

American Municipal Power

Proposal to the Capacity Construct/Public Power Senior Task Force

Executive Summary

I. Introduction

The genesis of the AMP proposal was in part due to AMP's strong belief that any "solution" developed in response to state public policy initiatives should be developed with the input of PJM stakeholders. AMP, and other PJM stakeholders were concerned about PJM's direction and offered a problem statement and issue charge to bring the debate into the PJM stakeholder process.

Many stakeholders were reluctant to take up this effort. Over a six month period, AMP representatives appeared five separate times before the PJM Markets and Reliability Committee ("MRC") and facilitated the discussion as the stakeholders sought to define the problem and limit the universe of solutions.

This background is important to understand as AMP wants it be crystal clear that AMP did not necessarily perceive a problem but instead reacted to PJM's comment at the August 2016 Grid 20/20 meeting that they would not be seeking stakeholder input on their "capacity re-pricing" proposal. The "capacity re-pricing" proposal is fraught with market design errors and having a robust stakeholder process with input from a diverse set of Members from all of the PJM sectors could lead to a better solution than that developed unilaterally by PJM.

II. AMP's Perspective

AMP's concern over PJM's administrative resource adequacy construct is well documented. The proposed actions of FirstEnergy and AEP, with approval by the Public Utility Commission of Ohio, to recover "out of market" payments from retail customers paid to their unregulated generation affiliates in an effort to keep what were described as uneconomic capacity resources, the advent of ZECs, and the general angst over states having the right and authority to make public policy decisions appears to AMP as yet another symptom of the overall inadequacy of RPM to withstand any type of exogenous actions that threaten "the market." The Department of Energy's Notice of Proposed Rulemaking is another symptom of growing dissatisfaction with wholesale market results. PJM has inadvertently fueled this perception via its 27 major design changes to RPM since 2010, some rushed through, to preserve reliability. From AMP's perspective and experience, any resource action that does not fit into the administratively determined construct is deemed a "threat" by PJM and the rules must be adjusted to protect the "market" (e.g., MOPR). Indeed MOPR has evolved from its

stated purpose (mitigate buyer-side market power) to a preferred mechanism to maintain prices administratively determined to be the “right price.”

AMP supports competitive markets. But RPM is not a market and, in our opinion is moving further away from market principles and is creating barriers to truly competitive results. While it is necessary to have some administrative construct for capacity, it need not be a barrier to consumer preferences as expressed through state and local public policies. A simpler capacity construct as proposed by AMP, along with a focused look at energy market price formation to ensure we are identifying all intrinsic value from existing units, is required.

AMP notes that the original RPM construct served to provide states an opportunity “...to resolve a projected capacity shortfall in the Delivery Year affecting that state as determined pursuant to a state evidentiary proceeding...”. The capacity construct needs to return to being a residual construct and not a primary source of revenue for supply.

With this perspective, AMP observes the following regarding state public policy decisions:

- States clearly have the right and authority to develop public policy so long as payment of funds are not conditioned on capacity clearing the auction. There are many reasons that states may grant subsidies, but the subsidies that are the focus of this stakeholder process are those that are intended to support an otherwise uneconomic merchant generator that results in an artificially low offer into the capacity construct. We need to decide what action, if any, PJM should take in response to state public policy initiatives.
- The current structure of RPM is of itself a barrier to states implementing public policy decisions:
 - PJM’s “market” is too narrow and ignores the wider, organic market around it;
 - RPM rules have become too complex (this is also a barrier to state public policy decisions);
 - A resource adequacy construct with an administratively determined price will always be overly sensitive to external influences;
 - PJM’s administratively determined price is too high and results in an oversupply of new resources when a true market would indicate there is not a need for new entry (prices are low when supply is high) and signal retirements; and,
 - The rules keep changing, at a minimum every four years (i.e., quadrennial review) and in reality much more frequently than that with 27 major rule changes to RPM since 2010.
- Resolution of the “state subsidy issue” requires not only AMP’s proposed modifications to the resource adequacy construct but also significant changes to energy price formation to provide accurate price signals based on system operational needs.

