
Preface to the Competitive Market Plan: 2011 Update

In February 2009, the American Public Power Association (“APPA”) released a proposal to reform the centralized markets run by Regional Transmission Organizations (“RTOs”), which it called the “Competitive Market Plan” (“CMP”). In doing so, APPA hoped to “jump-start” a dialogue among industry participants to develop much needed reforms to RTO-run markets. As APPA noted at the close of its proposal (CMP at 39):

The debate should no longer be about who can best massage the statistics or whether it is more virtuous to support “competition” or “regulation.” Instead, the industry must work together to develop a regulatory regime for electricity markets in RTO regions that will truly benefit consumers, businesses and the environment. Unless the electric utility industry and its regulators can agree on a market design and regulatory paradigm that fairly balances the interests of both load and generation, the industry will be condemned to continued upheaval.

Unfortunately, the release of APPA’s CMP did not have the effect that APPA had hoped. There was plenty of public reaction by incumbent generation owners to the plan, but it consisted primarily of mischaracterization and resultant dismissal of APPA’s proposal,¹ and claims that APPA in fact wanted to return to cost-of-service ratemaking or institute a “pay-as-bid” auction regime.² Those asset owners with financial interests in maintaining the current RTO market structure (including locational capacity markets) expended their energies on a public relations effort to discredit the CMP and APPA, rather than to use the CMP’s issuance as an opportunity to engage in an actual debate about possible RTO market reforms³.

The result has been the “continued upheaval” that APPA feared. Litigation at the Federal Energy Regulatory Commission (“FERC” or “Commission”) and in the appellate courts regarding RTO market features continues apace, as generator and load interests attempt to craft specific market rules and procedures that work best for their respective interests. This new version of the CMP updates APPA’s 2009 proposals and concerns to address several

¹ See, e.g., John D. Chandley and William W. Hogan, *Electricity Market Reform: APPA’s Journey Down The Wrong Path*, LECC, prepared for the COMPETE Coalition, April 16, 2009, <http://www.competecoalition.com/files/LECC%20study.pdf>

² For example, at page 8 of their paper, Chandley and Hogan characterize the CMP as follows: “It is not an exaggeration, therefore, to describe this approach as akin to detailed less-than-cost-of-service regulation.” APPA found these criticisms somewhat mystifying, given that the CMP retained a “single clearing price” (SCP) auction format, and expressly called for continuation of market-based rates for bilateral contracts.

³ This was in marked contrast to some limited informal feedback from the asset owner sector that APPA staff received, to the effect that the proposal, while not acceptable in its current form, was indeed a thoughtful and good faith proposal worth further discussion.

Against this backdrop of continued inadequate market oversight, are increasingly successful attempts by incumbent generation owners to develop new sources of revenue, either through changes to current market rules or through the creation of new markets – almost always over the strenuous objections of consumer and load-side representatives.

issues that have since risen to prominence in RTO markets, and raise additional concerns for public power.

Events over the past two- and- a-half years continue to illustrate the absence of adequate regulation and oversight of RTO markets by FERC. For example, APPA's and others' experiences with the development of RTO performance metrics illustrate the barriers to developing necessary measures that accurately assess the costs and benefits of wholesale electricity markets. In response to a 2008 report by the Government Accountability Office ("GAO")⁴, FERC issued a set of proposed RTO performance metrics in February 2010, developed largely in conjunction with the RTOs themselves. APPA and many others of the commenters stated that the proposed performance metrics were insufficient, primarily because they lacked essential measures of comprehensive revenue streams from wholesale markets, generator profits and accurate price-cost differentials.⁵ The final measures that FERC approved were similar to those recommended by the RTOs and did not include such key measures. The ISO/RTO Council then provided a report to FERC that was essentially a recounting of the many achievements of RTOs. Hence, the entire exercise failed to meet the original intent of the GAO's recommendation — to accurately measure the validity of such claims about market benefits.⁶

Against this backdrop of continued inadequate market oversight, are increasingly successful attempts by incumbent generation owners to develop new sources of revenue, either through changes to current market rules or through the creation of new markets – almost always over the strenuous objections of consumer and load-side representatives. Such enhancements of revenue streams, however, are being implemented absent any measures to ensure a reliable supply of power in the future to justify the payment of such revenues.

