

**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

**STATEMENT OF WILLIAM L. MASSEY  
ON BEHALF OF THE COMPETE COALITION**

I appreciate the opportunity to participate in the Commission's technical conference on centralized capacity markets, and respectfully submit this statement on behalf of the COMPETE Coalition ("COMPETE").

COMPETE is an organization of more than 730 electricity stakeholders, including customers, suppliers, traditional and clean energy generators, transmission owners, trade associations, technology innovators, environmental organizations and economic development corporations -- all of whom support well-structured, competitive electricity markets for the economic and environmental benefit of consumers.

COMPETE customer members have benefitted from centralized capacity markets and some of them directly participate in those markets. Our experience is that the capacity markets when correctly structured have ensured a reliable supply of electricity at just and reasonable prices through the interaction of competitive market discipline and transparent price signals that accurately convey the resource costs of supply and consumption decisions.

In the agenda for this conference, the Commission indicates interest in ways capacity market design can accommodate federal or state resources procurement, planning and environmental policies. COMPETE strongly urges the Commission to avoid adopting any

capacity market design changes that would allow government-granted subsidies or other resource preferences to impact capacity market prices or distort the incentives for resources to enter or exit the market. Such policies pick winners and losers administratively and, over time, force otherwise efficient resource providers from the market and raise prices to consumers.

### **The capacity markets have proven to be beneficial**

Assuring that there are sufficient resources to meet demand and keep the grid in balance is an essential function of any electricity market. An effective forward-looking mechanism is necessary to ensure that adequate regional resources will be available in the future to meet reliability needs.

To better ensure the long term reliability in the PJM, New York ISO and ISO New England regions, the centralized capacity markets were adopted with the objective of ensuring electric system reliability at the lowest possible cost. The markets ensure reliability by using competitive auctions to lock in firm prices on electric capacity from resources well in advance of when they are needed. The auctions focus solely on selecting only the cheapest resources to meet future needs reliably, and thus guarantee the least-cost reliability solution. The least-cost reliability solution can be met by customer-initiated energy efficiency and demand response, upgrading an existing generating unit, reactivating a previously retired unit, deferring the retirement of an existing plant, building a new plant, or investing in transmission. Prices do not differ between new or existing resources or by fuel type, but are based on the location and timing of the capacity commitments.

Before the capacity markets were implemented, price signals in these markets were short term in nature, inadequate to support existing assets and incent new development, and

discouraged demand response from participating in the market. The centralized capacity markets are fully consistent with COMPETE's principle that resource adequacy should be ensured by a market-based mechanism, which I will discuss later.

The centralized capacity markets have effectively met their objective of ensuring system reliability at the lowest cost. To the extent that additional capacity resources have been needed and were economic relative to the available existing resources, additional capacity resources have been added. However, the objective of the capacity markets is not to add generation capacity *per se*. To the extent new generation resources have not been installed as much as some stakeholders would like, that is because additional generation resources simply were not justified. For example, in evaluating PJM's RPM capacity market in 2011, the Brattle Group found that "[t]he main reason for the low activity of new power plant construction in eastern PJM is...that new plants are not needed for several more years due to a combination of low load growth...and lower cost supply options such as deferred plant retirements, transmission upgrades, demand response penetrations and upgrades to existing units."<sup>1</sup> As such, "new generation is simply not cost-competitive with lower cost options", and is "inherently unprofitable and not part of the least cost solution to resource adequacy."<sup>2</sup>

While there may be some regional challenges, the capacity markets have assured resource adequacy. And by signaling for new resources only when they are needed and economic relative to available existing resources, and empowering customers to bid demand response and energy efficiency innovations, the capacity markets have assured a reliable supply of electricity at the lowest available prices for consumers.

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<sup>1</sup> Brattle Group, *Second Performance Assessment of PJM's Reliability Pricing Model*, August 2011 at p. 58.

<sup>2</sup> *Id.* at p. 59.

## **Market principles**

The experience of COMPETE is that well-functioning competitive electricity markets are beneficial for consumers, at both the wholesale and retail levels. To evaluate whether proposed or existing policies will contribute to a well-functioning market, COMPETE has developed a set of principles. These principles are clearly applicable to how FERC structures the capacity markets. The principles are:

- Electricity markets must have accurate and transparent price signals to guide investment and consumption decisions.
- Competitive markets must be open to all market participants without arbitrary restrictions on market participation.
- Market rules and practices must be non-discriminatory so that all resources participate on a level playing field.
- Non-bypassable charges that retail customers are forced to pay must not be used to recover the costs of generation and other supply services.
- Subsidized resources distort the market and harm customers, and should not be allowed to interfere in competitive markets.
- Competitive procurements must be open to all qualifying resources, and not restricted to specific technologies, locations or vintages.
- To ensure long-term resource adequacy, electricity markets must have clear and transparent standards that rely on market-based mechanisms, which can include a capacity construct where needed.
- Independently administered organized wholesale markets, such as those operated by Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs), are needed for competitive electricity markets.
- Competitive markets must have clear and transparent rules and effective independent oversight to ensure compliance with the rules and accountability to customers and regulators.

