

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Centralized Capacity Markets in  
Regional Transmission Organizations  
and Independent System Operators

Docket No. AD13-7-000

**POST-TECHNICAL CONFERENCE COMMENTS  
OF THE TRANSMISSION ACCESS POLICY STUDY  
GROUP**

The Transmission Access Policy Study Group (“TAPS”) appreciates the opportunity to submit comments following up on the September 25, 2013 Technical Conference on “how current centralized capacity market rules and structures in the regions served by ISO New England Inc. (“ISO-NE”), New York Independent System Operator, Inc. (“NYISO”), and PJM Interconnection, L.L.C. (“PJM”) are supporting the procurement and retention of resources necessary to meet future reliability and operational needs.”<sup>1</sup> TAPS members both within and outside of eastern RTOs are concerned about evolving capacity market rules, particularly as they affect the ability of load-serving entities (“LSEs”) to self-supply their resource adequacy requirements, optimized through bilateral markets and RTO capacity markets.

TAPS urges the Commission to initiate a process to consider development of alternatives to eastern capacity market constructs. As made clear at the Technical Conference and in the August 23, 2013 Staff Report,<sup>2</sup> we need a way out of the eastern

---

<sup>1</sup> Notice Allowing Post-Technical Conference Comments 1, Oct. 25, 2013, eLibrary No. 20131025-3045 (“Notice”).

<sup>2</sup> Centralized Capacity Market Design Elements, Commission Staff Report 22, Aug. 23, 2013, *available at* <http://www.ferc.gov/CalendarFiles/20130826142258-Staff%20Paper.pdf> (“Staff Report”).

capacity market construct box, where the claimed need to maintain the “integrity of the market”—a set of artificial constructs rather than a structure within which buyers and sellers freely interact—crowds out all other resource adequacy and procurement objectives. These “markets” attempt to assure resource adequacy by driving prices high enough to incent generator investment in regions where most LSEs no longer have a traditional obligation to serve at retail. But many aspects of this framework are counter-productive, particularly the restrictions on the ability of LSEs that *do* retain an obligation to serve to self-supply resource adequacy needs. Subject to limited exceptions available in certain eastern RTOs, those LSEs whose business models enable them to make long-term resource commitments do so at the risk of having to purchase capacity a second time if, as a result of minimum offer price rules (“MOPR”), their “subsidized” resource does not clear the capacity market.

TAPS agrees with the American Public Power Association<sup>3</sup> and others<sup>4</sup> that one way out of what is portrayed as a “zero sum game” is to make organized capacity markets residual rather than the only game in town. To make that alternative approach work in the eastern RTOs, other structures are needed to induce resource adequacy in areas where retail deregulation limits the ability of LSEs to contract on a long-term basis.

In response to then-Commissioner LaFleur’s question “if you were starting, and now you’re building a capacity market now, are there things you might do differently?” (Tr. 91:17-19), Robert Ethier, ISO-NE, pointed to the crucial (but largely missing in New

---

<sup>3</sup> TAPS generally supports the comments filed today by the American Public Power Association (“APPA Comments”).

<sup>4</sup> *See, e.g.*, Comments of James F. Wilson, Sept. 9, 2013, eLibrary No. 20130909-5355 (“Wilson Comments”).

England, with the exception of the region's consumer-owned utilities) role played by LSEs capable of making long-term capacity commitments (Tr. 91:22-92:19). We cannot turn back the clock; nor is it the Commission's role to undo state retail deregulation decisions. But it should work with states and other stakeholders to develop alternatives to achieve long-term commitments to support resource adequacy, and move away from reliance on the eastern capacity market constructs. In the meantime, the Commission should preserve and maximize LSE self-supply and state procurement options.

In addition, TAPS asks that the Commission not support expansion of the eastern capacity market designs. Doing so would do more harm than good where LSEs largely retain an obligation to serve at retail, and are well-positioned by state cost-of-service recovery to maintain existing generation and develop needed new resources. Putting ratepayer-funded long-term investments at risk, by subjecting LSEs to double payments if their capacity (offered at a MOPR-elevated price) fails to clear the market, threatens the traditional regulatory model of ensuring resource adequacy. In regions where effective alternative structures are alive and well, the Commission should not impose capacity market constructs that undermine their vitality and effectiveness. The Commission should not kill the goose that (as Robert Ethier recognizes) lays the resource adequacy golden eggs.

### **INTEREST OF TAPS**

TAPS is an association of transmission-dependent utilities ("TDUs") in more than 35 states, promoting open and non-discriminatory transmission access.<sup>5</sup> Representing

---

<sup>5</sup> Tom Heller, Missouri River Energy Services, chairs the TAPS Board. Jane Cirrincione, Northern California Power Agency, is TAPS' Vice Chair. John Twitty is TAPS' Executive Director.

