Pepco Holdings, Inc.

Pepco Holdings, Inc. (PHI) provides these comments to the PJM Interconnection, LLC (PJM) staff’s Capacity Performance Proposal and the Enhanced Liaison Committee (ELC) process. PHI is the parent company of the PJM Members Atlantic City Electric Company, Delmarva Power & Light Company, Potomac Electric Power Company, and Pepco Energy Services Inc.

Background

At the end of July 2014, the staff of PJM initiated an ELC process to address the issue of generation incentives and penalties in light of the operational difficulties of the January 2014 Polar Vortex. As part of that process, on August 20, 2014, PJM staff released a paper entitled “PJM Capacity Performance Proposal”. That paper laid out a new capacity product and dramatically changed the obligations of capacity resources under the current RPM construct.

The current PJM RPM model has a single capacity product – regardless of the type of resource it comes from or the characteristics of that resource. The new proposal essentially splits the resources that provide adequate capacity in PJM into two types – Capacity Performance (CP) and Base Capacity (BC). Both types of capacity can be composed of resources from generation, demand response (DR) or energy efficiency (EE). The two classes of capacity will be differentiated by the obligations each is willing or able to undertake.

CP has new and more stringent obligations put on it than in the current capacity construct, including more severe penalties that will likely occur more often. Most importantly CP will have to meet specific operational characteristics. CP will essentially be expected to perform at all times when called and face significant penalties for non-compliance.

BC has lower performance requirements, more similar to the performance requirements that resources face today. BC resources will face the same expanded penalties that CP faces, although with a lower maximum impact cap.
COMMENTS

Reliability is Critical

PHI supports efforts to assure the reliability of the electric system that the PJM region has come to expect. The events of the last year have helped to identify the risks. PHI wants to see changes that help to eliminate the possibility of those events recurring. That means improved load forecasting, improved scheduling and dispatch and improved price results and pricing signals in the market. We also recognize that the generation market has experienced significant changes and new environmental rules that impact the ability of the system reliably to supply power. This may warrant new incentives and new penalties, but that has not been proved, and implicates many of the concerns raised in these comments.

New Infrastructure is Critical

PHI believes that part of ensuring reliability in PJM is providing a robust infrastructure base – both electric transmission and gas pipelines - that supports the effective operation of the market and ensures reliability. We have repeatedly expressed concern that the transmission system is operating close to its limit, dealing with new challenges and aging infrastructure. The proposal should address this fundamental issue. Indeed, the emergency events of last September can be partially traced to infrastructure and maintenance at certain substations. The proposal has no discussion of these critical issues. Notably, it omits any discussion of lack of headroom, the need for new infrastructure or the need to replace aging infrastructure.

Indeed, the proposal, if unchanged, could aggravate these issues. A CP unit faces very strong penalties for any outage (or other failure to produce energy) in emergencies – Hot Weather, Cold Weather and Maximum Generation. This may further push generation outages into the few months when those emergencies are unlikely to be called – in the extreme only April and October. This is the period of time when the transmission system requires outages to perform maintenance.

Currently, PJM’s transmission system has little or no headroom/redundancy to support operational and maintenance needs. With ever growing NERC reliability requirements, the pressure to perform maintenance at fixed times and the need to rebuild transmission and to support construction outages, it is increasingly difficult to get feeders out to do required
maintenance. Currently, it can take many months to years to schedule an outage on a critical transmission line. The CP proposal should seek to resolve these issues and not exacerbate them. In a related context, PJM has not indicated if performance penalties on CP will also apply during a local emergency. It is conceivable that there will be local emergencies that require the operation of generation. PHI assumes that the penalties will apply to CP these instances as well. PJM should clarify this item.

**Accelerated Process**

PHI is concerned that the ELC process is too abbreviated for such a major rule change and does not allow for the proper vetting and review of this proposal. PHI has repeatedly expressed concern in the stakeholder process about the accelerated pace of action that PJM staff seems to be pursuing. Often, for PJM staff proposals, stakeholders face accelerated schedules, rapid fire meetings, proposals being placed on a senior committee agenda for a first read when not final and in some cases when still being developed in the lower committees.

