

MJB&A Summary ■ January 3, 2020

FERC Order on Minimum Offer Price Rule in PJM Markets

On December 19, 2019, the Federal Energy Regulatory Commission (FERC) directed PJM to submit a replacement minimum offer price rule (MOPR) for forward capacity market auctions that “retains PJM’s current review of new natural gas-fired resources under the MOPR and extends the MOPR to include both new and existing resources, internal and external, that receive, or are entitled to receive, certain out-of-market payments, with certain exemptions” for existing resources.¹ Chairman Chatterjee voted in favor, while Commissioner McNamee concurred and Commissioner Glick dissented.

The Order directs PJM to expand the MOPR to new and some existing resources that receive or are entitled to receive certain out-of-market payments,² specifically those referred to in the Order as “state subsidies”. These state subsidies include state renewable portfolio standard (RPS) programs, nuclear generation subsidies, and other potential state-specific generation subsidies (with some exceptions). However, certain existing resources are exempt: the Order makes clear that existing renewable resources that participate in state RPS programs, as well as existing demand response, energy efficiency, storage resources, self-supply resources, and any resource that does not receive state subsidies are exempt from the MOPR.

Thus, FERC intends for PJM to raise the minimum price that resources can bid into future capacity market auctions, which will make it less likely that new state-subsidized resources will set the capacity market auction clearing price. However, critics of the Order, including Commissioner Glick, have cautioned that the Order may affect more resources than FERC discusses and will result in higher capacity clearing prices.

The Order is in response to PJM’s October 2018 response to FERC’s previous June 2018 Federal Power Act (FPA) section 206 filing that found that PJM’s existing capacity market structure was “unjust and unreasonable, and unduly discriminatory or preferential” as a result of out-of-market state subsidies for existing and new resources.³

¹ Federal Energy Regulatory Commission, Order Establishing Just and Reasonable Rate, (December 19, 2019), 169 FERC ¶ 61,239, Docket Number EL16-49-000 & EL18-178-000 (consolidated).

² FERC’s The June 2018 Order defined “out-of-market payments” as “out-of-market revenue that a state either provides, or requires to be provided, to a supplier that participates in the PJM wholesale capacity market. Out-of-market payments include, for example, zero-emissions credits (ZEC) programs and Renewable Portfolio Standards (RPS) programs.”

³ Federal Energy Regulatory Commission, Order Rejecting Proposed Tariff Revisions, Granting in part and Denying in part Complaint, and Instituting Proceeding Under Section 206 of the Federal Power Act, (June 29, 2018), 163 FERC ¶ 61,236, Docket No. E16-49-000.

The Order directs PJM to design a replacement MOPR that sets the price floor for new resources at the Net Cost of New Entry on a resource-specific basis. For existing resources, the price must be set at the resource-specific Net Avoidable Cost Rate. PJM has 90 days to submit to FERC a compliance filing consistent with the Order. In addition, PJM must detail revised dates for the postponed 2019 Base Residual Auction (BRA) and revised dates for the May 2020 BRA.

Background

PJM is a regional transmission organization (RTO) with thirteen member states⁴ plus the District of Columbia. It is the largest competitive wholesale electric power market in the United States, with a combined generation capacity of 180 gigawatts (GW) and over 65 million customers served. PJM’s capacity market, the Reliability Pricing Model (RPM), is intended to ensure that sufficient reserve margins exist in the RTO to meet future projected peak demand. The RPM is settled through periodic capacity auctions, usually for delivery three years in future.

The MOPR, first adopted by PJM in 2006 to address monopsony, or buyer-sided, powers to depress market prices in the capacity market below a competitive level, establishes a minimum price floor for certain generating units to bid into competitive capacity markets. The program has been revised and redesigned over the years, notably in 2008, 2009, 2011, and most recently in 2013.

In March 2016, a group of retail electricity suppliers and independent power producers⁵ filed a complaint with FERC, arguing that the existing MOPR in PJM’s tariff was unjust and unreasonable given artificial suppression of prices in the RPM due to state subsidies for some electric resources. The December 19 Order highlights that the “PJM region has experienced a significant increase in out-of-market payments provided by states for the purposes of supporting the entry or continued operation of preferred resources that may not otherwise be able to clear in the competitive wholesale capacity market.” In other words, these parties argued, these resources were able to submit artificially low capacity prices in the market due to their additional out-of-market payments, leading to depressed capacity auction clearing prices.