III. What is an actionable subsidy?

Before we can decide what to do in response to a subsidy, we first need to define an actionable subsidy. For the purposes of AMP's proposal we define a subsidy that would require some action (*i.e.*, "actionable") as:

Actionable Subsidies include any payments, concessions, rebates, or incentives other than Market Revenue where Market Revenue is defined as revenue that is received under a tariff administered by PJM or other RTO or ISO and regulated by the Commission but shall not include payments (including payments in lieu of taxes), concessions, rebates, subsidies or incentives:

- A. that are consistent with and part of a public power business model made to a municipal utility, a cooperative utility, a joint action agency or any instrumentality of the state;
- B. designed to incent participation in a program, contract or other arrangement that promotes general industrial development in an area;
- C. are from a county or other local governmental authority using eligibility or selection criteria designed to incent the siting of facilities in that county or locality rather than another county or locality;
- D. are from the federal government and are available to generators without regard to the geographic location of the generation (e.g., production tax credits, investment tax credits, and similar tax advantages);
- E. that are supported through any contracts obtained in any state-sponsored or state-mandated procurement processes that are deemed to be Competitive and Non-Discriminatory as described in under the requirements for a procurement process to be deemed "Competitive and Non-Discriminatory" as specified in Attachment DD, Section 5.14 h) (7) ii), which requires that the process must:
 - i. allow both new and existing resources to satisfy the requirements of the procurement;
 - ii. the requirements of the procurement are fully objective and transparent;
 - iii. the procurement terms do not restrict the type of capacity resources that may participate in and satisfy the requirements of the procurement;
 - iv. the procurement terms do not include selection criteria that could give preference to new resources; and,
 - v. the procurement terms do not use indirect means to discriminate against existing capacity, such as geographic constraints inconsistent with LDA import capabilities, unit technology or unit fuel requirements

- or unit heat-rate requirements, identity or nature of seller requirements, or requirements for new construction.;
- F. that are unknowable or unquantifiable; or
 - G. that are in exchange for a tradeable credit that both: 1) represents the environmental attributes of one megawatt hour of energy produced from a renewable energy resource as defined by a state or federal law; and 2) is not contingent on the price of energy or capacity.

IV. AMP's Proposal

A. Accommodation

AMP's proposal seeks to accommodate state policy decisions in the sense that there must be a place for these decisions in the *entire* market. AMP doesn't believe a price driven, administrative construct should reprice state decisions to maintain an artificially high price in the RPM auction. Accommodation is not modification of what has been offered. The entire market, not just the administrative residual construct, should drive the price.

B. Bilateral Contracts

The current construct allows for bilateral contracting. However, it is AMP's experience that this option is detrimentally limited by the three year forward administratively determined price available from the base residual auction and PJM's consistent attempts to artificially prop up the auction prices in the near term at the expense of a properly developed long-term price signal that is truly reflective of what investors look to for guidance. In short, AMP's view is that suppliers are reluctant to tie up resources in an oversupply situation for the long term so long as there is the possibility of more revenue as regulatory intervention continues to inflate the auction results.

AMP proposes to address this deficiency by moving to a one year versus three year forward auction, referred to as the Annual Residual Auction or "ARA" in AMP's proposal. Shortening this timeframe will enable the broader market forces to come into play for resource entry and exit decisions. It also provides the opportunity to eliminate MOPR for new entry as natural gas resources would need more than a year to develop its facility.

C. How State Actions Fit In

States would be free to offer subsidies for specific units or technologies. Several paths would be available to resource owners that are eligible for actionable subsidies: 1) the resource owner could decline the actionable subsidy and either enter into a bilateral contract or participate in the ARA; or 2) the resource owner could accept the actionable subsidy in lieu of seeking additional capacity revenue – essentially opting out of the ARA. The resource can choose only one of these options, which are described in greater detail below.

D. Annual Residual Auction (ARA)

The ARA would retain the same design as PJM's current Base Residual Auction ("BRA"), but would only be one year forward as opposed to three. Additionally, it would be comprised of those suppliers and load that did not enter into long term bilateral arrangements, load serving entities that did not choose to self-supply, or capacity resources without an actionable subsidy.

This approach would make the auction truly residual (which is what the BRA was touted as when PJM first implemented RPM in 2006). The entire and true market would drive prices and outcomes as opposed to forcing everything through the centralized auction.

