

November 26, 2008

**VIA EMAIL AND FIRST CLASS**

Mr. W. Terry Boston  
President and CEO  
PJM Interconnection, LLC  
955 Jefferson Avenue  
Norristown, PA 19403

Mr. Howard Schneider  
Chairman, Board of Managers  
PJM Interconnection, LLC  
955 Jefferson Avenue  
Norristown, PA 19403

**RE: Load Group Proposal for RPM Enhancements**

Dear Mr. Boston and Mr. Schneider:

The undersigned customers and customer representatives are writing to express appreciation for PJM's efforts in leading a stakeholder process to discuss enhancements to the PJM reliability pricing model ("RPM"). That stakeholder process was founded on the basis of the evaluation of RPM by PJM's consultant, the Brattle Group ("Brattle Report"), and has identified several significant enhancements that are needed for RPM to achieve the objective of ensuring long-term resource adequacy at the lowest possible cost.

The RPM Load Group (which was referred to in the Members Committee Voting Report as the "RPM Buyers Group") writes to explain the rationale for the elements of the comprehensive proposal that it developed on the basis of PJM's proposal. The RPM Load Group proposal received majority support from the PJM Members Committee on November 20, 2008 ("Majority Proposal"). The RPM Load Group respectfully requests that PJM adopt the Majority Proposal as the PJM proposal, and file the proposal (with the necessary accompanying PJM Tariff changes) in its forthcoming filings with the Federal Energy Regulatory Commission ("FERC"). We understand that the FERC Order on Technical Conference required a report within 15 days of the conclusion of the stakeholder process (i.e., on or about December 5, 2008), with tariff changes to be filed by December 15.

Below we provide a high-level explanation for each element of the Majority Proposal. Where necessary or appropriate, reference is made to corresponding elements of the "PJM Comprehensive Proposal" that was also subject to voting at the November 20 Members Committee meeting.

### **Element 1: Gross Cost Of New Entry ("CONE")**

The RPM Load Group disagrees that any increase to Net CONE, or any administrative update to Gross CONE, is necessary at this time. The RPM Load Group's position is supported, in part, by PJM's assessment of the results of the 2011/2012 RPM Based Residual Auction ("BRA"). Specifically, PJM claims that the prices in the 2011/2012 BRA attracted a significant amount of new generation investment, from multiple fuel sources. The RPM Load Group's position is further supported by recent events in the world economy – the demand for power, new power plants, and other commodities that had driven sharp increases in CONE estimates have significantly weakened in the past two months, and prices are dropping rapidly. The RPM Load Group proposes that actual auction results guide future changes to RPM's price parameters, and that PJM's focus should be on developing and refining the empirical Net CONE update process, based on historical auction clearing prices, in time for the 2013/2014 auction. No change to Gross CONE is appropriate or necessary at this time.

### **Element 2: Energy and Ancillary Services Offset**

Because the RPM Load Group sees no need to adjust Net CONE at this time, current tariff provisions, which calculate an energy and ancillary services ("E&AS") offset using a three-year historical average, should remain in effect for now. Consequently, the E&AS offset for Delivery Year 2012/2013 should be based on 2006-2008 energy and ancillary services revenue.

The RPM Load Group also recognizes, as does the Independent Market Monitor ("IMM"), that revenue resulting from scarcity pricing in the energy market is duplicative of RPM revenue paid to cleared Capacity Resources. Accordingly, the RPM Load Group agrees with the IMM that cleared Capacity Resources should not receive revenue from scarcity pricing in the energy market, and that such adjustments are most appropriately made at the time of settlements for the real-time energy market. Addressing the revenue stream duplication at the time of real-time energy market settlements would avoid the need for accounting adjustments after-the-fact through an adjustment to the E&AS offset.

### **Element 3: Energy Efficiency**

As part of a comprehensive proposal, the RPM Load Group supports PJM's proposal to allow energy efficiency ("EE") projects to receive RPM revenue for up to four consecutive Delivery Years, subject to the other caveats and clarifications included in PJM's proposal. The RPM Load Group's position on EE as part of the RPM Load Group's overall proposal represents a compromise among the diverse views on EE shared by RPM Load Group members. A number of members of the group continue to believe that appropriately documented energy efficiency should be compensated in the capacity market in each year

that the measure serves load and clears the auction, exactly as generators are compensated.

#### **Element 4: Market Power Mitigation Reform**

The RPM Load Group supports changes to the existing RPM market power mitigation provisions as proposed by the Brattle Report. The RPM Load Group generally supports PJM's proposed revisions to the Capital Recovery Factors ("CRFs"), which lengthen the amortization period for investments in certain assets to more realistic timeframes. The RPM Load Group also strongly supports requiring major capital investments to use the longer amortization schedules, and permitting allowances for capital expenditures in the first year, as recommended by the Brattle Report.

Also, the RPM Load Group opposes any changes to the current tariff provisions on EFORd Offer Segments. Such changes were included in PJM's Comprehensive Proposal, but were not recommended by the Brattle Report. The EFORd Offer Segments should continue to be subject to a must-offer requirement, as they are today under the PJM Tariff.

#### **Element 5: Modeling of Local Deliverability Areas ("LDAs") In RPM Auctions**

The RPM Load Group generally supports PJM's proposal to implement a bright-line test for determining whether major transmission projects will be included in the planning parameters for RPM base and incremental auctions. However, the RPM Load Group is concerned that the PJM proposal includes some overly rigid and rather arbitrary milestones for filing Certificates of Public Convenience and Necessity and completion of transmission projects, and has made changes accordingly in the RPM Load Group Proposal.

