

Problem Statement and Issue Charge Replacement Capacity

Problem Statement

The current rules in RPM/CP allow capacity resources to offer into and clear Base Residual Auctions and afterwards, through purchases via bilateral contracts or Incremental Auction, obtain replacement capacity to satisfy the delivery requirement established by clearing the Base Residual Auction. The potential for the replacement purchase to be priced lower than the applicable clearing price of the Base Residual Auction provides a powerful profit motive that may encourage some market participants to take unneeded risks that may jeopardize reliability. Both PJM and FERC have supported consideration of whether additional measures should be implemented to assure continued reliability.

In March 2014, PJM submitted tariff revisions seeking to promote long-term reliability in its capacity market by barring speculative sell offers from being submitted into PJM's capacity market auctions. In May 2014 FERC issued an order rejecting PJM's tariff revisions and instituting a proceeding under Section 206 of the Federal Power Act to assess concerns about speculation. In its order, the FERC directed staff to convene a technical conference to facilitate the development of a just and reasonable solution. In August, PJM requested the FERC to defer action in the proceeding pending PJM's tariff filing to implement capacity performance. PJM subsequently filed several reports requesting continued deferral of the proceeding. In its November 2016 report to the FERC, PJM informed that a new stakeholder effort to review PJM's incremental auction structure.

From time to time, PJM's market monitor has presented an analysis of replacement capacity in PJM's capacity markets. In the report presented at the January 2017 MIC meeting, the market monitor demonstrated that the high replacement percentages still persist for certain resources. The IMM analysis to date has not included any Delivery Years that reflect PJM's implementation of Capacity Performance.

At the November meeting, the MRC approved a problem statement and issue charge to address certain aspects of incremental auctions. ~~One plausible interpretation of that problem statement and issue charge was the issues related to replacement capacity would be included within the IASTF's charter.~~ During the organizational meeting of the IASTF, the group discussed whether the replacement capacity item should be included in the charter. The group determined that the problem statement and issue charge of the IASTF would require a moderate number of revisions to address the replacement capacity issues and decided to forgo including replacement capacity in its charter without specific direction from the MRC.

Key Work Activities

1. Educate ~~interested~~ stakeholders on the problems caused by speculative offers and buy-backs in capacity markets.

~~2. Identify and Define~~ define parameters around what is considered to be a speculative ~~offer~~ behavior.

~~23.~~ Educate stakeholders on the uses of replacement transactions and, if necessary, identify options for treatment of capacity that must be replaced.

| 34. Review current requirements and identify appropriate standards for resources to be deemed physical prior to the BRA. and, if necessary, i identify changes, if necessary, to rules which determine eligibility to offer into the BRA.

| 45. Identify opportunities to streamline the replacement process.

| 56. Develop appropriate tariff revisions and manual revisions, if necessary, to implement preferable option.

Issue Charge

Stakeholder Group Assignment

This work should be assigned to the IASTF.

Expected Deliverables

Possible Tariff, RAA and/or manual changes.

Expected Overall Duration of Work

| The goal is to complete work and make recommendations to the MRC by the ~~November 2017~~ January 2018 MRC meeting.

Decision-Making Method

Tier 1, consensus (unanimity) on a single proposal.