

## **Self-Supply Issues in ISO/RTO Capacity Markets Should Be Left to FERC**

The American Public Power Association (APPA) seeks rifle shot legislative language as part of the pending energy bills under the guise of “capacity choice.” Regardless of various business and regulatory models across the country, all electricity systems must procure capacity to ensure sufficient resources are available to deliver electric energy in the future. Several RTO/ISO regions (New England, New York and PJM) independently administer and monitor centralized capacity markets under rules approved by the Federal Energy Regulatory Commission (FERC) for each RTO/ISO. These transparent mechanisms are critical to reliability at a time when capacity is increasingly important due to plant retirements and a changing resource mix. Regional power grids are intricately interconnected physically and financially (all plants are dispatched by the grid operator). Granting some market participants (public power) a statutory right to cherry pick and toggle between self-supply and market purchases distorts market results on which remaining resources depend. Thus, the multi-faceted issues around self-supply in each RTO/ISO are best left to the flexibility of the open stakeholder processes and regulatory review at FERC which allow regional concerns and issues to be considered. EPSA opposes categorical preferences for one subset of market participants in legislation. EPSA’s concerns are shared by independent experts such as grid operators and market monitors based on past FERC proceedings. Finally, the “capacity choice” legislation APPA seeks actually extends well beyond self-supply to hamstringing FERC’s ability to address broader capacity market and resource adequacy issues as they arise in the future. Below are responses to an APPA Q&A dated July 8, 2015, that focused only on PJM. Each RTO/ISO with a capacity market should have its own self-supply rules.

**1. Does the current design of PJM’s Reliability Pricing Model (“RPM”) allow public power utilities to self-supply capacity through the Fixed Resource Requirement option?**

Yes, the current design of RPM includes a Fixed Resource Requirement (“FRR”) option that allows all load serving entities with separate metering – including public power entities – to “opt-out” of RPM and to meet their resource requirements through alternate means. APPA acknowledges this option but claims it is not a reasonable approach because “the FRR does not allow for any incremental purchases from the capacity market. As a result, the FRR option is only viable for an LSE that is net long on resources.”

APPA’s carefully-worded allegation about the availability of “capacity market” purchases is technically correct but is misleading and ultimately irrelevant. It is true that an FRR entity cannot make purchases directly through the “capacity market” that is administered by PJM. To allow that would skew the outcomes of RPM auctions and hurt other consumers. The FRR option, however, *does* allow purchases through bilateral transactions from capacity resources located in regions that participate in RPM. Public power entities thus have the ability to rely upon the resources they own to the extent they cover their obligations and then to purchase from other suppliers to meet the remainder of their obligations.

**2. Is the current exemption for self-supply under the PJM tariff sufficient to allow self-supply resources to clear in Reliability Pricing Model?**

There have been three annual capacity auctions since the current PJM rules for new self-supply were approved by FERC. PJM data confirms that all of the self-supply resources that sought to participate were allowed to do so and cleared the auction. Thus, the current self-supply rules have not blocked a single megawatt of new self-supply notwithstanding APPA's procedural point that the FERC orders approving the PJM self-supply rules remain subject to rehearing. APPA acknowledges that PJM's RPM has an exemption for new self-supply provided certain criteria are met. These criteria were properly established through an extensive stakeholder process that considered and carefully balanced all of the regional concerns and that resulted in an impressively high 89% stakeholder approval rate (all of which was ultimately reviewed and approved by FERC). Part of this careful balancing establishes self-supply at levels that ensure that self-supply entities lack significant incentives to exercise "buyer-side" market power that could distort clearing prices. Addressing "buyer-side" market power is as important as addressing "supply-side" market power to produce competitive results. The better course of action is to continue to defer to the regional rule development process followed by FERC review to ensure balanced results.

**3. What about APPA's claim that the self-supply legislation would not "provide public power with an unfair advantage to clear excess capacity in the market"?**

APPA claims that "the language [in its proposed legislation] is directed at allowing an LSE [Load Serving Entity] to be able to use its resources to meet its capacity requirement—not to be able to sell excess capacity." A main concern about allowing public power entities to have the unfettered ability to build new resources and sell them into the market is that they may attempt to suppress capacity market prices for all other resources, which would harm reliability. Thus, for example, a public power entity with no current capacity resources could employ a cost-saving strategy of building a new power plant that would only meet a relatively small share of its load (and take a loss on the construction) because it would save much more by purchasing the remainder of its capacity requirements in a price-suppressed capacity market. In this case, it is irrelevant as to the likely adverse impact on the rest of the market that the public power entity is not "sell[ing] excess capacity." More broadly, recent energy price trends and market dynamics belie the notion that it would be more economical to self-build new generation rather than purchase power supply from the market; it would be less costly to purchase from the market at lower risk than self-build a new power plant. This remains true in light of performance-based changes to some centralized capacity markets, as recent capacity auctions based on those revisions have resulted in prices below the cost of new entry.

**4. Is APPA correct that "public power utilities [could not] somehow profit from their ability to self-supply (say, from a differential in bid versus clearing price)"?**

APPA claims that public power entities could not "somehow profit" from the proposed legislation because "any self-supply capacity bid into the market that is owned by an LSE would be matched by the LSE's capacity obligation and the transaction would net to zero." But this ignores the potential for a public power entity to construct a new unit ostensibly for self-supply but actually to suppress prices on which investments by others for reliability depend. Public power entities could realize net gains if the loss on constructing the new unit was exceeded by the advantage it could realize by satisfying the remainder of its obligations at a suppressed price level.