LSEs entirely or predominantly dependent on transmission facilities owned and controlled by others, TAPS has supported the Commission's initiative to form truly independent regional transmission organizations to foster efficient investment in transmission and generation, and to provide non-discriminatory transmission access.

As LSEs, TAPS members are concerned about maintaining resource adequacy at a reasonable cost to consumers. TAPS members participating in RTOs are concerned with how organized capacity markets accommodate the obligation-to-serve business model that TAPS members share, whether they are a municipal utility, cooperative utility, investor-owned utility, or municipal joint action agency. These members have a strong interest in making sure that LSEs are able to economically self-supply resource adequacy needs, consistent with their obligations to serve their wholesale and retail customers at the lowest reasonable cost, with access to bilateral and RTO markets to optimize given the lumpiness of generation additions (e.g., to allow for sales of temporarily excess capacity or purchases in the event of a temporary capacity deficiency). Unfortunately, the evolving eastern capacity market constructs threaten the ability of TAPS members in those RTOs to do so, and has made TAPS members in other RTOs seriously concerned about the potential for extension of these constructs to regions where other structures are in place (e.g., traditional retail cost-of-service regulation).

Communications regarding these proceedings should be directed to:

John Twitty  
Executive Director  
TAPS  
4203 E. Woodland St.  
Springfield, MO 65809  
Tel.: (417) 838-8576  
E-mail: 835consulting@gmail.com

Cynthia S. Bogorad  
Kathryn L. Boudouris  
Spiegel & McDiarmid LLP  
1333 New Hampshire Ave., NW  
Washington, DC 20036  
Tel.: (202) 879-4000  
Fax: (202) 393-2866  
E-mail: cynthia.bogorad@spiegelmc.com  
kate.boudouris@spiegelmc.com

**I. STAYING THE COURSE WILL BREED FURTHER TURMOIL  
AND IS NOT A SUSTAINABLE SOLUTION TO ASSURING  
RESOURCE ADEQUACY**

Although eastern RTO representatives portrayed their capacity markets as working well, we're nowhere near a market design that can be relied on to assure cost-effective resource adequacy. Rather, major market redesigns are continuously under consideration. While often touted as the "gold standard,"<sup>6</sup> PJM has recently filed to modify key terms regarding participation of demand response and imported generation.<sup>7</sup> ISO-NE's Mr. Ethier characterized New England's capacity market as generally "working as designed,"<sup>8</sup> but outlined plans for major changes to implement resource "performance incentives" and substitute a "sloped demand curve" structure for the "vertical demand curve" used in the region's capacity auctions.<sup>9</sup> More recently, ISO-NE

---

<sup>6</sup> Tr. 161:2-5 (Malik). *See also, e.g.*, Tr. 36:1-37:16; 150:19-25; 152:11-17.

<sup>7</sup> Revisions to the PJM OATT and Reliability Assurance Agreement Regarding Clearing Limited and Extended Summer Demand Resources, Nov. 29, 2013, *PJM Interconnection, L.L.C.*, Docket No. ER14-504-000; Revisions to the PJM OATT and Reliability Assurance Agreement Regarding Capacity Import Limit, Nov. 29, 2013, *PJM Interconnection, L.L.C.*, Docket No. ER14-503-000.

<sup>8</sup> Tr. 18:17-19:11.

<sup>9</sup> Tr. 22:4-23:3.

filed—on an “exigent circumstances” basis—for imposition of a new administrative price where the auction faces “insufficient competition” or “inadequate supply.”<sup>10</sup>

While energy market adjustments continue to be made periodically around the edges, the Commission is faced with nothing like the ongoing upheaval associated with eastern capacity markets. The twenty-five open dockets listed in the August 23, 2013 Supplemental Notice of Technical Conference<sup>11</sup> is symptomatic, with no end in sight.<sup>12</sup> MOPR litigation is before two courts of appeal,<sup>13</sup> as is related state program preemption litigation.<sup>14</sup> In describing the NYISO MOPR, David Patton conceded (Tr. 75:17-25):<sup>15</sup>

This is a complicated area, much more complicated than I anticipated when I first advocated that we needed something . . . . So I think we’re still in the process in New York of clarifying the rules. It’s only been applied to a few

---

<sup>10</sup> The cited exigent circumstances are the unforeseen increase in generation retirements and a resulting projected resource deficiency. Exigent Circumstances Filing of Revisions to Forward Capacity Market Rules, Nov. 25, 2013, *ISO New England Inc.*, Docket No. ER14-463-000. TAPS understands that ISO-NE will make its Performance Incentives filing later this month. Related materials are currently available on the ISO-NE website: [http://www.iso-ne.com/key\\_projects/fcm\\_perf\\_incentives/](http://www.iso-ne.com/key_projects/fcm_perf_incentives/).

