



## I. COMMENTS

EPSA requests that the Commission approve the PJM Energy Offer Cap Filing, notwithstanding the concerns outlined below, and underscores that the proposal should not be deemed the basis for a long-term solution within PJM or across the RTO regions. Specifically, this stop gap measure, which follows emergency waiver requests and a FPA section 206 filing, respectively, over the past two winters, simply ensures that the PJM region does not go through *another* winter with a \$1,000/MWh cost-based offer cap mechanism that does not allow recovery of demonstrated, justified fuel costs. As PJM states in the Energy Offer Cap Filing, this was never the intent of the offer cap, is “contrary to basic principles of PJM’s energy market design,”<sup>4</sup> and, was previously determined by the Commission to be unjust and unreasonable.<sup>5</sup>

In the Energy Offer Cap Filing, PJM proposes to allow incremental energy cost-based offers to be capped at \$2,000/MWh, and such offers are allowed to set LMP. Market-based offers for individual units are allowed to rise with their cost-based offers. Any costs in excess of \$2,000/MWh may be recovered through make-whole payments (i.e., uplift) and are subject to an after the fact review by PJM and the PJM IMM. PJM states that offers above \$2,000/MWh would be dispatched in merit order. Additionally, PJM proposes to provide a detailed analysis for any offers above the current \$1,000/MWh offer cap, and this information will be filed in reports to the Commission.

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<sup>4</sup> PJM Energy Offer Cap Filing. at 4.

<sup>5</sup> See *PJM Interconnection, L.L.C.*, 150 FERC ¶ 61,020 at P 33 (2014) (“PJM FPA Section 206 Order”) (“[W]e find that PJM has demonstrated that the current offer cap of \$1,000/MWh in PJM is unjust and unreasonable for the winter months.”).

The proposed changes are patterned after the FPA section 206 revisions made to the energy offer cap for short term relief last winter by PJM and accepted by the Commission, with some modifications. Further, it should be emphasized the changes proposed in the filing are the result of a compromise proposal developed on an expedited basis in the stakeholder process in order to finalize and submit for FERC approval a proposal to be in place for this coming winter. Stakeholders coalesced around the instant proposal due to time concerns and the expectation of future further direction from the Commission regarding a long-term, interconnection-wide revision.

EPSA maintains as it has in previous comments that the appropriate and comprehensive solution, which relies on fundamental market principles to address the same issues that underpin the instant PJM filing, is to allow cost-based offers based on verifiable marginal costs to set the market clearing price,<sup>6</sup> as reflected in the PJM Docket No. ER14-1145 Waiver Request previously approved by the Commission and reiterated in PJM's Comments in the Docket No. AD14-14 Price Formation proceeding.<sup>7</sup> Accordingly, EPSA urges the Commission to provide specific guidance in its order directing PJM to work with market participants and other stakeholders on a long term solution which removes outdated restrictions on energy price formation, including offer caps, in order to promote efficient investment decisions to meet current resource

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<sup>6</sup> See Request of PJM Interconnection, L.L.C. For Waiver, Request For 7-Day Comments Period, and Request For Commission Action By February 10, 2014, Docket No. ER14-1145-000 (January 23, 2014) ("ER14-1145- 000 Waiver Request"). That filing was approved by the Commission on February 11, 2014. See *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,078 (2014) ("PJM Waiver Request Order"). Requests for rehearing were denied on October 21, 2014. See *PJM Interconnection, L.L.C.*, 149 FERC ¶ 61,060 (2014).

<sup>7</sup> *Price Formation in Energy and Ancillary Service Markets Operated by Regional Transmission Organizations and Independent System Operators*, Docket No. AD14-14-000 (June 19, 2014) ("Docket No. AD14-14 Price Formation proceeding").

challenges. Further, EPSA encourages the Commission to move forward expeditiously with a formal proceeding addressing energy offer price caps that will apply to all ISOs/RTOs to ensure the benefits and efficiencies of these market design improvements will be derived across the regions, and safeguard against distortions or artificial intertie signals across markets based simply on different offer cap levels or approaches between neighboring ISOs/RTOs.

