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## PJM Members Committee

Dear Members:

After reviewing a considerable amount of information and stakeholder comments within the Enhanced Liaison process, the PJM Board has authorized the filing of a Capacity Performance initiative at FERC.

The Board decided, after much deliberation, that stronger incentives within the existing capacity market structure should be established to encourage needed investment by both new and existing resources. PJM is acting now to begin reversing trends in generation performance and fuel security that will continue to deteriorate reliability. Deferring action to a later date would result in the likelihood of additional transitional costs and would further delay investment needed to fully recognize the value that robust, reliable generating resources provide to the regional transmission system.

To improve the balance between the cost of infrastructure improvements and the benefits of reliability, PJM is submitting to FERC a modified version of the staff proposal, as indicated in the attached Addendum.

Many of the issues raised during this five-month discussion of capacity performance are not unique to the PJM region. PJM is modeling its approach after the "Pay for Performance" capacity market design that FERC recently approved for ISO-New England, along with changes in the transition period that allow time for market participants to adapt and to lessen cost impacts. This design also allows for greater opportunities for all resources to participate in this enhanced capacity market.

PJM markets have proven to be an effective and cost-efficient mechanism for delivering reliable power to PJM member companies and ultimately to the millions of people and businesses within the PJM region. This has been especially true during this time of rapid change in the generation mix. The Capacity Performance proposal will lessen future energy market costs and strengthen assurances that generating resources will be available when most needed. This initiative will provide enduring value and result in greater reliability of the grid.

The Board wishes to thank stakeholders, the Independent Market Monitor and PJM management for their engagement, valuable analysis and guidance throughout this intensive review process.

Sincerely,

A handwritten signature in black ink that reads "Terry Boston".

Terry Boston



## Addendum

The Board of Managers directs the following modifications to the conceptual proposal detailed in the October 7, 2014 paper titled *"PJM Capacity Performance Proposal -- Updated Proposal"* to reflect the Board's determination to:

- 1) Revise the performance requirement, incentive and payment structure to be similar to the ISO New England requirement and performance payment structure.**

This enhances incentives for capacity resources because performance payments from under-performing resources will be allocated to over-performing generators. This further protects consumers from increased energy costs due to generation under-performance.

Adoption of the ISO New England performance payment structure provides added incentives for energy-only resources to provide energy during emergency conditions. This provides opportunity for intermittent resources and non-capacity resources to earn additional revenue by providing energy in place of under-performing capacity when the system needs it most.

- 2) Adopt the "no excuses" approach to performance requirements except for retaining an exemption for resources following PJM scheduling and dispatch instructions.**

The "no excuses" approach will ensure capacity resources have maximum incentive to invest in fuel security and sustainable maintenance programs to ensure performance during peak load periods. This approach appropriately assigns performance risk to capacity suppliers who are in the best position to manage the risk.

- 3) Narrow the 2015 procurement for reliability and reduce the quantity of transitional Capacity Performance procurement in the transition auctions for 2016/17 and 2017/18 to 60% and 70% of requirement respectively.**

This will reduce transition costs but still maintain reliability through the transition period.

- 4) Expand the applicability of coupled resource offers to allow more flexibility for intermittent resources.**

This mechanism will reduce barriers to participation and maximize flexibility for resources to participate in the Capacity market.



**5) Eliminate the multi-year pricing mechanism.**

The purpose of the mechanism is to mitigate risk for multi-year investments in the single year market structure. Based on discussion with the Independent Market Monitor and PJM staff, this mechanism can create pricing anomalies and perverse incentives for resource offers based on parameters selected. Since this issue is broader scope than Capacity Performance, it is better dealt with as a separate initiative.

**6) Modify cost allocation for capacity performance to include all compliance hours.**

Based on discussions with the Independent Market Monitor, the cost allocation of Capacity Performance should be directly aligned with demand levels in the capacity compliance hours. This approach will maximize the efficiency of the market and further encourage comprehensive demand response through the entire year.

**7) Maintain demand response as a supply-side resource with the demand response product adapted to be a peak shaving commitment which conforms to the Capacity Performance approach.**

The issues raised by the court action on FERC order 745 are separable from this Capacity Performance initiative. The Capacity Performance approach will function with Demand Response on either the supply or the demand side. The current uncertainties surrounding demand response participation in wholesale markets will be addressed in a separate proceeding.

**8) Implement an adjustment to the forward load forecast to recognize the observed reduction in correlation with economic indicators.**

The October 7 PJM staff proposal included elimination of short term resource requirement mechanism -- often referred to as the "2.5 % holdback." The Independent Market Monitor has consistently recommended eliminating this 2.5 % holdback to reduce potential price distortions caused by systematic under-procurement.

PJM staff has analyzed forward load forecast performance and is recommending improvements to the Planning Committee to recognize the trend of separation between load forecasts and economic indicators.

The combination of these recommendations appears to address the issues most comprehensively.

*For additional information:* [Capacity Performance Proposal – Summary of Key Design Elements](#)