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# FERC Orders PJM Capacity-Market Reforms, Addresses Uncertainty, Allows Auctions to Resume

20 December 2019

On Thursday, December 19, 2019, the Federal Energy Regulatory Commission ("FERC") issued long-awaited guidance on the rules for the PJM Interconnection, L.L.C. ("PJM") capacity market.[1] The order addresses multiple pending FERC proceedings spanning nearly four years and has the potential to impact billions of dollars in costs and revenues for market participants and investors in the nation's largest electric market.

The order lays a foundation for delayed PJM capacity auctions to resume with fixes for the problematic capacity price distortions FERC identified in a June 2018 order, but it also sets the stage for potential rehearing and subsequent litigation. PJM must now take action to comply with FERC's directives within 90 days, including providing a timeline within which it will hold its delayed Base Residual Auction ("BRA") for the 2022/2023 Delivery Year (June 1, 2022 through May 31, 2023), originally scheduled to occur in April 2019, and to prepare for upcoming incremental auctions, while also gearing up for the 2023/2024 BRA originally scheduled for April 2020.

## Key Elements of FERC's Order

FERC has directed PJM to adopt multiple changes. Key elements of the order include:

- Adoption of an expanded Minimum Offer Price Rule ("MOPR," a construct that prevents new capacity-market sellers from depressing prices by offering at reduced prices for the purpose of clearing a capacity auction) that will apply, on a going-forward basis, to any resource that receives, or is entitled to receive, a state-level subsidy, unless that resource can qualify for certain exemptions;

- Application of the MOPR to resources that load-serving entities use for self-supply; and
- Exemptions from the MOPR for certain state-subsidized resources, including (a) existing renewable resources participating in state renewable portfolio standard ("RPS") programs; (b) existing demand-response, energy efficiency or storage resources; (c) existing self-supply resources; and (d) competitive resources that do not receive state subsidies.

Taken together, these requirements are likely to subject an increasing number of new resources, particularly new renewable and low- or zero-carbon resources, to the MOPR, while offering unsubsidized, existing resources capacity-market prices that are not subject to suppression as a result of state subsidies.

The order rejects multiple alternatives proposed by PJM and others and grants relief similar to the action sought in the original complaint, filed in March 2016 by a group of merchant electric generators in FERC Docket No. EL16-49. Their complaint alleged that the MOPR was unjust and unreasonable because it failed to address the price-suppressing impact of state-mandated payments for certain existing generation resources in Ohio to support non-economic coal and nuclear power facilities which had become uncompetitive as a result of low-priced natural gas-fired generation.

## Changes to the PJM Base Residual Auction

The changes to the PJM capacity auction directed in the order are likely to have significant impacts on several classes of electricity market participants. First, for owners of existing resources that sell into the PJM capacity market and do not receive state subsidies, FERC's order touts a "level playing field," which could increase projected capacity revenues. FERC's "grandfathering" approach for existing subsidized resources, on the other hand, should put owners and operators of such resources into roughly the same position as unsubsidized resources.

For existing resources that already receive state subsidies but do not qualify for one of the "grandfathering" exemptions (this includes nuclear resources that receive revenues from state-mandated zero-emissions credits), the impact of the FERC order will depend on whether each such resource is able to clear in the capacity auctions going forward and the price at which it may clear.

Similarly, for planned, development-stage resources that are likely to be subsidized and have not yet reached identified milestones, or for owners of resources that expect future state subsidies, the order may have negative implications insofar as they may become subject to the MOPR, and could therefore fail to clear future PJM capacity auctions. It is not yet certain, however, how new capacity-auction price levels will compare to past market-clearing prices, so the effect of the new MOPR is not certain.

Finally, for entities that serve load and own generation, and that previously relied on the ability to supply their own capacity needs, the order will introduce new uncertainty, as their new resources will become subject to the MOPR, making it unclear whether, or to what extent, they will be able to continue earning revenue from PJM's capacity market. Load-serving entities may, however, elect to use the existing Fixed Resource Requirement approach, which was left unchanged by the order.

## Details of Implementation Will Be Important

The order creates a new definition of state subsidy, for use in PJM's capacity auction:

> "A direct or indirect payment, concession, rebate, subsidy, non-bypassable consumer charge, or other financial benefit that is (1) a result of any action, mandated process, or sponsored process of a state government, a political subdivision or agency of a state, or an electric cooperative formed pursuant to state law, and that (2) is derived from or connected to the procurement of (a) electricity or electric generation capacity sold at wholesale in interstate commerce, or (b) an attribute of the generation process for electricity or electric generation capacity sold at wholesale in interstate commerce, or (3) will support the construction, development, or operation of a new or existing capacity resource, or (4) could have the effect of allowing a resource to clear in any PJM capacity auction."

