THE P3 GROUP

November 18, 2011

PJM Board of Managers
PJM Interconnection, L.L.C.
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Re: RPM Filings

Dear Board of Managers,

Since its inception in 2007, P3[1] has consistently supported efforts to improve PJM's capacity market. Properly structured capacity markets offer enormous value to consumers as capacity sellers compete against each other to provide the necessary capacity in the most economically efficient manner.[2] As capacity markets are dynamic, it is appropriate to continually monitor, analyze and improve them when appropriate.

As such, P3 supports most of the PJM recommendations set forth it its August 26, 2011, letter to PJM Members on items mandated by the tariff as part of the Triennial Review. P3 also supports the portions of the Brattle recommendations that PJM promoted with regard to the optional Member-directed issues that are outside of tariff mandates. For each of the issues that will be considered by the PJM Board next week, we explain our rationale below. As a general principle, P3 supports revisions that promote market-based outcomes which accurately reflect market fundamentals and promote reliability in a non-discriminatory fashion. We encourage the Board to consider these matters through the same lens.

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[1] The comments contained in this letter represent the position of P3 as an organization, but not necessarily the views of any particular member with respect to any issue. Combined, P3 members own over 88,000 megawatts of power, own over 51,000 miles of transmission lines, serve nearly 12.2 million customers and employ over 55,000 people in the PJM region. For more information on P3, visit www.p3powergroup.com.

[2] The Brattle Group ("Brattle") appropriately observed that RPM has, "attracted and retained sufficient capacity to maintain resource adequacy" in PJM. Supply has exceeded demand in all regions of PJM despite tightening environmental regulations and the retirement of 5,000 MWs of generation. Moreover, Brattle found that the price of capacity in PJM has been consistent with the supply-demand balance in the region.

Triennial Review

Gross CONE –P3 supports PJM's proposals to retain the nominal levelized method for determining cost of new entry ("CONE") values and to retain the mechanism for gross CONE increases based on the Handy-Whitman Index in years in which CONE studies are not performed. Brattle's alternate recommendation to use real levelized CONE values was premised on developing a forward-looking calculation of energy offsets, a calculation which stakeholders debated at length, but which proved to be impracticable.

Regarding the proposed update to gross CONE values, however, P3 is concerned that several key construction costs were erroneously valued by the Brattle Group's contractors, leading to understated gross CONE values for both the combustion turbine and combined cycle generating plants. Both of these values appear to be significantly understated with respect to fundamental cost components such as construction man-hours and turbine capital costs. In addition, at least for some areas, the studies have failed to account for local environmental requirements and soil conditions and thus omitted provisions for certain required features or equipment. In other instances, the interconnection cost estimates appear to be based on historical data that bears little resemblance to current costs. Although these issues were raised in the stakeholder discussions, they were not satisfactorily resolved and will likely need to be addressed in proceedings at FERC. Nonetheless, P3 highlights these concerns to encourage the Board to carefully consider whether the proposed gross CONE values accurately reflect costs to construct in PJM and to underscore that at a minimum the nominal levelized method for determining CONE should be retained.

Energy & Ancillary Services ("EAS") Offset– P3 supports revising the current method to calculate the EAS offset, which assumes that the proxy generator is only dispatched in the Real Time market. A first consideration in estimating any generator's revenues is whether the unit is committed in the Day-Ahead Market, and, if not, whether it would be subsequently dispatched in Real-Time. PJM's proposal, consistent with Brattle's recommendation, follows such logic and mimics actual unit commitment. To the extent that Day-Ahead and Real-Time prices diverge (they have historically and have the potential to do more frequently under shortage pricing), PJM's proposal will appropriately reflect this divergence in calculating net CONE. P3 asks the Board to accept PJM's recommendation.

VRR Curve – Brattle appropriately identified several shortcomings of the current construction of the VRR curve. For example, Brattle observed that the curve can collapse during periods of high EAS market revenues. P3 agrees with Brattle's recommendation to increase the height of the left side of the VRR curve to the level originally proposed by PJM in 2006. The

proposed level is based on the simulations performed by Dr. Hobbs demonstrating that the proposed shape provides for the greatest system reliability.[3] The proposed modification to the shape of the VRR curve will allow higher cost resources to clear if necessary to avoid a reliability shortfall when resources are scarce. P3 also supports the clarification that net CONE cannot fall below zero.

