

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

State Policies and Wholesale Markets)
Operated by ISO New England Inc., New York) Docket No. AD17-11-000
Independent System Operator, Inc., and)
PJM Interconnection, L.L.C.)

**PRE-CONFERENCE STATEMENT OF LISA G. MCALISTER ON BEHALF OF
AMERICAN MUNICIPAL POWER, INC.**

American Municipal Power, Inc. (“AMP”) is grateful to the Commission for holding this technical conference to discuss the role of state policies in shaping the quantity and composition of resources needed to cost-effectively meet future reliability and operational needs in the Eastern Regional Transmission Organizations (“RTOs”) and Independent System Operators (“ISOs”). This conference provides a forum in which the Commission and the participants can have a policy level conversation about whether centralized capacity constructs are sufficiently flexible and robust to integrate state policies while also satisfying reliability goals and meeting the needs of market participants and electric consumers.

AMP also wants to thank the Commission for granting its request to speak at this Technical Conference. As a non-profit wholesale power supplier and service provider for 135 members that are municipal electric systems and joint action agencies (instrumentalities of the states) across nine states, with a majority of AMP’s members being load-serving entities within the PJM region, and an active litigant in a number of the administrative dockets listed in the Commission’s April 13, 2017 Supplemental Notice (“April 13 Notice”), AMP has a unique vantage point on the questions raised for Session IV (“The Implications of State Policies for Wholesale Energy and Capacity Markets and Resource Adequacy”). AMP appreciates the opportunity to share its perspective and looks forward to discussing these matters further at the Technical Conference.

This is not the first technical conference the Commission has held regarding the ability of the centralized capacity markets to support the procurement and retention of resources necessary to meet future reliability and operational needs in the face of an evolving resource mix and state policies encouraging renewable resources or other resource prioritization.¹ There is a key difference that we find encouraging, though. In this technical conference, the Commission is focused on long-term approaches for integrating state policies into the competitive resource procurement framework, and is not merely looking for superficial cosmetic “tweaks” to the existing capacity constructs.

Let me be clear at the outset: AMP supports competitive markets. Truly competitive markets are important to public power because they offer opportunities for our members to serve their customers at a lower cost. But, as you have heard before from representatives of AMP and other load interests, PJM’s current capacity adequacy

¹ Centralized Capacity Markets in Regional Transmission Organizations and Independent System Operators, FERC Docket No. AD13-7-000.

construct—the Reliability Pricing Model (“RPM”)—is not a market in any meaningful sense. Rather, RPM is a complex rules-driven administrative mechanism for pricing and procuring capacity—one that relies on such distinctly non-market features as an artificial demand curve, price caps and minimum offer price requirements, and obstacles to competition from certain types of resources. And while the purpose of a true market is to arrive at the most efficient utilization of economic resources, RPM’s acknowledged goal is to provide a stream of revenues to suppliers to make up for “missing money.” RPM is a “market” in name only, and, as time has gone on, fewer and fewer PJM market participants use that term to describe it.

Another factor that sets RPM apart from a normal market is that RPM’s rules are in constant flux. During the ten years RPM has been in effect, PJM has been in a near-constant state of developing, filing or defending some new set of RPM rules, some of which fundamentally changed the nature of RPM.² While PJM may view each set of rule changes as necessary to address some unforeseen events or to provide market design improvements, the constant “rules churn” that is RPM has a number of negative impacts. The ongoing accumulation of rules and patches to rules, for example, has produced an unduly complicated mechanism; at this point, in fact, RPM’s complex web of rules, exceptions, and exceptions to exceptions is such as to confound many market participants while, at the same time, providing a cloak for “gaming” behavior by others. Furthermore, the ever-changing nature of RPM’s rules makes long-term resource planning and coordination next to impossible. These dysfunctional attributes are manifest in the fact that, even after more than a decade of operation and countless “tweaks” and “patches,” RPM still falls woefully short in terms of its ability to:

-) ensure reasonable, transparent and stable capacity prices;
-) incent required levels of electric infrastructure development;
-) promote fuel diversity (PJM has grown heavily dependent on natural gas generation, with limited growth in renewable resources); or
-) provide any assurance that in the long term sufficient resources will be built to meet the region’s reliability needs.

