

FirstEnergy's Perspective on PJM's Wholesale Electricity Markets: 2020

Q3 2020 ISSUES

This report will be updated on a quarterly basis (December 1, March 1, June 1, and September 1). The purpose of this report is to provide an overview of key FERC and PJM initiatives active in each quarter.

Executive Summary

A key issue during the past reporting period that continues to persist is FERC's December 19, 2019 Minimum Offer Price Rule (MOPR) Order and April 16, 2020 Order on Rehearing and Clarification. FERC's December 2019 Order aimed to address the capacity market impacts of certain subsidies to address state policy concerns (e.g., Zero Emission Credits, Renewable Energy Credits, etc.). PJM has filed two compliance filings related to the MOPR that are currently pending before FERC. Due to the long duration of the MOPR proceeding and corresponding uncertainties regarding the market rules, the capacity auctions for the 2022/2023 and 2023/2024 Delivery Years have been delayed indefinitely. In addition to ruling on the two pending PJM MOPR compliance filings, FERC will also need to approve PJM's methodology for a forward-looking energy and ancillary services (E&AS) offset methodology before the six and a half month schedule of pre-auction activities can start, as the offset is used in the MOPR floor price calculations.

Notwithstanding the uncertainty associated with the pending market reforms, the FirstEnergy Utilities will continue to advocate for holistic market reforms that will serve the long-term best interests of our Ohio customers rather than a series of piecemeal changes to PJM's markets. As directed by the PUCO, the FirstEnergy Ohio Companies filed a motion to change their upcoming standard service offer ("SSO") auction in Fall 2020 and Spring 2021 to procure 12-month products. The motion was granted on August 26, 2020.

Capacity Market Initiatives

Minimum Offer Price Rule Compliance Filings: On March 18, 2020, PJM submitted a compliance filing in accordance with the Commission's December 19, 2019 order that included revisions to the PJM Tariff to modify the application of the MOPR to address State Subsidies and proposed a timeline to conduct postponed capacity auctions. PJM's compliance filing acknowledged that the modified rules will not be implemented until approved by a Commission Order. On June 1, 2020 PJM submitted a second compliance filing concerning the MOPR as it will be applied to capacity resources with state subsidies, in accordance with the Commission's April 16, 2020 Order on Rehearing and Clarification. FERC has yet to act on either compliance filing.

Energy Market Issues

Fast Start Pricing: On January 23, 2020, FERC issued an order holding PJM's fast-start (*i.e.*, units able to ramp and start quickly) pricing proceeding in abeyance. In April 2019, the Commission issued an order finding that PJM's fast-start pricing practices were unjust and unreasonable and directed PJM to revise its tariff to allow fast-start unit offers to reflect the full marginal cost of dispatching the unit into the market. The January 2020 order found that PJM may not be able to implement the directives from the April 2019 order due to misalignment between market pricing and dispatch. Therefore, the January 2020 order directed that the PJM fast-start pricing proceeding will be held in abeyance until July 31, 2020 to allow PJM and its stakeholders to address PJM's pricing and dispatch misalignment issue in conjunction with the compliance directives of the April 2019 order. PJM filed a proposal July 31, 2020 (see below); FERC has yet to respond.

Five Minute Dispatch: On July 31, 2020, PJM submitted a filing to effectuate greater accuracy in the pricing and dispatch of resources in PJM's footprint through what was known in the stakeholder process as the "short-term" reforms. PJM submitted a corresponding informational filing in the fast start pricing docket notifying FERC of the filing, explaining that the short-term reforms address the "pricing/dispatch misalignment" issue that the Commission had previously identified in its January 23, 2020 Order holding the fast start proceeding in abeyance, and requesting that the Commission rule on PJM's fast-start compliance filing as soon as possible. On August 5, 2020, PJM filed clarifying edits and other information to supplement the pricing and dispatch filing.

Energy and Reserve Market Reforms: On March 29, 2019, PJM filed its expected energy market reform proposals at FERC. PJM's proposed energy market reforms include: (i) consolidation of Tier 1 and Tier 2 Synchronized Reserves into one Synchronized Reserve product; (ii) modification of its Operating Reserve Demand Curves ("ORDCs") by increasing the Reserve Penalty Factors used in the ORDCs and modifying the shape to add a downward sloping tail; and (iii) aligning its day-ahead and real-time reserve markets to ensure adequate forward procurement of reserves and related market efficiencies. On May 21, 2020, FERC issued an order that largely approved PJM's proposed reforms. The Commission's May 2020 order also found that the PJM energy and reserve market reforms rendered the PJM capacity market E&AS offset methodology to no longer be just and reasonable, and directed PJM to submit a compliance filing within 45-days. PJM submitted multiple implementation filings regarding the energy and reserve market reforms, including compliance filings on July 6, 2020 and August 5, 2020, as well as proposed indicative Net CONE values on August 16, 2020.

