

called upon to meet the needs of the PJM Region.⁴ The 2015 Base Residual Auction (“BRA”) is currently scheduled for May 11-15, 2015, although the Commission has issued an order today in Docket No. ER15-1470-000 granting PJM’s request for a one-time waiver of the PJM Tariff to allow a limited delay of this BRA,⁵ which would be *no longer than* three months and hopefully less, to allow the Commission an opportunity to decide on the important pending RPM reforms and related rule changes to improve capacity resource performance *prior* to commencement of this year’s annual capacity BRA.⁶

EPSA reiterates its general support of the PJM Capacity Performance Filing, as amended by the April 10 Response, and strongly urges timely Commission action on the merits of the proposal to allow implementation for the 2015 BRA to procure capacity for the 2018/2019 Delivery Year. Such action is consistent with the Commission’s responsibility to ensure properly functioning capacity markets, the underlying purpose of RPM to facilitate reliability, the precedent in ISO New England, and the detailed records in this docket and in the Commission’s work examining performance issues during the winter months of early 2014.

I. COMMENTS

A. FERC Should Expediently Approve The Capacity Performance Filing To Establish Clear Market Rules And Price Signals Needed For Reliability Improvements And Properly Functioning Capacity Markets

⁴ *PJM Interconnection, L.L.C.*, Docket No. ER15-623-000 (filed December 12, 2014) (“Capacity Performance Filing”) at 1. EPSA filed comments generally supporting the Capacity Performance Filing on January 20, 2015.

⁵ *PJM Interconnection, L.L.C.*, Request of PJM Interconnection. L.L.C. For Expedited Grant Of Tariff Waiver, Docket No. ER15-1470-000 (filed April 7, 2015) (“PJM Waiver Filing”). EPSA filed comments in support of the PJM Waiver Filing on April 14, 2015.

⁶ *PJM Interconnection, L.L.C.*, Order Granting Waiver, Docket No. ER15-1470-000 (issued April 24, 2015).

EPSA generally supports the PJM Capacity Performance (“CP”) proposal as amended as a mechanism to improve system reliability and facilitate efficient investment in the PJM region. EPSA agrees with PJM that the CP proposal builds on the success of the RPM forward capacity market to date, and recognizes that stronger incentives within the existing capacity market structure should be established to encourage investment by both existing and new resources.⁷ At this time of rapid change in the generation mix and other industry challenges, EPSA supports efforts such as this by PJM to address identified market and operational issues in both capacity and energy markets, as have been explored by the Commission in an array of recent proceedings and in light of expected forthcoming factors which will affect the available resource mix, performance limitations and expectations of existing resources, and signals for investment in both existing and new supply. In the March 31 Letter, the Commission asked specific tailored questions about a narrow set of key provisions to which PJM responded in only 10 days, although the Commission provided a 30-day timeframe for doing so. The PJM Capacity Performance proposal is largely patterned on the “Pay-for-Performance” proposal the Commission already accepted and deemed just and reasonable for ISO New England.

⁷ See Letter from PJM President and CEO Terry Boston to the PJM Members Committee regarding PJM Board of Managers Action regarding Capacity Performance, (December 3, 2014) (“PJM President Boston Letter to PJM Members”), available here <http://www.pjm.com/~media/committees-groups/committees/elc/capacity/letter-from-terry-boston-pjm-board-of-managers-action-regarding-capacity-performance.ashx>

Therefore, EPSA respectfully underscores to the Commission the importance of swift action on the pending Capacity Performance Filing to allow the requested changes to become effective for the 2015 BRA. These auction results will significantly impact current and future investment decisions as has been the case following capacity auctions in recent years. The three year lead time means that if market design flaws are not corrected and improvements implemented before these upcoming auctions, sub-optimal results will be carried forward for years into the future. In this regard, PJM has noted that if it had deferred these changes to the following BRA, to be held in May 2016 for the Delivery Year commencing June 1, 2019 (“2019/2020 DY”), “it would mean that the PJM Region would let *five more* winters pass after 2014 without implementing a full remedy to the manifestly deficient performance requirements in the current rules.”⁸

Further, while PJM generation resources performed well this winter, significant challenges lie ahead in the very near term, and certainty regarding market rules is needed to ensure that both reliability improvements are achieved and to provide correct price signals for investment. Of particular significance, the 2014 PJM State of the Market Report (“2014 SOM Report”) prepared by the PJM Independent Market Monitor (“IMM”) reflects that PJM has received notification of over 10,000 MW of planned generation retirements for 2015, and another 2,140 MW of post-2015 planned retirement notifications have been provided to date.⁹ The 2014 SOM Report also

⁸ April 10 Response at 3.