With regard to PJM's proposal for including Locational Deliverability Areas ("LDAs") in RPM, the RPM Load Group believes it is appropriate to address changes to the CETL/CETO thresholds concurrently with changes to the methodology for determining the reliability requirements that are imposed on LDAs, as recommended in the Brattle Report. Addressing the two issues in combination would help strike a more appropriate balance between identifying the areas that require additional investment and ensuring that over-procurement of new resources and excessive prices do not occur in those areas.

#### **Element 6: Increase Resource Eligibility in RPM Auctions**

The RPM Load Group supports PJM's proposed clarifications to facilitate partial year resource participation and planned external resource participation in RPM auctions. However, the RPM Load Group supports implementation of two additional Brattle Report recommendations intended to increase the resources that are available for participation in RPM auctions: (1) allowing the excess capacity held by fixed resource requirement ("FRR")

entities to be offered into RPM auctions, and (2) provisions to accommodate summer-only capacity.

#### **Element 7: Incremental Auction Redesign**

The RPM Load Group agrees with PJM that substantial modifications are necessary to the way in which RPM incremental auctions are conducted. The RPM Load Group also agrees, generally, with PJM's proposal to procure a small portion of the RPM reliability requirement in incremental auctions to create opportunities for short lead-time resources, as recommended by the Brattle Report. However, the RPM Load Group believes that such short-lead time resources comprise approximately 5% of the reliability requirement.

The RPM Load Group provides a few other clarifications as well. RTO and LDA reliability requirements should be updated in each incremental auction based on all elements of capacity demand that may significantly change, as recommended in the Brattle Report; this should include the load forecast, CETL, and also the target installed reserve margin. PJM's sell offers to adjust resource commitments in incremental auctions should be based on the cleared capacity in excess of the adjusted reliability requirement.

#### **Element 8: Interruptible Load For Reliability ("ILR")**

The RPM Load Group generally agrees with PJM's proposals on ILR, assuming that the RPM Load Group's positions on incremental auction redesign are accepted. At bottom, the changes to ILR provisions should result in no diminution in value for demand resources relative to the value provided by the existing tariff provisions.

#### **Element 9: New Entry Pricing**

The RPM Load Group is sensitive to the challenges being faced by developers in attracting capital investment for new projects. Accordingly, the RPM Load Group supports New Entry Pricing for new planned resources and for existing resources that are making significant capital investments exceeding \$100/kW. The RPM Load Group supports allowing new resources to receive stable revenue streams over a multi-year period, assuming the resource clears in the first BRA in which it bids, and would provide this opportunity to all types of resources throughout the RTO region.

One key distinction between the PJM proposal and the RPM Load Group proposal concerns the bidding requirements for cleared New Entry Resources in Year 2 and in subsequent years for which the New Entry Pricing option was elected. Whereas PJM proposed to accept non-zero bids by those resources in subsequent auctions, the RPM Load Group strongly supports a requirement that those resources must offer at \$0/MW/day in subsequent years, as recommended by the IMM. This structure will allow new resources to attract capital based on stable revenue commitments, while not permitting economic

withholding of those resources in subsequent years, which would artificially increase RPM prices for loads and all other resources.

#### **Element 10: RPM Penalty Structure**

The RPM Load Group generally supports PJM's proposed changes to various RPM penalty mechanisms, including the daily deficiency rate, Load Management Event Compliance Penalties, and Peak Hour Period Availability Penalties. The RPM Load Group also generally supports PJM's proposed penalties for seldom-run units, but believes that a resource's decision on whether to use EFORd or EFORp should remain in effect for a four-year period.

#### **Element 11: Capacity Resources In Day-Ahead Energy Market**

The RPM Load Group generally agrees with PJM's proposal that cleared capacity resources must offer on economic schedule, if they are not on forced or maintenance outages, unless the criteria for Maximum Emergency schedule offers are met.

PJM's proposal, however, addresses only part of the equation. It has become evident to the RPM Load Group that the PJM tariff rules do not necessarily preclude cleared Capacity Resources from submitting extremely high energy offers. This point became particularly evident as a result of FERC's investigation into a certain "high offer strategy." In order to address this shortcoming in the interrelationship between RPM tariff provisions and energy market tariff provisions, the RPM Load Group urges PJM to commit to a process for obligating cleared Capacity Resources to bid at marginal cost into the day-ahead energy market. As it stated repeatedly during the CMEC process, the RPM Load Group is open to discussion on a reasonable definition of "marginal cost," including opportunity costs for environmentally run-limited units.

\* \* \*

The RPM Load Group appreciates the challenge of developing an internally consistent and coherent package of enhancements to the RPM tariff provisions. The RPM Load Group's proposed combination of proposals is firmly grounded in the recommendations of the Brattle Report and designed and intended to help the PJM region achieve desired levels of resource adequacy in a cost-effective manner. The RPM Load Group is confident that its changes will address many of the concerns raised in the Brattle Report and begin to remedy the tariff provisions that led to anomalous results in the early RPM BRAs.

Thank you for your close attention to, and thoughtful analysis of, these very critical issues.

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Sincerely,

RPM Load Group

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