During the Commission’s September 25, 2013 Technical Conference on Centralized Capacity Constructs, PJM delivered a report on RPM’s goals and its claimed successes in several areas, including that of bringing forth the right capacity investments in the right locations.³ Yet, less than a year later, PJM believed it necessary to propose a fundamental overhaul of RPM in the form of its Capacity Performance (“CP”) proposal. Touted as a response to the “polar vortex” of early 2014, CP was rich in features that were uniquely disruptive and burdensome for stakeholders, such as unreasonable operational performance requirements, a paradigm shift for seasonal resource participation, penalties disconnected from the value of performance at the time and with the potential to exceed capacity revenue, and a near complete unwinding of the market

² Since 2010, there have been 27 significant filings made to modify RPM. According to PJM, the 2016 BRA was the first BRA with no rule changes from the prior year.

³ The goals identified were: (1) provide a mechanism to ensure rational retirement decisions; (2) meet the need for new infrastructure development; and, (3) promote innovation by treating demand response as a comparable resource. Statement of Andrew Ott at 6-13, FERC Docket AD13-7.

mitigation rules governing offer caps, to name a few. Rather than seeking to meet the challenge of extreme demands by adding flexibility to PJM's capacity construct, CP instead adopted an inflexible product definition that discourages fuel and technology diversity by imposing strict performance requirements which disregard the fact that, even among the most well-managed units, there will be variations in forced outage rates, fuel supply arrangements, ramping and minimum load levels, and environmental restrictions, among other things. And because CP imposes unduly discriminatory restrictions and requirements on the use of renewable and demand response resources, a whole family of resources that historically provided significant value to the region now are greatly hampered in the value they can bring. In making PJM's capacity construct less flexible, CP also has made it less capable of integrating the diversity of resources that may be an element of implementing important state policies.

More recently, PJM has faced another development it seems to view as a challenge to RPM—namely, the efforts by some states and LSEs to take a direct role in guiding the resource mix in order to implement state policies. These efforts have taken the form of legislatively required affiliate power purchase agreements (Ohio) that some market participants have opposed as “out of market threats” to RPM.⁴ The Commission's questions in the April 13 Notice suggest that it, too, has concerns about the impacts that policy-implementing payments to capacity resources may have on current RTO capacity constructs. An effort to distinguish between state actions that are “inside” versus “outside” the market would be misplaced, however, especially if the purpose of the distinction is to insulate the current capacity constructs from the “outside” influence of state policies. The reality is that, today, there already are factors at work that could be portrayed as “out of market” subsidies or advantages, such as state or local tax incentives, renewable portfolio standards (“RPS”), differing access to certain financing methods or vehicles, and variations in the cost of financing.⁵ Each of these factors ultimately has its roots in a particular state or local policy that may have differing effects across the spectrum of market participants and resources. Given this history, it is reasonable to expect that state and local governments, who are closer to and likely to take their cues from ultimate consumers, will continue in their efforts to guide asset decisions toward those that comport with relevant policies (as well as their long-term planning goals) regardless of the short-term and volatile signals produced by RPM and for reasons unrelated to the administrative determination of net Cost of New Entry (“CONE”) or Energy and Ancillary Services offsets. In a true market, nothing is truly “out of market.”

AMP and its members, for example, retain the obligation to serve customers and, as a result of feedback and strategic direction from our members and their customers, AMP made decisions to develop four new hydroelectric facilities totaling 350 MW at an investment cost of nearly \$3 billion. Those local decisions were reached in furtherance of a power supply strategy that incorporates long-lived (80-100 year) emission-free resources, and were pursued irrespective of RPM price signals or its three-year look-ahead. AMP is not alone; each state has valid environmental, political and policy goals

⁴ *Calpine Corp., et al. v. PJM Interconnection, L.L.C.*, FERC Docket No. EL16-49-000.

⁵ The Sustainable FERC Project presented a non-exhaustive list of “subsidies” received by resources that demonstrates the pervasiveness of subsidies. The list is available at: <http://www.pjm.com/~media/committees-groups/task-forces/ccppstf/20170421/20170421-item-04-kwa2-subsidy.ashx>.

that factor in a plethora of local and state considerations beyond the ability of a mechanistic administrative construct to accommodate. Consumers and, by extension, their elected officials are the parties best positioned to assign value to externalities in resource decision making. An administrative construct that fails to accommodate those choices (because it can't) will always be "missing money."

PJM needs a resource adequacy construct that is robust enough to withstand the effect of external events without the need to adopt another set of complex rule changes in response to each event. There are alternatives to the current centralized capacity constructs that, in concert with the energy and ancillary services markets and shortage pricing, would be more resilient to external events. Simpler, more robust alternatives to RPM and centralized capacity constructs exist. AMP hopes the Commission will consider them.