<sup>11</sup> eLibrary No. 20130823-3013.

<sup>12</sup> For example, a recently-filed New England Power Generators Association complaint against ISO-NE claims undue discrimination between existing and new resources during capacity shortfall periods, and seeks higher administrative prices for existing resources during such periods. Complaint of the New England Generators Association, Inc. and Request for Fast Track Processing, Oct. 31, 2013, *New England Power Generators Ass’n, Inc. v. ISO New England Inc.*, Docket No. EL14-7-000.

<sup>13</sup> *PJM Power Providers Grp. v. PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,022, *on reh’g*, 137 FERC ¶ 61,145 (2011), *appeal pending sub nom. N.J. Bd. of Pub. Utils. v. FERC*, No. 11-4245 (3d Cir. argued Sept. 10, 2013); and *ISO New England Inc.*, 135 FERC ¶ 61,029 (2011), *on reh’g*, 138 FERC ¶ 61,027 (2012), *appeal pending sub nom. New England Power Generators Ass’n, Inc. v. FERC*, No. 12-1060 (D.C. Cir. argued Nov. 19, 2013).

<sup>14</sup> *PPL Energy Plus LLC v. Hanna*, Civil Action No. 11-745 (D. N.J. Oct. 11, 2013), *appeal docketed*, No. 13-4330 (3d Cir. Nov. 5, 2013); *PPL Energy Plus LLC v. Nazarian*, Civil Action No. MJG-12-1286 (D. Md Oct. 24, 2013), *appeal docketed*, No. 13-2419 (L) (4th Cir. Nov. 25, 2013). These cases raise concerns about the future of the Commission’s vision, in which PJM states are free to build new resources, and can obtain capacity credit for them only if they clear following application of the MOPR. If affirmed, these decisions may severely limit the ability of states to implement resource development programs, leaving capacity auctions as driving certain forms of resource construction—a responsibility for which such auctions are ill-suited.

<sup>15</sup> See also Tr. 30:24-25 (Rana Mukerji, NYISO) (buyer-side mitigation has been “difficult to implement, and has been the source of much litigation in front of you before.”).

projects, and every time it's been applied there's been significant learning about ways in which the rules are not ideal.

The Staff Report (at 22, 26-28) recognized the tension between eastern capacity market constructs and other goals. *See also* Tr. 77:4-78:1, 159:8-12.

This continuing controversy is no surprise given the inherent contradictions. First, a “market” assumes buyers and sellers have choices. But eastern capacity markets treat LSE choices about what resources to develop—which are central to ensuring resource adequacy—as threats to the integrity of “market” price signals.

Second, Technical Conference speakers highlighted the disconnect between the short-term eastern capacity market construct, and the long-lived, capital intensive nature of generation investment, which cannot be supported on the basis of a one-year cost recovery and better aligns with long-term commitments.<sup>16</sup> This disconnect puts undue pressure on one-year capacity market prices and raises the cost of capital.<sup>17</sup>

Noting the “inside out” relationship between the centralized auctions and many design elements, speaker James F. Wilson highlighted:

- “Decisions to build new power plants are based upon long-term analysis of revenue and cost, and do not hinge upon the

---

<sup>16</sup> *See, e.g.*, Tr. 92:4-19 (Ethier) (“Right now, what we have in New England is, we have the load-serving entities for a range of reasons, some of them regulatory, some of them market-driven, presumably, have a relatively short-term focus, and so that tends to prevent them from entering into long-term agreements with the supply side of the house.”); Tr. 286:6-287:3 (Wilson) (“Long-term resources like a new power plant or a major rebuild to an existing power plant—it’s a long-term resource, and it’s naturally supported by some kind of long-term commitment on a bilateral basis.”); Tr. 209:3-6 (Erwin) (“When the bankers came before the Maryland Commission, they testified there’s no way I’m going to lend money on that price signal, and certainly not if it’s only for one year.”); Tr. 106:4-107-1 (Dumoulin-Smith) (discussing the relationship between capacity market constructs and the life of the underlying assets).

