

September 26, 2018

VIA ELECTRONIC DELIVERY

The PJM Board of Managers
c/o Ake Almgren, Ph.D., Chairman
PJM Interconnection, L.L.C.
2750 Monroe Boulevard
Audubon, PA 19043

Dear Chairman Almgren and Board Members:

On June 29, 2018, PJM's regulator declared its capacity rates to be unjust and unreasonable ("June 29 Order").¹ The Federal Energy Regulatory Commission ("FERC" or "Commission") came to this appropriate conclusion after PJM and numerous other parties, including the PJM Power Providers Group ("P3"),² established that the subsidization of politically selected resources leads to the suppression of capacity prices for non-subsidized units. In its June 29 Order, FERC whole-heartedly agreed with PJM (and P3) as to the nature of the problem and the need to find an appropriate resolution.

PJM and FERC have a six-month window in which to fix this problem. PJM's October 2, 2018, response to FERC's Order represents an opportune moment to set the course toward an enduring solution to a market-damaging problem. Above all else, this October 2 PJM filing must contain a solution that fixes the problem consistent with the direction provided by the Commission. As such, P3 urges the PJM Board of Managers ("Board") to make clear to the Commission that a unit specific Fixed Resource Requirement ("FRR") approach cannot be just and reasonable if it does not provide a means to ensure that non-subsidized units receive just and reasonable capacity market rates by determining the clearing price in a distinct, second round auction that negates the FRR units' price-suppressive impact by excluding bids from the FRR units.

As the Board contemplates PJM's October 2 response to FERC, P3 urges the Board to consider:

¹ *Calpine Corporation v. PJM Interconnection, L.L.C.*, 163 FERC ¶ 61,236 (2018) ("June 29 Order").

² P3 is a non-profit organization dedicated to advancing federal, state and regional policies that promote properly signed and well-functioning electricity markets in the PJM Interconnection, L.L.C. ("PJM") region. Combined, P3 members own over 84,000 MWs of generation assets, produce enough power to supply over 20 million homes and employ over 40,000 people in the PJM region covering 13 states and the District of Columbia. For more information on P3, visit www.p3powergroup.com. The comments contained in this specific letter represent the position of P3 as an organization, but do not represent the views of all P3 members.

- FERC has said unequivocally, “[PJM’s existing Tariff] fails to protect the integrity of competition in the wholesale capacity market against unreasonable price distortions and cost shifts caused by out-of-market support to keep existing uneconomic resources in operation, or to support the uneconomic entry of new resources, regardless of the generation type or quantity of the resources supported by such out-of-market support. The resulting price distortions compromise the capacity market’s integrity.”³
- FERC came to this conclusion by relying on PJM’s admission that, “the PJM Tariff currently has no means to address the price suppressing effects that might result from any of the existing or proposed state subsidy programs.”⁴
- The September 13, 2018 Decision by the 7th Circuit Court of Appeals rejecting arguments that the Illinois Zero Emission Credit program is unconstitutional now means that FERC regulation is the only option to address the problem of state subsidization of certain resources rendering wholesale capacity prices unjust and unreasonable.⁵

Evaluating PJM’s forthcoming filing against this backdrop, P3 urges the Board to recognize that this moment may be the single best opportunity to fix a problem that, if left unchecked, will lead to the unwinding of the PJM capacity construct. P3 does not offer such a statement lightly. Regulatory actions over the next six months will likely determine whether PJM continues to achieve resource adequacy through a competitively-procured centralized capacity market or whether the region devolves into a costly, balkanized capacity patchwork in which the market is supplanted by administrative and regulatory determinations. P3 continues to believe that harnessing the value of markets to achieve resource adequacy is worth a strong fight. P3 urges the PJM Board to do the same.

Unfortunately, P3 is concerned that PJM is on the precipice of a filing that will not fix the problem that demands fixing. The Resource-specific Carve Out (“ReCO”) proposal, as discussed during the PJM stakeholder process, is flawed and inconsistent with the direction provided to PJM by FERC. P3 will raise those specific concerns during the FERC paper hearing process in Docket No. EL18-178-000. P3 and its members will also be putting forth other alternatives that do not suffer from the same flaws as ReCO. P3, however, does not send this letter to detail the shortcomings of the ReCO proposal.

³ June 29 Order, P 150.

⁴ *Id.*, P 128.

⁵ *EPSA v. Starr*, ___ F.3d ___ (7th Cir., 2018).

P3's message to the Board today is more fundamental: **PJM must put before FERC a proposal that unequivocally addresses the problem of price suppression in the capacity market caused by the subsidization of politically selected resources.** Unfortunately, a unit-specific FRR mechanism, as a single-faceted proposal, results in the very price suppression that the Commission decries. Regardless of how hard one tries to make the FERC-suggested (but not mandated) unit-specific FRR idea work, one cannot escape the fact that the market impact is the same as having subsidized units bid in at zero. The only way to "save" a unit specific approach is with a two-stage proposal that at least preserves the integrity of the capacity price paid to units not receiving subsidies by determining the capacity clearing price in the second stage of the auction.

Admittedly, any two-stage auction proposal will not be a perfect solution and invariably will face serious scrutiny at FERC. However, **PJM should make it clear to the Commission that a just and reasonable means to set capacity rates for unsubsidized resources and the unit specific FRR are inseparable concepts to achieve just and reasonable capacity rates.** Likewise, a unit-specific FRR, standing on its own, without any additional mechanism to set the price of non-subsidized units, does not result in just and reasonable wholesale rates. PJM should not be afraid to deliver both messages to FERC.

P3 sincerely appreciates the challenge facing PJM staff and the PJM Board. The enormous amount of time and focus spent by PJM and its stakeholders to address this widely-recognized problem leads to a common conclusion - there is no easy answer that solves this problem. However, it is not hyperbole to suggest that the future viability of PJM's capacity market rests on the outcome of this proceeding. PJM must rise to the occasion and, above all else, put forth to the Commission a proposal that honestly and enduringly addresses the problem. Regarding PJM's proposed October 2 response to FERC, the PJM Board should insist that such a solution link a second-round pricing mechanism and a unit specific FRR into a single, non-severable proposal.

P3 thanks the Board for considering these comments and looks forward to continued collaboration as efforts continue to address the current challenges facing the market.

Respectfully submitted,

/s/ Glen Thomas

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