State Efforts to Protect their Consumers from PJM's Capacity Market

How the Largest Owners of Old Power Plants are Seeking to Trump States Rights, Prevent Competition and Protect their High Earnings at the Expense of Consumers

What is a capacity market?

A capacity market is a centralized market that provides revenue for electricity generators to stand ready to supply power when needed. An adequate supply of capacity is necessary to ensure a reliable supply of power. Capacity payments are intended to cover power plants' fixed construction costs not recovered through the energy and other markets.

In many regions of the country, capacity costs are recovered through bilateral contracts, procured and negotiated through competitive processes. Centralized capacity markets are instead operated by large bureaucratic, quasi-governmental entities, known as regional transmission organizations (RTOs). Falsely termed "competitive markets," these markets are centrally administered in accordance with thousands of pages of complex rules. Transactions in these markets are opaque with little data available to the public. Wholesale electricity markets are regulated by the Federal Energy Regulatory Commission (FERC.)

This fact sheet is focused on the capacity market operated by the PJM Interconnection, which covers all or part of 13 Mid-Atlantic States, including New Jersey, Maryland, Pennsylvania, Ohio and Virginia, an area that is home to about 51 million residents.

How does the capacity market in the PJM Interconnection work?

PJM's capacity market, the Reliability Pricing Model (RPM), determines prices through periodic auctions that procure power three years in advance of when it is needed. These auctions pay a single price to all generators in a single year, a mechanism that inevitably produces windfalls for the older, largely depreciated generation units.

Although the goal of the RPM is to incent the development of new power plants where they are the most needed, this has not occurred. A total of $42 billion has been spent to procure capacity through RPM. Of this total, just 0.5 resulted in net increases in generation capacity.

Why have these high prices not led to the development of new generation?

While the generation owners assert that RPM prices are just "too low" to incent new generation, this claim has not been substantiated. As numerous lenders have attested, long-term contracts with stable pricing are fundamental prerequisites for obtaining financing for new power plants.

The capacity markets are instead providing a stream of revenue to older generators, and not providing an entry into the electricity market for new, innovative, cleaner technologies, while at the same time greatly burdening consumers.

What is the impact of these high prices?

Capacity payments account for an increasing portion of electricity prices, and have helped keep energy costs high, even during the recession. Higher prices weigh heavily on families, small businesses and manufacturing facilities, and can impede job growth. Industrial facilities report a severe adverse impact on their operations from higher electricity prices within RTO regions. What are the states doing to address these problems?

The continued inaction by the Obama Administration to lower electricity rates and hasten the economic recovery, has led several states to take control of their energy resource future and protect their economies. Recently, Governor Christie signed legislation in New Jersey that creates a competitive bidding process for long-term fixed price contracts for new power plants. These plants would then sell into the capacity markets, greatly reducing the price. Maryland is pursuing a similar strategy through its state regulatory commission.

How have the generation owners responded?

A group of merchant generators, known as the PJM Power Providers (P3) is seeking to create even more federal rules to further protect their earnings by fighting these state actions in a complaint with both the FERC and in federal district court. These efforts would allow the Obama administration to usurp states' rights as a means to protect their windfall profits and prevent newer plants from competing.

PJM, the operator of the markets, has proposed similar rule changes to block New Jersey and Maryland from taking action to address these serious capacity market problems.

What can be done to solve this problem?

1) Tell FERC to let the states take needed steps to protect their economy and consumers. FERC should reject changes to the capacity market rules that would prohibit needed state actions to control their own electricity generation choices and foster an economic recovery.

2) Phase out existing capacity markets. After the expense of billions of dollars, these markets have simply not justified their costs. FERC should take steps to acknowledge this reality, and phase out these costly markets, allowing the growth of a truly competitive bilateral contracting market.

3) Stop the spread of new capacity markets. Oppose efforts in the Midwest to establish and an unneeded centrally-operated capacity market that will serve only to create high prices and windfall profits. This proposal will be filed at FERC this year.