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February 7, 2018

VIA ELECTRONIC DELIVERY

The PJM Board of Managers
c/o Mr. Howard Schneider, Chairman
PJM Interconnection L.L.C.
PO Box 1525
Southeastern, PA 19399-1525

Re: Recommendation that the PJM Board of Directors not Approve PJM Staff's Repricing Proposal for Filing at FERC

Dear Chairman Schneider and PJM Board of Managers,

The OPSI Board of Directors, and state policy makers generally, have been following PJM's reaction to recent restructured state policy initiatives and the developments in the Capacity Construct/Public Policy Senior Task Force ("CCPPSTF") with increasing concern. On January 16, 2018, PJM President Andrew Ott sent a letter to PJM members, states and stakeholders detailing PJM Staff's intention to recommend a capacity auction repricing proposal¹ to address the perceived impact of state policy initiatives on capacity auction clearing.² Mr. Ott's letter states that PJM has repeatedly voiced a preference to address state programs by "respecting the stated policy goals of these programs and designing the wholesale market to accommodate state programs advancing these goals while still protecting the integrity of the wholesale market investment signals." OPSI appreciates Mr. Ott's objectives, but for the reasons explained below, the OPSI Board strongly urges the PJM Board to take no action on PJM Staff's or any other repricing pro-

¹ PJM's Capacity Market Repricing Proposal. PJM. Jan. 16, 2018. <http://bit.ly/2EaUCpK>. ("Repricing Proposal").

² Letter to Members, States and Stakeholders. Andy Ott, PJM President and CEO. Jan. 16, 2018. <http://bit.ly/2n-wMvu9>. ("Ott Letter").

posal. Should the PJM Board believe that action is necessary, it should re-initiate a more holistic stakeholder process.³

EXECUTIVE SUMMARY

OPSI has numerous concerns with the repricing proposal. Chief among these are:

1. PJM Staff has not demonstrated or supported the assertion that state laws and policies threaten the integrity of its capacity auction or wholesale electric rates;
2. the repricing proposal does not properly respect state laws and policies;
3. the repricing proposal may raise capacity prices; and
4. FERC has a proceeding currently open to examine issues regarding state policy objectives and RTO-operated electricity markets.

OPSI recommends that the PJM Board reject the repricing proposal and re-direct PJM Staff on a course of action that will correct or otherwise address the lack of underlying support, flaws, and unintended consequences inherent in the repricing proposal. OPSI suggests a renewed and revised stakeholder process subject to a wider focus than that of the CCPSTF.⁴ It is important for PJM Staff to provide data, facts, and analytical expertise at all steps in such a process, given PJM's access to a range of applicable data and information. Proposals from such a process should take into account the link between PJM's capacity, energy, and ancillary services markets, be holistic, analytically supported, coordinated, comprehensive, transparent, market-based, respectful of state laws and policies, and aimed at clear objectives. Finally, such a process should be designed in alliance with state policy-makers and regulators to increase its likelihood of success.

DISCUSSION

1. PJM has not Demonstrated or Supported the Assertion that State Laws and Policies Threaten the Integrity of its Capacity Auction or Wholesale Electric Rates.

Mr. Ott's letter asserts that the conflict between state policy initiatives and the efficient operation of PJM's markets "is real and requires action." However, PJM Staff has not provided any meaningful facts, data, or information to support either of these assertions – in spite of numerous re-

³ Approved on February 7, 2018, and adopted by OPSI's Board of Directors: Vote: Yes: Delaware PSC, PSC of District of Columbia, Illinois CC, Indiana URC, Kentucky PSC, Maryland PSC, Michigan PSC, New Jersey BPU, Pennsylvania PUC, Virginia SCC, North Carolina UC, Tennessee PUC; Oppose: PUC Ohio, and PSC West Virginia

⁴ See RE: Concerns with PJM's CCPSTF. OPSI letter to PJM Board. Oct. 9, 2017. ("CCPPSTF's sole focus on RPM, without even the capability to assess whether there is an impact beyond the capacity market, much less attempt to measure such an impact to the extent that it might occur, will almost certainly raise the potential for distortions in total supply costs paid by customers.").

quests and opportunity to do so during the CCPSTF stakeholder process.⁵ Consequently, the repricing proposal is based on conjecture and theoretical impacts.

PJM Staff speculates that certain state laws will result in capacity price offers that will suppress and distort the capacity price⁶ but has not provided sufficient empirical data to support those assertions.⁷ PJM Staff has also failed to conduct scenario analyses or two-stage auction simulations to assess the clearing price impact of the repricing proposal or identify any unintended consequences that may result from the proposal. The repricing proposal lacks the necessary supporting evidence and meaningful analysis that typically accompanies PJM's rate-related proposals.

