UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Offer Caps In Markets Operated by	)	**Docket No. RM16-5-000**
Regional Transmission Organizations and	)	
Independent System Operators	)	

COMMENTS
OF THE PJM POWER PROVIDERS GROUP

Pursuant to the Notice of Proposed Rulemaking regarding offer caps in markets operated by Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) ("Offer Cap NOPR" or "NOPR") issued January 21, 2016, in the above-captioned proceeding by the Federal Energy Regulatory Commission (the "Commission" or "FERC"),[1] the PJM Power Providers Group ("P3")[2] submits these comments.

I. COMMENTS

P3 applauds the Commission's leadership in tackling the tough issues associated with energy price formation and especially energy market offer caps. P3 firmly believes that having energy market clearing prices that reflect market conditions is essential to the vitality of PJM's market. As the Commission is aware, in PJM there have been at least four different offer caps in

1 154 FERC ¶ 61,038 (2016) ("Offer Cap NOPR")

2 P3 is a nonprofit corporation dedicated to promoting policies that will allow the PJM region to fulfill the promise of its competitive wholesale electricity markets. The comments contained in this filing represent the position of P3 as an organization, but not necessarily the views of any particular member with respect to any issue. For more information on P3, visit www.p3powergroup.com

each of the last three winters.[3] It is long past time for a rational and stable energy market cap to be in place for both consumers and suppliers. While P3 applauds the Commission's issuance of the Offer Cap NOPR to provide certainty to this important issue, P3 is concerned with the proposal as set forth in the NOPR.

A. PJM's Energy Market Offer Cap

P3 continues to believe the correct solution for the market is grounded on two simple propositions: generators should be able to submit cost-based energy offers that reflect all short-run marginal costs of operating a generating resource and those offers should be able to set the Locational Marginal Price ("LMP"). As the PJM Independent Market Monitor ("IMM") stated on October 28, 2014, "the cost-based offer cap has to be as high as necessary to allow the recovery of actual costs."[4] Further, the IMM told the Commission, "[S]o if costs imply energy offers greater than $1,000, you have to allow them. That's the point. I mean, I talk about short-run marginal costs before and what doesn't belong, but one thing that very much does belong is the cost of gas. That's part of the short-run marginal costs. And if the cost of gas implies your offer is $1,500, that's what it should be. It should set LMP. It should not be an uplift; it should set LMP."[5] Having the marginal unit set LMP is important and a core tenant of the PJM market that must be recognized in any discussion about energy market offer caps.

While P3 appreciates the work the Commission has put into the Offer Cap NOPR, P3 members are concerned with the Commission's proposal to cap each resource's incremental energy offer to the higher of $1,000/MWh or that resource's verified cost-based incremental

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3 Offer Cap NOPR at PP 14, 16, 17.

4 FERC October 28, 2014 Price Formation Technical Conference Transcript, AD14-14-000 ("FERC Price Formation Transcript") at p. 215.

5 FERC Price Formation Transcript at p. 214.

energy offer, and to verify cost-based incremental energy offers above $1,000/MWh before-the-fact for purposes of calculating LMPs.[6] The Commission has not made clear what "cost verification" entails, and P3 has yet to identify a workable means of accomplishing a pre-bid verification as contemplated by the NOPR. PJM has identified similar concerns.[7]

Depending on the Commission's view of what is required with respect to verification, it may be largely impossible for a generator to fully determine and have PJM and/or the IMM verify its costs with exact certainty prior to markets clearing. If by verification the Commission is expecting review and approval of specific broker quotes by the IMM prior to clearing the market, the Commission would in effect be endorsing ex ante mitigation as such process is not meaningfully possible in that timeframe. First, a generator's dispatch level may not be known prior to procuring gas. If a generator anticipates it will be economic, it will likely procure all of its needed gas in the day-ahead markets. However, should a generator not anticipate to be fully economic, it may procure only a portion of its gas or none at all, requiring the generator to procure gas in the intra-day should it be required for reliability. As the Commission is aware[8], gas prices can change quickly – especially during times when the grid is under pressure which would likely be the case if LMPs were nearing $1000/MWh. As a result, precise cost verification, as contemplated by the NOPR, prior to clearing the energy markets does not appear feasible at this time.

Because of the realities of the electricity and natural gas markets, the only practical way for PJM and the IMM to have enough time and information to verify offers is after the market

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6 Offer Cap NOPR at PP 1 and 3.

7 See, http://www.pjm.com/~/media/committees-groups/committees/mrc/20160331/20160331-item-12-offer-cap-notice-of-proposed-rulemaking.ashx

8 See e.g, *PJM Interconnection, L.L.C.,* 151 FERC ¶ 61,206 (2015) (noting "the circumstances that gave rise to this proceeding", at P 73, which included fluctuating gas prices.)

has cleared.[9] Even if verification is completed after the market clears it will be very challenging for the generator to produce receipts, screen shots and broker quotes that match the exact costs incurred. A market participant may be procuring gas for its entire fleet, may procure the gas in several different blocks at several different times, and may burn less or more than its procurement. Even if after the fact verification is attempted, the marginal unit would not set the price in real time at precisely the moment of grid stress when it is critical that the proper market signal be sent. While the generator would be made whole for those costs it is able to fully verify under the proposed NOPR (which is an improvement from the rules in place in 2014), the market would not reflect economic realities. Such inefficiencies are precisely the outcomes that the Commission is working so hard to eliminate through its efforts in the AD 14-14 docket.

