

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

Capacity Markets in Regions with                    )  
Organized Electric Markets                         )                   Docket No. AD08-4-000

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**TESTIMONY OF  
COMMISSIONER FREDERICK F. BUTLER  
NEW JERSEY BOARD OF PUBLIC UTILITIES**

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Good morning, Chairman Kelliher and members of the Commission. My name is Frederick F. Butler, and I serve as a Commissioner on the New Jersey Board of Public Utilities (“NJBPU”). I am also privileged to serve as the First Vice President of the National Association of Regulatory Utility Commissioners, and a member of the Board of Directors of the Organization of PJM States.

I thank you for convening this technical conference to discuss the operation of forward capacity markets in New England and the PJM region, such as PJM’s Reliability Pricing Model (“RPM”). This conference follows the Commission’s recent decision rejecting PJM’s proposal for a substantial increase in the Cost of New Entry, and the Commission’s order requiring PJM to expand the scope of its analysis of RPM. All of these developments are promising signs of the Commission’s willingness to investigate the costs and the results of RPM and other forward capacity markets, and to fulfill the commitment that Chairman Kelliher made to New Jersey Senator Robert Menendez a year ago, when the Chairman promised to “closely monitor the implementation of RPM through a series of detailed reports and our continuing oversight of the

market within PJM,” to determine if RPM was “liv[ing] up to its objectives,” and to “evaluate any necessary changes.”<sup>1</sup>

That close monitoring and oversight depends upon the Commission and its staff bringing their more than ample knowledge and insights to bear as they investigate and evaluate RPM’s design and early results.

After the fourth Base Residual Auction under RPM was held a few months ago, Andy Ott of PJM stated the following:

Looking at the combined results of the four base auctions, the net minimum increase in capacity was 10,000 megawatts compared to what would have been available absent RPM. In other words, there will be 10,000 megawatts of capacity ready to keep the lights on for consumers that wouldn’t have been there without RPM.

Putting aside for the moment the lack of any basis to claim that none of the net increase in capacity would have appeared but for RPM, it will nonetheless be helpful to review the net increase of 10,000 in the context of the Commission’s stated concern that “appropriate price signals [be] available to provide incentives to construct facilities necessary for regional reliability. . .”<sup>2</sup> In approving the RPM settlement, the Commission had hoped that RPM would provide “a just and reasonable replacement for the existing construct by creating financial

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<sup>1</sup> Written Responses of Joseph T. Kelliher to Questions from Senator Menendez, appended to Transcript, Hearing Before The Committee On Energy And Natural Resources, United States Senate, On The Nominations Of Joseph T. Kelliher To Be A Member Of The Federal Energy Regulatory Commission And R. Lyle Laverty To Be The Assistant Secretary For Fish, Wildlife And Parks, Department Of The Interior, May 10, 2007.

<sup>2</sup> Order Denying Rehearing and Approving Settlement Subject to Conditions, Docket No. ER05-1410-001 et al., December 22, 2006, ¶68.

incentives within the context of a market system to encourage investment in additional infrastructure in the locations where they are needed.”<sup>3</sup>

The answers to the following questions will help the Commission put the results of the first four Base Residual Auctions into context:

- First, within PJM, new generation is most urgently needed in Eastern MAAC and Southwestern MAAC, which are at the core of PJM’s portion of the Mid-Atlantic “Critical Congestion Area” that the U.S. Department of Energy identified in its 2006 Congestion Study. How much of the “net increase in capacity” is located within Eastern and Southwestern MAAC?
- Second, within Eastern and Southwestern MAAC, how much of the “net increase in capacity” is new generation? How much comprises older, inefficient power plants that had previously been scheduled for retirement?

The answers to the questions above will help to demonstrate whether RPM has been effective to date. Answers to additional questions will help to demonstrate whether RPM is fulfilling Chairman Kelliher’s promise to the Senate Energy and Natural Resources Committee – specifically, that “Rather than simply rewarding existing generation, [RPM] will encourage entry by new generation.”<sup>4</sup>

- How much capacity revenue will result from the first four Base Residual Auctions?

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<sup>3</sup> *Id.* at ¶146.

