Summary of APPA's Proposal to Reform the Mandatory Capacity Markets Operated by Regional Transmission Organizations

APPA proposes that that the current Regional Transmission Organization (RTO) mandatory capacity market constructs be reformed to serve as voluntary, residual capacity procurement mechanisms. The specifics of a federal legislative or regulatory proposal should derive from this basic premise with key features of a reformed market as follow:

- Short-term and Voluntary. These would be short-term, voluntary markets intended to function as a residual market to supplement other, primary methods of procuring capacity (*e.g.*, bilateral contracting or self-builds) and to sell or procure marginal supply.

- Annual/Monthly Terms. The term of these residual auctions would be one-year, conducted one year ahead. They could be divided into monthly tranches or could be supplemented with monthly auctions during the delivery year closer to when the capacity is needed to allow for "timely" adjustments to capacity portfolios.

- Mitigation-Free. These auctions would have no buyer-side or seller-side mitigation (unless found necessary by the market power review discussed below); there would be no minimum offer price rules (MOPRs), no percentage of Cost of New Entry (CONE) requirements applicable to bids, or other limitations on buy or sell side bids.

- Resource Adequacy. The RTO, in close consultation with state commissions and affected load-serving entities (LSEs), would develop overall resource adequacy and load projections by year for the RTO region (reflecting projected reduced demand due to increased energy efficiency, demand response and distributed generation). Each LSE in the RTO region would have to meet an individual resource adequacy requirement based on their load ratio share of the overall requirement for the RTO. Such review should not transform public power LSEs into Federal Energy Regulatory Commission (FERC)-jurisdictional utilities, or empower RTOs (or FERC) to dictate how public power LSEs must meet their capacity obligations, or at what cost.

- Penalties for Non-compliance. LSEs failing to meet their resource adequacy requirements by the month ahead of the relevant delivery year would be subject to a substantial monetary penalty, one set at a level high enough to enforce compliance. (Such penalties are *not* the same as the controversial penalties approved for ISO New England and proposed by PJM for non-performance by individual resources, regardless of whether such non-performance is due to factors within the control of the resource operator.)

- Examination of Constrained Areas and Options to Eliminate Constraints. The RTO, in conjunction with relevant state commissions, would determine (with appropriate technical

support from market monitors and input from market participants) the most economic and efficient options that can be constructed or implemented to relieve transmission constraints.

- Market Power Review. Generation market power is a persistent concern in the capacity markets and the potential for market power within a bilateral contract regime also must be addressed. APPA recommends that the Commission form a cooperative work group with state commissions in the relevant RTO region that would undertake a region-wide assessment of potential market power. (One option could be to convene a federal-state Joint Board, as currently provided for under the Federal Power Act.) If the group finds that certain resource suppliers have sufficient seller-side market power to affect price outcomes in the bilateral contract market or a residual capacity auctions, then appropriate limitations on the market activities of such pivotal sellers would be developed and implemented.

- Transition Period. Implementing these reforms would require a substantial transition period and the close cooperation of RTOs, market monitors, FERC, market participants and state regulatory authorities. Therefore, an appropriate transition period (*e.g.*, five years) would be needed, commencing after the next relevant annual mandatory capacity market auction. The transition period would have to be lengthy enough for all outstanding capacity obligations incurred in prior mandatory capacity auctions to be honored and fulfilled, and for LSEs in the RTO region to develop, either jointly or severally, resource adequacy plans for review and approval by the relevant authorities. At the end of the transition period the annual capacity market auctions would become voluntary and residual for both buyers and sellers.

This proposal has numerous benefits:

- Fewer Moving Parts and Administrative Judgments. Because the primary procurement construct is decentralized and bilateral, it eliminates the onerous stakeholder processes, disputes and subsequent litigation over discrete features of mandatory capacity constructs.

- Harmonization with State and Local Public Resource Policies. This proposal appropriately honors state and local resource portfolio and public policy choices, and does not bias market rules towards or against specific resource types. Such state and local resource control over resource decisions is essential for implementation of EPA's proposed Clean Power Plan.

- Avoidance of Jurisdictional Disputes. By appropriately involving state and local authorities in the resource adequacy, constrained zone mitigation and market power issues, this new market sidesteps controversy over respective limits of state and federal jurisdiction in the capacity market area created by recent court decisions.

- Flexibility for Individual States. This proposal provides individual states within RTO regions with the flexibility to deal with the resource adequacy issues for their retail customers created by their prior decisions regarding retail access. An RTO-administered, centralized voluntary residual capacity market construct would still be available.

- Choice of Business Models for Merchant Generators. This proposal provides merchant generators and resource suppliers a choice as well: they can enter into individualized bilateral supply arrangements with LSEs, rely on the residual capacity market (in addition to the energy and ancillary services markets) to obtain their revenues, or pursue any combination of these approaches.

- Improved Product Differentiation and Resource Performance. The allowance of bilateral contracting and other customized arrangements to procure electric resources enables the development of tailored products and services that will meet specific needs rather than relying solely on generic, lowest common denominator type capacity products. For example, resources with desirable characteristics, such as those with dual fuel capability or firm gas contracts that allow for certainty during winter peaks, could be appropriately valued and supported without complex and costly performance penalties.

- Greater Market Oversight. With the FERC Commissioners unable to reach a decision on whether the outcome of the 2014 capacity auction in New England was just and reasonable due to allegations of market power, additional analysis and oversight of market power will improve the functioning of the markets.

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