We also note that there is no agreement among stakeholders that state policy initiatives present an actual problem or if there is a need for PJM to take any action.⁸ For example, on January 25, 2018, the Markets and Reliability Committee voted on the January 16, 2018 version of PJM Staff's repricing proposal and the result was a voting ratio of 1.07 in favor and 3.93 against. Mr. Ott's letter highlights the stakeholders' lack of a "shared agreement on the nature and extent of the problem to be solved."⁹

Current evidence shows that generation capacity and new entry is robust. The RPM base residual auction for the 2018/2019 delivery year produced a reserve margin of 19.8 percent for all of PJM¹⁰ and the summer peak forecasted reserve margin for 2018 is 25.7 percent.¹¹ The target reserve margin for the 2017 base residual auction (2020/2021 delivery year) was 16.6 percent, and PJM's capacity auction design procured sufficient capacity to achieve an actual reserve margin of 23.9 percent. Moreover, a significant amount of new generation capacity has successfully

⁵ See, e.g., *Id.* at 1-2. ("[T]here has been no demonstration of facts, data, or information other than hypothetical fears supporting the concerns of the CCPSTF."). See also PJM Stakeholders Look to Slow Capacity Redesign Process. RTO Insider. Nov. 7, 2017, at 16. (Describing analyses requested by stakeholders but not provided by PJM Staff).

⁶ Repricing proposal at 3, 8.

⁷ Specifically, PJM Staff provided no evidence to show that resources which receive out-of-PJM-market revenues offer into PJM capacity auctions at prices lower than they would have offered absent those revenues. Similarly, even if lower offers are assumed, PJM Staff provided no evidence that such offers would suppress the clearing price.

⁸ See CCPSTF Vote Results. PJM Presentation to the CCPSTF. Nov. 21, 2017, at 5. <http://bit.ly/2GFwdmd>. (In response to the poll question, "Do you prefer to make a change to the current capacity market construct to accommodate state public policy, or retain the status quo?", 64% of voting stakeholders chose to retain the status quo). See also MRC Summarized Voting Report. PJM. <http://bit.ly/2EB0Ehw>. (All proposals voted on by the MRC failed to receive stakeholder support).

⁹ Ott Letter at 1.

¹⁰ 2018/2019 Base Residual Auction Results. PJM. Aug. 28, 2015, at 1. <http://bit.ly/2DX468Y>.

¹¹ Forecasted Reserve Margin. PJM. Jul. 5, 2017. <http://bit.ly/2s3DMnV>.

cleared recent RPM auctions, with almost 3,000 MWs clearing in the base residual auction for the 2018/2019 delivery year, nearly 5,400 MWs clearing for the 2019/2020 delivery year and roughly 2,400 MWs clearing for the 2020/2021 delivery year. While PJM Staff may be concerned that state policy initiatives pose a threat to PJM's capacity auctions, the high reserve margins and volume of new generation capacity clearing the RPM auctions dispels this concern and the capacity-price-raising objective of the repricing proposal.

The repricing proposal also ignores or discounts the dynamic ability of market participants to adjust to changes in market supply conditions and assumes that market participants would not adjust their business strategies (both supply and demand) in response to state policy initiatives like those targeted by the repricing proposal.¹²

2. The Repricing Proposal Does Not Properly Respect State Laws and Policies.

OPSI agrees with Mr. Ott's statement that "it is vital for the regional market design to respect individual state interests . . ." ¹³ but the repricing proposal fails to accomplish this objective by labeling state policy initiatives as "subsidies" that must be countered with additional PJM intervention in already administratively constructed capacity auctions.¹⁴ State policies are often designed to induce entry or assist in maintaining specific resources that possess desirable attributes while being unlikely to clear PJM's capacity auction. These types of state laws and policies legitimately represent state preferences, and should be respected by RTO processes.

Mr. Ott expressed concerns that state policy initiatives will result in capacity auction offers detrimental to both the integrity of PJM's auction design¹⁵ and the efficiency of the clearing price signal.¹⁶ This concern led PJM Staff to propose misguided and untested auction design changes intended to "maintain the correct price signal."¹⁷ OPSI disagrees with the assertion that the

¹² See, e.g., Post Technical Conference Comments of James F. Wilson. Docket No. AD17-11-000. Jun. 22, 2017, at pp. 5-6.

¹³ Ott Letter at 3, first full paragraph.

¹⁴ Mr. Ott's Letter explains that the repricing proposal is "less punitive and less likely to frustrate the operation of state programs" than is the MOPR-Ex proposal, thereby implying that the repricing proposal is punitive and likely to frustrate the operation of state programs, and we agree. (*Id.* at 3).

¹⁵ *Id.* at 2.

¹⁶ Repricing Proposal at 1.

