COMMENTS OF CPV MARYLAND, LLC,
CPV SHORE, LLC, AND
CPV POWER DEVELOPMENT, INC. ON THE
PJM CAPACITY PERFORMANCE PROPOSAL

CPV Maryland, LLC, CPV Shore, LLC, and CPV Power Development, Inc. (collectively “CPV”) support PJM’s desire to include mechanisms in its tariff to incent operational performance in peak periods, increased fuel security, high availability resources, and flexible unit operations. However, as discussed below, many elements of the PJM Capacity Performance Proposal (“Proposal”) impose significant risks and restrictions that are unnecessary, unreasonable, and perhaps unintended, in light of the Proposal’s objectives. Accordingly, CPV suggests alternatives that would not create such harms, but would work to meet PJM’s objectives and attract such additional and diverse stakeholder support as would be necessary for the Proposal’s timely implementation.

A. The proposed penalties and the application of their timing are not reasonable and conflict with PJM’s objectives to ensure reliability

PJM proposes that the total possible penalty for non-performance applied to any individual Capacity Performance resource for any Delivery Year be capped at 2.5 times the Delivery Year Resource Clearing Price revenues applicable to the resource as a result of its having cleared in the RPM auctions applicable to that Delivery Year.1 For Base Capacity, PJM proposes that the penalty not exceed 1.5 times the Resource Clearing Price credit the resource received as a result of clearing in the RPM auctions applicable to that Delivery Year.2 As an example, assuming a $100/MW/day clearing price, the financial risk imposed on a 600 MW Capacity Performance resource is $55 million, of which about $22 million reflects a full forfeiture of RPM revenues for the year. If the clearing price were $200/MW/day, which occurs frequently in constrained LDAs, this would result in a financial exposure of $110 million for this same project. As discussed below, this penalty structure is unnecessarily punitive and could jeopardize the financial viability of a generation resource if imposed.

PJM has not explained why it is necessary to impose such egregious penalties in order to incent resources to take steps to ensure performance. While PJM has concluded that the existing Capacity Deficiency Charge is insufficient to meet its objectives,3 it has not shown why this is so, nor, more importantly, even if it were, why it needs to make the drastic leap from 120% of the clearing price applied only on the individual days of noncompliance to a financial exposure equal to 2.5 times the annual revenues for the same number of noncompliance days. By comparison, under the ISO New England (“ISO-NE”) capacity performance plan, the maximum annual loss is set at three times the maximum monthly loss (which is set at the capacity supply

1 PJM Capacity Performance Proposal, 29 (Aug. 20, 2014) [hereinafter Proposal].
2 Id., at 28-29.
3 Id., at 1.
obligation times the Forward Capacity Market auction starting price). Additionally, the ISO-NE plan provides additional revenues to resources that perform during scarcity conditions. If the Capacity Performance product moves forward, then PJM should adopt stop-loss mechanisms that provide protections and performance payments similar to those in the ISO-NE capacity performance plan, or if it does not, it should explain why it believes why such mechanisms would be insufficient under RPM.

In short, a penalty of 2.5 times the annual revenues—which in the example above could exceed $100 million for a 600 MW project—could easily place a supplier into financial jeopardy. A penalty that exceeds the amount necessary to provide incentives for performance during scarcity conditions imposes financial liquidity risks that could jeopardize the supplier’s ability to operate its facility so as to support PJM’s reliability needs. PJM’s proposed penalty and the associated timing that penalty is realized by the supplier creates these unreasonable and unnecessary risks and should be revised as discussed above.

B. A Stop-Loss Mechanism is Essential to Avoid Unintended Consequences of the Proposal

In addition to reducing the maximum financial exposure, PJM should not require a nonperforming resource to pay unreasonably large penalty amounts immediately following a penalty event. While the Proposal acknowledges that it will create additional risk exposures for generation owners “up to some threshold level, during peak periods in their offers. . . .”, as noted, it fails to account for the risk that the potentially large new penalties will violate the credit agreements relied upon by existing resources and those under construction.

Lenders typically require that borrowers maintain certain quarterly debt service coverage ratios. The imposition of tens or even hundreds of millions of dollars in penalties over a week or month could easily push the short-term ratios below requirements (even if long-term ratios could still meet the lender’s requirements) and therefore could unintentionally cause projects to go into default under their credit agreements. Hence, any penalty structure that imposes this type of risk will have the perverse result of jeopardizing the ability of the generator to maintain its business operations and its ability, therefore, to support PJM’s reliability needs. Furthermore, it could


5 See id., at PP 6-7 (stating that resources are eligible to receive Capacity Performance Payments for providing more than their share of energy and reserves—or for performing when they have no Capacity Supply Obligations—to incent all resources to provide energy and reserves when system reliability is at heightened risk).