Illustrative of these types of controversies are the proposal for scarcity pricing

⁴ The GAO found that "FERC has not conducted an empirical analysis to measure whether RTOs have achieved these expected benefits or how RTOs or restructuring efforts more generally have affected consumer electricity prices, costs of production, or infrastructure investment." *Electricity Restructuring: FERC Could Take Additional Steps to Analyze Regional Transmission Organizations' Benefits and Performance*, GAO-08-987, September 2008, p.55, <http://www.gao.gov/new.items/d08987.pdf>.

⁵ Initial Comments of the American Public Power Association and the Electricity Consumers Resource Council, Docket AD10-5-000, Federal Energy Regulatory Commission, March 5, 2010, <http://www.publicpower.org/files/PDFs/APPAELCONAInitialCommentsAD105352010asfiled.pdf>

⁶ ISO/RTO Performance Metrics, Commission Staff Report, Docket No. AD10-5-000, Federal Energy Regulatory Commission, October 21, 2010, <http://www.ferc.gov/legal/staff-reports/10-21-10-rto-metrics.pdf>.

The ISO/RTO Council subsequently issued its report on the data required by the metrics. APPA's response to that report is at: <http://appanet.cms-plus.com/files/PDFs/APPAResponsetoRTOMetricsReport121310.pdf>

in PJM, the recent battles over measures to prevent state-procured new generation resources from participating in ISO New England's Forward Capacity Market ("FCM") and PJM's Reliability Pricing Model ("RPM"), and the bitter disputes in the PJM Interconnection ("PJM") regarding the specific load forecasts that PJM uses in administering its RPM.

But even more disturbing to APPA has been the reappearance of "RTO-hopping," i.e., the practice of transmission-owning utilities with affiliates that have unregulated generation units moving from one RTO to another to take advantage of more lucrative payments for their generation assets. The prime examples of this were First Energy's migration from the Midwest Independent Transmission System Operator ("MISO") to PJM, proposed in August 2009 with full integration planned for June 2011, followed by Duke Energy's June 2010 proposal to move its Ohio and Kentucky transmission and generation assets (including jointly-owned assets) from MISO to PJM, expected to be completed in January, 2012.⁷

The desire of these companies to maximize the revenues from their unregulated generation assets is certainly understandable. And FERC's decision to allow such transfers,⁸ while deeply disappointing is also at least understandable, given the terms of the contracts under which these transmission owners had previously agreed to join MISO. What APPA had not expected, however, and what it finds both profoundly anti-consumer and deeply alarming, was the attitude of the current Chairman of FERC regarding these transfers. As reported in the October 22, 2010 Energy Daily (at 3) regarding the Duke Energy transfer:

FERC Chairman Wellinghoff said there was nothing wrong with utilities switching RTOs, whether for capacity market payments or other reasons. It is healthy for utilities to evaluate "where is the most competitive RTO that provides them the best opportunity for their business models to operate," he said. And from the RTOs' perspective, he said it was a good thing "to have other RTOs realize that there may be another RTO that may have a superior structure that is attracting more utilities and that they maybe should consider changing their structure."

When the concept of "competition" in RTO regions has devolved from determining which RTO (and RTO market designs) can best harness

⁷ FirstEnergy and Duke market integration materials are available at: <http://www.pjm.com/markets-and-operations/market-integration.aspx>

⁸ Order Addressing RTO Realignment Request and Complaint, Dockets ER09-1589-000 and EL10-6-000, 129 FERC ¶ 61,249 (December 17, 2009); and Order Addressing RTO Realignment Request, Request, Dockets ER10-1562-000 and ER10-2254-000, 133 FERC ¶ 61,058 (October 21, 2010).

competition to deliver just and reasonable prices to consumers (as the Federal Power Act (“FPA”) requires)⁹ to which RTO can offer generation asset owners the most dollars to join their organization, something is badly amiss. FERC regulation of RTOs under the FPA has reached the point where, when the GAO criticized FERC for not sufficiently evaluating and assessing RTO market performance, FERC turned to the RTOs themselves to design “metrics” to measure their own performance, and then adopted those metrics with very few changes,¹⁰ as described above.

