Federal Energy Regulatory Commission
June 16, 2016
Open Commission Meeting
Staff Presentation
Item E-2

“Good morning Mr. Chairman and Commissioners,

“Item E-2 is a draft Final Rule addressing settlement intervals and shortage pricing triggers. This Final Rule is the first final rule in the Commission’s ongoing price formation initiative. In advancing the Commission’s price formation goals, the reforms in the draft Final Rule will help ensure that rates for energy and operating reserves in Regional Transmission Organizations and Independent System Operators (or, RTOs and ISOs) are just and reasonable.

“Specifically, the draft Final Rule addresses the two existing practices in RTO and ISO markets that fail to compensate resources at prices that reflect the value of the service they provide to the system, thereby distorting price signals.

“First, the draft Final Rule addresses existing practices related to settlement intervals. The draft Final Rule would align settlement intervals with dispatch intervals by requiring that each RTO and ISO settle real-time energy transactions financially at the same time interval the RTO, or the ISO, dispatches energy. The draft Final rule would also require each RTO and ISO to settle operating reserve transactions at the same time interval it prices operating reserves, and to settle intertie transactions at the same time interval that they are scheduled. Currently, several RTOs and ISOs have a misalignment between dispatch intervals and settlement intervals. They dispatch resources every five minutes but settle transactions for these dispatches based on an hourly integrated price – that is, based on the average price of all the dispatch intervals across an hour. This misalignment distorts price signals because compensation is based on average prices across an hour rather than prices that apply during each dispatch interval during the hour. These distorted price signals can mute a resource’s financial reward for being able to quickly respond to system needs and create a disincentive for resources to respond to dispatch signals. Aligning settlement intervals with dispatch intervals – as proposed in the draft Final Rule – will compensate resources in a way that better reflects the value of the service they provide and provide better incentives to follow dispatch instructions. In addition, the proposed settlement interval reform should reduce uplift payments, thereby increasing system transparency and the ability of market participants to hedge their transactions financially.

“Second, the draft Final Rule addresses existing practices related to shortage pricing triggers. The draft Final Rule proposes to require that each RTO and ISO trigger shortage pricing for any dispatch interval during which a shortage of energy or operating reserves is indicated during the pricing of resources for that interval. In contrast, currently, on the systems of some RTOs and ISOs, a shortage is required to last a minimum time period before shortage pricing is triggered. As a result, there is a delay between the time when a system first experiences a shortage of energy or operating reserves and the time when prices reflect the shortage. In instances when a shortage lasts less than the minimum time period, energy and operating reserves prices never reflect the shortage condition. Due to such delays, short-term prices fail to reflect potential reliability costs, as well as fail to reflect the value of both internal and external market resources responding to a dispatch signal. The shortage pricing reform should provide resources with price signals that reflect the value of their services, and the value of system operating needs at each dispatch interval.

“Under the draft Final Rule, each RTO and ISO would be required to submit a compliance filing within four months of the effective date of the Final Rule. Under the draft Final Rule, full implementation of the settlement reform would be effective within twelve months from the date of the compliance filing. Implementation of the shortage pricing reform is not expected to be as complex. Thus, under the draft Final Rule, full implementation of the shortage pricing reform would be effective within four months from the date of the compliance filing.

“Thank you. This concludes our presentation. We would be happy to address any questions you may have.”