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DATE: September 17, 2019
TO: PJM Market Participants
FROM: Independent Market Monitor for PJM
SUBJECT: Grid Strategies Report

Grid Strategies published a report, “Consumer Impacts of FERC Interference with State Policies,” on August 26, 2019, that relies on analysis by the Independent Market Monitor for PJM (IMM) to draw broad and incorrect conclusions about the impacts of a forthcoming FERC ruling on capacity markets.¹ The IMM analysis does not support the claim that modifications of the capacity market rules will result in large increases in capacity market prices. The IMM analysis does demonstrate the negative impact of specific proposals to modify the capacity market rules. The IMM agrees with Grid Strategies that those specific proposals should be rejected. The IMM has repeatedly demonstrated that the PJM markets are working effectively to provide power to customers at the lowest possible price. The IMM agrees that any FERC modification to the capacity market rules should continue to result in competitive prices.

FERC is not interfering with state policies. FERC is properly focusing on drawing the appropriate jurisdictional line between wholesale power markets and state authority. Grid Strategies incorrectly asserts that any FERC action related to this jurisdictional line will necessarily significantly increase capacity market prices. FERC can modify the capacity market rules to protect competitive capacity markets without imposing price increases on customers.

The quantitative analysis in the Grid Strategies report focuses primarily on the IMM’s analysis of PJM’s extended resource carve out proposal (RCO) to modify the capacity market. The Grid Strategies report conflates the RCO proposal with all proposals to modify PJM capacity market rules. The IMM agrees that the RCO proposal is badly designed and would result in substantial and inappropriate price increases to customers in the PJM capacity market. The RCO proposal was rejected in its earlier repricing proposal form by the Commission and should be rejected again.

The IMM report shows that the impact of the PJM RCO proposal, if all units at risk of retirement were subsidized to remain in the market, would be an \$8.4 billion increase (90.8

¹ Grid Strategies LLC, “Consumer Impacts of FERC Interference with State Policies: An Analysis of the PJM Region,” August 2019 <<https://gridprogress.files.wordpress.com/2019/08/consumer-impacts-of-ferc-interference-with-state-policies-an-analysis-of-the-pjm-region.pdf>>.

percent), almost a doubling, in capacity market payments. If only half the units at risk of retirement were subsidized, the increase would be \$1.6 billion (17.4 percent).² The increases would be even greater to the extent that there were significant offers of new renewable resources. Such increases are not appropriate and not consistent with an efficient and competitive market outcome.

The Grid Strategies report fails to note that the IMM report also concludes that the Commission's suggested resource specific FRR approach would inappropriately and significantly suppress capacity market prices.³ The goal of market design should be competitive markets and not arbitrary increases or decreases in capacity market prices compared to the competitive level.

The Grid Strategies report fails to identify a preferable path forward other than vague references to bilateral purchases. The capacity market was introduced in PJM at the request of the Pennsylvania Public Utility Commission to protect small retail power suppliers from the exercise of market power in bilateral contracts by the companies that owned capacity. Seller side market power continues to be endemic in PJM capacity markets but it is explicitly addressed by market power mitigation rules which would not apply in a bilateral market design. The ability to engage in bilateral transactions is enhanced in markets with a transparent and competitive price signal.

The Grid Strategies report fails to address the IMM's proposed Sustainable Market Rule (SMR) approach which would permit the Commission to draw the appropriate jurisdictional line between wholesale power markets and state authority, maintain the competitive wholesale PJM power markets that have resulted in substantial cost savings to customers, respect state authority related to generation and not result in price increases to customers.⁴

The SMR approach 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. Unlike the PJM approach, the SMR does not require new renewable resources to offer at artificially high prices. Use of higher offers for new resources based on the full capital cost of entry, as proposed by PJM, would constitute a noncompetitive barrier to entry and would create an uneconomic bias in favor of existing resources and against new resources of all types, including new renewable resources and new gas fired

² Id. at Table 15 and Table 17.

³ "MOPR/FRR Sensitivity Analyses of the 2021/2022 RPM Base Residual Auction," Monitoring Analytics, (September 26, 2018) <http://www.monitoringanalytics.com/reports/Reports/2018/IMM_MOPR_FRR_Sensitivity_Analyses_Report_20180926.pdf>.

⁴ "Summary of the Sustainable Market Rule Proposal of the Independent Market Monitor for PJM," (October 31, 2018) <http://www.monitoringanalytics.com/Filings/2018/IMM_Summary_of_Position_Docket_No_EL18-178_ER18-1314_EL16-49.pdf>

combined cycles. Unlike the PJM approach, the SMR recognizes that 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.

In marked contrast to the PJM approach and to the unit specific FRR approach, 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 expected to clear in the capacity market.

The essential point in the discussions about the capacity market design is that the PJM competitive markets have worked since 1999 to provide reliable and low cost power to customers in all states across the PJM footprint. PJM markets overall and the PJM capacity market specifically have worked and can continue to work in harmony with state initiatives to support renewable energy. The PJM market design has brought significant benefits to participants and the fundamental design of PJM markets is sustainable. There is no reason to overturn the key components of the PJM capacity and energy markets. There is no reason to create convoluted capacity market rules to exclude any competitive offer from any technology including renewable and nuclear technologies. There is no reason to artificially increase energy prices to benefit uneconomic nuclear and coal plants. Markets are preferred to the integrated resource planning approach that some would reimpose because markets provide technology neutral incentives to all market participants, including those who will introduce technologies not yet in existence. Markets are the most efficient and effective way to integrate renewable technologies. Markets continue to provide the most efficient way to organize the production of power at the lowest possible cost.