Mark Takahashi
Chair, PJM Board of Managers

PJM Interconnection
2750 Monroe Blvd.
Audubon, PA 19403

VIA ELECTRONIC DELIVERY

December 17, 2024

Dear Stakeholders,

This correspondence conveys perspectives from the PJM Board of Managers (Board) on two matters. The first relates to an additional filing that enhances the capacity market, while the second matter communicates an update to the Board's December 9 correspondence regarding PJM's Reliability Resource Initiative (RRI) proposal.[1]

As to the capacity market, the Board supports an additional filing to modify the existing categorical "must offer" requirement exemption and to make corresponding changes to the Market Seller Offer Cap (MSOC). While this forthcoming filing is separate from other capacity market adjustments recently submitted in Federal Energy Regulatory Commission (FERC) Docket No. ER25-682-000, both sets of adjustments seek FERC approval to be effective for the 2026/2027 Base Residual Auction (BRA).

The Board expresses its continued gratitude to all stakeholders for the thoughtful engagement exhibited on these matters. The Board is aware that the discussions on the matters addressed herein were advanced quickly. PJM finds great value in the contribution of its stakeholders and generally prefers as robust a process as possible for any given issue. This expedited process was necessary to be able to effectuate future capacity market auctions without further delaying the upcoming Base Residual Auction, while timely addressing PJM's pressing resource adequacy needs.

Several factors have occurred over the last several weeks that have led the Board to believe that now is the appropriate time to eliminate the categorical "must offer" requirement exemption and, instead, adopt a "must offer" requirement for all resources with Capacity Interconnection Rights (CIRs). These factors include:

- Correspondence to the Board regarding the consequences resulting from the lack of a "must offer" requirement for all resources with CIRs;[2]
- Stakeholder feedback provided during recent discussions on the recently filed capacity market adjustments whereby stakeholders expressed concerns for the consequences of a lack of a "must offer" requirement for all resources with CIRs; and,
- PJM's analyses reflecting the changed market conditions since this categorical "must offer" requirement exemption was adopted one decade ago.[3]

---

[1] PJM Board Letter Outlining Support for Upcoming Interconnection and Capacity Market Filings, Dec. 9, 2024

[2] *See e.g.,* Organization of PJM States, Inc. Letter Regarding Results of the 2025/2026 Base Residual Auction (Sep. 27, 2024); Five Governors' Letter Regarding Capacity Auctions (Oct. 25, 2024) "Eliminate the must-offer exemption for intermittent generation resources, while protecting them from performance penalties that discourage participation"; PPL Electric Utilities Letter Regarding PJM Base Residual Auctions and Capacity Market Issues (Nov. 1, 2024); Organization of PJM States, Inc. Letter Regarding Proposed Capacity Market Adjustments (Nov. 21, 2024); See the Board Communications page on PJM.com for letters.

[3] *See* Consultation with Members: Capacity Market Must Offer and Market Seller Offer Cap Changes, PJM Members Committee, PJM Interconnection, at p. 12

At present, approximately 97% of PJM's queued generation is eligible for the existing categorical "must offer" requirement exemption. When combined with the shortening supply-demand conditions observed in the 2025/2026 BRA, the region will increasingly be reliant upon capacity that is currently eligible for the categorical "must offer" requirement exemption. Having the categorical "must offer" requirement exemption in place at a time when the system is becoming increasingly reliant upon this capacity risks the potential exercise of market power. PJM's filing aims to cure this dynamic while at the same time allows these resources to adequately reflect their quantifiable risk of Capacity Performance after proper and independent review.

As stated in the Board's December 9 correspondence, PJM does not expect that these filings, taken in aggregate, will fully resolve the resource adequacy challenge that we are collectively facing. At the same time, we believe these market adjustments will better reflect supply-demand conditions and should be advanced now. We expect for PJM and the stakeholders to continue to deliberate and act on this issue of utmost criticality and to bring their best proposals forward.

