SUMMARY OF THE SUSTAINABLE MARKET RULE PROPOSAL OF THE INDEPENDENT MARKET MONITOR FOR PJM

I. INTRODUCTION

The Sustainable Market Rule (SMR) is simple, based in economic logic and does not require complex rule changes to implement. The SMR would provide a straightforward way to harmonize federal and state approaches to the provision of energy, while respecting the distinction between federal and state authority.

Under the SMR, all nonmarket resources may participate in the energy market without limits. But to ensure the reliable operation of the energy market, the capacity market needs to be the balancing mechanism for required market resources to provide the appropriate incentives for entry and exit. This balancing function requires that all capacity resources offer at competitive levels.

If resources offer at competitive levels and clear the capacity market, the resources are paid the market clearing price. If resources do not clear the capacity market, the resources are not paid for capacity. Any nonmarket revenues required to meet the public policy goals associated with these resources would be provided outside the market in whatever manner the supporters of those resources choose.

II. BASIC ELEMENTS OF SMR

A. SMR Market Design

The SMR design is simple. All capacity has a must offer requirement. All MW required for reliability are included in the capacity market demand curve (VRR curve). All cleared resources are paid the capacity market clearing price. The SMR could be implemented fully in the next Base Residual Auction and would not require a transition mechanism.

B. Definition of Competitive Offer

All resources with a must offer requirement or that wish to sell capacity are required to make competitive offers in the capacity market.

Competitive offers in the capacity market for resources with nonmarket revenues are defined to be greater than or equal to net going forward costs (ACR), and less than the offer cap. Gross ACR uses unit specific facts, or technology defaults, and net ACR uses unit specific forward looking market net energy revenue. Competitive offers for resources with only market revenues are defined to be less than the offer cap.[1]

Attempts to distinguish between the definition of competitive offers of new entrants and the competitive offers of existing resources are a mistake. A competitive offer is a competitive offer, regardless of whether the resource is new or existing. A competitive offer in the capacity market is the marginal cost of capacity, or net ACR, regardless of whether the resource is planned or existing. ACR includes incremental capital expenditures, termed APIR.

Use of higher offers for new resources based on the full cost of entry, as proposed by PJM, would constitute a noncompetitive barrier to entry and would create a noneconomic bias in favor of existing resources and against new resources of all types, including new renewable resources and new gas fired combined cycles.

Use of higher offers for new renewable resources creates an issue because most such artificially higher offers are unlikely to clear in the market and would be categorized as subsidized. That would mean, under the PJM resource carve out approach, new renewable resources 20 MW or greater are offered at zero price, receive no PJM capacity payments,

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[1] The MW offered must meet the requirements of the capacity market design. For example, renewable capacity resources must have an accurate definition of capacity based on locational resource specific performance coincident with relevant peak loads rather than using generic discount factors.

and final market clearing would require the other convoluted mechanics of that approach including payment of opportunity costs to units with no capacity obligation.

C. Definition of Nonmarket Revenue

The SMR defines nonmarket revenue for a resource as all revenue not received under a tariff regulated by the Commission, i.e. PJM market revenues. The SMR proposed definition of nonmarket revenues is broad and therefore not discriminatory. The definition is based directly on the definition in the PJM tariff prior to the remand order in the NRG case and adds cost of service regulation. The proposed definition of nonmarket revenues excludes only nonmarket revenues generally available under federal programs.

Specifically, the proposed definition of nonmarket revenue is:

> Formal or informal agreements or arrangements to seek, recover, accept or receive any (1) material payments, concessions, rebates, or subsidies directly or indirectly from any governmental entity connected to the construction, development, operation, or clearing in any RPM Auction, of the Capacity Resource, that are not received under a tariff regulated by the Commission and administered by PJM, (2) other material support or payments obtained in any state-sponsored or state-mandated processes, connected to the construction, development, operation, or clearing in any RPM Auction, of the Capacity Resource, or (3) revenue attributable to the inclusion of costs of the resource in an LSE's retail rates. Nonmarket revenue shall not include federal government production tax credits, investment tax credits, and similar tax advantages or incentives that are available to generators without regard to the technology, fuel type, or geographic location of the generation.

D. Existing FRR Design

The existing FRR approach remains an option for utilities with revenues based on cost of service rates, including both privately and publicly owned (including public power entities and electric cooperatives) utilities. Such utilities have had and continue to have the ability to opt out of the capacity market and provide their own capacity. There is no reason for any special exemptions for such utilities.

III. IMPACT OF SMR MARKET DESIGN

The expected impact of the SMR design on the offers and clearing of renewable resources would be from zero to insignificant. The competitive offers of renewables, based on the net ACR of current technologies, are likely to clear in the capacity market.

The expected impact of the SMR design on the offers and clearing of nuclear plants would be from zero to insignificant. The competitive offers of nuclear plants, based on net ACR, are likely to clear in the capacity market.

The expected impact of the SMR design on the offers and clearing of cost of service resources would be from zero to insignificant. The competitive offers of these resources, based on net ACR, are likely to clear in the capacity market. In addition, cost of service resources have the option of using the existing FRR rules, which would retain their existing status.

Allowing competitive renewable offers, competitive nuclear offers and competitive cost of service offers to clear in the market would have essentially the same impact as carving out such resources using a resource specific FRR but without the need for complex federal and state rules.

The Commission has observed and accepted (at P 159) that "some ratepayers may be obligated to pay for capacity both through the state programs providing out-of-market support and through the capacity market."

Market and nonmarket resources that do not clear the capacity market based on their competitive offers are not paid a capacity price, do not contribute to meeting PJM's reliability requirements, and are not given any special treatment in the wholesale power market. Any revenues required to sustain such resources would come from the energy and ancillary services markets and from nonmarket sources. Nonmarket resources that do not clear the capacity market would be eligible to receive bonus payments under the capacity performance design for performance during performance assessment intervals, similar to energy only resources.