Please accept the following comments filed on behalf of the staff of the New Jersey Board of Public Utilities (“NJBPU staff”) regarding PJM’s Capacity Performance Proposal (“the Proposal”). NJBPU staff wishes to point out that it is a signatory to a companion letter, addressed to the PJM Board of Managers, submitted jointly by a number of parties which addresses the Transition Auction Mechanism (“Transition”) element of the Proposal. In addition to those comments generally regarding the Transition, NJBPU staff supplies this explanation of our concerns as to the impact of the Transition and the Proposal on NJ’s Basic Generation Service (“BGS”) mechanism, through which provider of last resort services are supplied to the State’s residential and small commercial electric customers.

1) PJM should take incremental, short-term steps to enhance reliability while affording adequate time to consider more substantive RPM changes.

As a general observation, NJBPU staff views the Proposal as a complex and, in certain critical areas, undeveloped set of unnecessary market changes designed to solve near-term reliability concerns that could be addressed far more simply and effectively. The Proposal would, moreover, impose significant, but not as yet precisely quantified, capacity cost increases on end-use customers. NJBPU staff must consider the cost impacts of any and all wholesale market changes upon the economic health of New Jersey. While the NJBPU staff shares PJM’s concerns about the fundamental reliability of the PJM system, especially in light of the events of this past winter, we believe that the likely imposition of significant electricity costs is unnecessary given that a more measured phase-in of market design changes is available as an alternative.

The Proposal represents a radical change to the Reliability Pricing Model (“RPM”) construct without the analysis and consideration of cost impacts that would normally precede implementation of such considerable market design changes. For these reasons, NJBPU staff recommends that PJM afford all stakeholders adequate time to thrash out the mechanics of the Proposal, as well as of other proposals which may emerge. At the same time, we would recommend interim changes to the market rules to better ensure generator performance, including significant penalties for non-performance.

NJBPU staff appreciates PJM’s concerns regarding near-term reliability, given the potential for a repeat of severe winter weather conditions and the promise of coal station retirements. But the reliability issues that faced PJM this past January were principally occasioned by generator performance failures and were not the direct consequence of market design failure. Simply put, cleared generation capacity simply failed to deliver energy when it was most needed, despite receiving lucrative RPM capacity payments which end-use customers understood as payment for delivering energy when needed. As confirmed by PJM staff member Jerry Bell, the majority of such failures were occasioned
by either the inability of the generators to secure firm gas fuel supplies or by the limited capability of the affected units to run below design-specified cold temperature thresholds, absent add-on pre-heating equipment. Presently constituted performance incentives were insufficient heading into January to incentivize these failed generators to adequately prepare for either fuel scarcity conditions or low-temperature equipment capabilities; the existing maximum penalty of 50 percent of RPM revenues for non-performance is patently insufficient as a risk facing generators who could have better prepared their units for operation but decided not to do so in the face of little, if any, risk.

PJM’s proposal to eliminate fuel deliveries as an out of management control forced outage rationale is but one positive step that might be taken in the short term to address generator non-performance. PJM should additionally implement for the upcoming winter a modification of the penalties applied for generator non-performance. Generators are paid 100 percent of their RPM revenue and should be expected to be available 100 percent of the time when needed. Generators who are not available and not experiencing legitimate forced outages should accordingly face the prospect of a 100 percent penalty for non-performance – that is, a 100 percent forfeiture of their annual RPM revenues. Such revision to the penalty provisions of RPM would at once restore the confidence of end-users that they are getting the capacity they are paying for when it is needed, and provide the proper incentive to generators to make necessary provisions for the delivery of committed capacity or face genuine penalties for failure to do so.

Additional short-term measures that may be taken in lieu of the Proposal’s Transition prescriptions include approval for cost recovery in RPM offers of the costs of firm pipeline transportation and/or third-party firm gas deliveries, and the costs associated with pre-heating equipment that would permit existing units start and run capabilities exceeding their cold-weather design limitations absent such add-on equipment. Acknowledging such costs in resource offer prices would put firm gas transportation costs and pre-heating equipment investments on par with dual fuel capability and weatherization investments currently recognized as legitimate inclusions under the APIR provisions of Attachment DD. These steps should result in substantially flatter forced outage curves, as demonstrated by PJM’s Mr. Bell.

2) PJM’s recommendation to add more capacity products creates avoidable complexities and appears to invite the potential for market power abuse.

