The definition will also provide reasonable transparent cost based alternatives for units under LTSA's and immature units.
3. Alternatives for non-FERC related accounting methodologies and options to reduce the administrative burden related to developing VOM costs shall be considered.
4. The CDS will use the proposal matrix to craft appropriate manual language for Manual 15 reflecting this definition.

Areas defined as out-of-scope:

Costs included in RPM are outside the charter of CDS and will not be considered as part of this proposal.

Expected Deliverables:

A proposal with the CDS preferred modifications to Manual 15 that address the components of variable operation and maintenance costs to be included in energy cost offers for all types of generating units will be presented to the MRC and the MC.

Expected Milestones and Deadlines:

| Meeting | Activity |
|------------------------|--|
| CDS: January 31, 2011 | Review Problem Statement |
| CDS: February 28, 2011 | Education and Fact Finding |
| CDS: March 21, 2011 | Identify and Explore Interest |
| CDS: April 25, 2011 | Develop Options for Each Component |
| CDS: May 23, 2011 | Develop Comprehensive Changes |
| CDS: June 20, 2011 | Develop Recommendations (including consensus and multiple options) |
| MRC: June 22, 2011 | Report to Senior Committee |
| MRC: July 20, 2011 | Endorsement vote at MRC |
| MC: August 25, 2011 | Endorsement vote by MC |

Approval by the PJM Board of Managers will follow the endorsement of the MC.