

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

PJM INTERCONNECTION, L.L.C) **Docket No. ER14-1461-000**

**COMMENTS
OF THE PJM POWER PROVIDERS GROUP**

On March 10, 2014, PJM Interconnection, L.L.C. (“PJM”), pursuant to section 205 of the Federal Power Act (“FPA”), 16 U.S.C. § 824d, submitted revisions to the Reliability Assurance Agreement among Load Serving Entities in the PJM Region (“RAA”) and the PJM Open Access Transmission Tariff (“Tariff”) to reform current Reliability Pricing Model (“RPM”) market rules that do not explicitly bar, and even incent, sellers in RPM’s three-year forward auction to submit speculative offers that can undermine the long-term reliability of the PJM Region (“PJM Filing”).¹ On March 11, 2014, the Federal Energy Regulatory Commission (the “Commission” or “FERC”) issued a Combined Notice of Filings #1 setting March 31, 2014, as the deadline to intervene or protest the filing. On March 14, 2014, pursuant to Rule 214 of the Rules of Practice and Procedure of the Commission, 18 C.F.R. § 385.214 (2014), the PJM Power Providers Group (“P3”)² submitted a doc-less motion to intervene.

¹ *PJM Interconnection, L.L.C.*, Docket No. ER14-1461-000, March 10, 2014.

² P3 is a nonprofit corporation dedicated to promoting policies that will allow the PJM region to fulfill the promise of its competitive wholesale electricity markets. P3 strongly believes that properly designed and well-functioning competitive markets are the most effective means of ensuring a reliable supply of power to the PJM region, facilitating investments in alternative energy and demand response technology, and promoting prices that will allow consumers to enjoy the benefits of competitive electricity markets. Combined, P3 members own over 87,000 megawatts of generation assets, own over 51,000 miles of transmission lines, serve nearly 12.2 million customers

P3 respectfully submits comments³ noting the following as further explained below:

- P3 supports PJM’s efforts to remove speculative behavior from capacity auctions; and
- P3 generally supports PJM’s proposed tariff revisions.

I. COMMENTS

A. P3 Supports PJM’s Efforts to Remove Speculative Behavior from Capacity Auctions

1. Capacity is fundamentally a physical resource

In order to fulfill its responsibility to insure reliability in the PJM footprint, PJM requires participation from specific, physical identifiable resources in RPM. As P3 has stated and continues to emphasize, it is imperative that the capacity market be viewed as a physical market and not a financial one. The unequivocal goal of RPM is reliability. In order to insure reliability, resources must be physically deliverable. Resources that participate in the Base Residual Auction (“BRA”) must be tangible and verifiable in order for RPM to be fully effective.⁴ The Commission has recently supported this principle stating, “We find that PJM provides sufficient justification . . . in assuring that offers into the PJM auction reflect physical resources that it reasonably can anticipate being available in the delivery year.”⁵

In its filing, PJM explains why RPM is designed to procure physical resources:

and employ over 55,000 people in the PJM region – encompassing 13 states and the District of Columbia. For more information on P3, visit www.p3powergroup.com

³ The comments contained in this filing represent the position of P3 as an organization, but not necessarily the views of any particular member with respect to any issue.

⁴ *Technical Conference on Centralized Capacity Markets in Regional Transmission Organizations and Independent System Operators*, Post-Technical Conference Comments of the PJM Power Providers Group, January 8, 2014, Docket No. AD13-7, at 5.

⁵ *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,150, at P25 (2014).

The requirement for physical resources [also] makes clear, *or should make clear*, that RPM is not a market served by speculative behavior. As a market for a physical product, offers into the BRA are not invitations to take a mere financial position. An offer cleared in the BRA represents a commitment to provide the specific physical resource in consideration for payment of the clearing price.⁶

Additionally, the Independent Market Monitor for PJM (“IMM”) has also supported the proposition that capacity resources must be physical. In the most recent State of the Market Report, the IMM stated:

An essential part of being full substitutes is the requirement that all capacity resources be physical resources. The definition of this requirement should be enhanced and enforced. The requirement to be a physical resource should apply at the time of auctions and should also constitute a binding commitment to be physical in the relevant delivery year. The requirement to be a physical resource should be applied to all resource types, including planned generation, demand resources and imports. Under existing capacity market rules, capacity imports, planned new generation and demand resources all face incentives to buy out of their positions in incremental auctions [“IA”] and do so.⁷

P3 joins the Commission, PJM, and the IMM, in support of the principle that the capacity market must secure commitments from physical resources.

2. Speculative activity must be removed from capacity auctions.

P3 agrees with PJM that the current market rules are not deterring and may be incenting speculative offers. P3 has noted its concern over the potential for speculative offers and has previously stated that the capacity market is not designed for speculation or to obtain commitments after resources are chosen in an auction. The capacity market is designed to secure physical commitments, not theoretical aspirations.⁸ P3 agrees with PJM that speculation has no

⁶ PJM Filing at 7.

