Federal Energy Regulatory Commission
November 17, 2016
Open Commission Meeting
Staff Presentation
Item E-2

"Good morning Mr. Chairman and Commissioners,

"Item E-2 is a draft Final Rule addressing caps on incremental energy offers – offer caps – in markets operated by Regional Transmission Organizations and Independent System Operators (RTOs and ISOs). This draft Final Rule is the second final rule in the Commission's ongoing price formation initiative. The draft Final Rule adopts the Commission's Noticed of Proposed Rulemaking (NOPR) proposal with modifications and clarifications as discussed below.

"Presently, five RTOs and ISOs have a $1,000/megawatt-hour (MWh) offer cap – the California ISO, ISO New England, the Midcontinent ISO, the New York ISO, and the Southwest Power Pool. One RTO, PJM Interconnection, currently requires that all incremental energy offers above $1,000/MWh be cost-based and caps incremental energy offers at $2,000/MWh when calculating Locational Marginal Prices (LMPs).
"The offer cap reforms set forth in the draft Final Rule would ensure clearing prices in RTOs and ISOs are just and reasonable and would advance the Commission's price formation goals for several reasons. First, the reforms would help ensure that resources with short-run marginal costs above $1,000/MWh can recoup those costs. Second, the reforms would better enable LMPs to reflect the marginal cost of production when fuel costs increase dramatically. Third, the reforms would enable RTOs and ISOs to dispatch the most efficient set of resources in periods when several resources have short-run marginal costs above $1,000/MWh because the RTOs and ISOs would be able to see the underlying costs of each resource. Fourth, the reforms would encourage resources to offer supply to RTO and ISO energy markets when it is most needed. Finally, adopting the same offer cap structure in each RTO and ISO would avoid seams issues that could arise if offer caps differ materially across markets.

"To ensure just and reasonable rates, this draft Final Rule sets forth three requirements. The first requirement is the offer cap structure requirement. Under this requirement, an RTO or ISO would cap each resource's incremental energy offer at the higher of $1,000/MWh or that resource's verified cost-based incremental energy offer. The first requirement would modify the NOPR proposal by directing RTOs and ISOs to cap verified cost-based incremental energy offers at $2,000/MWh when calculating LMPs. A resource with short-run marginal costs above $2,000/MWh would be eligible to recover those costs through an uplift payment.

"The second requirement is the verification requirement. This requirement is intended to protect customers from paying unjust and unreasonable rates. The draft Final Rule would clarify the NOPR proposal and explain that, under the verification requirement, the RTO or ISO – or the Market Monitoring Unit – would verify that any cost-based incremental energy offer above $1,000/MWh reasonably reflects the associated resource's actual or expected short-run marginal costs. If a resource's incremental energy offer above $1,000/MWh is not verified prior to the market clearing process, it cannot be used to calculate LMPs. Instead, if dispatched, that resource may be entitled to an uplift payment based on its actual verified short-run marginal costs.

"The third requirement is the resource neutrality requirement. Under this requirement, any resource – regardless of type – would be eligible to submit a cost-based incremental energy offer above $1,000/MWh.

“As a result of this Final Rule, an RTO/ISO would treat resources’ incremental energy offers differently, depending on the level of the offer. An incremental energy offer below $1,000/MWh would be treated the same as it is today. An incremental energy offer at or above $1,000/MWh may be submitted but only if it is cost-based, that is, if it reflects that resource’s actual or expected short-run marginal costs. Additionally, for an incremental energy offer at or above $1,000/MWh, the RTO/ISO or Market Monitoring Unit must verify that the offer is cost-based before the RTO/ISO may use it to calculate LMPs. An incremental energy offer above $2,000/MWh would also be subject to a hard cap; that is, it would be capped at $2,000/MWh for purposes of calculating LMPs. Nonetheless, a resource that submits such a verified cost-based incremental energy offer above $2,000/MWh would be eligible to receive an uplift payment if dispatched.

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