TO: capacityperformance@pjm.com

Re: Comments on PJM Proposal Defining Capacity Performance

By this letter, Shell Energy North America (US), L.P. is providing comments on PJM’s Capacity Performance Proposal. Shell Energy supports PJM’s effort to improve generator resource performance through market-based mechanisms. Last winter’s events demonstrated a need to address the situation. A properly structured proposal can achieve PJM’s goal of improving performance. In addition to improving performance and reliability, another significant benefit should be less uplift charges that retail customers in PJM have to pay as more generating resources will presumably be in the market. However, PJM’s proposal needs to be modified or clarified in several respects since, as it stands, the proposal could produce unintended consequences such as unexpected retirements or less than expected participation in the PJM auctions with the Capacity Performance Product.

The goal of the proposal should be to get the risk/reward relationship correct so that generating resources will believe that they have a reasonable opportunity to earn additional revenues to accept the risk associated with the premium Capacity Performance (CP) product. Some of the risks can be addressed through investments in fuel supply arrangements and O&M and weatherization, as noted on pages 8-9 of the PJM proposal. The problem is that generators or market participants have to be willing to accept these risks. From Shell Energy’s perspective, it may make more sense to offer capacity that we control into the capacity auctions as a Base Capacity Product, rather than as CP, as we are concerned that the current proposal does not provide a reasonable opportunity to earn a return on investments we may make in such resources, nor does it compensate us for the risks we will face with the CP as proposed.

For example, an approximate 900 MW generator that Shell Energy controls in the Dominion Zone would have experienced significant penalties if it was on forced outage and the proposal was in place last January. It would have almost hit the CP penalty cap based on the methodology set out in the examples described in the PJM proposal. A generator that receives a day-ahead schedule and fails to perform already faces significant penalties. The question becomes what is the right penalty when it declares a forced outage and cannot even offer into the day-ahead market during the critical periods. The penalty side of the equation under these circumstances is excessive.

The other problem PJM faces is that it is trying to apply standard pool-wide metrics to generating resources that are not the same in terms of operating performance capabilities. On page 30, PJM
indicates that a pool-wide EFORd of 7 percent might be used as the "limit to which risk could be reflected." That may work for many generators but such an approach may force generators that PJM expected to be offering the CP product to offer the Base Product. Each generator will have its own risk profile for a number of reasons. PJM will need to allow generating resources to have some flexibility in the risk calculations and certifications around performance standards and should define metrics that afford generators some flexibility in their risk profile. Again, imposing too excessive a penalty in combination with unreasonable limitations on offer adders reflecting risk could cause too many market participants to back away from the premium product that PJM hopes to bring to the capacity market, thereby undermining its goal of improving performance during peak demand conditions.

Another problem with the proposal relates to the impact of other efforts in the PJM stakeholder process and beyond with respect to generator resource activity during peak conditions. First, there is the offer cap rule proposal scheduled for votes before the MRC and MC tomorrow. The outcome of those votes and potential rule changes could impact the performance risk profile. If there is no clear resolution to the offer cap issue, generators will not know if they will get cost recovery when their costs exceed $1000 per MWhr or even if the higher offers will be allowed to set the clearing price.

Another risk relates to proposed rules around improving the scheduling of gas units and gas-electric coordination. Several committees within PJM are looking at these issues. Obviously, improved coordination will reduce risk that fuel or other operational factors do not result in performance failures.

The FERC initiated effort to improve gas-electric coordination also has a bearing on risk and cost to obtain reliable fuel delivery. FERC issued a proposal on changing the start of the gas day, nomination schedule times and number of nomination cycles and referred the effort to the NAESB collaborative process. The NAESB collaborative process ended June 6, 2014 with a resolution from NAESB to adjust the nomination schedule timing and number of nomination cycles. The collaborative did not produce a consensus on the new gas day start time however. Comments on these proposals are due to FERC from all interested parties November 28, 2014. In other words, PJM has been looking at its procedures and FERC/NAESB has been considering changing gas scheduling to improve generator access to natural gas supplies but little has happened with respect to these efforts that will reduce the cost and risk of scheduling natural gas-fired generators during extreme conditions.

The PJM proposal passes the entire risk of gas supply activity on to generators. The time that the risk is most acute is when gas markets are tight and constraints on the interstate pipeline systems occur and natural gas prices, and, in turn, LMPs in PJM increase. The scenario that probably presents the most risk is when a gas-fired generator that has a long lead startup time and does not get a day-ahead schedule but receives a dispatch request at 8 am of the power - operating day to help with the evening peak in the winter months. To the extent that the generator has pipeline capacity or firm supply, there is a cost to hold this or re-enter the gas market this late in the gas day cycle, and the risk of constraints on the pipelines or access to gas supply that late in the cycle are different. Shell Energy's experience from last winter was that PJM operators did their best to communicate their needs but recognizing the risk and cost of being asked to start operating late in the intraday gas cycle should be addressed.

Another concern with the proposal is that it does not appear to accommodate instances where a Generation Capacity Resource is subject to an off-take or tolling agreement. In this situation, the market participant offering the resource's capacity, energy and ancillary services into the PJM markets is not the owner of the resource but has contractual rights to all of the output of the generating resource. For example, an entity with a long term toll may not be able to unilaterally make physical changes to a
generating facility that it does not own to improve its performance. In addition, existing agreements may have limitations on plant operating performance that are not consistent with PJM's performance proposals. Certainly, entities can attempt to renegotiate terms but it could come at a cost and the question is how that cost will be recognized in this process. In addition, whose officer will be responsible for the proposed certifications, the plant owner or off-taker's officer?

Finally, the proposal does not seem to address how a market participant can offer a dual-fuel generating facility that has different maximum output levels on oil versus natural gas. For example, a generating unit may have the ability to generate up to 900 MW on natural gas but it will not be able to generate to that level on oil as physical limitations will not allow it to hit the upper operating limits on the alternate fuel. Thus, it may be able to generate 750 MW on oil and 900 MW on natural gas. The generator would have to participate with the CP product at the lower output level and potentially collect less capacity market revenue under this proposal while assuming more risk. It is unclear if the generator can get any capacity credit for the higher output level it can achieve on gas or can bid the incremental megawatts in a way that avoids the penalty. It would seem that PJM would want access to those megawatts for reliability reasons.

Shell Energy looks forward to continuing to work with PJM on its Capacity Performance Proposal.

Yours sincerely,

Matthew J. Picardi
Regulatory Affairs - Vice President
Shell Energy North America (US), L.P.