⁷ 2013 IMM State of Market Report, March 13, 2014, at 1, *available at* http://monitoringanalytics.com/reports/PJM_State_of_the_Market/2013.shtml (2013 State of the Market Report).

⁸ *PJM Interconnection, L.L.C.*, Motion for Leave to Answer and Answer of the PJM Power Providers Group, September 5, 2013 Docket No. ER13-2108, at 2.

place in RPM “...the RPM construct is not, cannot, and should not be designed to accommodate speculation.”⁹ PJM’s concern with speculation is not new. At the September 25, 2013, FERC Technical Conference on Capacity Markets, Andy Ott, PJM Executive Vice President of Markets, on behalf of PJM stated:

We do address issues related to the interactions of the incremental auctions. We’ve seen again capacity buyouts. Most of the buyouts are from the shorter-term resources, the demand response and the imports. We’ve seen a disproportionate amount of folks buying out of their forward physical obligation. We need to deal with that and make sure that that on balance is insuring long-term adequacy.¹⁰

Similarly, the IMM has expressed concerns over speculation. The IMM at the FERC Tech Conference on Capacity Markets, stated: “If you're making speculative offers in the base residual auctions, because you've certainty of a lower price, then the option to buy that out in an incremental auction is not consistent with the underlying fundamental physical feature of capacity. That should be part of the initial obligation.”¹¹ P3 agrees with PJM and the IMM that speculative activity should not be a feature of the PJM capacity construct.

3. Adverse effects on the market result when resources offered in the BRA are not delivered

P3 is concerned about the adverse effects on the market when resources that are offered in the BRA are not delivered. These adverse effects include price suppression, uneconomic retirements, and interference with the efficient entry of new economic generation. The IMM issued an extensive study on replacement capacity in 2013 and noted many of the same concerns.

⁹ PJM Filing at 10.

¹⁰ September 25, 2013 Transcript of FERC Technical Conference on Capacity Markets, Docket No. AD13-7. Andy Ott Testimony at 38.

¹¹ September 25, 2013 Transcript of FERC Technical Conference on Capacity Markets, Docket No. AD13-7. IMM Testimony at 51-52.

The dynamic that can result is the speculative DR suppresses prices in the BRA and displaces physical generation assets. Those generation assets then have an incentive to offer at a low price, including offers at zero and below cost, in IAs in order to ensure some capacity market revenue for long lived physical resources which the owners expect to maintain for multiple years. The result is lower IA prices which permit the buyback of the speculative DR at prices below the BRA prices which encourages the greater use of speculative DR.¹²

The IMM put the problem in context in the recent 2013 State of the Market Report by stating:

It is more critical than ever to get capacity market prices correct. A number of capacity market design elements have resulted in a substantial suppression of capacity market prices for multiple years. The impact in the 2016/2017 base auction *was about \$4.6 billion*. That price suppression has had and continues to have a negative impact on net revenues and thus on the incentive to continue to operate existing units and to invest in new units. Price suppression is more acute in western zones than in eastern zones. Price suppression leads to premature and uneconomic retirements and the failure to make economic investments. Coal units and nuclear units are under stress in PJM markets. The MMU estimates that the actual net revenue results for 2013 mean that 14,597 MW of capacity in PJM are at risk of retirement in addition to the 24,933 MW that are currently planning to retire.¹³

P3 is extremely concerned by these numbers . . . a \$4.6 billion impact and 14,597 MW of capacity at risk of retirement in addition to the 24,933 MWs planning to retire. While the entire \$4.6 billion figure is not entirely attributable to speculation, the number speaks to the importance of getting the capacity market rules correct – including the rules to address the price suppression caused by speculative activity. While speculative activity may cause capacity market prices to be lower in the short term, long-term capacity prices will likely rise as a result of inefficient price signals. Further, energy market prices are likely to increase, as PJM will procure more commitments from resources with higher variable costs, such a demand response, displacing lower cost physical generation resources.

¹² Analysis of Replacement Capacity for RPM Commitments June 1, 2007 to June 1, 2013 (September 23, 2013), at 35.

¹³ 2013 State of the Markets Report at 1, *emphasis added*.

B. P3 Generally Supports PJM's Proposed Tariff Revisions.

While the market-damaging impacts of speculative activity in the BRA are well-understood, the tariff changes necessary to curtail the activity are more challenging to articulate. As PJM stated, "there is no single or simple solution that can eliminate speculation from RPM or any other market mechanism." That said, PJM's proposed tariff revisions, when considered as a package, are a reasonable means of achieving the desired goal of curtailing speculative activity in the capacity market.