Member-directed Issues

2.5% Holdback - P3 has consistently maintained that the 2.5% holdback is an anathema to a properly designed and well-functioning market in PJM that jeopardizes the reliability of the RTO. PJM systematically under-procures capacity by applying the holdback. In doing so, PJM distorts the price signals that are necessary to drive the market and ensure reliability while overtly discriminating between classes of capacity supply resources. The dramatic growth of demand response since the inception of RPM has made the reliability problems associated with the holdback more acute. P3 encourages the Board to eliminate the holdback in its entirety. Short of complete elimination, the Brattle compromise to restrict the holdback to the limited DR product is a step in the right direction and a viable interim measure.

Long-term Voluntary Capacity Agreements – P3 appreciates the desire expressed by some stakeholders to provide price persistency for new capacity seeking to enter the market. In concept, P3 agrees with the voluntary mechanisms described by PJM to match willing buyers with willing sellers to create capacity agreements that are perhaps longer than one year in duration and extend beyond the current three year forward commitment. P3 looks forward to a productive stakeholder process to address the many important details of such a structure.

MOPR Exemptions – Stakeholders have advanced several proposals to develop exceptions to the Minimum Offer Price Rule, including specific exceptions for "self-supply" or modifications to the established Fixed Resource Requirement (FRR) alternative. P3 suggests that these exceptions are superfluous, unnecessary accommodations to special interests.

As clearly established in FERC's April 12, 2011 order and reinforced in its November 17 order on PJM's compliance filing, any party seeking an exemption from the Minimum Offer Price Rule may do so by submitting the party's actual cost to build new generation to the IMM

[3] The Brattle Group, *Second Performance Assessment of PJM's Reliability Pricing Model* ("Brattle Study") , Table 21, at p. 103 (demonstrating that the PJM/Brattle proposal provides cleared resources in excess of the reliability requirement 77% of the time in historical simulations).

and PJM for approval. As FERC stated in the April order, "a sell offer would be permissible when such offer is consistent with the competitive, cost-based, fixed, nominal levelized, net cost of new entry were the resource to rely solely on revenues from PJM-administered markets." P3 believes that FERC's standard provides ample opportunity for new entrants to show that a bid below MOPR is justified based on their unique cost structure or business model. The Board should not seek to redefine this standard as part of any upcoming filing. Despite stakeholder pressure to expand avenues to circumvent the MOPR, the Board should stand firmly in support of the FERC-articulated standard and uphold the integrity of the MOPR which is fundamental to a competitive capacity market.

LDA Modeling – Like PJM, P3 supports Brattle's recommendation to provide greater transparency to the transmission modeling process. Greater visibility to future CETL dynamics, as well as more frequent load forecast updates will lead to a more efficient market. P3 supports the near term changes to improve CETL/CETO transparency brought forth by the PJM Planning Staff to be effective for the next BRA. In addition, P3 supports the Brattle Group recommendation that PJM more proactively model LDAs that "have a large fraction of capacity resources at risk for needing environmental upgrades."[4] The PJM tariff currently provides PJM with the discretion to separately model LDAs for RPM auctions that do not meet the specific triggering criteria based on PJM's finding that separate modeling may be necessary to "achieve an acceptable level of reliability consistent with the Reliability Principles and Standards."[5]

Consistent with our comments above, P3 urges the Board to present these necessary RPM improvements to FERC for its consideration.

Finally, at the time this letter was transmitted, the Markets and Reliability Committee meeting has been held. Two proposals at the November 16 meeting received super-majority approval. It is not clear whether these results, or similar results, will occur at the November 22 Member's Committee.

The members of P3 recognize that the achievement of a super-majority vote is not without significance and should not be set aside without good cause. Examination of member voting patterns at the MRC, however, negates the presumption of consensus that might normally be reflected in a super-majority vote. Several vote margins are almost entirely attributable to divergences among buyer and supplier interests, dominated by the influence of two voting blocs,

[4] Brattle Study, p. 120.

[5] *See* PJM OATT, Attachment DD, Section 5.10 (a)(ii)(C).

and thus do not reflect genuine consensus among sectors. For these reasons, P3 cautions the Board against over interpreting the MRC votes or possible similar outcomes at the Members Committee. P3 anticipates further communications with the Board regarding inequities associated with the PJM voting structure.

As always, P3 appreciates the Board's consideration of our comments and the opportunity to engage directly with Board members on this and other matters.

Respectfully submitted,

Glen Thomas

Glen Thomas, President,

PJM Power Providers Group

Glen Thomas, President • gthomas@gtpowergroup.com • 610-768-8080

1060 First Avenue, Suite 400, King of Prussia, PA 19406 • www.p3powergroup.com