The IPP Coalition appreciates the efforts made by PJM to modify its initial August 20, 2014 proposal (the “Initial Proposal”) to take into account the concerns raised by members of the IPP Coalition and others. These changes have resulted in a revised proposal that is, as a general matter, better structured to encourage investment in Capacity Performance (“CP”) resources that will provide enhanced reliability benefits to the PJM region.

Although the IPP Coalition encourages PJM to take steps to implement the Updated Proposal as soon as possible, we caution PJM to modify its transition auction plans in order to avoid the over-procurement of capacity that would impose excess costs on consumers, not necessarily meet the reliability goals intended, and have unintended adverse consequences for the PJM markets. Rather, PJM should enable a transition auction process to first incent best practices or investment among existing generation with RPM commitments in order to procure more reliable capacity in the least cost manner without causing disruption to the PJM markets.

The IPP Coalition supports the Updated Proposal, but believes it can be strengthened to better provide the incentives PJM seeks by (i) modifying the transition auctions, (ii) providing additional guidance on offer caps to encourage suppliers to reflect the risk-weighted cost of their

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1 West Deptford Energy, LLC is LS Power’s PJM Voting Member.
2 Tenaska Power is the PJM Voting Member for Tenaska and its affiliates.
3 Capitalized terms not otherwise defined herein have the meaning set forth in the Updated Proposal or, if not therein defined, the PJM Open Access Transmission Tariff (“Tariff”).
investments in their capacity offers; and (iii) limiting inefficient, unduly risk-adverse expenditures by excusing performance under truly unforeseeable, uninsurable circumstances.

**THE IPP COALITION**

The IPP Coalition own and operate over 10,000 MW of power generation in PJM consisting of single-fueled and dual-fueled combustion turbines and combined cycle, steam turbines, pumped storage, run-of-river hydro and solar facilities. The IPP Coalition has invested billions of dollars in PJM over the past several years through the construction of new power generation, bringing facilities into compliance with all environmental requirements, and the acquisition of existing generation. The IPP Coalition has also made the long-term decision to bring certain power generation from neighboring markets into PJM.

**COMMENTS**

It will take significant investment, as well as operational and business changes, for existing generating resources to take on the obligations PJM envisions for the CP Product. The IPP Coalition therefore supports many of the revisions made by PJM to its Initial Proposal, which are necessary to provide the financial incentives and cost recovery required to meet PJM’s CP goals. Accordingly, PJM should promptly implement the Updated Proposal, with certain modifications discussed herein, that will reduce the burden imposed on load, minimize disruptions to the energy and capacity markets, and better reflect the risks associated with owning and operating CP resources.

**A. The IPP Coalition Supports Many Of The Features Of The Updated Proposal**

The Updated Proposal has the fundamental framework to (1) create a defined, consistent and reliable capacity product that will provide fuel security and weather-related reliability, and (2) provide more accurate price signals regarding the value of, and need for, the CP Product. In

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4 The IPP Coalition is also actively developing over 4,000 MW of power generation in PJM.
particular, the following features of the Updated Proposal are critical to provide certainty and to incentivize investment in CP resources:

- Reliance on market signals and an appropriately-designed penalty structure to incent CP Product performance rather than artificial qualification criteria that would unnecessarily exclude resources from participation as a CP Product.
- Recognizing that the current Short-Term Resource Procurement Target, or 2.5 percent holdback, dampens price signals, and therefore proposing to eliminate the use of this holdback.
- Eliminating multiple products designed to accommodate lower-performing resources.
- Permitting CP resources to offset penalties through excess production, from uncommitted resources, or through bilateral purchases.
- Acknowledging that suppliers must have the ability to reflect performance risk in their offers by providing resources the ability to offer up to the Net Cost of New Entry ("CONE") for the CP Product to fairly reflect the value of the product being provided.

The IPP coalition also generally supports the concept PJM has proposed to incorporate a multi-year investment mechanism to provide longer-term pricing stability within the capacity market. This proposed rule change is a fundamental change to the PJM capacity construct, and as such, PJM needs to outline the specific details of this concept so it can be fully evaluated.