PJM's proposal appropriately places additional requirements on planned generation in order to better ensure that yet to be constructed generation will be on line by the delivery year. In order to do this, PJM proposed a series of additional reporting thresholds that closely mirror the recently approved participation requirements on planned demand response.¹⁴ Among these changes are an officer's representation of the intent to deliver, additional progress reports and a letter of non-recallability from the hosting balancing authority for external resources. These and other BRA participation requirements proposed by PJM are all just and reasonable changes that the Commission should accept.

P3 believes that the proposed revised credit requirements and deficiency penalties are an improvement over the status quo; however, they may not be sufficient to deter unduly risky BRA offers. PJM proposes to change the deficiency penalty to the greater of \$50/MW-day or 50% of the clearing price. While this change is an improvement from the current 20% or \$20/MW-day, P3 believes that a more appropriate penalty structure would be \$100/MW-day or 100% of the capacity prices.¹⁵ Penalty factors set at this level would deter unduly risky or speculative offers

¹⁴ *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,150 (2014).

¹⁵ P3 notes that any change to the deficiency penalty would also require corresponding changes to the credit requirement to reflect the higher penalties.

by increasing the carrying cost of the risky position. For example, the developer of a planned resource has little disincentive to offer risky or speculative positions in the BRA under the current paradigm (even in the presence of PJM's proposed Replacement Capacity Adjustment Charge ("RCAC,") since the developer bears little cost to offer the resource then determine if its generator can be built, transmission can be obtained to support an import, or customers can be attracted to fill a DR portfolio. Risk of failure to bring the resource to delivery is bounded only by the carrying cost of credit, the risk of obtaining cover capacity or, in the worst case, assessment of a deficiency penalty. While PJM's proposed RCAC eliminates the blatant speculation between the BRA and IA, it does not increase the risk of covering an unduly risky BRA offer. Increasing the credit and penalty requirement (especially in conjunction with other tariff changes offered by PJM in this filing) does address such risk-taking.

P3 believes that increasing the penalty and credit requirements beyond the slight increase PJM proposes is consistent with rates established for the ISO-New England¹⁶ and, given the strong evidence of risky behavior in PJM auctions, is not an undue barrier to entry. Conditioning approval of the PJM proposal on increasing the penalty and credit requirements to \$100/MW-day or 100% of the capacity prices would better address the unduly risky and speculative offers identified by PJM and the market monitor.

Additionally, the RCAC is offered as a means to protect the market from the ill effects of profiting from replacing offers in the BRA during the IA. While P3 believes that the appropriate

¹⁶ ISO-New England is an apt basis of comparison since it is the only other RTO with a three-year-forward capacity market. In the last Forward Capacity Market auction in ISO-New England the Commission-approved Tariff yielded a post-auction credit requirement for planned resources of \$230/MW-day (and \$493/MW-day in the constrained Northeast Massachusetts zone). Planned resources in ISO-New England must post additional financial assurance in each subsequent incremental auction until they are operational. In contrast, PJM's 2016/2017 post-auction credit rules require a single posting at a rate that ranges from \$71.24/MW-day for the RTO region to \$262.80/MW-day in the most constrained PSEG/PSNorth LDAs. Therefore, PJM's proposed rate at 1.5 times the BRA clearing price would range from \$89/MW-day in RTO to \$328.50/MW-day in PSEG (applied to the 2016/2017 auction), while P3's proposed rate at 2.0 times the BRA clearing price would range from \$119/MW-day in RTO to \$438/MW-day in PSEG (applied to the 2016/2017 auction).

focus of the tariff changes should be preventing speculative activity and not penalizing legitimate portfolio management activities. P3 is prepared to accept this mechanism as part of a complete package of reforms. However, P3 would be open to future consideration of tariff provisions that would allow owners of existing capacity resources to utilize their own offered, but un-cleared BRA capacity to re-balance their portfolio in the IA without penalty provided any resulting tariff provisions effectively curtail speculative activity in RPM.

Finally, PJM proposes to eliminate the three current incremental auctions and replace them with one auction three months prior to the delivery year while allowing for up to two “conditional auctions” if they are necessary. Having three incremental auctions has offered resources an opportunity to speculate based on the price in the three separate auctions without providing commensurate benefits. Therefore, P3 supports this change and believes it will be an improvement from the current construct.

II. CONCLUSION

For the foregoing reasons, P3 agrees with the PJM that a problem currently exists and speculative offers in RPM must be stopped. P3 respectfully requests that the Commission accept PJM’s Filing.

Respectfully submitted,

On behalf of the PJM Power Providers Group

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Dated: March 31, 2014

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the Official Service List compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 31st day of March, 2014.

On behalf of the PJM Power Providers Group

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