Moreover, if this ex-post verification is the likely outcome of the proposed Offer Cap NOPR, the Commission's well-placed efforts to reduce uplift in the competitive markets would be undermined. The problems associated with energy offers over $1000/MWh that did not set LMP were well-documented in 2014. For the month of January of 2014, which featured extreme weather conditions and an energy market cap of $1000/MWh, uplift soared to nearly $600 million.[10] While not all of that uplift was attributable to the offer cap in place at the time, a more flexible offer cap that would have allowed LMPs to be set by the actual cost of the marginal unit, would have certainly reduced those out of market payments substantially. For these reasons, P3

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[9] Note, P3 is not sure that such post-clearance verification can always be completed. Allocating specific gas costs to specific unit offers may not always be possible where a generator develops offers in the DAM based on its assumptions around load, expectations for dispatch, etc. For example, based on a generator's view of where it expects the market to clear, it may purchase some gas for some of its portfolio (and it often may purchase on a portfolio basis). Then it has to purchase (or sell) incremental gas depending on how it is ultimately dispatched. Given it has a portfolio of gas assets that it can use to serve a portfolio of gas plants, it can sometimes be difficult to allocate specific gas molecules to specific electrons. In addition, this problem can be compounded by the changes it may make in its gas purchase arrangements based on how it is dispatched.

[10] https://www.pjm.com/~/media/documents/reports/20140509-analysis-of-operational-events-and-market-impacts-during-the-jan-2014-cold-weather-events.ashx at 44.

continues to believe generators should be able to submit their cost-based energy offers in the real time market and those offers should be able to set the LMP.

Additionally, there are oversight mechanisms already in place which consumers enjoy and which motivate proper market behavior by suppliers. All generators are required to submit a fuel cost policy to the IMM pursuant to PJM Manual 15. A fuel cost policy contains the methodology used by generation owners to calculate their cost-based energy offers as defined in PJM OATT Schedule 2 and PJM Manual 15. Generators submit their fuel cost policies to the IMM for review and agreement prior to using these policies as a basis for cost based bids.[11] If agreement with the IMM cannot be reached, a submission can be made to PJM. Further, the IMM also subsequently reviews a generator's compliance with its submitted fuel cost policy, whenever the IMM deems it is necessary. Therefore, cost based bids must be grounded in a generator's fuel policy which provides a degree of confidence to consumers that generator cost-based bids will not be inappropriately submitted. Further, in a competitive market, "[b]y paying all resources that clear in a given market the price offered by the marginal resource, resources are given the incentive to submit offers equal to their own marginal cost so that they will be selected when the clearing price equals or exceeds their cost."[12]

Additionally, the threat of investigation by the Office of Enforcement and exposure to penalties of up to $1 million per day per violation,[13] motivate proper market behavior and offer a strong disincentive for a generator to exercise market power. As a result of the Energy Policy

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[11] See PJM Manual 15 at http://www.pjm.com/documents/manuals.aspx; see also http://www.pjm.com/~/media/committees-groups/committees/mic/20151104/20151104-item-12-pjm-fuel-cost-policy-guidelines.ashx

[12] *Public Citizen, Inc. V. Midcontinent Independent System Operator, et al.*, 154 FERC ¶ 61,224, P88 (2016).

[13] 132 FERC ¶ 61,216 (2010) at P 17, citing 16 U.S.C. § 825o (2006).

Act of 2005 and the significant efforts of FERC to bolster enforcement efforts, consumers have a greater degree of confidence in market outcomes. Indeed, the consumer protection benefits of an arbitrary energy market cap, from a policy perspective, are likely available in nearly equal measure through these other means.

That said, P3 understands that PJM and others are actively considering avenues to work within the framework of the Offer Cap NOPR. P3 is open to further discussions about the verification of cost based bids and looks forward to reviewing PJM's and other proposals; however, for now, P3 continues to believe that the best solution – indeed the only viable solution that has been put on the table that will be sustainable over the long term - is one that allows generators to reflect their full costs in their energy market bids and, if marginal, to have those units set LMP.

B. P3 agrees with the FERC's Proposal to Apply the Same Offer Cap Standard to All Markets

P3 agrees with the Commission proposal "to make a generic change to the offer cap applicable to all RTOs/ISOs through a rulemaking to avoid exacerbating seams issues. Seams issues could arise if one RTO/ISO has an offer cap that materially differed from a neighboring RTO/ISO's offer cap."[14] As P3 has previously noted, it shares the Commission's concern about different energy market offer caps in neighboring regions, creating potential inefficient market outcomes and more troubling reliability issues. If electricity prices driven by higher fuel prices allow a generator to be paid more in a neighboring market as compared to the generator's "home" market due to the effect of differing offer caps, it is only natural that the generator will want to export that energy so it can be appropriately compensated for serving the load. If that energy is

[14] Offer Cap NOPR at P 70.

needed for reliability in its home market, this outcome is far from desirable. By adopting an offer cap standard in all organized markets, this problem can be eliminated.

II. CONCLUSION

For the foregoing reasons, P3 respectfully requests that the Commission consider these comments in deciding issues regarding offer caps.

Respectfully submitted,

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Dated: April 4, 2016

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the Official Service List compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 4th day of April, 2016.

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