VIA ELECTRONIC DELIVERY

The PJM Board of Managers
c/o Mark Takahashi, Chairman
PJM Interconnection, L.L.C.
2750 Monroe Boulevard
Audubon, PA 19043

Dear Chairman Takahashi and Board Members:

The PJM Power Providers Group (“P3”)\(^1\) would like to thank the PJM Board of Managers (“Board”) for launching the Critical Issue Fast Path (“CIFP”) process to elevate the urgency of issues related to the capacity market and to put PJM stakeholders on a timeline for action before the end of the year. Like the Board, P3 recognizes the need to have a functioning capacity market in PJM that utilizes competitive market pressures to provide sufficient resources to consumers at competitive prices. We are pleased to see that the Board shares that vision.

PJM’s capacity market is the single-most important tool available to ensure the region has sufficient capacity at the lowest possible cost. A mere four years ago, PJM’s capacity prices were competitive, market entry was significant, reserve margins were robust and the transition from a coal-dominated generation fleet to a gas-dominated generation fleet was going smoothly (leading to a dramatic reduction in NOx, SOx and carbon emissions from the power industry in the region). The capacity market played an important role in welcoming new resources to the grid (including renewable resources) and units that were no longer economically viable received a market signal suggesting retirement.

P3 rejects the assertions of some parties that the capacity market is a flawed construct. In its initial phase, the Reliability Pricing Model (“RPM”) Capacity Market retained resources that were otherwise facing retirement

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\(^1\) P3 is a non-profit organization dedicated to advancing federal, state and regional policies that promote properly designed and well-functioning electricity markets in the PJM Interconnection, L.L.C. (“PJM”) region. Combined, P3 members own over 83,000 MWs of generation assets and produce enough power to supply over 63 million homes in the PJM region covering 13 states and the District of Columbia. For more information on P3, visit [www.p3powergroup.com](http://www.p3powergroup.com). The views expressed in this letter represent the position of P3 as an organization, but not necessarily the views of any particular member with respect to any issue.
decisions due to poor market design and impending state and federal environmental initiatives. The best historical example of the capacity market working was with the Mercury and Air Toxics Standards (‘MATS”) that led to nearly 30,000 MW of retirements while also attracting more than enough capital to reinvest in some units or invest in new resources and technologies. What some feared was an impending reliability problem, turned into a non-event because of the capacity market. Finally, the implementation of Capacity Performance (“CP”) in the wake of the 2014 Polar Vortex provided even stronger reliability incentives at prices that were competitive.

Unfortunately, the capacity market is under undeniable duress and absent significant changes, will be challenged to achieve its promise. As evidenced by PJM’s recent “Resource Retirement, Replacements and Risks” report, PJM needs its capacity markets to be functional to meet the challenges of the future. Current market dynamics do not reflect the urgency of the moment. In short, where we are now will not get us to where we need to be. Consider the events of the last several months:

- Capacity prices are at historic lows, which is inconsistent with PJM’s report detailing looming reliability challenges,
- Capacity market participation is shrinking significantly as the last three auctions have shown a steady decline in resources seeking capacity obligations,
- Capacity auctions that once cleared nearly 6,000 MWs of new generation, cleared a mere 328 MWs in the most recent auction,
- The number of constrained zones is increasing,
- The quantity, location and quality of new resources are insufficient to sustain reliability as PJM recently noted,
- The DPL-South matter has undercut confidence that markets will operate in a transparent and non-discriminatory fashion, and,
- The events of December are a recent reminder that being a capacity resource in PJM comes with potentially billions of dollars of exposure to penalties for relatively short-term failures.