COMPETE believes these are robust and timeless principles that can inform FERC's policy decisions regarding capacity market design. For example, COMPETE's first principle addresses the need for accurate price signals, a fundamental function of the capacity markets. And several other of the principles must be satisfied if capacity market operations are to produce accurate price signals. Capacity procurements must be open to all qualifying resources, and not restricted to specific technologies or vintages, and market rules must be non-discriminatory to facilitate a level playing field on which all qualifying resources may compete. FERC has embraced these principles. Without them, winners and losers would be picked without the discipline of open competition, dampening innovation and raising costs for consumers. And subsidized resources will have similar deleterious impacts on capacity markets.

### **Subsidies and other preferences harm capacity markets**

As I have mentioned, in the agenda for this conference, the Commission indicates interest in ways capacity market design can accommodate federal or state resource procurement, planning and environmental policies. COMPETE is very concerned with such potential accommodations to the extent that the state resource procurement, planning and environmental policies are implemented through out-of-market purchase arrangements that can interfere with capacity market outcomes, distort price signals, pick winners and losers, drive relatively efficient resource providers from the market, and raise prices to consumers.

A prime example of COMPETE's concern is the decisions by New Jersey and Maryland to procure capacity by subsidizing a select few new power plants within those states with guaranteed long term revenue streams that are independent of actual market prices. By bidding into a capacity market as required by state policy, these subsidized generators can suppress

market prices and mute the market signal on which consumers, generators, and demand response providers rely. Allowing these plants to clear in the market interferes with the working of the capacity market and frustrates its fundamental purposes of efficient price formation and procurement of capacity at the lowest available cost. The function of capacity market prices is to provide signals to investors regarding the efficient level and location of investment in new facilities, and to customers to offer demand reductions and energy efficiency innovations. In order to serve this signaling function, market prices must be established by bids determined by the forces of true competition, not by state-mandated programs that distort the incentives of some market participants and alter the perception of the market held by all other participants. The Maryland and New Jersey contracts provide a guaranteed stream of revenue regardless of capacity market prices as long as the plants clear the capacity auction. Thus, in determining its bid, the state-subsidized generator need not worry about recovering its costs or other factors that competitive suppliers would normally rely upon in determining how to bid into the centralized capacity market. The only consideration is to bid as low as possible to clear the auction.

In the PJM Base Residual Auction conducted in May 2012, bids from three of the subsidized generating plants in Maryland and New Jersey cleared the auction. These bids unfairly tilted the playing field and likely prevented unsubsidized generation and demand resources from clearing.

While the state-subsidized resource bids were successful in clearing the market and possibly lowering capacity market prices and, in turn, consumer prices, that benefit is fleeting and harmful long term. The deleterious impacts of state-mandated subsidies for new generation resources are described in a recent report prepared for COMPETE by Dr. Jonathan Lesser of

Continental Economics.<sup>3</sup> Dr. Lesser concludes that “government subsidies for new generation resources both raise capacity costs for the very customers whom the subsidies are supposed to benefit and jeopardize resource adequacy and reliability in the long run for all consumers.”<sup>4</sup>

The capacity market interventions by Maryland and New Jersey require local distribution utilities to purchase generating capacity at prices guaranteed by their customers, thus eliminating the normal financial risk that competitive generation suppliers bear. The new state-subsidized generating capacity is then offered into the capacity and energy markets to suppress market prices. As discussed in the Lesser Report, the lower prices made possible by state government-subsidized entry are short-lived because they drive unsubsidized competitive suppliers from the capacity market. Merchant generation firms will not invest either in new resources or existing resources for fear that state governments will intervene and eliminate the return on investment needed to compensate unsubsidized developers for the risks they take. If they are willing to invest at all, competitive resources will require a higher rate of return to account for this additional risk which results in higher prices. This harms consumers and, in turn, will harm long-run resource adequacy. Eventually, only state-subsidized suppliers will be left, and the capacity market will cease to exist, thereby eliminating the benefits that competitive markets provide for consumers across the entire RTO region. And because of the regional scope of the capacity markets, the impact of state actions like those of Maryland and New Jersey are not limited to those states; consumers in all states in the region are harmed. As the Pennsylvania Public Utility Commission put it:

