



OSW's Loss of Capacity Payments Under FERC's Recent PJM Order



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On December 19, 2019, the Federal Energy Regulatory Commission (FERC) gob smacked the renewables industry by issuing an order that makes it nearly impossible for most new renewable energy projects in the PJM system to sell capacity into the market.¹ The reaction was swift. Approximately 55 individual parties have moved for FERC to reconsider the order including ten state public utility commissions, no less than five of which have indicated that they may consider pressuring their utilities to withdraw from PJM if relief is not granted.

The specific impact on offshore wind is direct: PJM is the intended point of connection for approximately 8800 MW of offshore wind projects from New Jersey through Kitty Hawk off the northern coast of North Carolina. The impacts may spread into New York and New England because it is not known how FERC may apply the policies contained in the PJM order those regional transmission organizations ("RTOs"). Market structures in California may be sufficiently dissimilar to insulate projects there.

RTOs price capacity through reverse auctions. All capacity bids are rank ordered by price. A line is drawn at the level where the capacity bids below the line equals the capacity required by the RTO. The highest bid in the resulting stack sets the price for all lower bids. Bidders whose offers are higher than the highest bid receive nothing for their capacity.

Reverse auctions create incentives for holders of high-cost generation to offer prices below their actual costs. After all, being paid something for capacity is better than being paid nothing. To prevent below-cost bids from distorting price signals and creating inefficient markets, FERC has long required that initial capacity bids be tied to actual the actual fixed cost of the resource. The resulting price limitation is called the minimum offer pricing rule or MOPR.

Historically, the MOPR has not applied to renewable energy projects. But recent FERC orders have changed that. In the PJM order, FERC cited the dramatic growth of state subsidized renewable resources on the PJM system, including uneconomic nuclear and coal generation as well as renewables and OSW. In fact, OSW is leading the way in the growth of renewables in PJM. The 8800 MW of OSW projects under development there compares to the approximately 600 MW of solar and wind resources that cleared the 2021 capacity auction.

In response to this wave of new state sponsored renewable capacity, FERC terminated the exemption for renewables from MOPR pricing and specifically applied MOPR pricing to new renewable energy projects that receive direct or indirect support from state and local governments. Support has been defined broadly to include all state and local economic

¹ 169 FERC ¶ 61,239

benefits for renewable projects, including renewable portfolio standards, mandatory purchase contracts, offshore wind renewable energy credits (ORECS) and even private renewable energy credits.

As a practical matter, the PJM ruling means that capacity from offshore wind projects cannot clear the PJM capacity market: Absent subsidies, OSW costs are simply too high when compared with the costs of gas-fired peaking turbines against which they will compete.

Under the new rule, the only option for OSW to receive capacity payments in PJM is for the utilities buying the capacity to withdraw from the PJM capacity markets entirely and purchase the OSW capacity directly. That is difficult and disruptive path for utilities to pursue.

The PJM order reflects the continuation of a trend that goes back at least as far as FERC's 2018 order related to MOPR pricing for renewables on the ISO-New England system.² That order terminated a special exemption for renewable resources that had existed since early in the RTO's history.

In that order, FERC provided a safety valve in the form of a second auction to allow disappointed renewable energy project developers to buy a place in the capacity stack from existing resource owners. In the second auction, generators whose bids were successful in the initial capacity auction are allowed to submit offers to sell their place in the generation stack to a renewable provider for a one-time payment. If the bid is accepted, the offeror must permanently retire the resource that won a spot in the initial capacity auction.

Having once brought its way into the capacity stack, the renewable resource project is no longer subject to the MOPR rules for new projects and can bid more freely into future capacity auctions.

The approach taken in the ISO New England order can be effective in accelerating the early retirement of aging resources to make way for renewables to enter the market. But the practical benefits are limited by the number of resources willing to exit the market permanently and the price required for them to agree to do so.

Like the PJM order, rehearing of the ISO New England order is pending before FERC. Whether it will emerge from rehearing in its current form is unknown at this time.

How important are capacity payments? As intermittent resources, OSW resources are allowed to bid into capacity markets at levels that reflect projected capacity factors. These are typically in the 30-40% range. The Vineyard Wind project, for example, theoretically would have been allowed to bid 273 MW into the 2021 ISO New England capacity auction³ or 38% of its nameplate capacity of 800 MW. Vineyard Wind was not able to participate in the 2021 capacity auction but in appealing the auction, Vineyard Wind provided data indicating that the value of its capacity would have been on the order of \$8-\$10 million per year if it had cleared the market. The most recent PJM auction have produced capacity values significantly lower.

Whether FERC's new policy limiting renewable capacity pricing will survive the rehearing and appeal of the PJM order is uncertain. Opponents claim FERC is intruding on the authority historically preserved for states to choose capacity resources. They also point out that excluding renewable capacity from capacity markets will mean that more capacity will be built than is needed with "phantom" renewable capacity being held outside of established capacity market structures. If this happens, customers may be required to pay for capacity twice, once under the state policies mandating the renewable construction, and a second time when other capacity is purchased to fill the need the renewable capacity could have filled in the capacity auction.

Politically, the PJM order pits the aggressive decarbonization commitments of the progressive coastal states against a Federal administration that is much more skeptical of economic and policy value of rapidly expanding reliance on renewable energy. In fact, the PJM order is symptomatic of a State/Federal fault line that runs through much of US energy policy today and is seen by many as consistent with the delays imposed on the environmental permitting of the Vineyard Wind project. In all likelihood, the split personality of environmentalism in the US will continue to result in challenges for the OSW industry here.⁴

² 162 FERC ¶ 61,205.

³ Capacity auctions are typically held three years in advance of need to allow short-lead time facilities like natural gas turbines to be bid into auctions and built if the bid is successful.

⁴ It is worth noting that group of letters from US Senators opposing FERC action to extend MOPR pricing to renewable capacity resources were filed under a cover letter from Senator Charles E. Schumer of New York, a leading antagonist of the Trump administration and proponent of impeachment in the United States Senate.

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