As PJM launches the Critical Issue Fast Path process, P3 would like to share its perspective on why in a relatively short period of time the capacity market has lost its vitality. P3 has sharply criticized recent actions by PJM and FERC which, in P3’s view, have diminished the capacity markets to the point where reliability-needed resources are not receiving sufficient compensation to remain viable and asset owners are no longer able to exercise independent judgment about the resources they own. To be sure, factors outside of PJM’s control, including state and federal policies, have played a role in shaping the dramatic downslide of the capacity market. However, there are several specific actions that were entirely within PJM’s and FERC’s control that led, and will continue to lead, to reliability challenges, if not addressed. Specifically, P3 offers the following examples of actions in the recent past that are contributing to the capacity market malaise:
1. **Market Seller Offer Cap** – As the result of Commission action and PJM inaction, asset owners are seriously constrained in their ability to make independent judgments regarding the costs and risks associated with the facilities they own. This is an untenable proposition for any rational business owner and is not sustainable in PJM. P3 appreciates that PJM continues to identify this issue as a concern, but the reality is that the last three Base Residual Auctions have been run under administratively set offer caps that are simply not sustainable. Resources are no longer able to reasonably reflect future energy price uncertainty, nor their risk of performance under the current MSOC that is inconsistent with the Capacity Performance design. This dynamic must change and P3 is pleased to see this issue among those identified by the Board to be addressed by the CIFP process.

2. **The 24/25 Base Residual Auction Re-run.** Perhaps most troubling and most difficult to resolve is the considerable undermining of market confidence resulting from the decisions in and around the 24/25 BRA. P3 has no issue with rules being considered on a prospective basis, but retroactively changing capacity market rules to get a desired answer is entirely antithetical to a sound market design and kryptonite for capital investment. While the DPL South issue was portrayed as a unique event that is unlikely to reoccur, the damage to PJM’s reputation has been done. Overcoming the impact of PJM’s actions in this matter will be perhaps the highest mountain to overcome if it wants to restore the confidence that will be necessary to attract the investments that are clearly going to be needed to achieve resource adequacy.

3. **MOPR** - As P3 has offered to PJM, FERC and the federal court on multiple occasions, the lack of meaningful protections from the exercise of buyer-side market power from the state subsidization of specific resources is a pall over the market that will dissuade merchant capital from the market. The lack of protections against the exercise of buyer market power is something that any rational investor would need to consider and, unfortunately, remains a deterrent from those considering deploying merchant capital in PJM.

4. **VRR Reforms** – PJM’s reforms to the VRR curve will negatively impact the capacity auctions for resources seeking to enter or remain in the market at same time that PJM is predicting energy shortages in the region (delivery years between 2026 to 2030). PJM made significant changes to the reference unit and the calculation of the EAS offset (among other things) that will interject significant uncertainties and volatility into capacity auctions which create a difficult environment to attract investment. P3 notes that suppliers in the past could reflect such uncertainties in their offers but can no longer do so under the current MSOC. Without relitigating those matters here, P3 wishes to reiterate that these reforms will hurt and not help attract and retain resources at a time PJM is saying those resources will be needed.

5. **Real Time Operational Decisions** -- The events of last December are a chilling reminder that being Capacity Resources in PJM comes with billions of dollars of exposure to penalties. The events of Winter Storm Elliott also shone a light on a new set of risks suppliers must now consider: (1) inaccurate load forecasting that leads to under-commitment of the needed resources to ensure reliability; (2) opaque
operational decisions that leave resource owners confused and uncertain; (3) the non-performance of other entities such as gas producers and transmission providers, and (4) non-performance of units outside of PJM that led to significant exports out of PJM while PJM consumers paid high energy prices and PJM suppliers paid hefty penalties.

P3 appreciates that many of the decisions referenced above have complicated histories associated with them and most of them are being reviewed by federal courts, but the Board needs to appreciate that the cumulative impact of these decisions have been deleterious to investment in PJM. P3 looks forward to trying to correct things moving forward. P3 would like nothing more than to have a capacity market that gives regulators and PJM stakeholders more confidence that the grid will have a sufficient and sustainable resources to meet projected demand. The fact that capacity markets were once mostly capable of achieving that purpose makes us confident that with leadership from PJM, capacity markets can be restored to their original promise.

As the Board anticipates the results of the CIFP process, P3 offers the following thoughts as to issues that should be addressed in that process as well as issues beyond that process that the Board should consider:

- **Restore Confidence in PJM’s Capacity Markets** – Market-damaging regulatory actions need to stop. This restoration of confidence begins with PJM carefully considering all decisions through the lens of restoring confidence in its markets. Past actions by PJM, such as those related to the MOPR, the revised VRR parameters and the “do-over” of the capacity auction for the 24/25 delivery year, were all individually problematic and cumulatively destructive. Similar actions in the future must be avoided if PJM is serious about attracting merchant investment in capacity. P3 cannot predict what future decisions come before the Board, but in its decisions the Board should consider the message it is sending to those looking to invest at-risk dollars in PJM.