Predictably, this lack of evenhandedness in balancing the interests of generation and load in the design of RTO markets, the application of RTO market rules, and FERC oversight of RTO markets and activities, has resulted in consternation and restiveness among load side interests. This has been seen most recently and clearly in the ongoing events in Maryland and New Jersey, two states in PJM that have been required to pay high rates in PJM’s RPM capacity auctions. Both states are located in transmission-constrained areas of the PJM footprint. New Jersey Governor Chris Christie signed legislation in January, 2011 providing for a “self help” remedy in the form of mandated bilateral generation contract procurements for the utilities that provide default retail power supply service in New Jersey, to “anchor” the construction of new generation capacity.¹¹ The Maryland Public Service Commission issued a draft RFP for long-term contracts and indicated that it is strongly considering implementing a measure similar to New Jersey’s.¹² Because a key component of these states’ plans is to bid the resulting new generation into PJM’s capacity market auctions, thus potentially lowering the price, owners of existing generation in PJM (PJM Power Providers or “P3”) filed a complaint with FERC aimed at preventing new generators with bilateral contracts from seeking to lower capacity prices.¹³ Following a drop in prices in the New England capacity market,

⁹ 16 U.S.C. §§ 824d and 824e.

¹⁰ Notice Requesting Comments on RTO/ISO Performance Metrics, Docket AD10-5-000, 75 Fed. Reg. 7,581 (February 22, 2010); Initial Comments of the American Public Power Association and the Electricity Consumers Resource Council, Docket AD10-5-000, Federal Energy Regulatory Commission, March 5, 2010 <http://www.publicpower.org/files/PDFs/APPAELCONInitialcommentsAD105352010asfiled.pdf>; and ISO/RTO Performance Metrics, Commission Staff Report.

¹¹ New Jersey P.L.2011, Chapter 9, Senate, No. 2381, §§1,3,4 - C.48:3-98.2 to 48:3-98.4 §5 - C.48:3-60.1, http://www.njleg.state.nj.us/2010/Bills/AL11/9_.PDF

¹² Notice of Comment Period on Request for Proposals for New Generating Facilities , Case No. 9214, Maryland Public Service Commission, December 29, 2010, http://webapp.psc.state.md.us/Intranet/Casenum/NewIndex3_VOpenFile.cfm?ServerFilePath=C:\Casenum\9200-9299\9214\34.pdf

¹³ Complaint and Request for Clarification Requesting Fast Track Processing, PJM Power Providers Group, Docket EL-20-000, Federal Energy Regulatory Commission, February 1, 2011, <http://www.p3powergroup.com/siteFiles/News/BA60285E201B5659BBD906367C86FBC9.pdf>

the New England generators filed a similar complaint seeking to mitigate the effects of Connecticut’s or other states’ bidding of procured generation as a price taker (referred to as “out-of-market resources”).¹⁴

In response to these complaints both RTOs proposed changes in their respective capacity markets. In April 2011, FERC approved changes to PJM’s RPM that would make it very difficult for new natural gas-fired resources contracted for outside of RPM— such as resources obtained under a state procurement program like New Jersey’s or by a municipal utility for self-supply— to bid into the auctions at zero.¹⁵ Without the option to bid into an auction at zero, these resources now face the danger that they would not clear the auction, thus potentially endangering their construction. In New England’s FCM market, FERC also approved the ISO’s development of a minimum price requirement for bids from new resources into the capacity market¹⁶, which will likely have an similar effect similar to the approved RPM rule change.

APPA notes that these state actions are consistent with APPA’s recommendation in the first edition of the CMP (at 17) that “state public service commissions establish competitive power supply procurement processes to develop diversified resource portfolios for incumbent [investor-owned utility load-serving entities], with a significant portion of their power supplies being obtained under longer-term contracts or owned-generation arrangements.” APPA noted that such measures could “provide much needed price discipline in RTO-run centralized markets.” *Id.* The Commission’s recent rulings, however, seem to ensure that states will not have the necessary tools at their disposal to assure reasonable rates for electric power supply to their own citizens.

The frustration in Maryland, New Jersey and other states (such as Connecticut) stems from a basic flaw in RTO-run centralized markets — they do not sufficiently support new generation investment but instead overcompensate existing generators. While those supporting locational capacity markets claimed to regulators and load-side interests that such markets would send “price signals” to generators as to where to invest in new generation, there has been no demonstrated relationship between prices and investments in new resources.¹⁷ Instead, consumers have paid

¹⁴ Motion to Intervene and Protest of the New England Power Generators Association, Docket ER10-787-000, Federal Energy Regulatory Commission, March 15, 2010, <http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=12292579>

¹⁵ Order Accepting Proposed Tariff Revisions, Subject To Conditions, And Addressing Related Complaint, 135 FERC ¶ 61,022 (April 12, 2011), <http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=12617771>

¹⁶ Order On Paper Hearing And Order On Rehearing, 135 FERC ¶ 61,029 (April 13, 2011), http://elibrary.ferc.gov/idmws/File_list.asp?document_id=13909713

literally billions of dollars through these markets to incumbent generators with existing units. While it is true that these markets have supported development of new demand response resources, and existing generation that might have otherwise retired has stayed on line, it is questionable whether these benefits justify the very high associated costs.

