Comments of the PJM Power Providers Group (P3) on PJM’s Capacity Performance Proposal

September 17, 2014

As an initial comment, P3 applauds PJM for recognizing a long standing concern of P3’s: generators are not receiving sufficient revenues to justify further investments that are necessary for sustaining reliability in PJM. This concern is not new; however, it was apparent last winter that some units that were called to run in extreme weather conditions were not available due to a lack of fuel supply and forced outages due to operational issues. For a variety of reasons, the existing market rules do not produce price signals that reflect the value that PJM places on reliability in all conditions. Furthermore, these rules have failed to produce sufficient price signals to incent the desired fuel purchasing practices, or the necessary capital expenditures and forced premature retirements.

The goal of the capacity performance proposal is noble – providing capacity resources with sufficient revenue to make investments for reliability. However, as currently constituted, the proposal contains several features that will likely thwart the purpose of this effort if not properly amended. P3 offers the following thoughts and observations for consideration.¹ While this list should not be considered exhaustive and P3 reserves the right to raise other issues during the stakeholder process and at FERC, the issues identified are of broad concern to the organization and PJM is urged to address them.

1. As a matter of principle, properly compensating resources for the value they provide to the grid is fundamental to the success of the grid. If resources are not compensated appropriately they will leave the market prematurely and jeopardize reliability. In regard to the capacity performance proposal, as currently structured, P3 is struggling to see how

¹ These comments represent the views of P3 as an organization and not necessarily the views of any individual P3 member with respect to any issue. P3 is a non-profit organization that supports the development of properly designed and well-functioning markets in the PJM region. All P3 members are PJM members.
the enormous additional risks that will be forced upon generators will be appropriately compensated, year after year, with corresponding revenues. P3 has not been convinced that there is a sufficient amount of capacity that could qualify as a capacity performance resource that could lead to an under-procurement of that resource and a corresponding glut of base capacity. Moreover, as written, the proposal poses a significant risk that capacity performance clearing prices will not remain at a sufficient level to justify long term investments, particularly given the risks of failing to clear as a capacity resource. PJM should consider a persistent minimum clearing price or other mechanisms to provide additional confidence that clearing prices will be sufficient to justify investment. Additionally, market participants should be able to quantify and price risk in their bids based on their own expectations of future market prices and demand. A single, arbitrary system-wide risk premium as currently proposed cannot accommodate these needs. All generating units have significantly different risk profiles that also change over time due to continuous degradation and renewal of plant equipment that affects plant performance. Market participants must be able to reflect their view of all these changing risk components in their market offers. Generators are being asked to assume significant new penalty and operational risks as part of the capacity performance proposal and must be able to reflect this increased risk in their bids based on their own view of the market while understanding the competitive need to price risk at the lowest tolerable levels.

2. P3 has long supported a single, clearly-defined, demand response capacity product, with attributes that are as closely aligned as possible with the attributes of the capacity product required from generation resources and the elimination limited demand response products from the market. However, as a result of the EPSA v. FERC decision in which rehearing was denied today, demand response is not under FERC’s wholesale market jurisdiction and any payments from PJM to demand response providers are illegal. PJM should immediately eliminate demand response and energy efficiency from the capacity performance proposal as well as all existing tariff provisions. As a retail/state jurisdictional matter, compensation for
demand response must be set by state retail policies not by PJM and/or FERC.

3. Any effort to improve the capacity market materially must eliminate the 2.5% holdback. As a market rule, the 2.5% holdback has always been unwarranted and perverse. There is no economic justification for intentionally under-procuring capacity and suppressing capacity prices that should be reflected in the market. No other RTO has a holdback and FERC clearly does not view it as an essential element of an organized market. If PJM is serious about having capacity prices accurately reflect market conditions in order to incent performance, eliminating the holdback should be a leading priority.

4. The must offer obligation for capacity performance resources must be clarified. Units that are not capable of meeting the higher performance standards should not be forced into doing so. It is also conceivable that the status of a unit could change such that it can no longer meet the higher obligations and be forced to transition from capacity performance to base capacity. P3 recognizes, however, that there are market power concerns in this area and would support narrowly tailored rules to address this problem. Such rules should focus on investigating alleged exercise of market power with appropriate penalties for the exercise of market power. Any final proposal should refrain from making participation in the capacity performance market mandatory.

5. The officer certification must be carefully constructed. PJM appropriately requires officer certifications in existing tariff provisions governing transmission upgrades and demand response. P3 would urge PJM to recognize that officer certifications for capacity performance should be based on standards similar to the demand response certification requirements recently approved by FERC; particularly as they are given three years in advance of performance. Given the prospect of a FERC referral, corporate officers need comfort that they can sign the certification
without unintended retribution. An overly prescriptive certification could force resources that would otherwise qualify for capacity performance into base capacity thereby undermining the very reason for the proposal.

6. Penalties should be structured so as to incent resource performance for system reliability. They should not be punitive to the point of being crippling. P3 is concerned that the proposed penalty structure could lead to unintended consequences. As a matter of principle, P3 supports penalties for non-performance. Resources that are paid to perform should be expected to perform and deliver electricity. While there is great risk to tying penalties to LMP (given that the market offer cap is currently under review), P3 understands that the penalty for non-performance by a capacity performance resource should be meaningful. However, the proposed penalty cap at 2.5 times a resource’s RPM clearing revenues may go too far. Penalties for non-performance should not lead to market default or even bankruptcy due to their severity.

7. Notwithstanding the most prudent investments, it is nonetheless impossible for every generator to foresee every eventuality. A capacity performance design that imposes risks on generators that cannot be reasonably foreseen will discourage participation. Thus, appropriate exceptions, including those for force majeure, should be added to the proposal, recognizing that there are possible scenarios beyond which generators should simply not be expected to perform.

8. Speculative activity in the capacity markets could still be a problem and must be addressed. P3 notes that nothing in the capacity performance proposal or existing market rules addresses the possibility of speculative activity suppressing clearing prices. PJM’s experience with this problem is well-documented and rules must be in place to address it. Regardless of whether it is in the capacity performance process or the separate FERC process, rules preventing speculative activity must be part of the permanent “fix” to the capacity market.
9. Given the significant changes that the capacity performance proposal will usher into the market and the relatively short amount of time until the next BRA, it is important that stakeholders be given a complete picture of the changes being brought to the market. As currently written, the capacity performance proposal leaves many important questions unanswered. For example, PJM should clearly define the obligations of a capacity performance resource. Specifically, PJM should detail operational bid parameters like minimum run time, maximum run time, notification times and rules regarding changing them in circumstances when a unit has a day-ahead award or does not. Moreover, P3 also encourages PJM to publish the business rules, even in proposed form, as soon as possible for stakeholders to consider.

P3 appreciates the opportunity to offer these comments and looks forward to additional opportunities to provide input on the capacity performance proposal.