Board-Supported Filings

Below is a description of filings that the Board supports, along with the Board's response to particular feedback we heard from stakeholders through discussion in the stakeholder process as well as through posted *ex parte* Board communications, where applicable.

Capacity Market Must Offer Exemption and Market Seller Offer Cap Changes

To be effective, PJM's capacity market must achieve both reliable and cost-effective outcomes that reflect supply-demand fundamentals. Additionally, it must serve as a stable signal for investment in new resources. These reforms are balanced, equitable and improve the market's ability to reflect both existing and emerging supply-demand fundamentals.

PJM's proposal addresses three areas: (1) the expansion of the "must offer" requirement for all Existing Generation Capacity Resources with CIRs; (2) reforms to the MSOC to allow capacity market sellers to submit an offer that reflects the incremental cost of risk associated with taking on a capacity commitment; and (3) allowance for MSOC to be determined by offer segment.

1. Expansion of "Must Offer" Requirement for All Resources With CIRs

To lower the risk of market power exertion through the act of physical withholding, existing generation capacity resources within PJM have a "must offer" obligation for bidding their supply into the capacity auction. Any existing generation capacity resource may request an exception to the "must offer" requirement consistent with meeting the limited circumstances that are enumerated in PJM's Open Access Transmission Tariff. At present, however, there also exists a categorical exemption from the "must offer" requirement based on technology class. This categorical exemption applies to all: Intermittent Resources, Storage Resources, Hybrid Resources, Demand Resources and Energy Efficiency Resources.

This categorical exemption was adopted upon PJM's 2015 implementation of its Capacity Performance (CP) market design (ER-15-623). Prior to CP's adoption, when the risk of a capacity commitment was minimal, all existing generation capacity resources had a "must offer" requirement. At the time of CP's development, this class of resources did not represent a large share of either existing or emerging capacity resources. What's more, at that time, the PJM region enjoyed system capacity reserves nearly 30% in excess of peak demand forecasts; meaning, the likelihood was limited for these types of resources to meaningfully affect market outcomes through physical withholding. Placing a "must offer" requirement on these resources in 2015 at the introduction of CP would have yielded minimal market benefit relative to the level of potential CP penalties thereby potentially chilling early investment in these technologies in PJM.

Since that time, however, wind and solar resource types have become a larger part of the region's resource mix, and their role will only grow as the energy transition continues. In the current interconnection queue, solar, wind, storage and hybrid resources represent the majority of new capacity to be built and brought online. Given these facts, the rationale that the exemption is sufficiently narrow to prevent withholding no longer holds true. This is especially relevant now because as system margins tighten due to load growth and resource retirements, the impact of this unoffered capacity is magnified.

As a result, beginning with the 2026/2027 BRA, the PJM proposal would remove the categorical "must offer" exemption for all Intermittent Resources, Storage Resources and Hybrid Resources. Energy Efficiency Resources have been removed from the PJM capacity auction. Demand Resources would retain this exception because PJM does not have the authority to force load to curtail outside of a load shed event.

At the December 13 Special Members Committee and through posted *ex parte* Board communications, the Board heard comments from stakeholders regarding the consequences and merits of both retaining and removing the "must offer" exemption from the aforementioned resource classes. The Board also heard perspectives from stakeholders regarding the equity of retaining the categorical exemption for Demand Resources.

The Board supports PJM's proposal as outlined above. It is apparent that since 2015 when the "must offer" exemption was first adopted, market conditions have changed. The increasing share of the supply stack represented by these resources – both today and in the foreseeable future – combined with tightening system reserves, support the need to make this change now.

For these reasons, and those further elaborated in PJM's forthcoming filing, the Board supports the PJM proposal related to modifying the categorical "must offer" exemption as detailed above.

2. Corresponding Modifications to the Market Seller Offer Cap

Net Energy and Ancillary Service (EAS) revenues are used to offset the gross avoidable cost rate in calculating the MSOC for a resource offering into the capacity market. Capacity Performance Quantifiable Risk (CPQR) is a cost treated the same as other going-forward costs and is currently netted against Net EAS revenues to arrive at the MSOC. This can result in Capacity Market Sellers being capped at a level (e.g., $0/MW-day), which is less than their incremental risk of taking on a capacity commitment.