The failure of RTO-run centralized locational capacity markets to support substantial new generation investment leads directly to the most important reason why the industry now needs to engage in the “rational debate” on the design of RTO markets that APPA had hoped to spur in 2009 — the likely retirement of a substantial portion of the nation’s coal-fired electric generation fleet in the next several years. The Environmental Protection Agency (“EPA”) is currently planning to issue a panoply of new and revised regulations in the 2010-20 time frame, dealing with everything from NO_x, SO₂ and mercury emissions to power plants’ continued use of once-through cooling, to storage and disposal of coal ash. The cumulative effect of these new regulations will likely make a substantial number of existing coal-fired generation units uneconomic to operate in the future. There are many estimates of the plant closures likely to occur, ranging from 30 to 70 gigawatts (GW) of coal generation within the next ten years, with most estimates trending towards the higher end of this range.¹⁸

RTO regions currently have excess generation capacity, due to the impacts of the recession and the payments made to keep existing generation units (some of them old and inefficient) in operation. But this situation could well change quickly once demand begins to increase if the recession eases, and as generation unit owners assess their units’ continued economic viability in

¹⁷ Despite the payment of \$42 billion in the first seven auctions, actual new generation net of deactivations and retirements, has equaled just 0.5 percent of the total generation that has cleared the market and 3 percent of the average cleared in each auction. Moreover, a recent analysis shows that high prices within the constrained zones within PJM’s Reliability Pricing Model have not incented greater levels of new generation clearing the RPM auctions or existing plant upgrades, demand response, energy efficiency resources, and net imports offered in constrained zones. See Direct Testimony of James F. Wilson in Support of First Brief of the Joint Filing Supporters, Docket ER10-787, Federal Energy Regulatory Commission, July 1, 2010, Section V, http://www.wilsonenec.com/FCM_Testimony_July_1.php

¹⁸ Studies of projected coal plant closures have been undertaken by: The North American Electric Reliability Corporation (10 - 35 GW of coal and 40 - 70 GW of all capacity by 2018), 2010 Special Reliability Scenario Assessment, October, 2010, Table IV-6, http://www.nerc.com/files/EPA_Scenario_Final.pdf; Credit Suisse Equity Research (60 GW of coal capacity between 2013 and 2017), Growth From Subtraction: Impact of EPA Rules on Power Markets, September 23, 2010, [http://op.bna.com/env.nsf/id/jstn-8actja/\\$File/suisse.pdf](http://op.bna.com/env.nsf/id/jstn-8actja/$File/suisse.pdf); The Brattle Group (50 – 66 GW of coal capacity by 2020), Potential Coal Plant Retirements Under Emerging Environmental Regulations, December 8, 2010, http://www.brattle.com/_documents/UploadLibrary/Upload898.pdf, and FBR Capital (30 – 70 GW in the next few years), EPA regs may shut 70,000 MW of U.S. coal plants: FBR, Reuters, December 13, 2010 <http://www.reuters.com/article/2010/12/13/us-utilities-epa-coal-idUSTRE6BC3JN20101213>

light of these new EPA regulations. The industry and its regulators need to start considering now how best to manage the transition to new, more efficient and cleaner generation. Current RTO locational capacity markets, with their relatively short (3-5 year) payout periods, simply cannot support the required new generation investment. Something will have to give, and relatively soon.

In short, APPA believes it is now even more important than it was in 2009 that the industry begins the honest dialogue among its participants in RTO regions that will be needed to manage this transition to a lower-carbon generation future. APPA is therefore updating and re-releasing its CMP as its contribution to the debate. It urges other sectors of the industry to see this as a new opportunity to discuss the huge challenge before all of us, rather than to continue the partisan battles now taking place in RTO stakeholder processes and Commission proceedings. Such a result would be the triumph of hope over APPA's past experience with its release of the first version of the CMP, but hope survives nonetheless.