

## **Alert** | Energy & Natural Resources



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### **FERC Orders Sweeping, Expedited Changes to PJM Capacity Market, Rehearing Requests Filed**

On June 29, the Federal Energy Regulatory Commission (FERC) issued an order rejecting market revisions proposed by PJM Interconnection, LLC (PJM) to its capacity market structure to accommodate State public policy initiatives in wholesale competitive markets. In a 3-2 decision divided along party lines,<sup>1</sup> FERC determined that PJM’s capacity market has become “untenably threatened” by state out-of-market payments to certain preferred generation resources, and that PJM’s proposed market revisions (as well as revisions proposed by market participants) to address this threat were inadequate.<sup>2</sup>

*New, Consolidated Proceeding:* Furthermore, FERC consolidated two PJM proceedings relating to this issue into a new proceeding to establish a “just and reasonable” market revision because it did not have adequate information based on the record before it. Setting the matter for paper hearing, the Commission found a bifurcated capacity construct composed of the following two components may be just and reasonable: 1) a revised Minimum Offer Price Rule (MOPR) to fully address the suppressive effects of out-of-market payments on PJM’s capacity prices, and 2) a complete revamping of an existing concept known as a Fixed Resource Requirement (FRR) Alternative that would allow generation that receives out-of-market payments to essentially opt out of PJM’s capacity market together with a matching amount of load.<sup>3</sup> The Commission is seeking initial and reply comments on its proposed approach and other options presented by parties. The proposal of a strong MOPR and an entirely novel FRR Alternative sends a

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<sup>1</sup> *PJM Interconnection LLC*, 163 FERC ¶ 61,236 (June 29, 2018) (“Order”). Commissioners LaFleur and Glick dissented from the order, and Commissioner Powelson concurred in the order while also joining in the majority.

<sup>2</sup> Order at P 1, 7.

<sup>3</sup> *Id.* at P 8.

strong message to all capacity market participants, both in PJM and in all other organized markets, that this composition of FERC Commissioners was able to decide that state preferences and subsidies for specific resource types poses an existential threat to capacity markets. However, it remains to be seen what replacement rate will be adopted and, if the Commission’s bifurcated capacity construct proposal or some variation thereof is adopted, whether the proposed revisions will be the salvation of capacity markets or spell the end of such markets as they are presently understood.

PJM’s capacity market, known as the Reliability Pricing Model, functions similarly to other organized capacity markets: load-serving entities must purchase sufficient capacity to meet load, capacity resources (generally generation resources or demand response) offer that capacity for sale, and PJM’s auction processes determine the clearing price. Resources are expected to enter competitive capacity offers that reflect the costs of operation and not to submit offers designed to “artificially depress auction clearing prices.”<sup>4</sup> In the order, FERC determined that out-of-market payments to generators, such as Renewable Energy Credits (RECs) or Renewable Portfolio Standard (RPS) requirements, allowed resources to submit below-cost, non-competitive offers which would have a suppressive effect on auction prices, causing PJM’s capacity market to not reflect supply and demand fundamentals and the substantial increase in these programs was a change in circumstances adversely affecting the integrity and effectiveness of the PJM capacity market.<sup>5</sup>

*FERC’s View of an Acceptable Proposal:* After rejecting the proposals of PJM<sup>6</sup> and PJM market participants as not just and reasonable, the Commission went on to outline what the majority viewed as a proposal that may be just and reasonable to the problem posed by out-of-market subsidies by state governments: 1) an “expanded MOPR” that may have “few or no exceptions” and may address *all* out-of-market support to *all* new and existing resources regardless of resource type coupled with 2) a so-called FRR Alternative that would allow subsidized resources to essentially opt out of the PJM capacity market (and avoid the expanded MOPR) by removing subsidized resources and a commensurate amount of load from the PJM capacity auction.<sup>7</sup>

FERC’s proposed “expanded MOPR” would be a minimum-offer price rule expanded to apply to all new and existing resources that receive out-of-market support. As currently constituted, PJM’s MOPR mitigates capacity auction offers to an administratively determined Cost of New Entry price, which, historically, has meant that any resource subject to the MOPR generally does not clear the capacity auction, as the MOPR price floor is significantly higher than the ultimate capacity clearing price.<sup>8</sup> The order held that such an expanded MOPR with “few or no exceptions” will “protect PJM’s capacity market” by ensuring that subsidized resources “are not able to offer below a competitive price.”<sup>9</sup>

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<sup>4</sup> <https://www.pjm.com/-/media/committees-groups/task-forces/ccppstf/20170911/20170911-mopr-education.ashx>

<sup>5</sup> Order at P 2.

<sup>6</sup> PJM proposed two alternative market solutions: 1) a two-stage annual auction known as “Capacity Repricing,” where one phase of the auction would determine commitments and the second phase would determine the clearing price and 2) a revised MOPR to mitigate potentially price-suppressive capacity offers from both new and existing resources, subject to certain exemptions. The FERC majority rejected both alternatives as unjust and unreasonable. See Order at PP 32-106.

