Federal Energy Regulatory Commission
January 21, 2016
Open Commission Meeting
Staff Presentation
Item E-1

“Good morning Mr. Chairman and Commissioners,

“Item E-1 is a draft Notice of Proposed Rulemaking (NOPR) addressing energy offer caps. This draft NOPR is intended to further advance the Commission’s price formation efforts. Other recent Commission actions on price formation include issuing a NOPR about settlement intervals and shortage pricing in September 2015 and an Order Directing Reports to obtain additional information about price formation topics in November 2015.

“The draft NOPR proposes to reform the offer cap in the day-ahead and real-time energy markets for Regional Transmission Organizations and Independent System Operators (RTOs and ISOs). The proposal in the draft NOPR would advance two of the Commission’s price formation goals. First, the proposal would result in clearing prices that better reflect the marginal cost of production. Second, the proposal would ensure that a resource can recoup its short-run marginal costs when those costs exceed the offer cap.

“Presently, California, New England, the Midcontinent ISO, New York, and the Southwest Power Pool have a $1,000/MWh cap on incremental energy offers. Pursuant to recent tariff revisions, PJM has a $2,000/MWh offer cap on incremental energy offers.

“Extreme weather during the ‘Polar Vortex’ in the winter of 2013 and 2014 led to a significant rise in the price of natural gas that could have caused some resources to face short-run marginal costs in excess of the existing $1,000/MWh offer cap. In that winter and in the two following winters, the Commission granted limited waivers and accepted tariff revisions in some RTOs and ISOs to either raise their offer cap or permit cost recovery above their offer cap through uplift.

“The existing offer caps in RTOs and ISOs may be unjust and unreasonable for the following reasons. First, the offer cap may prevent a resource from recouping its costs. Second, the offer caps may suppress prices to a level below the marginal cost of production. Third, the offer caps may discourage a resource with costs above the offer cap from offering its supply to the RTO or ISO. Finally, the RTO or ISO may not be able to dispatch the most efficient set of resources when several resources with costs above the offer cap are unable to reflect those costs in their supply offers.

“To remedy these problems and meet the Commission’s price formation goals, the draft NOPR proposes to revise the cap on each resource’s incremental energy offer. Under this proposal, the offer cap would be the higher of: $1,000/MWh or the resource’s verified cost-based incremental energy offer.
“The draft NOPR imposes three requirements on RTOs/ISOs. The first requirement is that a cost-based incremental energy offer above $1,000/MWh would be eligible to set the clearing price.

“The second requirement is that the market monitor – or the RTO or ISO – would verify cost-based incremental energy offers above $1,000/MWh before that offer could be used to calculate clearing prices. This verification process is intended to protect customers from paying unjust and unreasonable rates. If a resource’s incremental energy offer above $1,000/MWh is not verified prior to that calculation, that particular offer could not be used to calculate clearing prices. Instead, that resource may be entitled to an uplift payment if its costs are verified after-the-fact.

“The third requirement is that any resource – regardless of fuel type – would be eligible to submit a cost-based incremental energy offer above $1,000/MWh.

“The draft NOPR proposes to make the change to the offer cap applicable to all RTOs and ISOs in order to avoid exacerbating seams issues. Otherwise, different offer caps in neighboring regions could result in power flows that reflect the level of the two offer caps as opposed to reliability needs or economics. The draft NOPR would permit regional variation in compliance by not prescribing the precise manner in which an RTO or ISO must comply with the three requirements.

"The draft NOPR seeks comment on the offer cap proposal. Among other things, the draft NOPR seeks comment on: (1) whether a hard cap, in addition to the proposed offer cap, is necessary. This additional hard cap would restrict any cost-based incremental energy offers above a certain level from being used to calculate clearing prices. The draft NOPR also seeks comment on what the level of any hard cap should be; (2) the implementation of the cost verification process; and (3) the applicability of this proposal to virtual transactions and imports.

"Comments would be due 60 days after the draft NOPR's publication in the Federal Register.

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