

## Comments of LS Power on the Capacity Market Critical Issues Fast Path-RA Process

LS Power Development, LLC on behalf of itself and its affiliates (“LS”) appreciates the opportunity to provide written comments to the Board prior to final presentations and voting on the Capacity Market Critical Issues Fast Path Process-RA (“CIFP-RA”) proposals on August 23, 2023. LS wishes to highlight its concerns on process and substantively about the CIFP-RA and make recommendations for going forward.

- A. *PJM moved too fast in this process and lost focus on the specific asks of the Board.*
- B. PJM introduced a seasonal market at the June 14, 2023 meeting, seven meetings into the process, and after stakeholder pushback, nonetheless continued to pursue a seasonal concept with seasonal demand curves. The new proposal was discussed in just a couple of meetings, resulting in many unanswered questions. MISO took a few years and with FERC guidance to implement a seasonal construct, and ISO-NE stated it will take two years to develop such a change, demonstrating the complexity involved. LS is not inherently opposed to a seasonal market construct, but we lack a thorough understanding of how it would work. Without market transparency and confidence in a redesigned capacity market, investment will be more challenged than it is today. This may actually be detrimental to what PJM is trying to accomplish as part of the CIFP-RA process. LS suggests PJM move all discussion of seasonal constructs to a stakeholder process such as the Resource Adequacy Task Force (“RASTF”) so the concept can be fully developed and vetted.
- C. On the other hand, PJM has failed to address adequately the Board’s concerns about better alignment of supplier offers and risks, as discussed further below. While LS supports some components of PJM’s proposal, we remain concerned that they fail to address PJM’s own Reliability Report and NERC concerns about a reliable transition, and will not result in meaningful reforms necessary to maintain a reliable grid.
- D. PJM’s proposal does not address two critical areas, one specifically identified in the Board’s letter, and the other implicit in the directive to ensure a more reliable system.
  - a. Market Seller Offer Cap: PJM fails to adequately address the risk reward proposition between those resources that have mandatory must offer bids into the capacity market. For example, for non-performance in DY 2023-24, the RTO, penalties are tied to Net CONE at \$274.96/MW-Day, when capacity revenues are merely \$34.13/MW-Day. It is simply indefensible that units that have must bid requirements are exposed to such an enormous imbalance in the risks they take in exchange for the revenues they receive. Some may point to a recent D.C. Circuit Order as reinforcing the current methodology, but that Order was predicated on the belief that the Polar Vortex was a one-off event and extreme weather was unlikely to occur again. WSE proved this to be a false assumption. PJM’s current proposal does nothing to fix this imbalance.
  - b. Lack of focus on gas-electric coordination: While this process was intended to address enhancements to the capacity market, PJM’s markets were always designed to be complementary – thus addressing market flaws must be done across all markets. In particular, because of the lack of balance between risk and reward, it becomes even more critical that this area be addressed. These gas peaking units bear the brunt of PJM forecast error. They are mostly dispatched in Real Time when it is too late to submit a firm gas nomination. These resources have to guess at forecasts and at times buy fuel over multi-day periods with no ability to recoup losses if the gas is sold back at a loss. And they are not compensated for the times when electric system stress is highest and

they are required to take a “ratable” amount of gas from the pipelines – meaning they must burn the same quantity of gas for 24 hours, regardless of being dispatched for just a few hours. This is not a sustainable position for these units. And they are not compensated for the times when system stress is highest and they are required to take a “ratable” amount of gas – meaning they must burn the same quantity of gas for 24 hours, regardless of being dispatched for just a few hours. This is not a sustainable position for these units. Peaking units must be compensated in the capacity market for the benefits they provide (ability to be controlled by PJM and be dispatched on and off by PJM when needed and not needed as load changes or weather dependent resources shutdown), and the risks they must assume. PJM should focus on enabling supply offers to reflect risk and implementing rule changes in the energy market that will better align gas-electric coordination. Such changes will ensure customers do not bear performance risk, but generators are appropriately compensated for such risk. Such changes will enhance reliability.