<sup>17</sup> *See* Tr. 106:18-20 (Dumoulin-Smith) (“The cost of capital is inversely related with the duration of the contract allowed for.”).

outcome of an auction that determines only a capacity payment for a single year.”<sup>18</sup>

- “The usual state of capacity in any region is a little long. This has always been the case, because utilities always plan conservatively. . . . Prices in spot capacity auctions will usually be relatively low, due to the excess capacity, but will sometimes rise to higher levels to clear sufficient capacity to meet the established reserve requirement.”<sup>19</sup>

The proof is in the pudding. Although PJM touted the new generation resulting from its RPM,<sup>20</sup> APPA’s analysis of this data tells a very different story, and demonstrates that RPM has relatively little to do with new construction, and that whatever has been achieved has come at extremely high cost to consumers. *See* APPA Comments at Section V.

Even generators question the fundamental premise that they would construct capacity on spec in response to capacity market price signals. Although NRG’s Lee Davis stressed the importance of capacity market prices,<sup>21</sup> President and CEO David Crane recently told investors that the model’s assumption is flawed:<sup>22</sup>

In the low gas price environment that exists it’s nearly impossible to justify the construction in new capacity on a merchant basis.

“NRG Yield,” which focuses on “contracted assets” (i.e., those supported by long-term Power Purchase Agreements), was characterized as key to NRG’s future growth as to

---

<sup>18</sup> Wilson Comments at 5.

<sup>19</sup> Wilson Comments at 6.

<sup>20</sup> *See* Tr. 36:25-37:2 (Ott); Statement of Andrew Ott, Executive Vice President – Markets, PJM Interconnection, L.L.C., Sept. 9, 2013, eLibrary No. 20130909-5360.

<sup>21</sup> *See* Tr. 122:21-124:5; 132:2-7. *See also* Comments of Lee Davis, President of NRG’s East Region 3-5, Sept. 10, 2013, eLibrary No. 20130910-5036, which touts investments (coal-to-gas conversion, installation of environmental controls, restarting mothballed units) that fall far short of new generation.

<sup>22</sup> NRG Energy Inc, *Q2 2013 Earnings Call Transcript* (Aug. 9, 2013), available at <http://www.morningstar.com/earnings/PrintTranscript.aspx?id=55316147>.



conventional (as well as renewable) generation,<sup>23</sup> and its “long term strategic perspective.”<sup>24</sup> NRG’s presentation explains that in the “low gas price environment, long term contracted assets are the key to replacement capacity market for conventional assets[.]”<sup>25</sup>

Duke is likewise looking beyond spot capacity market price signals to make generation decisions. It has told investors that “long-term strategic decisions about [its] Midwest generation fleet” would be informed by the outcome of a “cost-based capacity filing” with the Public Utility Commission of Ohio.<sup>26</sup> Duke is seeking compensation for its capacity costs through, among other things, approval of a tariff that will be applicable to “all jurisdictional retail customers in the Company’s electric service area including those customers taking service from a competitive retail electric service provider.”<sup>27</sup>

Thus, there is ample reason to doubt the ability of the eastern capacity market constructs to ensure resource adequacy, particularly as generators retire.

---

<sup>23</sup> NRG’s president discussed the trend toward “RFPs either by state entities or sponsored by the state for 10 years plus. And a lot of it is specifically targeted at replacement capacity. To be frank, my point of view, our Company’s point of view is we don’t really see conventional generation being a growth business in response to sort of tepid demand growth in a post-industrial society.” *Id.*

<sup>24</sup> NRG, *NRG’s Second Quarter 2013 Results Presentation* at 6 (Aug. 9, 2013), available at <http://phx.corporate-ir.net/External.File?t=1&item=VHlwZT0vfFBhcmVudEIEPTQ5ODcyMTR8Q2hpbGRJRD01MTU2ODY=>.

<sup>25</sup> *Id.*

<sup>26</sup> Lynn Good, President and CEO, and Steve Young, Executive VP and CFO, Duke Energy, *Third Quarter 2013 Earnings Review and Business Update* at 27 (Nov. 6, 2013), available at <http://www.duke-energy.com/pdfs/3Q2013Slides.pdf>. Previously, Duke’s then-Chairman, President, and CEO Jim Rogers stated that if Duke received an unfavorable PUCO decision, it would “have to make a tough decision” about keeping its merchant generation. *Duke’s CEO Discusses Q1 2013 Results – Earnings Call Transcript*, Seeking Alpha (May 3, 2013), available at <http://seekingalpha.com/article/1399481-duke-energys-ceo-discusses-q1-2013-results-earnings-call-transcript>.

<sup>27</sup> Application of Duke Energy Ohio, Inc. 4-5, Att. D, Aug. 29, 2013, *In re Application of Duke Energy Ohio, Inc., for the Establishment of a Charge Pursuant to Revised Code Section 4909.18*, Case No. 12-2400-EL-UNC.