## I. COMMENTS

### A. The Current PJM Energy Offer Cap Is Unjust And Unreasonable; The Commission Should Provide Guidance To PJM On Developing A Long-Term Solution Consistent With FERC Precedent And PJM's Stated Position

EPSA appreciates the fact that PJM and stakeholders diligently considered various proposals under an expedited timeline and agreed on a compromise solution approved by a supermajority as the basis for the PJM Energy Offer Cap Filing. Initially, this stakeholder discussion centered on developing a long-term solution as encouraged by the PJM Board,<sup>8</sup> but shifted to a short-term focus<sup>9</sup> after issuance of the Commission's Settlement Intervals and Shortage Pricing NOPR in Docket No. RM15-24 ("RM15-24 NOPR"), which indicated "[t]he Commission expects to undertake further action addressing various price formation topics, including **offer price caps**, mitigation,

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<sup>8</sup> See Direct Energy Presentation before the PJM Market Implementation Committee ("MIC"), Slide 2, (August 12, 2015), available at <http://www.pjm.com/~media/committees-groups/committees/mic/20150812/20150812-item-14b-pjm-energy-caps-08-15.ashx>.

<sup>9</sup> See Energy Market Offer Cap Potential Consensus Framework presentation before the PJM Markets and Reliability Committee, Slide 3, (October 1, 2015), available at <http://www.pjm.com/~media/committees-groups/committees/mrc/20151001/20151001-item-03d-potential-consensus-framework.ashx>.

uplift transparency, and uplift drivers.”<sup>10</sup> The PJM Energy Offer Cap Filing states consensus on the as-filed proposal “was reached in large part because stakeholders understood that these proposed revisions would address or avoid, in the near term, potential offer-cap consequences associated with energy uplift charges and unrecoverable generation costs, with as few Tariff and operational changes as possible.”<sup>11</sup> However, the instant proposal, even while interim in nature and moving in the right direction away from the existing hard cap, still has the potential to produce the same flawed market results – artificially suppressed market prices and inefficient resource selection – as maintaining a \$1,000/MWh offer cap. Further, proposing an uplift payment for bids above the proposed offer cap is inconsistent with longstanding Commission precedent as the Commission previously opined in the PJM Docket No. ER14-1145 Waiver Request Order.<sup>12</sup> EPSA’s serious concerns about flaws in energy market price formation under current rules and practices predates the extreme weather conditions experienced in January 2014, as well as last winter. In particular, the association has commented in extensive detail and submitted expert reports expressing concerns with the current offer price cap in PJM, as well as other ISOs/RTOs, and the need for a solution similar to that unanimously approved by the Commission for PJM in the Docket No. ER14-1145 Waiver Request.<sup>13</sup> As that PJM Docket No. ER14-1145 Waiver Request Order compellingly states,

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<sup>10</sup> RM15-24 NOPR at P 7. [Emphasis added.]

<sup>11</sup> PJM Energy Offer Cap Filing at 6.

<sup>12</sup> PJM Waiver Request Order at PP 40-41.

<sup>13</sup> See, e.g., Comments and Affidavit of the Electric Power Supply Association, Affidavit of Dr. Susan Liese Pope, Managing Director, FTI, Inc. (“Pope Affidavit”), *PJM Interconnection, L.L.C.*, Docket Comments and Affidavit of the Electric Power Supply Association, Affidavit of Dr. Susan Liese Pope,

**Market clearing prices derived from PJM's security constrained bid-based economic dispatch, where all bids have been appropriately mitigated for market power, yield competitive prices that all sellers should receive.**

Generators with marginal costs greater than \$1,000/MWh and that clear the market are, in fact, economic – not uneconomic, as some parties allege. The market clearing price under these conditions—even if it is higher than before—is a just and reasonable price that does not reflect the exercise of market power.

