

## **American Public Power Association's Renewed Call for Capacity Market Reform**

The American Public Power Association is renewing its long-standing call for fundamental reform of electric generating resource planning and procurement within the Regional Transmission Organizations and Independent System Operators (RTOs/ISOs) with mandatory capacity markets. In support of this call for reform, APPA commissioned a new white paper: *Mandatory Capacity 'Markets' and the Need for Reform*, by Raymond L. Gifford and Matthew S. Larson, of Wilkinson Barker Knauer.

The paper shows how recent developments in PJM Interconnection, ISO-New England, and the New York ISO (referred to as the “Eastern RTOs”) demonstrate an urgent need for reform of the capacity constructs used in these regions. This proposal centers on competitive capacity procurement through bilateral contracts and resource ownership, along with a transition to a voluntary residual capacity market. The white paper’s critique of the capacity constructs is also intended to deter policymakers and stakeholders from considering similar mandatory models in other regions.

The paper shows how an increase in state resource procurement aimed at achieving energy policy goals, and the resulting series complex rule changes by the Eastern RTOs and the Federal Energy Regulatory Commission have increasingly impeded both state energy policies, and public power and cooperative utility self-supply. Both state and public power resource procurements are driven by a variety of policy goals not being achieved by reliance on the capacity constructs, including fuel diversity and security, emissions reductions, flexibility, economic development, and reliability needs.

The energy markets are generally working well and efficiently dispatching resources, and APPA does not suggest reforming these markets at this time.

These developments highlight the fundamental flaws of the capacity markets:

- Capacity auctions were not designed to differentiate among each megawatt (MW) of capacity, and therefore are not tools to procure a specific technology type or attribute.
- Complex rules and frequent changes to such rules create uncertainty for state and public power resource planning and procurement.
- The expansion of the minimum offer price rule (MOPR) and similar types of buyer-side mitigation places resources at risk of not clearing the auction, which in turn means utilities may have to pay twice for capacity – once for the resource that didn’t clear the auction and a second time to procure needed capacity.
- This purchase of excess capacity through the RTO/ISO-operated capacity auctions in turn creates inefficiencies in resource procurement and development.
- Highly volatile short-term revenue streams that are not well suited for long-term financing of new generation.
- The short-term and volatile nature of these constructs has proliferated merchant-funded generation, comprised almost entirely of natural gas-fired resources, which in turn has reduced resource diversity and created a set of merchant resources dependent upon market revenues.

### Public Power Perspective

The time is ripe for fundamental reform. States and local utilities generating resource decisions are being increasingly impeded by the RTO/ISO markets. All consumers would benefit from a more stable and less complex framework for resource planning and procurement.

Within the Eastern RTOs, public power utilities retain an obligation to serve their customers and procure supply through both ownership and bilateral contracts. These utilities engage in resource planning on a holistic basis. Because public power in these RTO/ISOs generally must sell into and purchase from the capacity auctions, the RTO-operated capacity constructs directly impact the prices paid for capacity and public power's ability to self-supply resources to serve their load. The reforms proposed by APPA would benefit public power by removing self-supply impediments and reducing price and market rule volatility. Such reforms would also benefit consumers, states, integrated utilities and other stakeholders by shifting the paradigm of resource adequacy procurement to one that can achieve multiple policy goals, mitigate cost increases, reduce price and rule volatility and guard against excess procurement.

### Our Proposed Reforms

We suggest the following key reforms.

- Capacity markets should be operated on a strictly voluntary, residual basis (where procurement occurs close to the time when the capacity is required). This approach resembles the Midcontinent Independent System Operator (MISO) Planning Resource Auction (PRA).
- Capacity markets should not include any buyer-side mitigation, such as a minimum offer price rule.
- States should be able to choose to engage in more comprehensive and coordinated resource planning with investor-owned utilities without impediments from the RTO/ISO rules, *but such decisions would remain with the states.*
- Allow public power and cooperative utilities within RTO/ISOs to meet their resource adequacy obligations through mechanisms of their choice, including bilateral contracts, ownership, or procurement through the voluntary residual capacity market.
- Allow seasonal and variable resources to count toward resource adequacy criteria, as appropriate.

These reforms would not change the fact that load-serving entities are subject to resource adequacy requirements and would still be fined for failure to meet those requirements.

A common justification for the mandatory capacity constructs is that the states with restructured electricity markets no longer have control over resource adequacy. But many of the problematic rule changes have been in response to states' efforts to exercise their jurisdiction over generation resources to correct the limitations of the capacity constructs by procuring resources with certain attributes to achieve various policy goals. APPA recommends that states go further down this path and develop mechanisms for comprehensive resource planning. Doing so would also stimulate a more robust bilateral contracting market.