B. The Transition Mechanisms Should Be Modified To Avoid Unnecessary Costs And Market Disruptions

The IPP Coalition notes that this is the first time PJM has put forth details on the transition mechanisms for stakeholder review and appreciates an opportunity to provide comments on the proposed mechanisms.\(^5\)

The IPP Coalition understands and supports PJM’s desire to begin implementing a CP structure as soon as possible in order to ensure that the operational issues that arose in the winter of

\(^5\) PJM’s Initial Proposal merely included the concept of a transition mechanism and did not include a detailed proposal as contained in the Updated Proposal.
2013/2014 do not reoccur. However, the transition mechanisms contained in the Updated Proposal result in excessive and unnecessary costs and unintended impacts to the overall market. Specifically, the Updated Proposal is deficient in two major respects.

First, it fails to take into consideration the capacity and reliability improvement costs that have already been committed for the transitional Delivery Years in response to winter peak market signals. As a result, the proposed transition mechanisms will result in the procurement of excess capacity at a higher cost to consumers.

Second, for all transitional Delivery Years, PJM is procuring new additional capacity without offsetting existing capacity obligations. This additional procurement results in excess capacity that will have the unintended consequence of distorting market signals, threatening the economic viability of existing generation with RPM commitments and suppressing investment. Accordingly, the IPP Coalition recommends that PJM modify the transition mechanisms as described herein.

1. 2015/2016 Delivery Year

PJM states that it will address a potential capacity shortfall in the 2015/2016 Delivery Year by, among other things, “[i]ncrementally procur[ing] up to 10,000 MW of additional Capacity Resources for the winter season (December 2015 – March 2016) . . .”\(^6\)

a. Flaws with the Updated Proposal

The Updated Proposal provides for PJM to procure as much as 10,000 MW of additional Base Capacity for the 2015/2016 winter season. This approach wrongly emphasizes over-procurement of Base Capacity which may not resolve the identified reliability concern. PJM is not proposing to implement any other facets of its Updated Proposal (i.e. penalty structure), and therefore it is unlikely that the newly procured Base Capacity will perform to PJM’s expectations

\(^6\) Id. at 34.
and provide the reliability needed during extreme events such as last winter. Furthermore, the capacity available for PJM to procure is otherwise uneconomic and being operated and maintained in anticipation of retirement – capacity that in of itself will be less reliable with little to lose. PJM has established the current capacity product doesn’t work – procuring more of it will not make it work.

Additionally, the procurement of additional Base Capacity will result in unintended, longer-term consequences that will adversely affect the health of the markets and jeopardize PJM’s goals in implementing a CP Product in the first instance. Such procurement will mean that a significant amount of capacity that was not economic and did not clear in the BRA or Incremental Auctions (“IAs”) for the 2015/2016 Delivery Year will be entering or retained in the market. This will result in PJM significantly over-procuring capacity at the expense of customers and requiring suppliers who have upgraded their facilities to share capacity revenues with those who have not. These newly-procured resources will likely remain operational for the summer season (even without capacity payments for the remainder of the Delivery Year), further distorting market signals and dampening investment incentives.

b. IPP Coalition Recommendation

(i) Establishing the Need

As an initial matter, PJM should evaluate the true need for any additional capacity. Such evaluation must consider the extent to which existing capacity resources have taken steps to improve reliability since last winter,\(^7\) including investments related to weatherization and contractual commitments for firm fuel supply in future years. In developing the transition auction approach, PJM has simply assumed a forced outage rate equal to the one experienced last winter,

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\(^7\) January 2014 represented the coldest and most extreme weather conditions experienced since 1994. Many generation resources had never experienced such extreme temperatures given that over 50,000 MW became operational after 1994.
but has not provided any support for such an assumption. In fact, the IPP Coalition is aware that many generators were not satisfied with performance last winter and have already taken steps to ensure improved cold weather performance, and merely incorporating last winter’s EFORd into PJM’s assumptions does not necessarily reflect the performance of the current generation fleet or produce an accurate need assessment.