<sup>7</sup> *Id.* at P 149, 158, 160.

<sup>8</sup> For example, the clearing price for the 2020/2021 PJM Base Residual auction was between \$76.53/MW-day and \$130.00/MW-day based on region. See <https://www.pjm.com/~media/markets-ops/rpm/rpm-auction-info/2020-2021-base-residual-auction-report.ashx>. The corresponding MOPR price floors for that auction were between \$135.85/MW-day and \$1335.23/MW-day based on resource type and region. See <https://www.pjm.com/-/media/committees-groups/task-forces/ccppstf/20170911/20170911-mopr-education.ashx>. Accordingly, no resource subject to the PJM MOPR for the 2020/21 auction cleared in that auction, as the resources were required to offer above the ultimate clearing price.

<sup>9</sup> Order at P 158.

Recognizing that such a strict MOPR could result in double payments for resource procurements by the states and the state’s electric customers,<sup>10</sup> FERC coupled its expanded MOPR concept with the FRR Alternative as a companion measure. The FRR Alternative would allow subsidized resources to exit PJM’s capacity market (along with a corresponding amount of load and operating reserves) while still participating in PJM’s energy and ancillary service markets.<sup>11</sup> Depending on its structure, this could allow states and load-serving entities within those states to avoid over-procurement of generation capacity.

*What’s Next/Rehearing and Extension Requests Filed:* FERC left open for comment and proposal the best way to develop and implement such a construct to the new, consolidated proceeding in docket EL18-178-000.<sup>12</sup> Initial comments and reply comments for this proceeding are due by Aug. 28, 2018, and Sept. 27, 2018, respectively and the order expected that FERC would be able to issue an order establishing a just and reasonable replacement rate by Jan. 4, 2019 to allow implementation in time for the May 2019 BRA for Capability Year 2022-2023.<sup>13</sup> Interventions in this consolidated proceeding continue and intervention out-of-time is still available.<sup>14</sup>

Two parties have requested rehearing of the order. The Maryland Public Service Commission objected on the grounds that 1) the order impermissibly intrudes on areas of traditional state jurisdiction, including shaping of generation mix, RECs, and state policies to recognize externalities of generation; 2) the order erroneously portrays RECs; and 3) both the conclusions of the order and the “highly abbreviate hearing schedule” for the new consolidated proceeding are arbitrary and capricious, and this abbreviated schedule does not allow stakeholders the “necessary due process” to address the issues.<sup>15</sup> The Organization of PJM States filed for rehearing on substantially similar grounds,<sup>16</sup> and also have filed a motion to extend the deadline for initial comments in the consolidated proceeding from August to October in order to allow “states and other parties. . . time to more fully and thoughtfully develop their positions.”<sup>17</sup> FERC has yet to rule on either the rehearing requests or the motion for extension of time.

*Dissents:* As the dissenting Commissioner LaFleur noted, FERC’s order in this proceeding signaled FERC’s intent “to adopt, through a 90 day paper hearing, the most sweeping changes to the PJM capacity construct since the market’s inception more than a decade ago.” Dissenting Commissioner Glick disagreed that PJM’s tariff failed to mitigate state efforts to shape the generation mix, stating that the “Commission’s role is not—and should not be—to exercise its authority over wholesale rates in a manner that aims to mitigate, frustrate, or otherwise limit the states’ exercise of their exclusive authority over electric generation facilities” and that the Commission “should be striving to accommodate and give effect to those state initiatives.”<sup>18</sup>

*Bottom Line:* FERC’s order in this case signals a strong stance against state preference in wholesale capacity markets and for the value of competitive capacity markets free of potential price-suppressive effects of out-of-market support. However, while the order is significant, Commissioner Powelson’s

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<sup>10</sup> *Id.* at P 159.

<sup>11</sup> *Id.* at P 160.

<sup>12</sup> *Id.* at P 172.

<sup>13</sup> *Id.*

<sup>14</sup> See 18 C.F.R. § 385.214 (2018).

<sup>15</sup> *PJM Interconnection, LLC*, Request for Rehearing of the Maryland Public Service Commission, Docket No. EL18-178 at p. 2 (filed July 27, 2018).

<sup>16</sup> See *PJM Interconnection, LLC*, Request for Rehearing of the Organization of PJM States, Inc., Docket No. EL18-178 at p. 2 (filed July 30, 2018) (requesting rehearing on the grounds of interference with states and arbitrary and capricious determinations).

<sup>17</sup> *PJM Interconnection, LLC*, Organization of PJM States, Inc. Motion for Extension of Filing Deadline, Docket No. EL18-178 at P 3 (filed July 27, 2018).

<sup>18</sup> LaFleur Dissent at p. 3; Glick Dissent at p. 1.

departure from the Commission next month would appear to result in a 2-2 split on this issue and raises uncertainty as to where this proceeding will land. The proceeding is expected to engender a substantial number of stakeholder submissions.

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