While many of the issues that are of concern from the polar vortex were being worked in the lower committees – many at a brisk but good pace – PJM staff announced this process with a hyper-accelerated time line and using a process which, while described in Manual 34, has not been used before. We now face the immediate prospect of an abrupt major change in critical PJM market rules that took over four years of discussion in the stakeholder process to develop, plus 3 months of intensive negotiations at FERC to finalize and which have continued to be tweaked ever since. PJM is now seeking to change these rules after only four or five half day stakeholder meetings.

Note that these changes will occur in an area of the market that PJM staff has regularly held up as an example of a market-based approach to providing capacity needed by the system. Further, this proposal seems to undo much of the work done to assure the continued availability of existing generation and the development of new generation. An example would be the work on extended start-ups - while always viewed as an impediment to easy scheduling; it was also seen to be important to keep resources on the system for peak periods. Additionally, PJM has entered into Reliability Must Run agreements with retiring units. The impact of this proposal and the new obligations on these units need to be explained.
PJM staff should explain why this major modification needs to be addressed on such a short time frame. Are interim options, such as ISO-NE has developed, available that would give stakeholders additional time to consider this issue?

**Customer Costs**

An important part of PHI’s concerns are the costs to our customers. Indicative of the hurried pace of this process, PJM has not provided any estimate of the cost impact of this proposed change. PHI can only assume this proposal will result in major increases to customer costs.

Recently, Monitoring Analytics reviewed price sensitivities in the event of the loss of DR resources.¹ That analysis showed capacity prices as high as $400 per MW-day in the event of the loss of all DR. PHI believes this proposal will cost at least that much, although the costs of meeting the Capacity Performance requirements may drive that up even further. PHI can only assume, based on its analysis of the PJM proposal and those values from Monitoring Analytics, that consumers may see a significant increase in their capacity costs and the cost of energy.

While the value of losing power to areas for potentially unknown periods of time is clearly significant, this risk must be weighed against these expected large cost increases to consumers.

**Demand Response**

PHI, through its state-sponsored programs, offers demand response (DR) products to our customers. While the proposal preserves DR as both CP and BC, PHI believes that most of our programs will be BC. Clearly, PHI, its regulators and customers have made significant investments to provide DR to the market and that may be undone. PHI currently offers the Extended Summer DR product to our customers and has made significant commitments to our state commissions. Devaluing this product will affect the ability of the PHI utilities and others to deliver on state commitments and product offerings to customers.

An equally important issue that must be addressed is price impact. PJM has stated that it plans to fill up to 85% of its capacity needs with the new CP product. Consequently, since most DR will be in BC, which will also include any generation not able to perform as CP, it appears that

¹ See: [http://www.monitoringanalytics.com/reports/Presentations/2014/IMM_MIC_20172018_Sensitivity_Analyses_Revised_20140903.pdf](http://www.monitoringanalytics.com/reports/Presentations/2014/IMM_MIC_20172018_Sensitivity_Analyses_Revised_20140903.pdf)
the price for BC will be much lower than for CP. This has been supported by PJM in answer to questions, but without specific values being provided. PHI believes that lower values for DR may dissuade customers from participating in the capacity market, further dampening the DR element of the market. Further, the restrictive 15% cap that PJM plans to impose on BC will leave little head room for existing Extended Summer MW to clear or for future DR program growth. Furthermore, transition issues must be carefully considered to protect the benefit of the bargain for DR which has cleared the RPM auction to date and mass market DR which may clear in the future.

**Existing Generation**

The generation, both within our footprint and within the entire PJM footprint is critical in assuring the adequacy of the energy that our customers need. As such we have concerns about the adequacy and stability of the generation fleet in PJM.