Accordingly, PJM should conduct a survey of the generation resources that experienced outages last winter to understand whether future performance will be improved.\(^8\) Every MW that has taken a step to improve its reliability is one less MW that PJM needs to incrementally procure.

(ii) Supplemental Procurement

To the extent the needs assessment described above demonstrates that supplemental procurement is necessary, PJM should design an auction to minimize cost, and that will not distort the capacity or energy markets in such a way that threatens the economic viability of existing generation with RPM commitments or otherwise suppresses investment.

Rather than the Base Capacity procurement proposed in the Updated Proposal, a better approach is to first incent best practices or investment among existing generation with RPM commitments in order to procure capacity in the least cost manner without causing disruptions to the energy market. Examples include some of the approaches outlined in the Updated Proposal, such as improving gas/electric market coordination, allowing gas units to update offers intraday, and addressing the $1,000/MWh cost-based offer limitation.

Additionally, the IPP Coalition recommends introducing a CP transition auction similar to the one proposed for the 2016/17 and 2017/18 Delivery Years. Although the Updated Proposal expresses concern that it would not be feasible to transition to a CP product by the 2015/2016

\(^8\) PJM has initiated a survey of generation owners in advance of the winter of 2014/15 that could be expanded to identify investments made to improve reliability.
winter season “due to the short time available for investment in winterization, dual-fuel capability, firm fuel contracts, etc.,” the IPP Coalition’s experience indicates that, although dual-fuel capability may not be achievable, suppliers do have adequate time to obtain firmer fuel contracts, and to make winterization and other facility improvements. Incentivizing generators to go after this “low hanging fruit” is certainly a preferable approach to bringing in thousands of megawatts of uneconomic generation of unknown reliability.

(iii) Winter MW Capability

To the extent PJM pursues procurement of additional Base Capacity for the 2015/2016 winter, it should minimize the costs to consumers by looking first to those resources with RPM commitments. Specifically, PJM should recognize that resources, for RPM purposes, utilize their lower summer ratings since the system has historically operated as a summer peaking system. Given the current focus on winter reliability, cleared generation should be permitted to offer the difference between their winter-rated and summer-rated capacity to satisfy PJM’s procurement goals. This approach will minimize costs, because the resources that will be participating will already have capacity payments for that Delivery Year.

2. 2016/2017 and 2017/2018 Delivery Years

For the 2016/17 and 2017/18 Delivery Years, PJM has proposed a “replacement”, rather than an “incremental”, approach to CP. Specifically, PJM proposes to “hold an auction to procure a transitional version of the [CP] product”\(^9\) for the 2016/17 and 2017/18 Delivery Years, for which it has already secured approximately 155,000 MW of Base Capacity for each Delivery Year.

a. Flaws with the Updated Proposal

PJM proposes that if a resource that already has an RPM commitment clears as a CP Product, the CP Product would “replace” its previous commitment. In other words, the CP

\(^9\) Updated Proposal at 34.
transition auction clearing price would replace – rather than be incremental to – the BRA clearing price. Conversely, if a resource that already has an RPM commitment does not clear as a CP Product, then PJM proposes to procure additional CP Product from previously uneconomic resources that do not already have RPM commitments. This approach would result in excess costs to consumers as it fails to recognize the embedded cost that consumers are already paying for existing RPM commitments.

Fundamentally, replacing an existing RPM commitment is an entirely different economic proposition than procuring an entirely new commitment. For example, a resource committed in the RTO region to the 2017/18 Delivery Year will be getting paid $120/MW-Day. To the extent it would bid and clear in the “replacement” auction at $150/MW-Day, the incremental cost to consumers would be $30/MW-Day. In contrast, a previously uncommitted, uneconomic resource clearing in the “replacement” auction at $150/MW-Day would represent an incremental cost of $150/MW-Day. The key is that the newly committed, uneconomic resource is not otherwise “replacing” an existing economic commitment, it is incremental to it. Not only would consumers be paying more, existing generation would be harmed as PJM has now over procured capacity which would distort market signals in both the capacity and energy markets.