Prior to FERC ruling on the March 2016 complaint, PJM, in April 2018, submitted its proposed tariff revisions to the RPM and proposed two possible solutions to address the potential for state subsidies to depress resource bids. In one, PJM proposed a two-stage annual auction in which capacity commitments would be auctioned in the first round and a clearing price for resources would be set in the second round. Alternatively, PJM proposed a “MOPR-Ex,” or extension of the existing MOPR, that would apply a price floor to some new and existing resources, in addition to certain exemptions and unit-specific review.

⁴ PJM covers, in full or in part, Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, and Washington, D.C.

⁵ Complainants included Calpine, Dynergy, Eastern Generation, Homer City Generation, NRG Companies, Carrol County Energy, C.P. Crane, Essential Power PJM Companies, GDF Suez Energy Marketing North America, Oregon Clean Energy, and Panda Power Generation Infrastructure Fund.

In June 2018, FERC found that “the integrity and effectiveness of the capacity market administered by [PJM] 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 FERC also rejected PJM’s proposed double-auction proposal and the MOPR-Ex proposal as unjust, unreasonable, and unduly discriminatory. FERC ordered PJM to postpone the 2019 BRA for delivery years 2022/2023 and 2023/2024.⁷

In October 2018, PJM responded with an Expanded MOPR proposal and a Resource Carve-Out.⁸ PJM proposed to apply the MOPR to all new and existing resources, subject to some exemptions. The Resource Carve-Out would then remove from capacity auctions resources that receive state subsidies. The remaining capacity would be repriced after the potential price-depressing state-subsidized resources had been removed.

Summary of FERC December 19 Order

FERC’s December 19 Order directs PJM to submit a replacement MOPR for both new natural gas-fired resources and to expand the MOPR to include new and existing resources that either receive or are eligible to receive state subsidies, subject to several exemptions. Thus, the replacement MOPR will continue to apply to new natural gas-fired combustion and combined cycle turbines, as well as to resources that receive state subsidies. The Order defines a state subsidy as:

[a] direct or indirect payment, concession, rebate, subsidy, non-bypassable consumer charge, or other financial benefit that is (1) a result of any action, mandated process, or sponsored process of a state government, a political subdivision or agency of a state, or an electric cooperative formed pursuant to state law, and that (2) is derived from or connected to the procurement of (a) electricity or electric generation capacity sold at wholesale in interstate commerce, or (b) an attribute of the generation process for electricity or electric generation capacity sold at wholesale in interstate commerce, or (3) will support the construction, development, or operation of a new or existing capacity resource, or (4) could have the effect of allowing a resource to clear in any PJM capacity auction.

FERC noted that its definition for state subsidy is not intended to apply to every form of state financial assistance that could indirectly affect wholesale electric rates or other potential commercial externalities. Rather, FERC explained that its concern is with state subsidies that are not federally preempted but “nonetheless are most nearly ‘directed at’ or tethered to the new entry or continued operation of generating capacity in the federally-regulated multi-state wholesale capacity market administered by PJM.” In response to arguments that an expanded MOPR

⁶ Federal Energy Regulatory Commission, Order Rejecting Proposed Tariff Revisions, Granting in part and Denying in part Complaint, and Instituting Proceeding Under Section 206 of the Federal Power Act, (June 29, 2018), 163 FERC ¶ 61,236, Docket No. E16-49-000.

⁷ PJM, PJM Message Regarding Suspension of Reliability Pricing Model Base Residual Auction Activities and Deadlines until Further Notice, (September 27, 2019). <https://pjm.com/-/media/markets-ops/rpm/rpm-auction-info/2022-2023/2022-2023-pjm-message-regarding-suspension-of-rpm-base-residual-auction-activities-and-deadlines-until-further-notice.ashx?la=en>.