- **Market Seller Offer Cap** – Simply stated, capacity market sellers need flexibility to reflect their costs, risks, and tolerance for future energy market uncertainty in their capacity market offers. P3 supports a return to an offer cap that appropriately targets market power while allowing asset owners to exercise reasonable commercial judgement and provides a meaningful Safe Harbor for offers below a certain level. Such a construct has been approved by FERC before and would provide consumers with confidence that market power would not be exercised and provide suppliers the ability to appropriately submit their offers.

- **Penalty Reform** – P3 supports a penalty structure that is more in line with the risks and compensation that is provided to capacity resources. For example, under the current penalty structure and offer cap provisions, a $28.92/MWday clearing price as recently cleared for the 24/25 delivery year and a PAI of 23 hours as was just seen during Winter Storm Elliott, would wipe out five years of capacity revenues for any resource with a capacity obligation (assuming a balancing ratio of 0.8). If a reasonable MSOC were reinstated, then the penalty structure may not require significant adjustment. However, without the ability to reflect the cost of the risk suppliers face from disproportional penalties, the exposure must be
reduced and/or capped. The market cannot continue in its current state that subjects suppliers to significant penalties without the opportunity to reflect the cost of that risk in their offers.

- **No Changes to Planning Parameters after Offers are Submitted** – As a result of the recent FERC decision regarding the 24/25 auction, PJM has the ability for the first time in its history to change the BRA planning parameters after capacity offers are submitted. This is an untenable position for market participants who rely heavily on those parameters for commercial transactions. P3 and other parties, have offered a wide range of potential solutions that can prospectively address any concerns that PJM and FERC may have while providing confidence to suppliers that planning parameters will not change after offers are submitted. This issue can be easily addressed and should be in the CIFP.

- **More Transparency Around PJM Operations** - As details following Wither Storm Elliott emerge, it has become clear that PJM has significant discretion around calling a Performance Assessment Interval (“PAI”). Market Participants have insufficient signals as to when a PAI will be called other than when as a last resort, demand response is triggered. There needs to be more specific steps that make clear when a PAI will happen so that the event is foreseeable and manageable. It is unclear how exports are treated during an emergency, and this must be made clearer both from a rule perspective and real time operations data posting. Additionally, there needs to be clearer rules on what are the determinants that drive PJM’s decision to terminate a scarcity event, especially when market signals indicate no scarcity, as they did during many PAIs during Storm Elliott. Some of these changes may be addressed in PJM manuals and not in the October FERC filing, but it is very important that PJM provides this transparency.

- **Marginal Accreditation for ELCC Resources** - P3 is supportive of marginal accreditation for ELCC resources and open to a conversation about ELCC applying to all resources.

- **Meaningful Protections from Buyer Side Market Power** - PJM cannot continue to ignore the lack of any meaningful protections to the market from the exercise of buyer side market power through subsidization. While this issue is beyond the immediate discussion, this hole in the PJM tariff is a gapping one that needs to be filled if PJM is serious about attracting merchant resources to the grid.

- **Reforms to PJM Market Mitigation Rules** – P3 believes a longer-term conversation is required surrounding the Three Pivotal Supplier Test and market mitigation in general. P3 believes in strong measures (on both the buy and supply side) to prevent the exercise of market power; however, the current structure goes beyond what is necessary and in doing so is unnecessarily disruptive to appropriate commercial activity. P3 suggests that after the current CIFP, the Board consider a similar exercise regarding market oversight of both buy and sell side activities.

- **FRR Reform** – FRR plans need to commit resources at the same reserve level as the RPM BRA. Also, FRR resources and their performance should be subject to like kind penalties as other capacity resources within the PJM market. These are surgical fixes to a long-standing imbalance in the tariff.
P3 remains open to discussing other issues in the process, but it is critical that the above listed issues be addressed and, as such, P3 supports a delay of the currently scheduled BRAs to address these concerns. Again, P3 applauds the Board for launching the CIFP process focused on capacity market reforms and P3 members hope to be able to stand up before the Board later this year and endorse a PJM package that includes these elements. Restoring PJM’s capacity market can be achieved, and the consumers and suppliers of PJM deserve nothing less.

Respectfully submitted,

/s/ Glen Thomas

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