## II. LSE SELF-SUPPLY RIGHTS AND STATE GENERATION OPTIONS ARE CENTRAL TO THE REASONABLENESS AND VIABILITY OF EASTERN CAPACITY MARKET CONSTRUCTS

Eastern capacity markets' single-minded focus on producing "efficient" price signals puts at risk LSE generation choices to meet resource adequacy, as well as other objectives such as locational energy price protection, fuel diversity, renewable goals, and other state and local energy policies. Section 2 of the Notice properly focuses on the tension between self-supply and state procurement policies, and eastern capacity markets.

The Commission previously resolved this tension, and related assertions that requiring participation in centralized capacity markets was beyond its jurisdiction, by highlighting the flexibility afforded LSEs in meeting resource needs. In rejecting state commission claims that approving RPM "would be endorsing PJM's intrusion into state jurisdiction over generation[.]" the Commission noted that, "PJM is not proposing to mandate or in any way require the construction of new generation" and that:

LSEs may either (a) build their own needed capacity or create an incentive for the construction of new capacity by entering into long-term bilateral agreements, (b) refrain from entering into bilaterals and pay the (presumably higher) prices set by the demand curve, or (c) develop transmission or demand response solutions to capacity problems.

*PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, P 172 ("RPM Order").<sup>28</sup> LSE flexibility to self-supply from resources of their own choosing was also crucial to

---

<sup>28</sup> *Reh'g denied*, 117 FERC ¶ 61,331 (2006), *petition for rev. denied sub nom. Pub. Serv. Elec. & Gas Co. v. FERC*, No. 07-1336 (D.C. Cir. Mar. 17, 2009) (unpublished). In July 2010 comments filed with the New Jersey BPU following a technical conference on capacity issues, PJM explained that "RPM was never intended to be the sole source of revenue through which resource development decisions would be made, nor was it intended to be the only mechanism through which new capacity resources could be financed or constructed." Comments of PJM Interconnection, LLC 2, *In the Matter of the New Jersey Board of Public Utilities Review of the State's Electric Power and Capacity Needs*, Docket No. EO09110920 (N.J. Bd. of Pub. Utils. July 6, 2010), available at [http://www.state.nj.us/bpu/pdf/energy/PJM\\_comments.pdf](http://www.state.nj.us/bpu/pdf/energy/PJM_comments.pdf). Instead,

affirmance of Commission authority over ISO-NE's Installed Capacity Requirement.<sup>29</sup> In *Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477, 481 (D.C. Cir. 2009), the court found that the Commission did not seek to dictate *which* resources LSEs used to fulfill their obligations. To the contrary, if "a state wishes to place controls on the amount or type of electrical generating capacity built within that state, or at particular locations within that state, the Commission's regulation of ISO-NE's calculation of ICR does not prevent it from doing so." *Id.* at 482, quoting 120 FERC ¶ 61,234, P 28 (footnote omitted).<sup>30</sup>

It is inconsistent with the FPA's reliability mandate and rational energy policy to approve market rules that deter those capable of funding new, clean generation from doing so, even if they may be more costly (by some measures) than other short-term capacity resources.<sup>31</sup> Recent federal court decisions that, if affirmed on appeal, could severely limit certain state procurement mechanisms,<sup>32</sup> highlight the unintended consequences of capacity market rules that treat state- and LSE-procured generation as "subsidized" efforts that must be discouraged because they may expand supply and reduce capacity market prices. An alternative resource adequacy model is clearly needed.

---

RPM was designed to "augment long-term contracting." *Id.* at 5).

<sup>29</sup> "In essence, ISO-NE says to its LSEs, 'Provide X amount of resources.' But *how* those resources are provided is up to the LSEs and the states." *ISO New England, Inc.*, 120 FERC ¶ 61,234, P 29 (2007); *id.* P 13 (the Commission was "not requiring that any state build generation, or that any participant satisfy its capacity obligation via a particular resource").

<sup>30</sup> As discussed above, subsequent Commission orders eliminating or restricting the MOPR exemptions are pending before two circuit courts.

<sup>31</sup> *Compare Astoria Generating Co. L.P. v. N.Y. Indep. Sys. Operator, Inc.*, 140 FERC ¶ 61,189, P 135 (2012), *reh'g pending* (requiring NYISO to use the proxy cost of capital because the power purchase agreement, and its lower financing costs, were produced by a solicitation limited to new resources).

<sup>32</sup> *See supra* n.14.

