

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

Centralized Capacity Markets in	*	
Regional Transmission	*	Docket No. AD13-7-000
Organizations and Independent	*	
System Operators.	*	

Comments of the Maryland Public Service Commission

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The Maryland Public Service Commission appreciates the opportunity to speak at the FERC technical conference on electricity capacity markets. Given that the Maryland Commission, like all state Commissions, is obligated to ensure safe and adequate electric service at just and reasonable rates within our state, our participation at this conference is important to the successful resolution of the many challenges facing organized electricity markets that FERC is seeking to resolve.

The Maryland Commission's views and concerns regarding the PJM Reliability Pricing Model and Minimum Offer Price Rule are well known, and we will not dwell on them here. Instead, we will use this opportunity to identify what we view as key flaws in the currently prevailing notion of what a capacity market should look like in the context of the paramount public interest in adequate, reliable and reasonably-priced electricity resources. We will then offer constructive and workable ideas for ensuring the timely development of more functional capacity markets that provide real and demonstrable benefits to consumers, who ultimately must pay for the services these markets are expected to provide, and that can further, rather than hinder, state public policy goals.

Based on our experience in PJM to date and the deficiencies we have identified in that capacity market, the Maryland Commission offers the following recommendations to rectify those shortcomings:

1. RTOs/ISOs should break up the capacity bundle into more discrete segments that would result in more accurate price signals based on the kind and duration of the capacity services being provided.
2. Capacity compensation should vary to reflect the type and value of the capacity services provided to the market.

3. Administrative rules, though necessary, should not be used to establish arbitrary and unnecessary pricing floors or prevent price competition that could benefit end-users.
4. FERC must preserve the ability of sophisticated buyers and sellers to engage in mutually beneficial long-term transactions.

The FERC Staff White Paper, *Centralized Capacity Market Design Elements*, did a good job of outlining the different approaches Eastern RTOs/ISOs have taken to design capacity markets both to retain existing generation and to incent new investments in generating capacity when and where they are needed. While pointing out their intended benefits, the paper did not address equally how these markets have failed to achieve what should be a primary focus: harnessing the forces of competition to provide adequate generating capacity at a reasonable cost.

In PJM, we have witnessed billions of dollars per year transferred from PJM consumers to capacity suppliers under the mistaken belief that this money is needed to keep the system operating reliably over the long term. Despite these wealth transfers, we have seen little evidence to support the argument that this money is indeed producing the level of investment that is needed, when it is needed, and where it is needed, and doing so in a way that will provide reliable electric service at a reasonable cost. Indeed, in response to this lack of new investment where needed and out of concern for the future reliability of electricity supplies in their respective regions, some parties in organized markets with a clearly defined jurisdictional responsibility to electricity users, including the States of Maryland, New Jersey and Virginia, have taken concrete steps to procure new capacity precisely because the centralized RTO/ISO markets on which we are told to depend have not demonstrated to our satisfaction that we can entrust the future energy security of our citizens on those markets.

Instead, based on both Maryland's experience in PJM and the review provided in the Staff White Paper, capacity market mechanisms that determine how providers of capacity will be paid have become an unwieldy compilation of administrative processes overlaid upon complex and sometimes arbitrary bidding processes. The constant and contentious changes to the market structures under which market participants must operate have resulted in questionable benefits to consumers and provided little long-term certainty to the market relative to what is expected to be needed – particularly that which is required to attract new market entrants. Rather, these markets have largely facilitated the transfer of wealth from a large number of customers to a limited number of existing owners of largely depreciated generation facilities that were originally financed and paid for by the customers of the vertically integrated, regulated utilities that built them.

Efforts to incent new generation by building in higher price levels via administratively-determined bidding mechanisms have seen incumbent generators profit from the additional revenues provided by capacity markets without ever having to deliver new capacity into the market place. Indeed PJM Stakeholder processes in which the Maryland Commission now participates are proposing administratively established Minimum Offer Prices which well exceed regulated jurisdiction cost of service allowances provided to fund new generation construction, raising concerns that competitive capacity markets intended to lower costs to the end-user may in fact be raising them. The one size fits all approach to capacity markets ends up over-paying existing market participants to remain, but not providing a sufficiently large and long- duration revenue stream to allow new generation developers to obtain financing. Given this state of affairs, we are concerned that FERC and centralized market advocates appear to be more focused on states exercising their statutory responsibility to ensure safe and reliable service for their

citizens than they are with the failure of organized capacity markets to produce the outcomes that these proponents have claimed they would achieve.