⁸ PJM, Initial Submission of PJM Interconnection, L.L.C., (October 2, 2018). <https://www.pjm.com/-/media/documents/ferc/filings/2018/20181002-capacity-reform-filing-w0172181x8DF47.ashx>.

will increase costs to consumers, the Order explains that while states have the right to “pursue policy interests in their jurisdictions, [w]here those state policies allow uneconomic entry into the capacity market, the Commission’s jurisdiction applies....The replacement rate directed in this order will enable PJM’s capacity market to send the price signal on which investors and consumers can rely to guide the orderly entry and exist of economically efficient capacity resources.”

For renewable resources and RPS programs, the Order states that FERC’s “assessment of renewable resource participation in the market has changed,” and “a new renewable resource that does not meet an exemption, receives support from a state-mandated or state-sponsored RPS program or other State Subsidies, and offers into the PJM capacity market will be subject to the default offer price floor.” Thus, most new renewable resources will be subject to the MOPR. FERC also noted that while voluntary renewable energy credit (REC) transactions are not state subsidies, as they are commercial agreements between a REC resource-owner and business or individual, it is not possible to disaggregate which RECs from new renewable energy projects will be used to meet mandatory state RPS compliance and which RECs will be bought and sold in the voluntary market. Therefore, capacity that may participate in the voluntary REC market is not exempt from the MOPR. However, FERC noted that voluntary, bilateral contracts for power are not subject to the revised MOPR “at this time.”

With respect to self-supply resources, FERC explained that it sees “no reason to treat new resources owned by self-supply entities differently from resources owned by other types of electric utilities, and...can no longer assume ‘that there is any substantive difference among the types of resources participating in PJM’s capacity market with the benefit of out-of-market support.”

Exemptions

FERC’s Order outlines exemptions to the revised MOPR for three categories, provided those resources also meet additional criteria: (1) existing self-supply resources; (2) existing demand response resources, energy efficiency, and storage resources; (3) existing renewable resources participating in RPS programs. The Order states that these exemptions are reasonable because those investment decisions were based on the Commission’s prior determinations.

The exemptions for existing self-supply resources, capacity storage resources, and existing renewable resources are available for such resources that have: (a) successfully cleared an annual or incremental capacity auction prior to the Order; (b) executed an interconnection construction service agreement on or before the Order; or (c) have an unexecuted interconnection construction service agreement filed by PJM for the resource with the Commission on or before the Order.

The exemption for existing demand response resources and energy efficiency is available if the resource has: (a) successfully cleared an annual or incremental capacity auction prior to the Order; (b) completed registration on or before the date of the Order; or (c) has a measurement and verification plan approved by PJM on or before the Order. The Order also explains that because demand-side resources were not previously subject to the MOPR, those resources may have made decisions to lapse participation in the capacity market. Given the policy shift of the Order, FERC, therefore, included a one-time exemption for existing demand-side resources that have lapsed participation if they had previously cleared in a capacity auction. After the next BRA, such resources will be treated as new resources, consistent with the treatment of repowered resources.

Additionally, FERC directed PJM’s MOPR to include a competitive exemption for new and existing resources other than new gas-fired resources that certify to PJM that they will forgo any state subsidies. If, however, an

existing resource claims the competitive exemption in a capacity auction but subsequently elects to accept a state subsidy for any part of that delivery year, PJM must ensure that the resource does not receive capacity market revenues for any part of that delivery year unless it can demonstrate under the unit -specific exemption described below that it would have cleared in the relevant capacity auction.

New and existing resources are also allowed to justify a competitive offer below the applicable default offer price floor through a unit-specific exemption. While the Order agrees with arguments that such an exemption needs more transparency or will be “unwieldy and burdensome,” FERC directed PJM to provide “explicit information about the standards that will apply when conducting this review as a safeguard against arbitrary ad hoc determinations that market participants and the Commission may be unable to reliably predict or reconstruct.”

With respect to state payments relating to industrial development and local siting, FERC agreed with PJM’s request to exclude those indirect subsidies, including “payment 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.”