6 While CPV strongly believes that a financial exposure greater than the annual revenues is unnecessary and imposes an unreasonable burden, should any multiplier be adopted, it should not exceed 1.2x the annual revenues. The potential forfeiture of all annual revenues together with a 20% penalty demonstrably would provide a strong incentive for resources to take such steps as are necessary to ensure that they are available during scarcity conditions.

create a significant barrier for new generation resources receiving construction financing to enter the market. Again, the ISO-NE stop loss limits provide an example of how this can be avoided.

Another reason that stop-loss mechanisms are an important component of any penalty proposal is to avoid distorting the incentive to meet performance requirements over the entire annual period. A supplier that hits its penalty limit early in the year would have no incentive to take steps for the remainder of the year in order to avoid further penalties.\(^8\) A more efficient penalty structure would ensure that the incentives are maintained on a going forward basis regardless of any failures that might occur on a given day.

While the Proposal contemplates that suppliers can mitigate their risks to the extent they can use uncommitted resources to step in and perform if the Capacity Performance resource is unavailable and would otherwise incur penalties, this option favors large companies that have multiple resources, some of which might not be fully committed, but might not provide a hedging strategy for project financed companies like the CPV companies.\(^9\) The proposed penalty structure disincentivizes participation in the Capacity Performance auction by companies based on their financing structure rather than the underlying physical capabilities of the resources, an outcome that is at odds with PJM’s underlying objectives. CPV notes that additional mitigation could be provided if resources that do perform during scarcity conditions earned additional revenues.

Accordingly, regardless of the penalty cap adopted, CPV feels very strongly that PJM should establish daily and monthly caps on the penalty exposure. In addition, PJM should provide that, if the penalty exceeds an established threshold, the resource will have the option to pay the penalty in arrears, e.g., converted to a monthly payment to be assessed over the following Delivery Year. This does not dilute the incentive provided by the penalty, but does allow the company to incorporate the expense into its operating budgets and financing requirements.

\(C.\) There must be exemptions for events that are out of a generator’s control

As currently drafted, the Proposal contains no exemptions for matters outside of management control or force majeure events. At a minimum, there must be exemptions in circumstances where the resource is available, but is unable to be dispatched due to a force majeure event. PJM is responsible for ensuring deliverability of resources, and resources have no ability to take steps to ensure that transmission outages\(^10\) or other similar infrastructure outages do not prevent them from meeting dispatch requirements. PJM’s goal is to ensure that resources take all necessary contractual and investment steps to ensure that they are available to

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\(^8\) See, e.g. ISO New England, Inc., 147 FERC ¶ 61,172, at P 42 (describing ISO-NE’s mitigation mechanisms to avoid such an occurrence).

\(^9\) See, e.g. Proposal, at 28 (describing the non-performance penalty off-set). This off-set is available to Capacity Market Sellers via energy production from uncommitted units, providing a direct route for mitigation to those owners with sizable generation fleets.

\(^10\) Based on discussions at the last stakeholder meeting, it is CPV’s understanding that PJM intends to add such an exemption.
be dispatched during scarcity events. There is no basis for penalizing resources that have, indeed, taken such steps and are ready, able and willing to meet PJM’s needs. For example, CPV believes that if a resource has contracted firm gas transportation (i.e., the highest level of security available today) and the pipeline fails to deliver the gas, this should qualify for an exemption. However, if a resource has contracted for interruptible gas transportation and fails to receive the gas or operate, this should not qualify as an exemption.

While it is reasonable to hold resources accountable for matters which they have the ability to control, it is not reasonable to expose them to such large penalties for matters where they lack any ability to manage the risks. To the extent that PJM is concerned that force majeure might be interpreted broadly to include certain risks that it seeks to shift to generators, e.g., the risk of extreme weather preventing resources from operating at maximum levels or starting up in the required timelines, PJM can clarify those circumstances that would not be considered force majeure.