Rather than focus upon the experience of last winter and the failure of committed generation to perform as expected, the Proposal introduces a revamped set of RPM capacity products that at once behooves far greater elaboration and appears to open up a distinct new opportunity for strategic withholding. The bifurcation of existing annual capacity resources into Capacity Performance and Base Capacity categories would, absent an explicit set of additional provisions that stakeholders have yet to see, invite generation fleet entities to withhold Capacity Performance capacity and bid such capacity in as Base Capacity in an effort to drive up the Capacity Performance clearing price. There is nothing evident in the Proposal that would prevent such strategic behavior.
Moreover, there is nothing evident in the Proposal that would prevent fleet entities to simply not offer in a portion of their existing capacity and retain it as a hedge against the substantial and laudatory penalties for non-performance that the Proposal includes. Such potentialities would at once artificially inflate RPM prices above the already high estimates the Proposal is likely to produce, while undermining the enhanced reliability outcome that it ostensibly strives to achieve.

The NJBPU is on the record in proceedings at both PJM and FERC supporting a must-offer requirement for all annual capacity resources. Resources that are paid annual RPM revenue, whether they are generation capacity or demand side resources, must be compelled to offer in and be available to produce energy or curtail consumption in all hours of the year. Only in this manner will end-use customers receive the benefits of RPM for which they are compelled to pay. However, there appears to be no must-offer requirement in the Proposal. Any proposed RPM changes considered for advancement to FERC for implementation must include a must-offer provision, PJM’s Proposal included.

A uniform must-offer requirement implies a consolidation rather than an expansion of annual capacity resource products, with all annual products accruing the benefits of revenue adequacy and bearing the responsibility for 8760-hour annual deliveries. The Proposal instead establishes a premium annual capacity product and an evidently inferior one, which does not appear to lend the needed simplicity to a capacity resource definition that better serves reliability objectives. Based upon the information thus presented by PJM, NJBPU staff opposes the disaggregation of annual capacity resources, especially generation capacity resources, into two discreet categories with different levels of expected performance.

3) The Transition introduces substantial and potentially paralyzing consequences for NJ’s Basic Generation Service mechanism.

For the last thirteen years, the NJBPU has implemented the joint Basic Generation Service proposals of the State’s Electric Distribution Companies (“EDCs”) -- Atlantic City Electric Company (“ACE”), Jersey Central Power & Light Company (“JCP&L”), Public Service Electric and Gas Company (“PSE&G”) and Rockland -- that use an auction format to procure one-third of the State’s BGS supply requirements for 36-month periods for residential and small to mid-sized commercial customers who have elected to be served on default service, extending presently through May 31, 2017. The Board has approved procuring the BGS requirements for the period beginning June 1, 2015 that will supply one-third of the BGS load for the period June 1, 2015 through May 30, 2016, and one-third of the BGS load for the period June 1, 2016 through May 30, 2017 (“Delivery Year 2015 and 2016”). The NJBPU is currently in the process of examining the recently filed joint EDCs BGS proposal, which would procure additional supply requirements for one-third of the BGS load for the period June 1, 2017 through May 30, 2018. The product procured through BGS auctions is a full requirements service, which is made up of energy, capacity, ancillary services, RPS compliance costs, etc. Bidders in the BGS auction use the outcome of the RPM as a factor to determine their bids in the BGS auction. After the NJBPU approves the auction results, the EDCs enter into contracts
with the winning bidders which commit them to provide the BGS full requirements product at the cleared BGS auction prices.

PJM’s Transition mechanism provides for conducting incremental auctions for the 2015/16, 2016/17 and 2017/18 Delivery Years to incrementally procure a sufficient amount of the Capacity Performance product. The Proposal indicates that the incremental auctions will establish a required amount of Capacity Performance product that must be procured and the procurement auctions will provide opportunity for resources with an existing capacity commitment and resources with no capacity commitment for the applicable Delivery Year to compete to provide the required amount of Capacity Performance product for which they would receive an incremental payment.

The Transition mechanism is problematic for the NJ BGS mechanism. Specifically, New Jersey has previously conducted two BGS auctions with a potential third auction in February 2015, all of which are based upon completed RPM auctions where BGS bidders have used and are expected to use the resulting resource clearing price to develop their BGS offers. Winning BGS bidders are now and may be obligated by contract to provide that full requirements product at the final BGS auction clearing prices, which are in turn based on already-established RPM clearing prices. The NJBPU staff is concerned over possible ratemaking implications of the Transition on the final BGS clearing prices for the Delivery Years 2015/16, 2016/17, and 2017/18, as well as how these transitional prices will be allocated to Load Serving Entities. The Transition implies significant uncertainty for BGS bidders serving load in New Jersey for these delivery years and potential future delivery years. NJBPU staff is concerned over how BGS suppliers will recover these additional capacity costs, how this uncertainty will manifest itself in future BGS procurements and how to address the possible risk premiums that suppliers will attempt to embed in their BGS offers. For these reasons, PJM should abandon its proposed Transition and instead endeavor to develop and implement specific, limited RPM design remedies that will engender greater generator performance in the short term while engaging all stakeholders in a deliberative consideration of more expansive RPM design changes.