⁹ See Monitoring Analytics, IMM Presentation of the 2014 State of the Market Report for PJM, Markets Committee Special Session, at Slide 39, March 26, 2015, (Table 12-6, Summary of PJM unit retirements (MW): 2011 through 2019)), *available at*, http://www.monitoringanalytics.com/reports/Presentations/2015/IMM_MC_Special_Session_2014_State_of_the_Market_Report_for_PJM_20150326.pdf

reflects that there is 7,000 MW of generation utilizing various fuel sources which is at risk for retirement because these units are not currently recovering going forward (or avoidable) costs.¹⁰ This data does not include MWs for other units that may be at risk that have not announced retirements, or that may be pursuing other solutions to address the lack of revenue sufficiency issues they are facing in the wholesale markets. In considering whether demand response resources (“DR”) will serve as a means to provide necessary reliability, it appears that to the extent DR volumes have increased in RPM, so has the extent to which DR resources are buying out their positions either in the incremental auctions or bilateral transactions, thereby eroding overall DR levels. For example, PJM has reported that in the current Delivery Year which started June 1, 2014, nearly half of these DR resources (46.5%) have bought out capacity positions.¹¹

Also on the horizon is the EPA’s proposed Clean Power Plan (“EPA CPP”), with proposed implementation in 2020, adding further urgency to the need for clarity and timely action on the Capacity Performance Filing. The PJM BRA for the 2020/2021 Delivery Year will be held only two years from now – in 2017. As the North American Electric Reliability Corporation (“NERC”) stated in releasing its assessment of the EPA CPP: “The generation mix in the United States is going through a fundamental change. Policy considerations, such as the proposed CPP, impact and accelerate this

¹⁰ Id. at Slide 38. (Table 7-37, Profile of units that did not recover avoidable costs from total market revenues or did not clear the 16/17 BRA or 17/18 BRA but cleared in previous auctions.)

¹¹ See PJM Presentation: DR Forecast for Use in Load Deliverability Studies, Slide 3, presented to the Markets and Reliability Committee, March 26, 2015. (Specifically, the DR Net Replacement Levels are: 25.9% for 2012/2013; 30.7% for 2013/2014; and, 46.5% for 2014/2015. Source: PJM Capacity Market Operations) The presentation is available here: <http://www.pjm.com/~media/committees-groups/committees/mrc/20150326/20150326-item-05-dr-forecast-in-rtep-presentation.ashx>.

transition.”¹² Given the lead time required for development of a combined cycle gas turbine (“CCGT”) unit, if the Commission does not move now to implement these CP reforms, as reflected above, there could be yet another auction under the current BRA rules with a significant increment of new entry CCGT units that have not made necessary commercial arrangements for firm natural gas transportation or dual fuel capability.

B. For The Capacity Performance Proposal To Achieve Its Intended Goals The Market Seller Offer Cap Must Be Established At A Level That Is Just And Reasonable

The foundation of PJM’s CP proposal is to establish a new capacity product, the Capacity Performance Resource (“CPR”), which is expected to provide energy and reserves when called upon by PJM during emergencies with “no excuses” for non-performance, with limited exceptions. Overall, EPSA has stated support for the establishment of CPR with more stringent performance requirements, to the extent this new product is combined with a meaningful opportunity to reflect the increased costs and risks associated with offering a resource into the market with higher obligations and greater penalty risk.

Given the significant risks combined with the increased investment and operational costs of CP, PJM originally proposed, as necessary and reasonable, to increase the Market Seller Offer Cap to allow unmitigated bids up to the Net Cost of New Entry (“Net CONE”) for the Delivery Year and Locational Deliverability Area for which the CPR is offered.¹³ EPSA agreed with this rationale in initial comments, and

¹² NERC, “*Potential Reliability Impacts of EPA’s Proposed Clean Power Plan: Phase I*,” issued April 21, 2015, available at, www.nerc.com.

¹³ PJM Capacity Performance Filing at 54-60.

continues to support the Net CONE default offer cap provisions as a critical and just and reasonable component of PJM's Capacity Performance Filing to ensure that resources can perform during emergencies occurring at any time of year.

Importantly, in the April 10 Response, PJM states it has collaborated with the IMM to develop an alternative default offer cap of Net CONE times B¹⁴ (the "PJM/IMM Agreed-to Offer Cap") instead of the Net CONE method initially proposed by PJM.¹⁵ In light of the considerable requirements placed on Capacity Performance Resources, EPSA has some reservations with this modified approach, and continues to support, based on the record, the original Net Cone default offer cap as the just and reasonable proposal that should be approved by the Commission. EPSA does acknowledge there can be more than one just and reasonable proposal, and recognizes the Commission need not find the proposal in the initial Capacity Performance Filing to be "superior to other possible solutions"¹⁶ or to be "the most just and reasonable among all possible

¹⁴ The balancing ratio, B, is defined to be the ratio of load plus reserves to total UCAP cleared in the capacity markets. See *Answer And Motion For Leave To Answer Of The Independent Market Monitor For PJM*, PJM Interconnection, L.L.C., Docket Nos. ER15-623-000 and EL15-29, at 3 and Appendix A, (filed February 27, 2015 – Corrected version).

¹⁵ April 10 Response, Response 1.