The auction will occur annually, one-year ahead of time and will follow all of the rules within today's BRA such as, but not limited to:

1. Utilizing the VRR Curve
2. Utilizing existing rules for RPM bids
3. Abiding by the approved Capacity Performance rules
4. Abiding by the approved RPM rules
5. Maintaining PJM development of auction planning parameters which includes, among other things, the calculated installed reserve margin required to maintain reliability.

Additionally, moving the timing for the ARA to one year forward will allow PJM to utilize a better, and ideally more accurate, forecast of projected demand levels than is in place today. It is undebatable that the three-year forward nature of the BRA has produced an over-procurement of capacity due to load forecast error. Moving the auction closer to the start of the delivery year will help to minimize over-procurement of capacity due to load forecast error.

E. Annual Incremental Auction (AIA)

As a result of moving the timing of the ARA to one-year forward, RPM would no longer require three Incremental Auctions as we have today. Only one incremental auction would be required. AMP proposes modifying the incremental auction calendar such that the timing would be the same as the Third Incremental Auction (i.e., three months forward) that is conducted today. This auction would simply be called the Annual Incremental Auction.

F. PJM's Role

Five months before the ARA, PJM would verify the resource and load obligations for resources that accepted an actionable state subsidy and long-term bilateral contracts between resources and LSEs. PJM would also determine each LSE's peak load obligation based on the previous year's contribution to the 5 coincident peaks.

PJM would continue to calculate its installed reserve margin ("IRM") and Forecast Pool Requirement ("FPR"). Load associated with resources accepting a subsidy and not

participating in the ARA would be adjusted down to reflect the FPR. LSEs' load would be adjusted to include their peak load obligation plus FPR. The demand curve in the ARA would utilize IRM as its inflection points as done today and load utilizing the ARA would procure an amount of resources determined by the ARA clearing mechanism (possibly IRM plus 2-5%).

G. Resource Owner Options

For resource owners with no actionable subsidies, they may either enter into a bilateral contract or participate in the ARA.

For resource owners who accept an actionable subsidy, the generator is excused from participating in the ARA along with a corresponding, but reduced, amount of load accounting for the IRM. Specifically, the amount of load participating in the ARA would be reduced, on a pro-rata basis, across its footprint accounting for any internal constraints (*i.e.*, Locational Deliverability Areas). The generator would also not be eligible to enter into a bilateral contract with an LSE as the subsidy is equivalent to a bilateral contract with the state that awarded the actionable subsidy.

In order to enable and implement any actionable subsidy, the state would be required to authorize a non-bypassable retail charge that requires the regulated distribution utilities to collect the cost of the actionable subsidy from all jurisdictional retail customers, that may be filed at FERC and included as part of the PJM RAA to obtain cost recovery, as well as any credit mechanism required to allocate the actionable subsidy to the appropriate resource owner.

These options respect the rights of the states to enact public policies they deem to be in the best interests of their jurisdictional retail customers but within the limits of *Hughes v. Talen*. Should a state wish to subsidize a particular resource, it should design the subsidy as a substitute for the resource owner's capacity revenue. States would thus be able to achieve their desired resource adequacy outcomes unencumbered by the residual capacity construct rules.

These options also respect the rights and business models of both competitive generators and competitive retail electric service ("CRES") providers in retail choice states. The competitive generators have the option to seek out subsidized capacity payments that fully compensate them if they are not getting what they need from RPM. The nearer term capacity commitment (not more than one year forward as opposed to three years forward) should give CRES providers adequate time to know their capacity obligations.

H. Curtailment Service Providers

AMP's proposal has evolved over the course of the PJM stakeholder discussion. We have carefully listened to the comments raised and concerns expressed by various stakeholder groups and have modified our proposal to address these concerns whenever possible.

One area AMP is still evaluating is the impact its proposal may have on curtailment service providers (“CSPs”). We recognize there may be significant barriers to implementing load side demand response in some states. AMP expects that supply side DR will still be able to participate in the ARA and AIA. AMP will continue to discuss this issue with the CSPs to determine if transitional measures could be employed to mitigate potential impacts to this market segment until such time as retail barriers to demand response can be addressed.