***A. Eastern Capacity Market Constructs Hinder LSE Self-Supply***

The first bullet in Section 2 of the Notice asks “[i]n what ways do the current centralized capacity market designs facilitate, or hinder, the ability of market participants to enter into arrangements to supply their own resource adequacy requirements?” As made clear at the Technical Conference and in APPA’s Comments (at Section III, Response to Question 2, First Bullet), minimum offer pricing rules impede LSEs from making long-term self-supply commitments.

Consistent with their business model, LSEs with long-term service obligations will make long-term commitments to meet multi-dimensional capacity adequacy, topology, fuel diversity, and other criteria. A MOPR makes such commitments risky because the LSE may be obligated to pay twice to meet the same capacity need—once for the new resource and again to meet the LSE’s resource adequacy requirements through auction purchases if its resource fails to clear when offered at the MOPR-elevated price.

Municipal governing bodies will be reluctant to approve investments for long-term resource adequacy if the MOPR leaves them vulnerable to having the investment’s value nullified, while doubling the cost. Imposing that risk on LSEs might benefit merchant generators, because it would block LSEs from applying, to their ratepayers’ advantage, the financing security afforded by their stable LSE-load relationship, as well as lower financing costs afforded by tax exempt status. But mitigating upward LSE capacity offers, without regard to whether the LSE was intending to reduce the cost of its other capacity purchases (if any), imposes unreasonable restrictions on actions that do not

qualify as an exercise of “buyer market power.”<sup>33</sup> Yet, the Commission has done so without regard to intent. *See* Staff Report at 27.<sup>34</sup> Nor has the Commission squared singling out LSE and state procurement commitments for such treatment with the fact that myriad actions taken by market participants (and others) can affect auction prices.<sup>35</sup>

While the scope of the resources subject to the MOPR and available exemptions differ among the eastern markets, the chilling effect and harm to the business model is real, especially given the continuously changing rules. For example, after reversing a previously approved PJM settlement (that included a MOPR self-supply exemption),<sup>36</sup> the Commission approved (with modifications) a further settlement that includes a limited self-supply exemption; but the latter ruling remains subject to rehearing and continual pressure as to its implementation by the RTO.<sup>37</sup> Securing appropriate recognition for municipal or cooperative business models/cost structures in the MOPR implementation process adds unjustified hurdles. Further, to the extent these resource

---

<sup>33</sup> See Staff Report at 22 (“Buyer-side market power is typically the result of a net-buyer with the incentive and ability to suppress prices below a competitive level by offering its capacity at a price below its cost, or by subsidizing the entry of another capacity supplier. If the net-buyer is able to suppress the market-clearing price enough, the cost savings to its load will more than offset any costs it incurs by bidding its capacity below cost or providing a subsidy to another supplier” (footnote omitted)). *Compare TC Ravenswood, LLC v. FERC*, 705 F.3d 474, 478-479 (D.C. Cir. 2013) (finding the analogy between subsidies and buy-side market power to be “exaggerate[d]”).

<sup>34</sup> In fact, and as the Commission has found, states in multi-state RTOs like PJM are unlikely to subsidize new entry for price-suppression reasons because such states would bear all of the cost of subsidizing new entry, while reducing clearing prices in other states as well, thus putting themselves at a competitive disadvantage compared to neighboring states. *New York Indep. Sys. Operator, Inc.*, 124 FERC ¶ 61,301, P 37 (2008), *clarified*, 131 FERC ¶ 61,170 (2010).

<sup>35</sup> At the Technical Conference, market monitors (Tr. 72:22-73:5 (Bowring), 76:7-15 (Patton)), as well as Roy Shanker (Tr. 113:8-18), argued for a “competitive supply” MOPR exemption. But why should a competitive supply be able to offer new capacity at levels that assure that it will get some value for its investment when LSEs and states are barred from doing so (i.e., made subject to a MOPR), when both can reduce the resulting capacity auction price?

<sup>36</sup> *PJM Power Providers Grp. v. PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,022. The Commission also overturned the previously accepted negotiated MOPR self-supply exemption applicable to ISO NE. *ISO New England, Inc.*, 135 FERC ¶ 61,029.

<sup>37</sup> *PJM Interconnection, L.L.C.*, 143 FERC ¶ 61,090 (2013), *reh'g pending*.

classes are subject to a MOPR, LSEs' ability to make commitments to renewable resources or otherwise cost-effectively implement state energy policies is also impaired.

TAPS agrees with APPA (Comments at Section III, Response to Question 2, Bullets 1 & 2) that self-supply exemptions (such as those approved for PJM) should be retained and expanded, with adjustments made to existing capacity market constructs to accommodate self-supply. It makes no sense to impede those ready, willing, and able to support adequacy from making long-term commitments to do so.

