

FERC's Rejection of PJM Proposal and New Proceeding

Overview

On June 29, 2018, the Federal Energy Regulatory Commission (FERC), in a 3-2 split decision, issued an order that rejected two capacity market reform proposals filed by PJM and found the PJM capacity market unjust and unreasonable for insufficiently protecting electricity prices from the impacts of state policy. The Commission then initiated a subsequent "paper hearing process" in which PJM will propose a structure to expand its existing Minimum Offer Price Rule (MOPR) in a way that more strongly mitigates the effects of state policies. At the same time, the Commission recognized that this action would harm states' abilities to make resource choices and require ratepayers to pay twice for some capacity, so it suggested a bilateral contracting opportunity where bids and sales are not subject to mitigation.

In our view, the majority oversteps their authority under the Federal Power Act (FPA) in an attempt to negate state programs to support the environmental attributes of certain generation sources. However, the proposed bilateral contract option may reduce or eliminate the damage caused by the expanded mitigation of state policy – if a workable structure is adopted.

Background: PJM's Tariff Proposal

In January 2018, PJM, the nation's largest Regional Transmission Organization (RTO), submitted a proposal to FERC to adopt one of two new capacity pricing rules. The primary proposal would replace PJM's MOPR with a new two-stage annual capacity auction. The first stage would proceed "normally" by determining capacity commitments without mitigation to any offers. However, in the second stage, any offer from resources with "Material Subsidies" would be replaced with a PJM-determined competitive offer, and the auction would be run again to set the final clearing price for resources selected in the first stage.

PJM defined Material Subsidy as "material payments, concessions, rebates, or subsidies directly or indirectly from any governmental entity connected to the construction, development, operation, or clearing in any capacity auction, of the capacity resources, or . . . other material support or payments obtained in any state-sponsored or state-mandated processes[.]"¹ While PJM's proposed definition includes a number of exemptions², it is clear that state renewable portfolio standard (RPS) programs and zero emission credit programs for nuclear power are considered Material Subsidies.

PJM's proposal included a mutually exclusive alternative option, in the event the Commission rejected the first proposal, which would revise and expand PJM's current MOPR to mitigate capacity offers from both new and

¹ Calpine Corporation et al v. PJM Interconnection, LLC, 163 FERC ¶ 61,1236 at PP 17 (2018).

² "Specifically, PJM proposes to exclude: (1) payments (including payments in lieu of taxes), concessions, rebates, subsidies, or incentives designed to incent, or participation in a program, contract or other arrangement that utilizes criteria designed to incent or promote, general industrial development in an area; (2) payments, concessions, rebates, subsidies or incentives designed to incent, or participation in a program, contract or other arrangements from a county or other local governmental authority using eligibility or selection criteria designed to incent, siting facilities in that county or locality rather than another county or locality; or (3) general government production tax credits, investment tax credits, and similar tax advantages or incentives that are available to generators without regard to the geographic location of the generation." Id. at 17.

existing resources that receive Material Subsidies. The expanded system is called MOPR-Ex and it uses the same flawed definition of Material Subsidy as the primary proposal. The MOPR-Ex would have four categorical exemptions discussed below.

Both of PJM's proposals are designed to counteract the effects of state-sponsored support for specific generation resources. Such state programs, according to PJM, would include RPS programs in various states; the Illinois zero-emission credits (ZECs) payable to a 1,400 MW nuclear plant; pending New Jersey legislation that would provide payments to select nuclear facilities; and offshore wind procurement programs in Maryland, New Jersey and New York. PJM argues that these programs can significantly reduce capacity clearing prices and therefore "threaten the longstanding balance that has allowed PJM's markets both to remain competitive and to meet resource adequacy objectives at a reasonable rate."³

Majority Decision Summary

The majority decision consists of three parts: (1) a rejection of PJM's proposed tariff revisions, (2) a partial grant and partial denial of a complaint by Calpine, and (3) the initiation of a new proceeding as Docket EL18-178-000 examining an expanded MOPR with a bilateral contract opt-out provision.

I. Rejection of Tariff Revisions

Two-Stage Capacity Repricing

The majority in this decision, which consists of Chairman Kevin McIntyre and Commissioners Neil Chatterjee and Robert Powelson, found PJM's Capacity Repricing proposal to be unjust and unreasonable, and unduly discriminatory and preferential. The majority found that the proposed two-stage auction sets a clearing price that is disconnected from the price used to determine which resources receive capacity commitments, and that the market-clearing price would send incorrect signals, increasing uncertainty with respect to entry and exit decisions.