¹⁷ *Id.* at 3.

repricing proposal will “strike an appropriate balance between legitimate state interests and wholesale market integrity.”¹⁸

OPSI acknowledges that the repricing proposal will permit “actionable” resources to be committed as capacity resources in PJM auctions, but OPSI does not consider the repricing proposal to be accommodating or respectful of state laws. Rather, the likely increase in capacity prices as a result of the repricing proposal and as a direct response to certain state policies would be unaccommodating. PJM Staff has not demonstrated that the repricing proposal is necessary for wholesale electric markets or that it would result in just and reasonable wholesale rates, despite such implications in Mr. Ott’s letter.¹⁹

3. The Repricing Proposal May Raise Capacity Prices.

As noted above, the purpose of the repricing initiative is, presumably, to counter-act, offset, or otherwise respond to alleged price suppression in the capacity auction. Accordingly, the two-stage clearing design of the repricing proposal will likely lead to higher capacity prices, as compared to the current single-stage auction clearing mechanism.²⁰

In Stage 2, PJM Staff proposes to administratively adjust the price offers of targeted units that are committed in Stage 1, based on reference price levels for those targeted units.²¹ The clearing price in Stage 2 would then be paid to all resources that were committed in Stage 1 and charged to all load serving entities. The Stage 2 clearing price remaining below the repriced units’ reference price level depends upon offers of non-repriced units in Stage 1. However, the level of those non-repriced unit offers is impacted by many factors, including the competitiveness, or lack thereof, in capacity supply.²²

Mr. Ott states that the reference price substitution will be done “to approximate what would have occurred had all offers been competitive.”²³ There is little reason to believe, however, that the reference price substitution accurately represents offers that the impacted units would have submitted into the auction absent the “actionable” state policies. Available evidence suggests that offers in past auctions were submitted at prices lower than the reference prices that PJM Staff

¹⁸ Ott Letter at 3.

¹⁹ *Id.* at 2.

²⁰ *See* Repricing Proposal at 4. (Demonstrating price-raising impact of the Repricing Proposal).

²¹ *Id.* at 3.

²² In constrained locational delivery areas, competition is more limited, increasing the concern about high Stage 2 auction clearing prices in those areas.

²³ Ott Letter at 3

now proposes to apply to targeted unit offers in Stage 2.²⁴ This suggests that, in instances where the repriced unit is setting the clearing price, the proposed reference price substitution is likely to overstate the “competitive” price level that PJM Staff is intending to simulate, with the result being unnecessarily higher auction clearing prices.

OPSI is also concerned that the low price offer incentives created in Stage 1 may lead to more Locational Deliverability Area (LDA) binding, and resulting zonal price separation, than would occur under the current single-stage auction design. Zonal price separation provides additional market power to resource owners within the constrained zone, particularly those with large portfolios of generating units. PJM Staff has not provided two-stage auction simulations, so it is not possible to predict how frequent zonal price separations will be under the proposed two-stage auction process. However, given that capacity auctions are generally prone to market power, this concern deserves much more consideration than PJM Staff has given it so far.

4. FERC Has a Proceeding Currently Open to Examine Issues Regarding State Policy Objectives and RTO-operated Electricity Markets.

In May of 2017, the FERC initiated Docket No. AD17-11-000, a proceeding intended to examine the issues surrounding wholesale energy/capacity markets and state policy initiatives. The FERC determined that circumstances merit examination of tension potentially building between state policies and the preservation of valuable wholesale market price signals which impact business decisions such as market exit and entry as well as consumer benefits provided by regional electricity markets.²⁵ OPSI is encouraged by the FERC’s efforts to consider the matter and solutions that would enable wholesale markets to accommodate state policy initiatives, while preserving the benefits of regional markets for electricity consumers. We are concerned that the flaws of the repricing proposal, as described above, and the widespread stakeholder opposition could lead to protracted litigation and frustrate open and transparent exchanges in Docket No. AD17-11 or in the renewed and revised stakeholder process OPSI recommends.

CONCLUSION

For the reasons explained above, filing the repricing proposal at FERC is not a reasonable course of action for the PJM Board to address its concerns with recent state policy initiatives and, given the likelihood of litigation that will stem from such filing, will not soon resolve those concerns. If the PJM Board determines action is necessary, OPSI recommends that the PJM Board re-direct PJM Staff on a course of action that will correct or avoid the lack of underlying support, flaws, and unintended consequences inherent in the repricing proposal. OPSI suggests a renewed and

²⁴ For example, past auctions have cleared at prices substantially lower than Net CONE x B (a reference price under the Repricing Proposal), meaning that all cleared offers were submitted at prices less than Net CONE x B.

²⁵ See *Statement of Commissioner Honorable re State Policies and Wholesale Markets Operated by ISO New England Inc., New York Independent System Operator, Inc., and PJM Interconnection, L.L.C.*, Docket No. AD17-11.

revised stakeholder process subject to a wider focus than that of the CCPPSTF. Further, it is important for PJM Staff to provide data, facts, and analytical expertise at all steps in such a stakeholder process, given PJM's access to a wide range of applicable data and information. Proposals from such a process should take into account the link between PJM's capacity, energy, and ancillary services markets, be analytically supported, holistic, coordinated, comprehensive, transparent, market-based, respectful of and consistent with state laws and policies, and aimed at clear objectives. Finally, such a process should be designed in alliance with state policy-makers and regulators to increase its likelihood of success.

Sincerely,

/s/ John R. Rosales

Commissioner John R. Rosales
President
Organization of PJM States, Inc.