***B. PJM's Fixed Resource Requirement Approach does not Adequately Accommodate Self-Supply***

The third bullet in Section 2 of the Notice asks whether the PJM's Fixed Resource Requirement ("FRR") is an appropriate means to satisfy LSE self-supply needs in PJM and elsewhere. TAPS agrees with APPA (Comments at Section III, Response to Question 2, Third Bullet) that the FRR approach is too restrictive to be a viable alternative for most TDUs.

Under FRR, an LSE must be sure, on a three-year advance basis, that it will be long for the five-year period thereafter. During that extended time frame, it cannot secure any shortfall from the auction, and is subject to stiff penalties if it is deficient. Even if the LSE expects to be long, it cannot be certain that situation will continue through the FRR period. Myriad events not within its control (e.g., changes in environmental regulations; unexpectedly extended plant outages; changes in capacity deliverability zones; changes in other market rules; unanticipated load growth; RTO membership changes by the TDU's host transmission owner) can cause the LSE to become deficient, and expose it to severe

penalties. And FRR status limits the LSE's ability to sell its excess capacity.<sup>38</sup> As a result, the FRR approach is not practical except for the largest utilities.

### **III. THE COMMISSION SHOULD BEGIN THE PROCESS OF MOVING TO A TRULY RESIDUAL CAPACITY MARKET**

The final bullet of Section 1 of the Notice asks whether capacity should be procured through a centralized, mandatory auction or “a residual market that entities only need to use to meet their resource adequacy obligations that they cannot otherwise meet through self-supply.” For the reasons discussed above, the spot capacity market should be residual to LSE self-supply, state procurement, and the longer-term bilateral market. Only markets that provide the potential for long-term commitments to support long-lived, capital-intensive investments are capable of maintaining resource adequacy and meeting other federal, state, and local energy policies. Residual capacity markets are also fully consistent with the Commission's original vision.<sup>39</sup>

In states that have adopted retail competition, there will need to be a transition to new structures that will enable LSEs or other institutions to make the long-term and bilateral commitments to which the capacity market can be residual. Thus, TAPS

---

<sup>38</sup> An FRR entity is not allowed to purchase capacity from the PJM capacity auction, and through application of Reliability Assurance Agreement § 1.82 (“RAA”) and RAA Schedule 8.1.E.2, is subject to the equivalent of an extra reserve margin that restricts its sales into the PJM capacity auction. Further, RAA Schedule 8.1.E.2 imposes a cap on the FRR entity's sales of excess capacity.

<sup>39</sup> For example, PJM's Base *Residual* Auction was intended to supplement capacity procured elsewhere. RPM provided “price signals and price stability” that enabled LSEs to “make their own business decisions about how much capacity to build or procure in long-term contracts and at what cost, and how much to obtain through PJM's auction.” RPM Order P 169. FERC explained:

Under RPM, LSEs may procure capacity in advance and outside of the . . . procurement auction . . . [C]apacity that is procured in advance would be offered into the procurement auction at a price of \$0, but it would receive the applicable market-clearing capacity price established in the auction.

RPM Order P 91. PJM's procurement of additional capacity through auction was a “last resort.” *Id.* P 71.

supports APPA's suggestions (Comments at Section IV) as to how that can be accomplished, e.g., establishing a transition period, after which LSEs (or possibly DPs) will be subjected to high penalties if they do not meet reserve requirements, while allowing time for states, stakeholders, and this Commission to work together to develop new mechanisms to make this work.

For example, states with retail access could expand upon a capacity compensation regimen developed in Ohio that, through various mechanisms and rate-making devices, allows for the recovery of certain FRR Entity capacity costs through a non-bypassable charge applicable to both "shopping" customers and those who purchase "standard offer" service.<sup>40</sup> Some form of this concept could be considered for adoption by other retail access states, with application beyond the FRR context. The BiCap proposal in the December 18, 2013 Comments of Cliff W. Hamal (at 11-13)<sup>41</sup> is a variation on that theme.

In the meantime, the Commission should ensure that RTOs maintain and expand the opportunities for self-supply and state procurement.

