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ALTERNATIVE PRICING RULE FOR PJM

The Minimum Offer Price Rule (MOPR) has several shortcomings that the current stakeholder process is attempting to address. The current range of proposed fixes, however, consist in large part of Band-Aids to the procedure, suggesting that a fundamentally different approach, one that can be applied consistently and without exception, is called for.

In addressing this same issue in 2010, ISO New England (ISO-NE) proposed such a framework.[1] Under ISO-NE's proposal, the capacity auction is conducted in two stages. In summary, ISO-NE's proposal was:

- First, the auction is run with as-submitted offers.[2] The auction result in this stage sets the Capacity Clearing Price, and all resources that clear receive a Capacity Supply Obligation. All *new* capacity resources that clear are paid the Capacity Clearing Price.

- Second, the auction is run again, but with offers from Out-of-Market Resources reset to 100% of the benchmark Net CONE for the resource type. The auction result in this stage sets the Alternative Capacity Price. All *existing* capacity resources that offered at or below the Alternative Capacity Price receive a Capacity Supply Obligation and are paid the Alternative Capacity Price.

- *New* resources that cleared at the Capacity Clearing Price but would not clear when re-priced in the second stage are designated as 'out-of-market'. The out-of-market designation rolls off over time with load growth and resource retirements, on a first-in, first-out basis.

FERC did not accept this approach primarily for of two reasons: first, ISO-NE had to overcome a §206 standard to overturn the previous NEPOOL §205 filing of a different mitigation approach; and second, FERC was concerned that this approach could result in more capacity being purchased than the minimum reliability requirement, which FERC found to be contrary to a core design element of ISO-NE's Forward Capacity Market. Neither of these reasons, however, applies to the current situation in PJM.

NRG proposes that this two-tiered Alternative Price Rule be adopted in PJM *in lieu of all proposed alternatives.* The APR solves all of the issues before the stakeholders, without further ado:

- The APR does not need exemptions for self-supply, renewables, or competitive entry, because *all* resources with economic, as-submitted offers will clear.

- The APR addresses the Market Monitor's concern about setting unit-specific Net CONE values for units. While the Market Monitor will still need to compute a replacement offer for these mitigated resources, that replacement offer does not determine whether the resource clears, but rather may influence the Alternative Clearing Price. Thus, mitigated offers can be set strictly by unit type, taking into account only demonstrable cost difference among project technologies.

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[1] First Brief of ISO New England, Inc., FERC Docket Nos. ER10-787-000 *et al.*, July 1, 2010.

[2] Even in the first round, as-submitted offers from existing resources are subject to *downward* price mitigation, but no minimum offer price floors are imposed.

- The APR assures that the price paid to existing generators is not suppressed by uneconomic new entry, without setting a high price for new resources that would attract yet more capacity additions above and beyond reliability requirements. Thus, the decision to bring a new resource to market ahead of demand will be based entirely on the economics of that resource and the business models of the parties to that transaction; there is no knock-on benefit to bringing on an uneconomic resource to suppress capacity prices paid to other units.

The first example shows how this APR proposal would operate in PJM. In Panel A, the BRA has cleared three out-of-merit resources, shown in red, resulting in a price P and quantity Q clearing. Panel B shows the second iteration of the BRA, in which offers from out-of-merit resources have been reset by the Market Monitor to type-specific CONE values. With these offers repriced, the Alternative Capacity Price (P*) is read off the VRR curve. In this example, P* equals Net CONE, but that need not be the case. Existing resources that cleared in the first iteration are shown in green; two additional resources that also clear in this second iteration because their offers were below P*are shown in purple. Collectively, the total cleared capacity, including all the out-of-merit resources, is Q*. All *existing* resources in this LDA will receive P*, while all *new* capacity receives P.

Some might object that the gap between P and P*, and between Q and Q*, appears large. To the extent the gap is large, it is because far more new capacity was added to this LDA than was needed for resource adequacy. Contracting for new resources can play an important part in ensuring resource adequacy, though, and the second example shows how, if contracting is used to ensure resource adequacy (rather than overbuilding), the effect on price and quantity is very modest. In this modified example, the subsidized new entry is more closely matched to the need for new capacity in the LDA. As this example shows, there is now only a small gap between P and P* and, in this example, no "in-between" resources that clear in the second round, so Q equals Q*.

The APR is economically sound. Prof. McAdams, of the Fuqua School of Business at Duke University, demonstrated in his testimony supporting this approach in the ISO-NE proceeding that the two-tiered APR creates strong incentives to offer capacity—both new and existing—at competitive prices (doing so is a "weakly dominant strategy" by his analysis). Further, it increases incentives for states that are contracting for resources to select projects based on their relative economic merit.