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Ake Almgren  
Chair, PJM Board of Managers

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Dear PJM Stakeholders:

The Board appreciates stakeholders' active engagement in the Energy Price Formation Senior Task Force. Although the Task Force was unable to reach a consensus solution by the third quarter of 2018 (as requested in the April 11, 2018 letter from the Board regarding improvements to reserve procurement and shortage pricing in the energy market), the Senior Task Force provided valuable input from the stakeholder community to assist the Board and PJM in their efforts on these important issues. The issues with energy and reserve market pricing are well documented. While there appears to be widespread agreement that improvements to reserve markets are necessary, stakeholders have not been able to reach consensus on specific proposals.

The Board has reviewed evidence that demonstrates that when the system is experiencing stressed conditions, energy and reserve prices do not accurately reflect PJM operator reliability actions and, as a result, out-of-market payments increase substantially during those periods. Further, PJM's current reserve market rules do not accurately align the procurement of reserves with their reliability value or incentivize consistent response when deployed. The lack of alignment in the reserve markets mutes price transparency, shifts costs unfairly to consumers who have prudently hedged, and limits competition to secure reserves at the least cost to consumers. PJM has studied the reserve markets of other regions where more robust designs more effectively value reserves and price operator actions and has learned from these models. In fact, a number of the design elements that PJM has proposed to stakeholders have all been successfully implemented.

After deliberation at the December meeting, the PJM Board has determined that a comprehensive package inclusive of the components outlined below, is needed to meaningfully address the reserve procurement and pricing issues.

The comprehensive package should include the following components:

- Consolidation of Tier 1 and Tier 2 Synchronized Reserve products
- Improved utilization of existing capability for locational reserve needs
- Alignment of market-based reserve products in Day-ahead and Real-time Energy Markets
- Operating Reserve Demand Curves (ORDC) for all reserve products
- Increased penalty factors to ORDCs to ensure utilization of all supply prior to a reserve shortage
- Transitional mechanism to the RPM Energy and Ancillary Services (E&AS) Revenue Offset to reflect expected changes in revenues in the determination of the Net Cost of New Entry

Therefore, the Board has directed PJM management to work with the stakeholders on the components identified above regarding those on which consensus can be reached by January 31<sup>st</sup> of 2019. If such timely consensus cannot be achieved on all the aforementioned principal components, the Board will direct

PJM management to make a Section 206 filing to implement the remaining components to address the reserve procurement and pricing issues.

The Board thanks stakeholders for their engagement in the Senior Task Force and their ongoing support on this important matter.

Sincerely,

*Ake Almgren*

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