¹⁶ *PJM Interconnection, L.L.C.*, 128 FERC ¶ 61,157 at P 77 (2009) (citations omitted). See also, e.g., *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 703 (D.C. Cir. 2007) ("FERC is not required to choose the best solution, only a reasonable one." (citation omitted)); *Oxy USA, Inc. v. FERC*, 64 F.3d 679, 692 (D.C. Cir. 1995) (as long as the Commission finds a methodology to be just and reasonable, that methodology "need not be the only reasonable methodology, or even the most accurate" (citation omitted)); *California Indep. Sys. Operator Corp.*, 149 FERC ¶ 61,058 at P 38 (2014) (stating that an applicant in an FPA Section 205 proceeding "does not need to demonstrate that its proposal is the *most* just and reasonable approach, and the Commission need not consider whether alternative proposals are superior" (emphasis in original) (citations omitted)); *Entergy Servs., Inc.*, 116 FERC ¶ 61,275 at P 32 (2006) (stating that FPA Section 205 does not require that a proposed rate "be perfect, or the most desirable way of doing things, it need only be just and reasonable" (footnote omitted)), *on clarification*, 119 FERC ¶ 61,013 (2007).

alternatives”¹⁷ in order to approve the modified default offer cap proposal pursuant to the April 10 Response. Therefore, EPSA does not oppose approval of the PJM/IMM Agreed-to Offer Cap proposal to set the CP default offer cap at Net CONE times B in order to allow the overall Capacity Performance proposal to be implemented expeditiously.

To the extent that the Commission does accept the new PJM/IMM Agreed-to Offer Cap proposal to set the CP default offer cap at Net CONE times B, which is lower than the default offer cap that PJM originally proposed, more units are likely to require unit-specific offer caps in excess of the default, or “Avoidable Cost-based Offers.” Specifically, under the PJM/IMM Agreed-to Offer Cap proposal, PJM will allow resources with costs above the Net CONE times B default offer cap to submit unit-specific offer caps which detail all ACR components, including quantifiable risk. Thus, it will be all the more critical for the Commission to ensure that the methodology for calculating unit-specific offer caps accurately captures and allows all risks faced by suppliers to be reflected in those offers. The purpose of a unit-specific offer cap is to estimate the amount of capacity revenue that a unit must receive in order to cover its going forward costs after accounting for energy and ancillary services revenue. This must reflect all costs and risks including the extensive additional risk posed by the stringent performance requirements set out in the CP proposal.

¹⁷ *PJM Interconnection, L.L.C.*, 147 FERC ¶ 61,103 at P 59 (2014). See also *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,052 at P 62 (2014) (same); *Louisville Gas & Elec. Co.*, 114 FERC ¶ 61,282 at P 29 (“[T]he just and reasonable standard under the FPA is not so rigid as to limit rates to a ‘best rate’ or ‘most efficient rate’ standard. Rather, a range of alternative approaches often may be just and reasonable.”), *on reh’g sub nom. E.ON U.S. LLC*, 116 FERC ¶ 61,020 (2006).

Therefore, the Commission must accept the modifications proposed by certain generation owners to clarify the risk premium element proposed by PJM for Avoidable Cost-based Offers, particularly in light of the April 10 modifications. Importantly, PJM has previously indicated its support of this aspect of unit offer development, noting that “[g]iven the importance of these risk premiums to reasonably reflecting a seller’s costs of committing as a [CPR], and the inherent challenges in quantifying such risks, these are reasonable modifications.”¹⁸ With respect to how best to reflect risk in offers, other generation resource owners in this proceeding have developed and provided a comprehensive list of costs and risks associated with Capacity Performance Resources, as well as a quantification of those costs.¹⁹ PJM states that while it “does not adopt that analysis, it highlights the variety and scope of the Capacity Performance Resource costs and risks, and underscores that those costs and risks *are not* contemplated by the current ACR offer-capping rules.” Therefore, it is clear that the current ACR rules must be modified to ensure that all such risk elements are allowed and able to be fully captured in unit specific reviews if the PJM/IMM Agreed-to Offer Cap proposal to set the default offer cap at Net CONE times B is approved. For the CP initiative to achieve its intended goals, generators must be able to reflect investment costs and increased operating costs required by CP and the enhanced risks created by CP in their offer prices.

¹⁸ See Answer of PJM Interconnection, L.L.C., Docket No. ER15-623-000, at 89-90 in response to PSEG and Exelon requested clarifications or modifications (filed February 13, 2015).

¹⁹ Id. at 79, in response to NRG/Dynegy. Also, see *Comments and Limited Protest of the NRG Companies and the Dynegy Companies* at 11 and Attachment A, “The Morris Report,” Report of Dr. John R. Morris at 14-20, PJM Interconnection, L.L.C., Docket No. ER15-623-000, (filed January 20, 2014).

II. CONCLUSION

WHEREFORE, for the foregoing reasons, EPSA respectfully requests that the Commission consider these comments in expeditiously developing its Order on the PJM Capacity Performance Filing, as amended by the PJM April 10 Response.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the comments via email upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., April 24, 2015.



Nancy Bagot, Sr. Vice President