According to the majority opinion, a problem arises when a non-supported resource bids into the first-stage auction below the clearing price, and then that resource is not adjusted in the same way state-supported resources are in the second stage. In this situation, the state-supported resource may receive a higher clearing price in the end than the non-supported resource. Furthermore, the Commission finds it unjust and unreasonable that a capacity commitment should be awarded to a resource receiving out-of-market support in the first stage over a generator without a Material Subsidy. Therefore, the Commission's majority opinion essentially found that PJM's proposal does not go far enough to correct the effects of state support for specific resources in the capacity market.

MOPR-Ex Alternative

The Commission also rejected the alternative MOPR-Ex proposal, finding it to be unjust and unreasonable. The majority again found that PJM's proposal did not go far enough to prevent resources receiving out-of-market Material Subsidies from receiving capacity commitments "at the expense of competitive resources."⁴

The current PJM MOPR only applies to new natural-gas fired resources and was designed to prevent intentional capacity price suppression from those new sources. The MOPR-Ex proposal would have expanded the MOPR to new and existing resources that receive a Material Subsidy, but would exempt certain resources, including wind or solar generators that receive renewable energy credits (RECs) through an RPS program. It is this differentiated treatment between resource-receiving RPS-based support and those sources receiving non-RPS

³ Id. at 12.

⁴ Id. at 45.

support that the majority took issue with. The Commission found that PJM did not provide a valid reason for the disparity in the MOPR exemption for these different resources, and for this reason rejected this alternative proposal. The decision sends another clear signal to PJM and the industry that all renewable policies should be mitigated, however, the majority does not address why policies that promote fossil fuel generation are not included.⁵

II. Partial Grant and Denial of Calpine Complaint

On May 31, 2018, in response to PJM's filing, Calpine, along with CPV Power Holdings and Eastern Generation LLC (collectively "Calpine"), filed a complaint urging the Commission to adopt a "clean MOPR," with no exclusions or exemptions, that is applicable to both new and existing resources. Calpine argues that existing sources receiving subsidies are suppressing prices by submitting below-cost offers, and that such an action is necessary to effectively address the impact on capacity markets. Calpine also proposed elimination of the competitive exemption proposed in the MOPR-Ex and urged the Commission to require PJM to expand the definition of Material Subsidy to cover not only state subsidies but also include federal subsidies. The Commission granted Calpine's Section 205 complaint, asserting that the existing MOPR is unjust and unreasonable, but rejected Calpine's proposed solution, instead combining Calpine's docket into the new proceeding described below.

III. Initiation of New Proceeding

The majority wished to go further than the two options provided by PJM, finding that "the integrity and effectiveness of [PJM's] capacity markets . . . have become untenably threatened by out-of-market payments provided or required by certain states for the purpose of supporting the entry or continued operation of preferred generation resources that may not otherwise be able to succeed in a competitive wholesale capacity market."⁶

When the Commission finds a rate to be unjust and unreasonable, it must impose a replacement rate that is just and reasonable; however, it did not do that here. Instead, the Commission consolidated the previous Dockets into EL18-178-000 and moved those proceedings to a paper hearing to help identify an alternative approach to address two existing aspects of PJM's tariff structure. The paper hearing provides 60 days from the date of the order (June 29) for testimony, evidence, and/or arguments, and then will accept replies for a 30-day period after that. FERC indicated it will try to make a final decision on the new docket by January 4, 2019, in time for implementation in its next capacity auction in May 2019.

FERC Proposes Possible Alternative

While the Commission was unable to determine a just and reasonable tariff rate based on the existing record, they did issue a preliminary finding that modifying two aspects of PJM's tariff might produce a result that FERC could approve. "Specifically this approach would (i) modify PJM's MOPR such that it would apply to new and existing resources that receive out-of-market payments, regardless of resource type, but would include no exemptions; and (ii) in order to accommodate state policy decisions and allow resources that receive out-of-market support to remain online, establish an option in the tariff that would allow, on a resource-specific basis,

⁵ "PJM's assertion that the RPS exemption was based on deference to public policies favoring renewable generation resources is inconsistent with the well-established desire of some states in PJM to support other resources, such as nuclear plants. In addition, PJM has not explained why its proposed criteria for determining eligibility for the RPS exemption are just and reasonable, and not unduly discriminatory. For example, it is unclear why state programs limited to offshore wind should not be eligible for the RPS exemption given that such resources would likely have a market impact similar to other exempted state-sponsored renewable resources." *Id.* at 47.

⁶ *Id.* at 3.

resources receiving out-of-market support to choose to be removed from the PJM capacity market, along with a commensurate amount of load, for some period of time.”⁷ This proposed approach is explained in more depth below.