**Marginal cost bidding is competitive bidding. We did not anticipate that, when the \$1,000/MWh bid cap was adopted, it would prevent marginal cost bidding.** Presently, however, the \$1,000/MWh bid cap is preventing competitive marginal cost bids and resulting competitive prices that are needed to balance supply and demand.<sup>14</sup> [Emphasis added.]

EPSC further notes that the Energy Offer Cap proposal is contrary to the PJM position on the offer cap issue as outlined in its comments in the Price Formation Docket No. AD14-14 proceeding where the RTO stated:

PJM believes it is appropriate to **eliminate** the cap on cost-based offers. Resources should be allowed to recover their costs of providing energy and not be limited by any arbitrary cap. **Not allowing resources that provide energy the opportunity to recover their costs of operating would result in unjust, unreasonable, and likely confiscatory rates. While some may argue that not having a cap on cost-based offers would invite offers that would unreasonably raise prices on consumers, PJM does not believe this would be true.** In PJM, cost-based offers must be submitted in accordance with PJM's Cost Development Guidelines, which in [and] of themselves limit the type of costs that can be included in cost-based offers. Absent fraud or an inadvertent failure to adhere to the Cost Development Guidelines, the Cost Development Guidelines effectively cap cost-based offers at the approximate actual costs incurred by generation resources when operating.<sup>15</sup> [Emphasis added.]

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Managing Director, FTI, Inc. ("Pope Affidavit"), *PJM Interconnection, L.L.C.*, Docket No. ER14-1145-000 (filed January 30, 2014); Limited Protest of the Electric Power Supply Association, PJM Power Providers Group, and the New England Power Generators Association, *New York Independent System Operator, Inc.*, Docket No. ER14-1138-000 (filed January 29, 2014); Comments of the Electric Power Supply Association, *PJM Interconnection, L.L.C.*, Docket No. EL15-31-000 (filed December 23, 2014); Comments of the Electric Power Supply Association, *Midcontinent Independent System Operator, Inc.*, Docket No. ER15-691-000 (filed January 9, 2015); and, "The Polar Vortex: Implications for Improving the Efficiency of Wholesale Electricity Spot Market Pricing," by A. Joseph Cavicchi, Compass Lexecon, Prepared for the Electric Power Supply Association (March 2014).

<sup>14</sup> *Id.* at P 42.

<sup>15</sup> Comments of PJM Interconnection, L.L.C. at 3, *Price Formation in Energy and Ancillary Services Markets Operated by Regional Transmission Organizations and Independent System Operators*, Docket No. AD14-14-000, (filed March 6, 2015).

Importantly, although the offer cap is rarely triggered, when it is, there are major negative consequences for the market, as both PJM and the Commission previously recognized in the PJM Docket No. ER14-1145 Waiver Request proceeding. In the instant proceeding, the PJM proposal to pay uplift (i.e., make whole payments) above the proposed short-term cap of \$2,000/MWh is contrary to the tone and tenor of the majority of speakers at the Commission’s September 8, 2014 Price Formation Workshop on Uplift Payments in Energy and Ancillary Services Markets; allowing this, even for a limited period, is also contrary to prior Commission action that uplift as opposed to “efficient market signals – not constrained by a cap – should provide market participants with the information necessary to make informed business decisions, including hedging fuel risk.”<sup>16</sup>

Finally, the PJM filing notes that regarding the longer term, “the Commission recently indicated that it expects to issue a rule regarding offer price caps, which PJM and its stakeholders expect will apply on a national level.”<sup>17</sup> EPSC acknowledges this, but requests that the Commission provide specific guidance to PJM in its order to direct PJM and its stakeholders to begin work *now* on a long-term solution to address the market setting price.

