Akin

FERC Takes Modest Step Forward in RTO/ISO Price Formation

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Specifically, FERC is proposing to revise its regulations to require that each RTO/ISO:

- settle real-time energy transactions at the same time interval that the RTO/ISO uses to dispatch energy (e.g., every five minutes), and settle operating reserves transactions in the real-time market at the same time interval used to price operating reserves
- trigger shortage pricing measures during any dispatch interval where there is an actual shortage of energy or operating reserves, regardless of the duration of the shortage.

While this is an important first step in addressing inefficient market rules, the NOPR offers only incremental reforms and leaves many of the larger issues discussed in the price formation proceeding for another day. FERC intends to take further action at a later date to address other price formation topics, including offer caps, energy market mitigation and uplift.

Settlement Intervals

With respect to settlement of real-time energy and operating reserves transactions, FERC notes that some RTOs/ISOs (ISO New England, Midcontinent ISO and PJM Interconnection) price energy and dispatch resources at five-minute intervals, but settle transactions (i.e., pay producers for their energy) based on an hourly average price. FERC preliminarily concludes in the NOPR that this settlement practice is unjust and unreasonable, because it may result in distorted price signals and may contribute to markets failing to respond to system operating needs.

FERC explains that hourly average prices may not reflect the value of the service that resources provide during a specific five-minute dispatch interval. The Commission also states that hourly average prices can send an inappropriate signal to resources to disregard dispatch instructions. For example, FERC explains that high prices in the early dispatch intervals of an hour can encourage resources to ramp up their production to capture those high prices across the hour, even as demand and prices fall and resources receive instructions to correspondingly reduce their output in later dispatch intervals. FERC pointed to higher uplift payments as another disadvantage to hourly settlements.

Anticipating concerns that modifying RTO/ISO settlement systems will be burdensome and costly, FERC proposes to allow RTOs/ISOs 12 months from the date of their compliance filings (which would be due four months from the effective date of a Final Rule in the proceeding) to implement the required settlement reforms. FERC also asks for comment on the software and equipment changes that may be required to implement the settlement reforms, whether those changes would be necessary to implement other planned reforms and whether this implementation period could be shortened.

In addition, FERC seeks comment on whether the proposed settlement reforms which would apply to transactions only within an RTO's/ISO's borders, should also apply to transactions at the intertie between RTOs/ISOs.

Shortage Pricing

FERC's Order No. 719 (adopted in 2008) required RTOs/ISOs to have in place shortage pricing rules that raise the price of energy during operating reserve shortages to a level that "reflects the value of energy" during such an event. In the NOPR, FERC expresses concern that some RTOs/ISOs (including PJM and Southwest Power Pool) do not initiate their shortage pricing rules in all operating reserve shortage events, instead triggering the higher prices only for certain kinds of shortages or only for shortages that last more than a minimum amount of time. According to the Commission, not invoking shortage pricing during an operating reserve shortage, regardless of the duration of the shortage or its cause, "may result in unjust and unreasonable rates because prices do not accurately reflect the value of energy during a shortage." FERC emphasizes in the NOPR that it is proposing reforms to only the triggers for invoking shortage pricing–not to the level of shortage prices that resources receive.

Comments on the NOPR are due 60 days after publication in the *Federal Register*.

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