The Order does not require resources to be subject to the MOPR solely if they are supported by federal subsidies. The Order makes clear that federal subsidies are not at issue because FERC cannot, under the FPA, contravene Congressional intent to subsidize certain resources, although the Commission notes that federal subsidies for particular resources have similar depressive price effects on wholesale electric power markets. While FERC agreed such federal subsidies “distort competitive outcomes in the PJM capacity market in the same manner” as state subsidies, “the Commission may not...disregard or nullify the effect of federal legislation by finding that it would be unjust, unreasonable, or unduly discriminatory.”

FERC-Ordered MOPR Replacement Pricing

The December 19 Order does not establish the price floor for new and existing resources, but directs PJM to develop, within 90 days, a revised MOPR consistent with the Order. Thus, FERC adopted PJM’s proposal to set the default offer price floor for existing resources based on the resource-type specific Net Avoidable Cost Rate (Net ACR). Non-exempt new resources have a price floor set at the default Net Cost of New Entry (Net CONE) for all future BRAs. The Order defines “new resources” as those that have not previously cleared a PJM capacity auction and existing resources as those that have previously cleared a PJM capacity market, with repowered resources considered to be new.

FERC explained that it does not consider it appropriate to apply the Net ACR to new resources because it does not account for the cost of constructing a new resource and does not reflect the new resource’s actual cost of entering the market. In other words, it “would not prevent uneconomic State-Subsidized Resources from entering the market.” FERC adopted PJM’s proposal to update these values annually and as a part of PJM’s quadrennial review and directs PJM to use resource-type specific Net CONE values for resources that have not previously cleared a capacity auction.

Commissioner Glick Dissent

Commissioner Glick wrote a dissent, stating that the Order is “illegal, illogical, and truly bad public policy.” Commissioner Glick highlighted three primary concerns with the Order. First, Commissioner Glick argued that FERC’s definition of state subsidy is so wide that it will “potentially subject much, if not most, of the PJM capacity market to” a MOPR. He also noted that the result will be significant litigation over what constitutes a

state subsidy and will require PJM and the Independent Market Monitor to determine which public policy decisions are state subsidies and which are not. Second, Commissioner Glick stated that the exemptions for existing resources will have the effect of “entrenching the current resource mix by excluding several classes of existing resources from mitigation.” Third, Commissioner Glick argued that FERC “unceremoniously discards the so-called ‘resource specific [Fixed Resource Requirement] Alternative,’ which had been the Commission’s proposal in the June 2018 Order that sent [FERC] down the current path.”

Overall, Commissioner Glick reasoned that the states, not FERC, are the entities responsible for shaping the generation mix within their state. While noting that state policy actions will inevitably affect wholesale electric rates, such “cross-jurisdictional effects are the product of ‘congressionally designed interplay between state and federal regulation.’” Commissioner Glick also noted that the Order targets issues that Congress intended to be exclusively under state jurisdiction and that the Order could be subject to lengthy litigation.

The dissent noted that the Order “rejects the suggestion that the MOPR should only apply to those state policies that actually affect the wholesale rate.” Commissioner Glick stated that the Commission’s Order is an “attempt to establish a set of price signals for determining resource entry and exit that will supersede state resource decision making and better reflect the Commission’s policy priorities.” He further noted that the Order “permits the Commission to zero out *any* state effort to address the externalities associated with the sales of electricity.” As an example, Commissioner Glick cautioned that the Regional Greenhouse Gas Initiative (RGGI), as well as any future carbon tax, cap-and-trade program, or clean energy standard, could be viewed as affecting the wholesale market clearing price.

A literal application of the subsidy definition includes RGGI because it provides a financial benefit as a result of state action or state-mandated process. This means that every relatively low-emitting generator in Delaware and Maryland will be subject to mitigation. And the same fate may shortly befall relatively clean generators in Virginia, Pennsylvania, and New Jersey—all of which are considering or have announced their intention to join RGGI in the near future.

Finally, Commissioner Glick estimated that the Order “will likely cost consumers 2.4 billion dollars per year initially,” which is likely to increase, and that FERC did not consider those costs when establishing the replacement rate. Further, he cautioned that the Order may incent states to leave either the PJM capacity market or PJM entirely.

Next Steps

PJM must submit a compliance filing revising the MOPR within 90 days (due March 18, 2020), and many expect multiple parties to file requests for rehearing (due January 20, 2020).

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