Attempting to conduct a “replacement” auction will also introduce unnecessary complication and odd price disparity given that resources with existing RPM commitments are being paid different prices based on LDA location and in which auction they may have committed. This is further complicated by PJM’s proposal to implement an overall price cap given the concern enough CP Product may not exist.

b. IPP Coalition Recommendation

PJM has indicated that approximately 80% of capacity should be CP Product. For 2016/17 and 2017/18, such a percentage would indicate that roughly 125,000 MW of the existing 155,000
MW of RPM commitments would ideally be “transitioned” to CP Product. The cost for these resources to transition to a CP Product is an incremental cost to the existing product that already has been committed. Correspondingly, the transition auction should reflect only the resources’ incremental costs for qualifying as a CP Product.

As such, the CP transition auction clearing price should represent an incremental price that resources get paid above their base commitments. If a resource does not have a base commitment, it should obtain one bilaterally or through an IA. Doing so would ensure that PJM does not substantially over procure capacity.\(^{10}\)

Implementation of this type of auction would allow PJM to use a lower price cap, as the auction clearing price would only need to reflect the incremental price to transition to a CP Product. This will ensure the additional costs being paid are directly related to the incremental product being provided. As such, the price caps should be based on an analysis of the reasonable investment or risk premium that a resource would be incurring to take on the transitional CP Product obligation. The current price caps proposed appear somewhat arbitrary and do not appear to be backed by analysis demonstrating that such caps will be sufficient to permit cost recovery.

C. **The Market Rules Must Allow Suppliers To Be Adequately Compensated For Their Investments**

The IPP Coalition is pleased that PJM recognizes the importance of reflecting the cost of new investment in capacity prices to assure that such investments continue to be reliably and prudently made. To that end, we support PJM’s proposal of an offer cap of Net CONE, without second-guessing of any supplier’s risk-of-performance calculation. PJM should ensure that suppliers have adequate assurances that offers submitted up to the Net CONE value will not be

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\(^{10}\) PJM may consider conducting the CP transition auction at the same time as an IA to accommodate previously uncommitted resources the ability to participate in both auctions concurrently, such that they would not incur one obligation without the other.
considered economic withholding or market manipulation. This would include appropriate tariff language revisions and/or declaratory determinations from FERC in connection with PJM’s filing to effectuate the Updated Proposal.

The RPM auctions to date have resulted in volatile clearing prices, often depressed due to a limited number of participants willing to set price. The inclination of a resource with sunk capital costs to offer as a price taker is not surprising where the resource has one source of revenue and cannot abandon its large capital investment. The IPP Coalition therefore supports a concerted effort by PJM to consider RPM reforms which would bolster the ability of suppliers to provide offers that reflect the true cost of capacity and provide a multi-year investment signal to provide longer term stability in the market.

D. The CP Penalty Structure Should Accommodate Limited Force Majeure Events

Under the Updated Proposal, the only situations where CP non-performance will be excused due to being considered “Outside Management Control” (“OMC”) are situations where “the electric transmission and/or distribution facilities necessary to allow the generator to deliver energy to the PJM system are physically unavailable such that the generator cannot operate.”11 The IPP Coalition understands that PJM would want to limit the circumstances where non-performance is excused. However, PJM needs to be consistent in its determination of what is considered an OMC event. The IPP Coalition believes the only OMC-excused circumstances would be those which (i) arise from events which are not unique to the supplier alone, but are widespread in impact; and (ii) could not have been reasonably mitigated under a “prudent utility standard”. Based on our experiences with long term bilateral contracts, we believe a fair allocation of loss from these force majeure events would be that the supplier forfeit a pro rata portion of its capacity payment for the period when it did not perform, but it should not suffer an additional penalty.

11 Id. at 21, 25.