<sup>4</sup> Transcript, Hearing Before The Committee On Energy And Natural Resources, United States Senate, On The Nominations Of Joseph T. Kelliher To Be A Member Of The Federal Energy Regulatory Commission And R. Lyle Lavery To Be The Assistant Secretary For Fish, Wildlife And Parks, Department Of The Interior, May 10, 2007.

- Of that amount, how much will flow to new generation in Eastern MAAC and Southwestern MAAC?
- How much will flow to existing generation throughout PJM that had not notified PJM of their intent to deactivate (excluding, of course, any plants that were proposed to deactivate in PJM only to reactivate in another RTO)? As an aside, the ability of a generator to do just that, deactivate in PJM only to reactivate that same generation asset in another RTO is a very important seams problem that the FERC needs to address, admittedly in another different proceeding, but I urge you to do so without delay.

RPM provides the same amount of capacity revenue to each megawatt of capacity at a particular location, without regard to how much energy the capacity resource is likely to provide, or the price at which the resource will sell energy. To better understand what types of investments that aspect of RPM is designed to encourage, the Commission should seek answers to the following questions:

- To the extent that RPM can encourage an increase in generation capacity, does RPM drive market participants toward increases that involve the lowest capital cost? Specifically, is the retention of older, inefficient power plants that had been scheduled for retirement the most likely generation response to the dramatically increased capacity prices under RPM?
- Is the next most likely generation response the development of peaking plants that generate electricity at a substantially higher price than baseload or mid-merit plants?

Finally, the Commission should seek to understand whether the market signals sent by RPM are being blunted by other factors, making it unlikely that the billions spent in higher capacity costs in PJM can be productive in encouraging the development of new generation where it is needed most. Specifically, the Commission should consider the effects of all of the following on the development of new generation in the most congested areas:

- Clean Air Act permitting requirements, especially in fine particulate nonattainment areas, that could make development virtually impossible regardless of how high capacity prices rise;
- Planned transmission expansions that would increase the capacity of congested areas to import electricity, raising questions about the future prospects for energy and capacity revenues for any new generation under consideration for construction in those congested areas;
- The retention of older, inefficient plants on sites that are ideal for more efficient and expanded generation; and
- The difficulty of siting new generation in congested areas on sites that are not already used for electric generation.

The NJBPU has made its view of RPM clear to the Commission. We opposed the RPM settlement; we sought rehearing of the Commission's approval of the settlement; and we have taken our challenge to the federal appellate courts after the Commission denied rehearing.

For the same reasons we have continued to oppose RPM, we expect the Commission to reach the same conclusions we have about RPM.

First, we expect that the first four years of RPM will produce minimal new generation in the areas of PJM where new generation is most urgently needed. Instead, the claims of a substantial "net increase in capacity" are essentially the postponement of retirements for older, inefficient units. That postponement may temporarily help to keep the lights on, and we have no complaint with that result. However, we are deeply concerned that retaining those units locks up the sites that are best suited for the development of new, efficient, and expanded generation because they already have access to transmission, fuel, and water, and because their current use for electric generation makes them less vulnerable to local opposition. Therefore, if RPM is having any significant effect in the most congested areas of PJM, it is to make us more reliant on plants that use scarce and expensive fuels inefficiently, contribute to higher prices in the energy market, and cannot be relied upon for the long term.

Second, we expect that almost all capacity revenues under RPM will have flowed in directions that have nothing to do with preserving reliability. Specifically, we believe that well over 90 percent of the revenues from the first four auctions were paid to existing plants that had shown no intent to retire. This distribution of revenues diffuses the market signal that the Commission had hoped RPM would send, while ensuring that the overall costs for capacity will be far higher than what is needed to bring new generation into the market in the locations where it is needed most.

For these reasons, we look forward to the presentations of alternatives to RPM in subsequent panels at this conference. The Commission approved the RPM settlement in the belief that RPM would be better than the previously existing construct in PJM. Experience with RPM has demonstrated significant structural problems that we believe can be overcome by the alternatives being presented today; these alternative approaches can be the basis for better

achieving the laudable and essential goal of RPM – to bring to the market the capacity resources needed for reliability of our supply of electricity.