One such alternative is for LSEs to satisfy most or all of their capacity needs through bilateral arrangements, in a real marketplace where willing buyers and willing sellers negotiate arrangements tailored to meet the parties' individual wants and needs (e.g., as to contract term, fuel type and resource flexibility, location on the grid, and financial terms), with a capacity auction available to satisfy any residual needs. Under such an approach, the RTO would retain its role of developing and specifying resource adequacy requirements for its footprint and Local Distribution Companies ("LDCs") of concern. Each LSE, LDC or other Relevant Electric Retail Rate Authority ("RERRA") would be responsible for securing capacity to meet its peak load obligation plus a predetermined reserve margin and would face significant penalties for failing to do so. LSEs, LDCs and RERRAs could procure resources bilaterally on a long-term portfolio basis in compliance with their respective resource adequacy requirements. The RTO could then conduct a residual auction to accommodate LSEs and supply that did not enter into long-term arrangements. This alternative has numerous advantages over current capacity constructs, including the following:

- **Fewer Moving Parts and Administrative Judgments.** Because the primary procurement construct is decentralized and bilateral, it eliminates the onerous stakeholder processes, disputes and subsequent litigation over discrete features of mandatory capacity constructs.
- **Harmonization with State and Local Public Resource Policies.** This proposal appropriately honors state and local resource portfolio and public policy choices, and does not bias market rules toward or against specific resource types.
- **Avoidance of Jurisdictional Disputes.** By appropriately involving state and local authorities in the resource adequacy, constrained zone mitigation and market power issues, this alternative sidesteps controversy over respective limits of state and federal jurisdiction in the capacity market area created by recent court decisions.
- **Flexibility for Individual States.** This proposal provides each individual state within an RTO region with the flexibility to address resource adequacy issues for its retail customers that may result from the state's prior decisions regarding retail access. An RTO-administered, centralized voluntary capacity market still would be available to satisfy residual needs.
- **Improved Product Differentiation and Resource Performance.** Bilateral

contracting and other customized arrangements to procure electric resources enables the development of tailored products and services that will meet specific needs rather than relying solely on generic, lowest common denominator-type capacity products. For example, resources with desirable characteristics, such as those with dual fuel capability or firm gas transportation contracts that allow for certainty during winter peaks, could be appropriately valued and supported without complex and costly performance penalties.

- **Choice of Business Models for Merchant Generators.** This proposal provides merchant generators and resource suppliers a choice as well: they can enter into individualized bilateral supply arrangements with LSEs, rely on sales into the residual capacity auction (and/or the energy and ancillary services markets) to obtain their revenues, or pursue any combination of these approaches.

In evaluating the viability of the bilateral contracting model, the Commission should use as its benchmark the value bilateral contracting would bring to market efficiency and reliability and its amenability to implementing varying state policies, rather than its implications for existing centralized capacity constructs. Moreover, in considering this alternative to centralized capacity constructs, the Commission should bear in mind, first, that the policy concerns that might lead LSEs, states or local regulatory bodies to favor local generation over distant generation, newer, more efficient resources over older, less efficient ones, lower-emitting resources over higher-emitting resources, *etc.*, are legitimate concerns deserving of recognition and weight, and, second, that policymakers will continue pursuing policies at the direction of their constituents. Market rules imposed by RTOs to protect administratively derived prices under centralized capacity procurement constructs should not erect barriers to meeting such policy goals. And, it bears noting, these prices, developed as they are in isolation from local consumer input, will be wrong. Capacity is not fungible and not all MWs of capacity are created equal. Consumers are in a better position to determine their value for a particular fuel or resource. Long-term contracts support legitimate public policy and should be encouraged, rather than being considered “out-of-market” subsidies. RTO market rules that effectively penalize long-term contracting and self-supply should be reformed.

As a second-tier alternative, and a minimum step to reform the capacity construct, public power systems’ unfettered ability to self-supply their own loads with their own resources at their own costs should be restored.

Finally, the consumer impacts of market reform alternatives must not be ignored. Market participants wishing to protect their economic interests dominate Commission adjudicative dockets and RTO stakeholder processes. In these fora, the interests of “load”—retail consumers and those charged with protecting them—often are drowned out by the self-interested concerns of larger and better-financed participants. It is up to the Commission to ensure that a capacity construct treats fairly the consumers that ultimately bear the costs, and does not create windfalls for those market participants with the most resources to devote to the administrative process.

AMP appreciates both the Commission’s ongoing support for the longstanding value of the public power business model and the opportunity to provide these comments. I look forward to discussing them further during the Technical Conference.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have on this date caused a copy of the foregoing document to be served on each person included on the official service list maintained for this proceeding by the Commission's Secretary, by electronic mail or such other means as a party may have requested, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010.

Dated this the 25th day of April, 2017.

/s/ Lisa G. McAlister
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