The proposal threatens to undo provisions designed to keep existing generation on the system. The existing generation may not be able to meet the CP standard and yet may not be selected in the small allotment to BC. Existing generation owners may look at the enhanced penalty structure and decide that the risks are not worth taking to become CP. This could precipitate additional generation retirements.

To introduce another potential driver to retirements seems risky to system reliability, after the spate of retirements over the last few years due to economics and environmental rules, and the looming retirements from the changed fuel economics landscape. Likewise, any perceived benefits to system operations from the new CP product may be quickly undone by additional retirements and the new round of reliability must run contracts that it precipitates.

The proposal maintains certain aspects of intermittent and environmentally-limited generation that may pose risks to reliability. While traditional generation will take on a wide range of obligations to become CP, intermittent generation will still be valued on only the average of the summer period (despite PJM’s concerns about winter). Also, environmentally limited generation will be allowed to be CP. Both of these generation types do not have the characteristics that PJM staff seems to be seeking – availability at all times and the ability to produce energy at PJM direction.

PHI is also concerned about the idea of getting waivers for environmentally limited generation. PJM would be well served to work with the generators to establish pre-arranged waivers of
environmental regulations that can be activated under certain operating situations. This would be a clear and immediate benefit to reliability.

**Gas Electric Scheduling**

In its review of the data PJM has provided as part of the ELC process, PHI believes a large portion of the concerns of January 2014 amounted to a gas-electric coordination issue and a scheduling/dispatch issue. We do not discount the possibility that a similar situation will occur again next year. However, the system may be better served by addressing the gas-electric issues instead of undertaking a major re-write of RPM.

PJM staff and stakeholders have been working on the gas-electric issues on an accelerated pace since the events of January. They have been addressed at various committees and sub-committees including - the Operating Committee, Combined Cycle Scheduling, Energy Market Uplift, Cap Review and the Gas Electric groups. Stakeholders have made progress in establishing better rules for the winter period and a better understanding of the needs of the electric and gas systems. In addition, progress is being made on the financial issues of including gas prices in market offers, gas unit scheduling and the issue of leftover/unused gas purchased in good faith. In addition, NAESB is addressing the issue of gas-electric scheduling, and FERC has proposed changes to the gas day to facilitate better coordination with electric market operations.

**PHI Questions:**

1. PM has stated that it would like to fill up to 85% of its capacity needs with the new CP product. Why is 85% CP procurement level necessary?
2. What would be the cost to consumers of PJM’s procurement of the CP product?
3. Why can’t the Extended Summer capacity product qualify as a CP product?
4. PHI is concerned about the impact of the CP product on the state DR programs and public policy objectives. Has PJM quantified this impact? Is PJM talking to the states and the utilities that offer these programs to understand and to evaluate the impact of PJM’s proposal on this important policy?
5. What transition mechanisms and timelines will PJM incorporate to ensure a seamless transition that properly protects DR market participants as well as support state regulatory processes to reconfigure existing programs?
6. Will the proposed penalty structure create unintended consequences with generators exiting the PJM market due to the high penalties?

7. Has PJM evaluated the interaction of this proposal with the impending EPA Rule 111(d) compliance and the potential impact on generator retirements?

8. Is there enough firm transport on the gas system to arrange for enough CP, can firm gas at the burner tip be arranged, are the costs of such service able to be collected, and how will these costs impact the dispatch order?

**PHI Information Requests:**

1. PJM staff and Monitoring Analytics should provide a cost impact analysis and conduct a review session of that analysis to better enable market stakeholders to understand the potential implications of any rule changes.

2. PJM staff should provide information on what they believe the price difference between the CP and BC products will be.

3. PJM staff should provide a comprehensive analysis by LDA of the potential for generation retirements.

4. PJM staff should explain the reasons for allowing intermittent and environmentally-limited generation to participate as CP under relaxed rules.

5. PJM should encourage and support the changes to the gas issues currently being worked in the stakeholder process and explain how better scheduling and testing in January 2014 would not have solved the polar vortex operational concerns.