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|  | NEPOOL Markets Committee |
|  | Catherine McDonough |
|   | August 27, 2014  |
|  | PER Modifications for CCP5-CCP8  |

**Background**

As directed by the order that FERC issued on May 30, 2014 in Docket No. [ER14-1050](http://www.iso-ne.com/regulatory/ferc/orders/2014/may/er14-1050-000_5-30-14_pay_for_performance_order.pdf), the ISO submitted rule changes on July 14, 2014 in Docket No. ER14-2419 to increase Reserve Constraint Penalty Factors (RCPFs) effective on December 3, 2014.

The increase in RCPFs will have no adverse impact on economic efficiency but could create a revenue transfer from resource owners to load-serving entities. Because the Peak Energy Rent adjustment mechanism (PER Adjustment) is applied to reach resource’s entire CSO, the increase in RCPFs will have a larger impact on the PER Adjustment (a deduction from FCM payments) than the prospective increase in real-time energy and reserve market revenue. The increase in RCPFs is also likely to increase Day-Ahead Energy Market and Forward Reserve Market revenue but these revenue impacts are difficult to accurately predict.

Resource owners are concerned that they could not factor the higher potential cost of the PER Adjustment into their FCA bids for auctions that have already occurred (FCA5 - FCA8) and that the increase in RCPFs may create a revenue transfer from resource owners to load-serving entities.

**ISO Proposal**

The ISO is proposing to recalibrate the PER Adjustment to minimize the real-time revenue impact of higher RCPFs on resource owners by raising the daily PER Adjustment strike price by $250.[[1]](#footnote-1) Adjusting the PER strike price is a simple way to reduce the impact of higher RCPFs on the PER Adjustment and could be done by December 3, 2014. With the higher PER strike price in place, the real-time revenue impact[[2]](#footnote-2) of higher RCPFs on resource owners would have been close to zero in CCP4. Resource owners would still experience the potential benefit of higher RCPFs on day-ahead energy and forward reserve prices.

**Stakeholder Discussion**

At the July 8-10, 2014 Markets Committee meeting, the ISO discussed the implications of raising RCPFs for the PER Adjustment. Near term (CCP5-to-CCP8), the FERC-ordered increase in RCPFs will increase energy and reserve market revenue and the Peak Energy Rent Adjustment Mechanism (a deduction from FCM payments). Longer term (FCA-9 and beyond), the implementation of the FCM Pay-for-Performance (PFP) mechanism may reduce the usefulness of the PER Adjustment in curbing the incentive to exercise market power. The ISO indicated that two separate evaluations would be required to address these issues. The ISO also reviewed recent history regarding in RCPFs and an example that described how higher RCPFs impact the PER Adjustment. The ISO also requested stakeholder input regarding how to address the near term and longer term issues related to the PER Adjustment.[[3]](#footnote-3)

At the August 5-6, 2014 Markets Committee meeting, the ISO reviewed a proposal to address both issues based on the input provided at the previous meeting and responded to suggestions from stakeholders. To address the near term issue, the ISO proposed to increase the PER Adjustment strike price by $250 as described above. To address the longer term issue, the ISO proposed to evaluate the usefulness of the PER Adjustment following the implementation of the PFP mechanism and to include the hedging role for the PER Adjustment as part of that evaluation.[[4]](#footnote-4)

**Response to GDF Suez Proposals**

At the August 5-6, 2014 Markets Committee meeting, GDF Suez proposed that the PER Adjustment be eliminated.[[5]](#footnote-5)

The ISO does not support the elimination of the PER Adjustment for CCP5-to-CCP8. Higher RCPFs do not reduce the rationale for the PER Adjustment under the existing FCM design. Moreover, FCA bids and clearing results for FCA-5-to-FCA-8 already factored in the existing PER Adjustment calculation. The ISO also indicated that it may support eliminating the PER Adjustment for FCA-10 and beyond if an internal review demonstrates that it no longer serves a useful role and this decision is made prior to running the auction for FCA-10.

GDF Suez further proposed that the PER Adjustment be calculated differently (unless the PER Adjustment is eliminated).

The ISO does not support the alternative calculation of the PER Adjustment proposed by GDF Suez for any commitment period. Even if participants do not change their DAEM bidding behavior, the alternative PER calculation weakens the hedge to load-serving entities; load-serving entities would get smaller PER Adjustment credit than what they paid for in the form of higher FCM clearing prices in CCP5-to-CCP8. More important, the alternative PER Adjustment changes day-ahead market bidding incentives in a way that could eliminate the PER Adjustment. If the ISO evaluation indicates that the PER Adjustment serves no useful role in FCA-10 and beyond, it is would be preferable to simply eliminate the PER Adjustment than to implement an alternative calculation of the PER Adjustment that essentially has the same effect.[[6]](#footnote-6)

**Next Steps**

At the September 3, 2014 Markets Committee, the ISO will be asking participants to support the ISO proposal to increase the PER strike price by $250. Because the ISO proposal addresses revenue allocation issues that raise equity issues and does not address a reliability or economic efficiency concern, the ISO likely would only file the proposal if there is at least 60% support from stakeholders. Please feel free to contact e-mail me at cmcdonough@iso-ne.com or call me at (315) 420-7322 if you have any questions or comments ahead of the meeting.( <http://www.iso-ne.com/event-details?eventId=122260>)

1. <http://www.iso-ne.com/committees/comm_wkgrps/mrkts_comm/mrkts/mtrls/2014/aug562014/a03_mr_1_section_13_7_redlined_08_05_14.docx> [↑](#footnote-ref-1)
2. [↑](#footnote-ref-2)
3. See <http://www.iso-ne.com/committees/comm_wkgrps/mrkts_comm/mrkts/mtrls/2014/jul89102014/a13_iso_presentation_07_10_14_r2.pptx> [↑](#footnote-ref-3)
4. See <http://www.iso-ne.com/committees/comm_wkgrps/mrkts_comm/mrkts/mtrls/2014/aug562014/a03_iso_presentation_08_05_14.pptx> [↑](#footnote-ref-4)
5. See <http://www.iso-ne.com/committees/comm_wkgrps/mrkts_comm/mrkts/mtrls/2014/aug562014/a03_gdf_suez_presentation_08_05_14.pdf> [↑](#footnote-ref-5)
6. [↑](#footnote-ref-6)