September 5, 2014

The PJM Board of Managers
c/o Howard Schneider, Chairman
PJM Interconnection, L.L.C.
2750 Monroe Boulevard
Audubon, PA 19403

Dear Mr. Schneider and the Board of Managers,

As an organization, P3 has consistently supported efforts to improve and enhance PJM’s capacity market.¹ The promise of the capacity market--allowing consumers to access the lowest priced capacity consistent with maintaining reliability--is a meaningful one that demands constant vigilance and evaluation. Properly structured capacity markets offer enormous value to consumers. P3 appreciates the Board of Managers’ commitment to capacity markets and is pleased to participate actively in efforts to enhance them through the ongoing capacity performance initiative.

In order for capacity markets to work as intended, it is imperative that the foundations of the RPM auction be set appropriately. In particular, the Cost of New Entry (“CONE”) must reflect market conditions and the Variable Resource Requirement (“VRR”) curve must yield stable investment signals over the long run. If these foundations are established correctly, RPM will perform better over both the short-run and the long-run. As a result, resource adequacy will be met at the lowest possible cost to consumers.

PJM has consistently followed a Member-supported and FERC-approved Triennial Review process to develop these key inputs to the RPM auctions. As part of this process, stakeholders have been afforded enormous opportunity to offer input and suggest improvements. In fact, PJM has expanded the time allotted for stakeholders to consider and deliberate PJM’s recommendations. Consistent with past practice, the stakeholders have made their recommendations to the Board; it is now time for the Board to act.

Regarding the proposal, P3 agrees with PJM’s proposed changes to the shape of the VRR curve as recommended by the Brattle Group and PJM’s recommendation to shift the curve 1% to the right. The proposed shape and the shift of the demand curve will enhance the long-run performance of the curve, ultimately improving auction outcomes, and supporting long-run reliability. P3 also agrees with the selection of the Combustion Turbine as the reference resource technology.

¹ The contents of this letter represent the views of P3 has an organization and not necessarily the views of any individual P3 member with respect to any issue.
However, P3 disagrees with PJM’s proposed cost of capital assumptions, which significantly diverge from the current state of the market in a manner that materially alters the CONE calculation. Specifically, P3 is concerned that the cost of debt, cost of equity and the debt/equity ratio are not realistic. According to analysis prepared by the PA Consulting Group and presented to the PJM stakeholders in July, Brattle’s after tax WACC numbers are inappropriately below market. P3 agrees with the well-documented PA Consulting analysis that places the after tax WACC number closer to 13% than the 8% proposed by Brattle. PJM’s proposal should be reformed accordingly.

P3 is also concerned about the proposal to move to a forward looking Energy and Ancillary Services offset at this time. PJM staff’s proposed forward Energy and Ancillary Services formula incorrectly calculates the future revenues expected by a generator and fails to recognize the necessity for making parallel reforms to use a consistent methodology for developing Market Seller Offer Caps. Despite our concerns with the current proposal, P3 members are open to further consideration of forward-looking offsets.

Finally, P3 underscores the importance of expeditiously completing and instituting the Triennial Review reforms, as described above. Contrary to the suggestions of others, these reforms should not be delayed. The purpose of the Triennial Review is distinct from the capacity performance proposal. The components of the Triennial Review work to establish the volume of procured capacity to meet resource adequacy standards. In contrast, the capacity performance proposal describes the attributes of the capacity commitment. Further, the outcome of the capacity performance proposal is uncertain. Its uncertainty should not cloud the completion of the Triennial Review. We note, however, that the tariff does not constrain PJM from modifying any of the Triennial Review components, if warranted, as part of the development of the capacity performance proposal.

P3 appreciates the Board’s consideration of these thoughts and looks forward to the eventual FERC filing on this important matter.

Respectfully submitted,

/S/ Glen Thomas

Glen Thomas, President