The effort to design and operate centralized capacity markets must allow the continuation of the historical role of the states in planning and ensuring adequate and reliable electric service to their citizens. The mere fact that Maryland has a restructured electric industry has not absolved our Commission of its statutory responsibility to ensure the safe and adequate supply of electricity to retail customers at reasonable rates. This is true not only regarding determinations of how much capacity is needed to ensure safe, reliable and adequate service in our state, but also the desired resource characteristics our state has chosen, i.e., including fuel diversity, limiting GHG emissions, robust demand response, energy efficiency, etc. State Commissions are in the best position to determine the willingness of their citizens to pay a premium to achieve such public policy objectives. It is in that context that we have opposed and will continue to oppose the establishment of market rules that would prevent or severely hamper Maryland and other similarly situated states from pursuing legitimate public policy goals, particularly in instances where there is no assurance that the markets will provide new capacity with the fuel characteristics and emissions profiles our state statutes and regulations require. From a market impact standpoint, the effect on clearing price of new generation is the same, regardless of whether the new participant is a vertically integrated regulated utility, a self supplied municipal or cooperative utility, or a state sponsored project. Therefore, the market's treatment of these resources should not be artificially delineated based on a project's owner or sponsor.

It is also important to recognize that today's capacity markets do a poor job of distinguishing between the various products an RTO/ISO is seeking to obtain, i.e., commitments from existing resources to remain available, an uprate from an existing resource, or a brand new

generating plant of a particular type or location. The current PJM RPM does not reflect the new and changing realities of the wholesale capacity market and does not appear to provide sufficient revenue incentives to encourage the development of both new generation resources and associated products to meet a changing competitive environment. Rules basically designed to keep existing capacity in operation and to incent traditional new capacity to serve an ever-growing demand for electricity may not be adequate in a world that is replacing existing capacity with more efficient generation, renewable resources, energy efficiency, demand response and other new technologies and modes of operation. We therefore question the wisdom of putting all of our generation eggs into a single capacity market basket that has been in need of continual administrative repair since its inception.

Finally, as the electric industry invests in more natural gas-fired generation, concerns about interdependency of our electric and natural gas systems have increased, as the current FERC investigation into this subject demonstrates. Numerous studies have shown that investments in new generation will require new gas pipeline capacity to support that shift. The gas pipeline industry has made it clear that the construction of new capacity will depend in large part on developers' ability to secure long-term firm contracts with natural gas users for 10-15 years. It is unclear to us how or why a merchant generation developer relying on a one-year price signal three years out would be able to commit to a long-term firm gas contract when it cannot obtain the same commitment for its output, or what the effect upon its cost of providing service would be if it must obtain firm natural gas delivery service. Thus, the need for long-term certainty on the part of project developers, whether gas or electricity, is not dissimilar.

To address these market structure deficiencies and concerns, Maryland offers the following recommendations:

1. **RTOs/ISOs should break up the capacity bundle into more discrete segments that would result in more accurate price signals based on the kind and duration of the capacity services being provided.** For example, RTO/ISOs could conduct bidding targeted at existing resources in the near to mid-term, while conducting a separate round of bidding designed and targeted at new resources that would be brought online in the mid to longer term; capacity that could come from upgrades at existing facilities or new generating resources. Surely, in almost every instance the payment necessary to persuade an existing efficient resource to commit to remaining available for a certain period into the future will be much less than that necessary to incent construction of a new power plant. FERC should also look at the desirability of requiring capacity markets to establish capacity payment terms of greater than one year, perhaps using a portfolio of staggered contract terms such as three, five, or ten years for a defined percentage of capacity resources – this approach would minimize price volatility and provide long term price signals which would also provide greater revenue certainty to developers of new merchant generation.
2. **Capacity compensation should vary to reflect the type and value of the capacity services provided to the market.** This includes providing quick start, shutdown and load-following capability, particularly given the increasing need to facilitate integration of intermittent renewable resources such as wind and solar, while recognizing the value of demand response, energy efficiency and emerging storage technologies, all of which will be necessary to meet RTO daily operation's needs, as well as accommodate state and federal public policy goals. The growth of distributed generation resources such as demand response and storage may not be sustainable without recognition of their specific

operating characteristics and locational benefits. These technologies should be fully compensated for the value of the services they provide.

3. **Administrative rules, though often necessary, should not be used to establish arbitrary and unnecessary pricing floors or prevent price competition that could benefit end-users.** RTOs/ISOs should also not be permitted to use such rules to block States from discharging their long-standing statutory authorities and responsibilities to ensure adequate, reliable and reasonably priced electricity supplies for their citizens.
4. **FERC must preserve the ability of sophisticated buyers and sellers to engage in mutually beneficial long-term transactions.** At present, capacity market mechanisms do not provide the signals, nor the opportunity, for developers of new generation to obtain the market assurance they need to commit capital based on a reasonably certain revenue stream required to obtain competitive financing and ensure long-term revenue adequacy. This is precisely where ensuring that willing buyers and sellers can enter into mutually beneficial long-term contracts for capacity and energy will help to remove one impediment to new capacity while avoiding the enrichment of incumbent generators offering fully or mostly depreciated assets into the market place.