- E. *LS encourages the Board to start taking a longer-term view of PJM’s capacity market. As LS commented in its FERC filing in the PJM Capacity Forum in Docket AD23-7:*

“The root problem is that PJM’s and others’ capacity markets were not designed to do what is now being asked of them. Specifically, the capacity markets were not intended to differentiate between unit parameters and weather dependency... At the time of their creation, megawatts (“MW”) of capacity were comparatively homogenous, where each resource providing capacity possessed enough similar characteristics that they did not need to be differentiated, the energy inputs to these capacity resources were essentially unconstrained, and how quickly offline generators could respond to dispatch signals was less important.”

We need to recognize the capacity market was intended to insure enough steel in the ground that reliability standards could be met. As the supply of energy is changing reflecting new attributes and limitations to grid reliability, it is important that PJM create a capacity market structure that distinguishes among what the system needs and rewards it accordingly (e.g. clean, longer duration, flexibility) etc. We look forward to working with PJM on identifying these attributes similar to what is being done in MISO and then ensuring PJM has the right mix of resources to ensure reliability as we continue to transition to a lower carbon emissions grid.

We would encourage the Board to read LS’ comments, and the comments of others who disagree with us, filed in this docket at FERC. It is troubling that some commenters dismiss PJM’s reliability concerns, casting aspersions on PJM’s Reliability Study and NERC concerns that have been expressed. In their view, the existing capacity surplus indicates clearing prices are appropriate and such entities do not believe: “the sky is falling,” but rather parties are playing Chicken Litte They believe PJM has surplus capacity and does not need to attract new investment to maintain reliability. This view misses the point: the elimination of the Minimum Offer Price Rule enables resources that receive substantial subsidies to participate in the capacity market, which combined with the reality that suppliers’ offers are mitigated to a third party, administratively determined avoided going forward costs that do not reflect risk, results in artificially depressed capacity clearing prices.

Ironically, peaking units are the only resources that can be turned on in short time and run for an extended period of time, but these attributes are not rewarded. Just the opposite: because these units do not run that frequently, they are the resources most dependent on capacity prices and must compete with all other resources not similarly situated. Capacity market prices at levels such as the last two auctions are NOT an accurate signal to incent the resources PJM will need to maintain reliability. Using a combined cycle plant, on behalf of PJM, the Brattle Group estimates that the Net Cost of New Entry (Net

CONE) ranges between \$314-\$356/MW-day. Compare this to the Base Residual Auction clearing prices for the 2023-2024 Delivery Year of \$34.13-\$69.96/MW-day, and the problem of incenting new flexible resources to enter the market is glaringly obvious. Moreover, in the most recent Quadrennial Review (2022), PJM changed the reference unit from a combustion turbine (peaker or CT) to a combined cycle (CC) based on the view that CCs were being built at the time of the study in early 2022. The use of the CC as the reference resource reduced Net CONE compared to the CT, further putting downward pressure on capacity clearing prices. As previously mentioned, CTs rely on capacity market revenues for the vast majority of their revenue stream. Moreover, costs are significantly underestimated given supply chain issues, increases in engineering and procurement costs, and the imposition of environmental rules that restrict emissions, and hence run times that correlate to expected energy revenues.

The capacity market must be designed to attract resources that will be built to meet public policy goals while maintaining reliability. Getting the right market signals is the biggest challenge we face as an industry, and we need to acknowledge and then design our markets appropriately to ensure a reliable transition to the grid of the future. We must design markets that enable all forms of supply to participate without sacrificing reliability to do so.

F. *With respect to any CIFP-RA FERC filing we recommend the Board:*

1. Remove any seasonal component from CIFP-RA and have stakeholders devote a more thorough, unrushed opportunity to flesh out the proposal;
2. Require PJM to delay filing until a more robust MSOC can be developed (or alternatively adopt the LS proposal) that mirrors energy market rules and capacity rules for buyer side mitigation (e.g. certification of no market manipulation), that aligns risk and reward.
3. Retain the must offer exemption for intermittent resources and energy storage as these resources are not technically capable of performing at all hours of the day and the current rules create an undue risk on potential non-performance while allowing them to continue to be eligible for PAI Bonus; and
4. Require PJM to commit in any CIFP-RA filing that PJM will implement changes to energy market rules to better align gas-electric coordination.

Thank you for your consideration of these comments, our proposals, and comments that we will present on August 23, 2023. We look forward to working with the PJM community as we grapple with the challenges of a quickly changing grid.

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