#### **IV. NEXT STEPS**

Section 5 of the Notice asks what steps the Commission could take to inform the development of eastern capacity market design. As shown above, self-supply and state procurement policies should not be viewed as collateral damage to "ensuring the integrity

---

<sup>40</sup> See, e.g., Opinion and Order 23, July 2, 2012, *In re Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, *on reh'g*, Entry on Rehearing, Oct. 17, 2012, *appeal docketed*, Case No. 2012-2098 (Sup. Ct. Ohio Dec. 14, 2012); Opinion and Order 35-37, Aug. 8, 2012, *In re Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to Section 4928.143, Revised Code, in the Form of an Electric Security Plan*, Case No. 11-346-EL-SSO, *on reh'g*, Entry on Rehearing, Jan. 30, 2013, *appeal docketed*, Case No. 2013-0521 (Sup. Ct. Ohio Apr. 1, 2013).

<sup>41</sup> eLibrary No. 20131218-5176.



of [the Commission's] wholesale markets,<sup>42</sup> or secondary options that must be tailored to accommodate capacity auctions. In fact, it should be the other way around. It is sensible to assume that temporarily deficient LSEs will want to meet remaining needs through the least expensive, auction-selected, remaining resources; and those with excess may look to the auction to make capacity sales. But it is inconsistent with sound resource planning to make these auctions the only effective option. To assure resource adequacy and end the cycle of market design litigation, the Commission should take actions to return capacity markets to their original residual purposes, rather than try to transform them into something they neither are nor were ever meant to be.

**The Commission should make clear that eastern RTOs need to better accommodate self-supply/state policies.** The Commission should enhance LSE self-supply opportunities and state procurement policies, rather than approving MOPR rules that impede the long-term commitments that advance and maintain adequacy.

**The Commission should issue a Notice of Inquiry** to begin engaging with eastern RTOs, market participants, and state regulators on how to move to a resource adequacy regimen that is sustainable economically and will support development of a range of resources needed to deal with environmental and other objectives. As discussed in Part III above, the aim should be a residual capacity market that fosters and accommodates self-supply, state procurement, and other mechanisms that enable the long-term commitments needed to support future resource adequacy.

**The Commission should not apply a one-size-fits-all approach,** but instead allow for regional solutions. Given regional differences and the fact that the eastern

---

<sup>42</sup> Notice at 2.

capacity market constructs are far from a sustainable resource adequacy model, TAPS urges against applying a “minimum level of best practices across the three eastern RTO/ISO centralized capacity markets” (Notice at Section 4), much less more broadly.

**The Commission should not extend the eastern capacity market constructs beyond their current boundaries.** TAPS appreciates that the Commission has sought to confine this proceeding to the eastern RTOs (Notice, n.1). However, the experience of TAPS members in the eastern RTOs makes those in other RTOs fearful that eastern capacity market constructs will migrate west. As noted in the Staff Report (at 1), those constructs were developed in regions that have largely deregulated their retail markets, and thereby limited the ability of many LSEs to commit on a long-term basis. The mandatory capacity market “solutions” to that set of problems should not be exported to regions that have largely retained the obligation to serve, or implemented other mechanisms to assure sufficient capacity. For example, most MISO LSEs<sup>43</sup> retain retail service obligations and the associated planning stability, assurance of cost recovery for prudently incurred investment, financial security, and ability to make long-term capacity commitments.<sup>44</sup> Similarly, while CAISO may face challenges associated with renewable requirements, LSEs are required to build or contract for sufficient capacity to meet load-serving obligations under the CAISO Tariff’s Resource Adequacy (“RA”) program, which reflects California’s strong preference to procure capacity needs through a bilateral

---

<sup>43</sup> MISO’s small portion of deregulated Illinois load and 10% of Michigan load, which amount to some 10,000 MW, or approximately 10% of MISO’s load (before Entergy’s recent integration, when that percentage would decrease).

<sup>44</sup> A number of TAPS members made this point in the Initial Brief of Midwest TDUs on MOPR Issues, Oct. 14, 2013, Docket No. ER11-4081-001, eLibrary No. 20131015-5126; and the Reply Brief of Midwest TDUs on MOPR Issues, Nov. 25, 2013, Docket No. ER11-4081-001, eLibrary No. 20131125-5194.

market, which can include LSE generation.<sup>45</sup> Thus, eastern capacity market constructs should not be transplanted.

Respectfully submitted,

/s/ Cynthia S. Bogorad

Cynthia S. Bogorad  
Kathryn L. Boudouris

Attorneys for  
Transmission Access Policy Study  
Group

Law Offices of:  
Spiegel & McDiarmid LLP  
1333 New Hampshire Avenue, NW  
Washington, DC 20036  
(202) 879-4000

January 8, 2014

---

<sup>45</sup> CAISO, the California Public Utilities Commission (“CPUC”), other state agencies and market participants are presently engaged in a number of stakeholder and CPUC proceedings to revise the RA program to incorporate flexibility needs associated with the state’s renewable resource policy goals.