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<sup>16</sup> PJM Waiver Request Order at P 41.

<sup>17</sup> PJM Energy Offer Cap Filing at 6.

## **B. The Commission Should Move Forward Expeditiously On Issuance Of A Proposed Rulemaking Addressing Offer Price Caps**

EPSA is encouraged by and strongly supports the Commission's statement in the RM15-24 NOPR that it expects to undertake further action addressing additional price formation topics, including offer price caps. This broader effort is directly relevant to the specific PJM Energy Offer Cap filing, as EPSA has consistently opined that holistic reforms are required on this issue to address seams and interdependency among the regions.<sup>18</sup> EPSA has urged the Commission to address this issue on a generic basis in the numerous waiver and related offer cap filings submitted by ISOs/RTOs to date.<sup>19</sup> As an example, failure to promptly address the energy offer cap in other regions adjacent to PJM, such as New York, raises significant reliability issues for PJM's neighboring control areas that share common interstate natural gas pipeline supplies. Specifically, differences in energy offer price caps between adjacent regions could impact access to

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<sup>18</sup> "As we have previously stated 'California is an integral part of a trade and reliability region in the West. Because of this interdependency of market and infrastructure, conditions in and changes to the California market affect the entire region.' Given this interdependency, we have previously determined that it would be advisable to have consistent caps in the CAISO and the rest of WECC.' In addition, a lower cap in the WECC could result in reduced supply options available to WECC purchasers." *Western Electric Coordinating Council*, 131 FERC ¶ 61,145 at P 7 (2010) (citing *California Independent System Operator Corp.*, 114 FERC ¶ 61,135, at P 14 (2006).

<sup>19</sup> See Request of PJM Interconnection, L.L.C. For Waiver, Request For 7-Day Comments Period, and Request For Commission Action By February 10, 2014, Docket No. ER14-1145-000 (January 23, 2014) ("ER14-1145- 000 Waiver Request"). That filing was approved by the Commission on February 11, 2014. See *PJM Interconnection, L.L.C.*, 146 FERC ¶ 61,078 (2014) ("PJM Waiver Request Order"). Requests for rehearing were denied on October 21, 2014. See *PJM Interconnection, L.L.C.*, 149 FERC ¶ 61,060 (2014); *PJM Interconnection, L.L.C.*, Docket No. EL15-31-000 (filed Dec. 15, 2014) ("PJM Offer Cap Filing"); also, see *California Independent System Operator Corporation*, Petition for Limited Waiver of Tariff Provisions, Request for Shortened Comment Period, and Request for Expedited Commission Action by March 19, 2014, Docket No. ER14-1440-000, filed March 6, 2014; *Indicated CAISO Suppliers*, Emergency Request for Temporary Waiver and Shortened Comment Period, Docket No. ER14-1428-000, filed March 4, 2014; *Midcontinent Independent System Operator, Inc.*, Request for Waiver, Docket No. ER15-961-000 (filed December 19, 2014); *New York Independent System Operator, Inc.*, Petition for Temporary Tariff Waivers, Request for Shortened Comment Period, and Request for Expedited Commission Action by January 31, 2014, Docket No. ER14-1138-000 (filed January 22, 2014).

fuel in the event that natural gas supplies and natural gas transportation become tight during severe weather and/or operational conditions, and higher caps and related rules in one RTO allow market participants in that RTO the ability to reflect the high gas prices that may need to be paid to attract limited gas supplies, but the offer caps and related rules in the adjacent RTO do not. Further, differing cap levels may also interfere with efficient import and export decisions at the seams, since one control area will show significantly higher real time (“RT”) energy prices compared to the neighboring control area which has not proposed to increase its offer cap.