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<sup>3</sup>*State Subsidization of Electric Generating Plants and the Threat to Wholesale Electric Competition.* (Lesser Report). The report is available at: [http://www.competecoalition.com/files/State%20Subsidization%20of%20Electric%20Generating%20Plants\\_Final.pdf](http://www.competecoalition.com/files/State%20Subsidization%20of%20Electric%20Generating%20Plants_Final.pdf)

<sup>4</sup> *Id.*

It would be one thing if the increased costs, and consumer harm, caused by unmitigated subsidized entry were borne only by the state that sponsored such entry. But that is not the case here. PJM administers a regional market spanning many states and the costs associated with unmitigated subsidized entry in that market necessarily will not be contained by state boundaries. If, for example, the New Jersey LCAPP results in the construction of subsidized new generation that is not effectively mitigated under the MOPR, that will affect RPM clearing prices in Pennsylvania and other PJM states – states, like Pennsylvania, that may prefer to rely on competition and spare their ratepayers the burden of subsidizing new resources. But without effective mitigation of subsidies, a single state within the interstate PJM market could force all states within PJM to return to cost-based regulation, because the markets could fail.

RPM is an interstate market. Market distortions imposed by one state will spread to other states within the PJM footprint. In these circumstances, the Commission must step in to protect wholesale markets, and to protect consumers.<sup>5</sup>

### **Minimum Offer Price Rule (MOPR)**

A minimum offer price rule, or MOPR, is an important line of defense against out-of-market arrangements adversely affecting capacity markets. A MOPR protects against buyer market power exercises to suppress capacity market prices as in the Maryland and New Jersey cases. COMPETE agrees with the Commission Staff Report that the goal of any market power mitigation construct “is to preserve the integrity of the prices produced by the capacity markets” and “should be designed to constrain actions that will alter competitive market outcomes.”<sup>6</sup> However, the report also notes a “tension between the goal of promoting competitive new entry through buyer side market power mitigation and accommodating state energy policy goals”<sup>7</sup> as implemented through such mechanisms as renewable portfolio standards.

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<sup>5</sup> Comments of the Pennsylvania Public Utility Commission, March 4, 2011, FERC Docket No. EL11-20-000 and ER11-2875 at 19-20.

<sup>6</sup> *Centralized Capacity Market Design Elements- Commission Staff Report* (Staff Report), AD13-7-000, August 23, 2013 at 26.

<sup>7</sup> *Id.* at 28.

Centralized capacity markets have built an impressive record of attracting investment, including renewables, customer demand response, energy efficiency and other innovative resources that are needed to keep supply and demand in balance at the lowest available costs. The keys to this success are a level playing field where all resources can compete on equal terms, fair rules, and transparent prices that signal the true cost of resource use decisions. There is no denying that a capacity market policy that accommodates states putting a thumb on the scale in favor of certain resources, by allowing carve outs from a MOPR or implementing similar capacity market design changes, will interfere with efficient price formation, one of the fundamental functions of markets, and thus would threaten the success of the capacity markets. A MOPR can limit the ability of state-subsidized generating capacity to distort capacity market-clearing prices only if it correctly and credibly screens out non-economic capacity additions.<sup>8</sup> Accordingly, the Commission should avoid weakening the MOPR to favor specific types of resources.

Likewise, the Commission should proceed cautiously in tailoring performance standards for capacity with operational characteristics needed to address market conditions, as discussed in the Staff Report.<sup>9</sup> The specific operating characteristics of capacity resources must be recognized by the market rules so that all have a fair chance to compete. A level playing field also requires basing the market rules and practices on the principle of comparability: all resources must abide by the same rules, must meet the same obligations, and must be compensated for a comparable service actually provided to the grid. The Commission should keep these considerations firmly in mind in addressing more granular performance standards.

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<sup>8</sup> Lesser at 10.

<sup>9</sup> Staff Report at 21-22.

I thank the Commission for the opportunity to submit these prepared remarks on behalf of COMPETE. COMPETE supports well-structured capacity markets where they currently exist because they are beneficial to consumers, and urges the Commission to focus on the long-term interests of consumers as it considers the comments in this proceeding. It is paramount that centralized capacity markets have accurate price signals to guide investment and consumption decisions. The Commission must ensure that state-subsidized resources do not distort the capacity markets. COMPETE urges the Commission to remain vigilant with regard to buyer-side market power and keep a strong MOPR in place.

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