2019 MOPR Order at ¶ 67. This definition significantly expands the potential application of the MOPR. The practical effects, however, will begin to become clearer in 90 days, when PJM makes its compliance filing with the details of implementation. That compliance filing also must address default offer-price floors for all resource types, which should provide additional insight into the potential for the MOPR to result in subsidized-resource bids that fail to clear the market.

We also will learn more as PJM prepares for the first auction under the new rules, applying the new definition of a state subsidy to determine which resources are price-limited by the MOPR and which resources will qualify for exemptions. Even then, it is difficult to predict the true price impact for different sectors of the capacity market until these steps occur and PJM conducts the delayed 2022/2023 BRA, follow-on incremental auctions, and the subsequent 2023/2024 BRA.

## Multiple Proceedings Culminate in December 19 Order

On June 29, 2018 (in Docket Nos. ER18-1314 and EL16-49), FERC determined that the existing MOPR failed to mitigate price distortions caused by out-of-market payments — which by that time had expanded to include so-called "zero-emissions credits" and other environmentally motivated prices supports for certain generation resources, such as RPS — to: (i) new capacity-market entrants not fueled by natural gas, and (ii) existing capacity resources of any type[2]. The June 2018 order initiated an investigation and paper hearing (in Docket No. EL18-178).

The June 2018 order also rejected two interim proposals from PJM to address the price-suppressive impacts of state-level subsidies, including a "Capacity Repricing" construct, which would have modified capacity auctions (including the BRA and incremental auctions, both of which are components of PJM's capacity market), to include a two-stage annual auction, with capacity commitments determined in stage one and capacity clearing prices set in stage two, and a "MOPR-Ex" proposal, in which PJM had proposed to expand the MOPR to apply to offers from some (but not all) state-subsidized resources, both new and existing. Despite its prior determination rejecting MOPR-Ex, FERC's Thursday order points to the MOPR-Ex as analogous to the approach FERC has now adopted.

In response to the June 2018 order, FERC received more than 900 filings from interested entities. PJM submitted a two-part proposal, which was not adopted in the December 19, 2019, order, to implement an "Expanded MOPR" with a "Resource Carve-Out" ("RCO") for load, plus an optional "Extended" RCO under which PJM would make adjustments to capacity auction prices in response to price effects of the RCO.

The 2019 MOPR Order leaves unaddressed a subsequent complaint from three merchant generators (in Docket No. EL18-169), which contained an additional alternative called the "Clean MOPR," which would have applied to all new and existing state or federally subsidized resources. The order also does not address a pending complaint filed by PJM's Independent Market Monitor (in Docket No. EL19-47), which also sought capacity-market reforms to mitigate the potential for entities to exercise market power, and which could subject an increasing number of participants to reviews of unit-specific offers.

## Delayed 2022/2023 and 2023/2024 Capacity Auctions

FERC most recently took action with respect to the PJM capacity market in July 2019, when it ordered PJM to postpone the 2022/2023 BRA (and any subsequent incremental auction or BRA) until FERC could provide a just and reasonable approach. According to FERC, the delay avoided the threat of a market rerun or resetting of prices or capacity awards. In its compliance filing, PJM must propose a schedule for these auctions.

## Strong Dissent Highlights Potential Vulnerabilities

Commissioner Richard Glick expressed sharp disagreement with the majority decision in a dissent. Commissioner Glick argues, among other things, that the order removes the ability for states to exercise authority reserved to them under the Federal Power Act to make decisions with respect to generation resources, threatens organized energy markets, and is not truly pro-competition because it will provide advantages for existing, largely thermal resources over new, cleaner and predominantly renewable resources. He also stated that costs for consumers will rise as a result of the December 19 order, which he characterized as a "multi-billion-dollar-per-year rate hike," and a "bailout, plain and simple." 2019 MOPR Order, Commissioner Glick dissenting, at ¶ 3.

## Next Steps

FERC's order represents a significant step to relieve the long-standing uncertainty for PJM market participants, creating a template for PJM to resume capacity auctions, and lending some predictability for investment and development decisions going forward. Given the high level of activity in the underlying dockets, however, multiple parties are expected to file requests for rehearing and clarification of the order (due January 20, 2020) and may also challenge PJM's compliance filing (due March 18, 2020). Thus, a final resolution may still be many months or even years away, subject to continued challenge and litigation.

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1. *Calpine Corp. v. FERC*, 169 FERC ¶ 61,239 (2019) ("2019 MOPR Order").↩

2. *Calpine Corp. v. FERC*, 163 FERC ¶ 61,236 (2018).↩

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