The perspectives of ISO/RTO market monitoring experts at the Commission’s October 28, 2014 Price Formation Workshop were compelling and indicated that, at the time of its imposition, the \$1,000/MWh offer cap was considered a “stop gap” measure under different conditions.<sup>20</sup> These market conditions have long since changed given

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<sup>20</sup> Excerpt of Transcript from October 28, 2014 Price Formation Workshop on Scarcity and Shortage Pricing, Offer Mitigation, and Offer Caps in RTO and ISO Markets, Docket No. AD14-14, reflecting the workshop Panel 3 (ISO/RTO Internal and External Market Monitors) discussion on goals of offer caps and market power mitigation, and in particular, the theory behind the current \$1,000/MWh offer cap and how it relates to current market power mitigation provisions:

Jeffrey McDonald, Vice President, Market Monitoring, ISO New England, Transcript at Page 207, Lines 8-9, 11-17:

8 As to where the \$1000 came from, I always thought  
9 it came from FERC.  
11 MR. McDONALD: I think it's an administrative  
12 cap, but I don't know where it came from. But we were--does  
13 anyone here have enough institutional history to--I know,  
14 and I don't speak for California, but I did used to work  
15 there. I know we were encouraged to move towards the \$1000  
16 cap over a period of time, and that seemed to be the point  
17 that everyone was encouraged to gravitate towards.

Joseph Bowring, PJM IMM, Transcript at Page 209, Lines 14-16,18-22:

14 MR. BOWRING: It was actually the highest number  
15 anybody could think of at the time and then multiplied by  
16 five.  
18 MR. BOWRING: Seriously. It was a number that  
19 people thought could never be reached, and as my colleagues

the significant improvements in electric market pricing and market monitoring since establishment of the current caps, which overwhelmingly supports not just reconsideration of, but removal of such a mechanism.<sup>21</sup> Most germane is the continued development of both the regional and national mitigation and enforcement programs. In PJM for example there is extensive mitigation to protect consumers and the market from seller- and buyer-side market power, enforced through detailed review and oversight of market behaviors and trends by the RTO's Independent Market Monitor ("IMM"), Monitoring Analytics.<sup>22</sup> The IMM mitigates the market to ensure that entities with FERC-approved market-based rate authority are not able to exert market power based on market or geographical factors. Such mitigation is extensive and pervasive, including the three pivotal supplier test and other related measures.

Further, the Commission's own Office of Enforcement ("OE") has seen dramatic growth in the past few years, buffeted by enhanced authority included in the Energy Policy Act of 2005 ("EPAct 2005"). OE's office is a multi-disciplinary team of economists, engineers, attorneys, auditors, data management specialists, financial

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20 here said, it was therefore a backstop. But it was just  
21 considered to be beyond the possible pale. That's where it  
22 came from.

<sup>21</sup> Pope Affidavit at PP 15-19.

<sup>22</sup> "Since 1999, the PJM Market Monitoring Unit has been responsible for promoting a robust, competitive and nondiscriminatory electric power market in PJM by implementing the PJM Market Monitoring Plan. Under the PJM Market Monitoring Plan, the PJM Market Monitoring Unit has been responsible for monitoring compliance with the rules, standards, procedures, and practices of PJM markets. We observe and comment on actual and potential design flaws in market rules, standards, and procedures, and identify structural problems in PJM markets that may inhibit robust and competitive markets. We monitor the potential of market participants to exercise undue market power, the behavior of market participants that is consistent with attempts to exercise market power and the market performance that results from the interaction of market structure with participant behavior. We monitor the actions of PJM and the impact of those actions on market outcomes." Available at <http://monitoringanalytics.com/company/about.shtml>.