D. Transition Issues

Aspects of the transition plan remain uncertain. However, it is essential that the new non-performance penalty structure not be implemented prior to the 2018/2019 Delivery Year for resources that have already been committed as annual resources in the preceding years and which now may be deemed Base Capacity resources. Offers into the RPM auctions were based on the risks created under the penalty structure then incorporated into the tariff. Resources that have already committed to provide capacity prior to the 2018/2019 Delivery Year have no opportunity to increase their offers now to reflect new risks created by additional penalties. Increasing the penalties for annual resources renamed as Base Capacity resources in not only unjust and unreasonable, but also a form of impermissible retroactive ratemaking. CPV notes that the ISO-NE capacity performance plan imposes increased penalties only in connection with capacity obligations established in auctions following the Commission’s making ISO-NE’s plan effective.11

E. Must Offer Requirement

Although PJM has not indicated whether the existing must offer requirement will be extended to require all resources to offer for the Capacity Performance product, the Independent Market Monitor (“IMM”) has suggested that this might be appropriate. PJM should not establish a Capacity Performance product must offer requirement. Under a regime where Capacity Performance resources are subject to significant financial risks, the decision to accept those risks must be retained solely by the suppliers. Each supplier will assess the relative risks and rewards and determine if it can or will accept those increased risks.

F. Officer Certification

CPV is concerned that the officer certificate process\textsuperscript{12} is ambiguous and there are no clear guidelines on what measures will support an officer’s certification on matters such as fuel supply security. Absent clear guidelines, there is a risk that, in PJM’s after-the-fact analysis, it determines that the measures relied upon by the officer are deemed insufficient. Yet, at the time the certificate was executed, the officer would not have the benefit of PJM’s interpretation of the requirement.

G. Retention of Elements of Prior Replacement Capacity Proposal

PJM has mentioned certain aspects of the Replacement Capacity proposal will be incorporated in this Proposal.\textsuperscript{13} PJM needs to clarify which aspects will be retained and explain why such retention would be acceptable to FERC given its earlier rejection and PJM’s decision to cancel FERC’s recommended technical conference.

H. Governance

PJM’s adoption of the Enhanced Liaison Committee (ELC) process\textsuperscript{14} is not in compliance with the governance requirements of the PJM Operating Agreement (OA) as approved by FERC. The PJM Tariff requires that PJM consult the Members Committee before any Section 205 filing,\textsuperscript{15} and the OA requires Sector-weighted voting for issues considered by the Members Committee.\textsuperscript{16} The fact that PJM has incorporated the ELC into its manuals is not dispositive.\textsuperscript{17} Moreover, the fact that the Members Committee itself might have authorized the inclusion of the ELC procedures does not provide authority for PJM to depart from the requirements of the OA.\textsuperscript{18} The Members Committee also lacks authority to modify the OA either directly or through its approval of a manual provision that is inconsistent with the OA. Because the ELC allows PJM and/or the PJM Board of Managers to bypass the stakeholder

\textsuperscript{12}Proposal, at 10.

\textsuperscript{13}Id., at 33.

\textsuperscript{14}See PJM Manual 34, Section 15.2.2.

\textsuperscript{15}See PJM Tariff, Section 9.2(b).

\textsuperscript{16}See PJM OA, Section 8.4(b); see also PJM OA, Section 8.4(a); PJM Committee Bylaws, Section 3(d)(1).

\textsuperscript{17}See, e.g. Pennsylvania-New Jersey-Maryland Interconnection, 81 FERC ¶ 61,257, 62,267 (Nov. 25, 1997) (describing FERC’s jurisdiction over PJM’s Manuals and making clear that PJM must revise its Tariff and any agreement on file with the Commission “to the extent that they define rates, terms, and conditions”); see also Midwest Independent System Operator, Inc., 132 FERC ¶ 61,185, at P 72 (2010) (stating that “the Business Practices Manuals must conform to the tariff, not the other way around.”)

\textsuperscript{18}The ELC procedures were incorporated into Manual 34 with Revision 01, effective September 22, 2011, as one of six sections added or revised. See also PJM, “Inside Lines” (Sept. 2011) (discussing the Governance Assessment Special Team’s Phase IIB recommendations that led to this inclusion), available at http://www.pjm.com/about-pjm/newsroom/Newsletter-Notices/inside-lines/2011/september.aspx.
voting requirements, the process PJM has undertaken could be invalid. We recommend that PJM either use the FERC-approved stakeholder and voting procedures or seek the broadest level of consent from the stakeholders prior to filing at FERC to avoid unnecessary litigation concerning the ELC process.