Uplift Allocation: On July 16, 2020, FERC issued an order finding that PJM's current uplift allocation rules are unjust, unreasonable, and unduly preferential because they do not allocate uplift to Up-to-Congestion Transactions (UTCs). FERC directed PJM to submit a replacement rate that revises PJM's current uplift allocation rules to allocate uplift to UTCs in a manner that treats a UTC, for uplift allocation purposes, as if the UTC were equivalent to a Decremental Bid at the sink point of the UTC. PJM must make a compliance filing implementing this determination within 45 days (or by August 31, 2020).

Ancillary Services Market Initiatives

See "Energy and Reserve Market Reforms" above.

Emerging Technologies

Electric Storage Participation: In 2018, FERC issued a rulemaking that required each RTO/ISO in the United States to develop a participation model for energy storage resources ("ESRs") that will remove barriers to

their participation in the wholesale markets. The Commission approved PJM's model in October 2019, and the model went into effect in December 2019. FERC found, however, that the record was unclear on what was the appropriate minimum run time for ESRs to serve as capacity resources. Specifically, PJM proposed a minimum run time of 10 straight hours, while certain Parties proposed a minimum run time of 4 hours. Therefore, FERC instituted a new proceeding for parties to further evaluate the appropriate minimum run time metric. The proceeding is held in abeyance until October 30, 2020 to allow PJM stakeholders to continue discussions on the use of an Effective Load Carry Capability ("ELCC") methodology for ESRs as an alternative to PJM's proposed 10-hour minimum run-time rule. On July 16, 2020, FERC issued an order accepting certain PJM ESR compliance proposals, but directed PJM to make an additional compliance filing by October 30, 2020 to clarify how its proposed tariff provisions prevent all distribution-connected ESRs from paying twice for the same charging energy or submit a new proposal to ensure such an outcome.

Other

Carbon Pricing: In April 2020, FERC initiated an administrative docket to discuss integrating state, regional and national carbon pricing in RTO/ISO energy markets in response to requests from a coalition of renewable and generation trade groups. 31 parties filed comments on May 21, 2020, with only one in opposition to FERC holding the technical conference. FERC announced it will convene a Commissioner-led technical conference on carbon pricing in organized wholesale markets on September 30, 2020. Panelists have not yet been announced. PJM stakeholders continue discussions in the Carbon Pricing Senior Task Force, with discussions continuing throughout 2020.

Credit Reforms: On May 29, 2020, FERC issued an order approving PJM's reforms to its credit risk and management policies. In March 2020, PJM filed its proposal to enhance its existing credit risk and management policies to address concerns stemming from the June 2018 GreenHat default. PJM's filing followed a consultant report and stakeholder process that developed proposed reforms, including, among other things, a new "Know Your Customer" approach that will allow/require PJM to perform ongoing credit risk evaluations of each Market Participant on at-least an annual basis. PJM has indicated its intention to use its fast track process to modify the Tariff to change liquidation language to a prescribes process while also providing PJM needed flexibility to allow for settlement liquidation if deemed necessary to protect Members.

COVID Impacts: On July 8 and 9, 2020, FERC held a "virtual" technical conference on the impacts of COVID-19 on the energy industry. Topics included the energy industry's ongoing and potential future operational and planning challenges due to COVID-19 and as the situation evolves moving forward; the potential impacts of changes in electric demand on operations, planning, and infrastructure development; the potential impacts of changes in natural gas and oil demand on operations, planning, and infrastructure development; and issues related to access to capital, including credit, liquidity, and return on equity issues. Charles E. Jones, CEO of FirstEnergy Corp., represented FirstEnergy on a panel covering a host of issues, including financial impacts, the importance of investment in the aging transmission infrastructure, sustainable ROEs, and transmission owner control over managing transmission assets. Overall, participants indicated that the industry responded well to the challenges of COVID, but could see some issues if a second wave occurs or if the crisis lasts for a long time.

State Policy Solutions Group: On June 29, 2020, PJM announced the formation of the State Policy Solutions group, focused on working with states to help advance state energy policy initiatives. The new

group is largely a formalization of existing work done on an ad hoc basis for the states, and it will report up to Asim Haque, PJM's Vice President of State and Member Services.

[NERC Releases 2020 Summer Reliability Assessment](#): On June 2, 2020, NERC released its annual Summer Reliability Assessment. The report concludes that: (i) there is sufficient capacity for the upcoming summer; (ii) RTOs/ISOs should monitor generation as maintenance may have been impacted by the COVID outbreak; (iii) protecting industry workforce during the COVID outbreak is a priority for reliability and resilience; and (iv) wildfire season poses a risk to reliability in the western U.S. Specific to PJM, NERC noted that PJM's expected reserve margin for the summer is 33.5%, which is significantly higher than the reserve margin requirement of 15.5%.

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Summary: Report Quarterly Update Report Pursuant to Section V.C.2. of the Third Supplemental Stipulation and Recommendation electronically filed by Ms. Christine E. Watchorn on behalf of Ohio Edison Company and The Cleveland Electric Illuminating Company and The Toledo Edison Company