analysts, regulatory policy analysts, energy analysts, and support staff organized in to four separate divisions tasked with carrying out the office's priorities: (1) fraud and market manipulation; (2) serious violations of the Reliability Standards; (3) anticompetitive conduct; and, (4) conduct that threatens the transparency of regulated markets.<sup>23</sup> Pursuant to EAct 2005, the Commission has enhanced civil penalty authority and may impose fines up to \$1 million per violation/per day, as well as require disgorgement of profits, for violations under the Federal Power Act, Natural Gas Act, Natural Gas Policy Act of 1978 and the Interstate Commerce Act. Other enforcement tools include the option of conditioning, suspending, or revoking market-based rate authority, and the Commission also has the ability to refer matters to the Department of Justice for criminal prosecution. These oversight and auditing functions are extensive and transparent, protecting consumers and the wholesale markets from undue discriminatory or preferential behavior by market participants. The Commission has significantly refined its policies with respect to electric market-based rate authority through a major rulemaking and other related proceedings.<sup>24</sup>

EPSA submits the record is compelling that, based on recent events across the ISOs/RTOs, the market has evolved to render the arbitrary offer cap, particularly at the

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<sup>23</sup> 2014 Report on Enforcement, Docket No. AD07-13-008, prepared by Staff of the Office of Enforcement (dated November 20, 2014), page 2. Available at <http://www.ferc.gov/legal/staff-reports/2014/11-20-14-enforcement.pdf>.

<sup>24</sup> *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, *clarified*, 121 FERC ¶ 61,260 (2007) (Clarifying Order), *order on reh'g*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268, *clarified* 124 FERC ¶ 61,055, *order on reh'g*, Order No. 697-B, FERC Stats. & Regs. ¶ 31,285 (2008), *order on reh'g*, Order No. 697-C, FERC Stats. & Regs. ¶ 31,291 (2009), *order on reh'g*, Order No. 697-D, FERC Stats. & Regs. ¶ 31,305 (2010), *aff'd sub. nom. Mont. Consumer Counsel v. FERC*, 659 F.3d 910 (9th Cir. 2011), *cert. denied*, 133 S. Ct. 26 (2012), *Refinements to Policies and Procedures for Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 816, 153 FERC ¶ 61,065 (2015).

current level of \$1,000/MWh, outdated and distortive.<sup>25</sup> Commission leadership and expedited action is required now to address a just and reasonable offer cap methodology on a national basis, rather than establishing another seemingly arbitrary offer cap. In the proposed rulemaking, the Commission should require all ISOs/RTOs to work with stakeholders to allow cost-based offers based on verifiable marginal costs to set the market clearing price<sup>26</sup> by a date certain not later than November 2016 to allow changes to go in to effect for the winter of 2016/2017.

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<sup>25</sup> *California Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,076, at P 488 (2007) (the Commission stated that “[a] significant downside to ‘soft’ caps is the lack of transparency and uplift costs they create. For these reasons, if generation costs were to appear sufficiently likely to exceed the prevailing cap, our preferred approach would be to adjust the level of the energy cap, as has been done in the past. This way, instead of suppressing the market clearing price by regulatory fiat, all competitive bids would be allowed to clear supply and demand and send transparent price signals to encourage demand response, market entry, and forward contracting”).

<sup>26</sup> Such guidance is similar to the approval previously granted to PJM in the Docket No. ER14-1145 Waiver Request.

### III. CONCLUSION

**WHEREFORE**, EPSA respectfully requests that the Commission grant the requested approval to PJM by December 14, 2015, as discussed herein. Additionally, the Commission should provide specific guidance and direct PJM to work with market participants and other stakeholders on a long term solution which reconsiders all restrictions on energy offers or price formation outcomes in order to promote efficient investment decisions. Further, EPSA urges the Commission to move forward expeditiously with its formal rule on offer price caps that will apply to all ISOs/RTOs to ensure the benefits and efficiencies of these market design improvements will be derived across the regions and protect against seams or inter-market distortions.

Respectfully submitted,

*/s/ Nancy Bagot*

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Dated: November 4, 2015

**CERTIFICATE OF SERVICE**

I hereby certify that I have served a copy of the comments via email upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., November 4, 2015.

*/s/ Nancy Bagot*

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Nancy Bagot, Sr. Vice President