Beginning with the 2026/2027 BRA, the PJM proposal would set a floor for MSOC at CPQR costs. This ensures that Capacity Market Sellers can always submit an offer that reflects the incremental risk of taking on a capacity commitment. To be nondiscriminatory, the PJM proposal would apply to all Generation Capacity Resources to the extent such CPQR may be justified. However, PJM's proposal does **not** include a default CPQR, nor does it modify the existing procedures or inputs related to determining the level of the CPQR.

At the December 13 Special Members Committee, the Board heard comments from stakeholders regarding the consequences and merits of PJM's proposal to modify the MSOC. Specifically, the Board heard suggestions from stakeholders to reflect risk for this class of resources by removing certain periods of performance and penalty expectations (e.g., no overnight performance obligations and penalty risks for solar). PJM has also heard arguments the other way – that exempting some CIR resources from a must offer requirement is discriminatory.

With the requirement for all Existing Generation Capacity Resources to offer into the capacity market, PJM recognizes that resources, particularly those of Intermittent Resources and Capacity Storage Resources, must be able to include their operational risk of committing a capacity resource in their offers. Improvements to allow for the reflection of the CPQR in their offers will afford these resources the ability to properly reflect the risk of their intermittency in their offers.

The PJM proposal does **not** establish a default CPQR, nor does it alter the existing review process or inputs associated with establishing a valid CPQR. Instead, the PJM staff proposal sets an offer floor where quantifiable, validated risk exists consistent with existing Tariff rules to approve CPQR. The Board supports PJM's modification to the MSOC calculation to allow the CPQR to be reflected in an offer.

3. Allowance of Segmented Market Seller Offer Caps

Currently, the MSOC is calculated at the resource level. However, offers could be submitted into the capacity market in segments (i.e., 50 MW at $10, the next 25 MW at $15, etc.). The PJM staff proposal would allow the MSOC to be determined by segments, and, importantly, those segments could reflect different levels of risk of performance. At the December 13 Special Members Committee, the Board heard feedback from stakeholders regarding this aspect of the proposal.

Such a modification more accurately captures the fact that a resource's risk to perform may vary based upon the commitment level of the capacity obligation. Lower megawatt commitments may prove less risky than higher megawatt commitments. This may be especially acute to resource types that rely upon nature to supply fuel; however, the PJM proposal would apply to all Capacity Market Sellers to the extent such segmented MSOCs may be justified.

For these reasons, the Board supports the PJM proposal related to changes that allow segmented MSOCs as detailed above.

Update: Reliability Resource Initiative (RRI)

The PJM Board, in consultation with PJM staff, supports an element of the RRI proposal filed with FERC on December 13, 2024, that reflects a change from the prior Board letter outlining the Board's support for RRI.

All RRI projects must post a deposit of $4,000/MW, in addition to study and readiness deposits required, as part of the interconnection process. This new RRI deposit will be 50% at-risk when Phase 2 of Transition Cycle #2 commences and 100% at-risk after the project's Generation Interconnection Agreement has been accepted by the Commission and effective. Once the project has achieved its commercial operation milestone, the deposit will be refunded back to the developer. If at any point the project is withdrawn or the Generation Interconnection Agreement is terminated, the at-risk portion of the deposit will be forfeited and used in accordance with other nonrefundable study deposits.

This change strikes a balance between creating an additional commitment from RRI projects in moving toward completion of their project without being excessively burdensome financially in a way that would discourage new entry to the queue.

Summary

The PJM Board supports the PJM staff in making a filing to further adjust the capacity market to remove "must offer" exemptions and adjust the MSOC. Further, the Board supports the change made to the RRI proposal as discussed above and filed with FERC.

The Board again expresses our appreciation to our stakeholders for your thoughtful feedback and suggestions on these critical and timely matters.

Sincerely,

Mark Takahashi
Chair, PJM Board of Managers