Expanded MOPR

First, FERC suggests that PJM should expand the existing MOPR to cover all new and existing resources that receive out-of-market support, with few or no exceptions, regardless of resource type. The Commission acknowledges that this may result in ratepayers paying twice for the capacity of a state-supported resource, once through the state program supporting the resource and again through the capacity markets. However, the Commission holds that the capacity market falls within their jurisdiction, and it is a state’s right to choose to support the resource through possible double payments by ratepayers.

Expanded FRR Alternative

Second, the Commission suggests that PJM could create a resource-specific Fixed Resource Requirement (FRR) Alternative that would allow state-supported resources to remain on the system outside of the capacity market and avoid the above mentioned double-payment for capacity by ratepayers. PJM could adapt its current FRR option to allow for specific resources receiving out-of-market support to choose to be removed from the PJM capacity market, along with a commensurate amount of load. This would allow a load-serving entity (LSE) to reduce their capacity obligation through bilateral contracts for resources that are now outside of the central PJM capacity market. This tack allows resources using RECs or ZECs to continue to participate in the energy and ancillary services market. FERC requests that the details of these two suggested approaches be examined more closely in the ensuing paper hearing.

Dissents by Commissioners LaFleur and Glick

Commissioner LaFleur Dissent

Commissioner Cheryl LaFleur’s dissent rejects the majority finding that the PJM capacity market is unjust and unreasonable and strongly disagrees with the decision to drastically overhaul the capacity market through a 60-day paper hearing. Here the concern is that such a hearing limits the Commission’s ability to secure adequate stakeholder engagement due to ex-parte communication rules. Commissioner LaFleur also suggests that rather than rejecting the MOPR-Ex, the Commission should provide guidance to refine the concept and make it a workable market reform.

Commissioner LaFleur is on record supporting the idea that increasing use of out-of-market compensation to support specific resource types will create long-term challenges for wholesale capacity market integrity. The Commissioner draws a distinction, however, between longstanding RPS programs that help shape a resource mix through competitive procurement, as opposed to proposals that simply prop up specific uneconomic units that could not otherwise compete in the marketplace. Therefore, she would have moved forward with the MOPR-Ex, refining it to ensure that it would not interfere with existing state RPS programs, or in the alternative adopt a “CASPR⁸-like” construct.

Commissioner Glick Dissent

Commissioner Richard Glick’s dissent strongly rejects the premise that the Federal Power Act grants FERC the authority to mitigate state efforts to shape generation mix, finding that these are “precisely the sort of actions that Congress reserved to the state when it enacted the FPA. The Commission’s role is not – and should not be

⁷ Id. at 6.

⁸ “Competitive Auctions with Sponsored Policy.” Visit <https://www.iso-ne.com/committees/key-projects/caspr/> for more information on CASP.

– to exercise its authority over wholesale rates in a manner that aims to mitigate, frustrate, or otherwise limit the states’ exercise of their exclusive authority over electric generation facilities”⁹

Furthermore, unlike Commissioner LaFleur’s dissent, Commissioner Glick argued that the record does not justify a determination that PJM’s tariff is not ensuring resource adequacy at just and reasonable rates. He points out that the PJM capacity market has thus far resulted in a capacity surplus well above the level required to reliably meet PJM’s electricity demands, which would suggest, if anything, that PJM’s capacity prices are too high instead of too low as a result of state programs.

ACORE Analysis: An Opportunity for Clean Energy and Market Efficiency

Assuming that FERC approves an expanded FRR Alternative in PJM similar to the structure they proposed in the majority opinion, the standard model for renewable energy participation in PJM’s market will likely shift. By allowing for resources supported by a state RPS to exit the central capacity auction and contract with the LSE bilaterally, the expanded FRR solution would help avoid double payment for that capacity. Renewable resources in states with an RPS will be motivated to exit the capacity markets in order to avoid being subject to minimum bids under the expanded MOPR. LSEs can then bilaterally contract with those sources and be credited for that capacity, reducing their capacity requirement. In this way, ratepayers are still receiving the value of that capacity supported through the RPS, without paying for it again in the capacity auction.

This approach will likely reduce overall participation in central capacity auctions. The minimum bids, as a result of the expanded MOPR, will likely lead to higher prices in the auction market compared to the direct bilateral market for capacity. This imbalance will drive LSEs to shift to more bilateral contracting and will decrease demand in the central capacity auction. This increased reliance on bilateral capacity contracting may stimulate more long-term contracting in PJM by the LSEs, which could benefit renewable resources which benefit from and rely on long term contracts to keep costs down. This may be a much more palatable solution compared to PJM’s proposed tariff structure, which does not create an option for renewables to provide capacity outside of the capacity auctions.

⁹ Glick Dissent at 1.