PJM INC/DEC Credit Policy for Winter 2015 – Proposal

Stephanie Staska
Twin Cities Power
History

• The current INC/DEC credit requirements were established in 2003.
• They include a Nodal Reference Price that is used in the bid screen process.
• This Nodal Reference Price is calculated individually for each location on the PJM grid.
• For the bid screen these prices are multiplied by the volume (MWh) of the INC/DECs to determine the credit requirements.
January and February 2015

• The January and February 2015 Nodal Reference Prices are based on the prices in the prior reference period (January and February 2014), so they are already known.

• The prices average 10x greater than the Nodal Reference Prices that were in place during January and February 2014, and many are in the range of $300-$500/MWh.
PJM Example

- PJM West Hub Jan/Feb 2015 Nodal Reference Price ~ $316/MWh.
  - To do a 50 MW on peak (800 MWh) INC or DEC, this would cost a participant $250k in a credit requirement.
  - The cost of capital (assuming 5%) for a market participant for this transaction: $35.08, ten times higher than in Jan/Feb 2014.
  - This cost is in addition to BOR, Schedule 9 fees already incurred.
Other Markets

• MISO’s virtual bid credit requirement is a fixed $18.47, which was increased after January 2014 from $8.68.
  • The same 50MW virtual would cost $15k, 17x lower than PJM.
  • Uplift fees have also been historically lower than PJM.

• To do a daily futures contract on ICE
  • The equivalent 50MW position would cost $50k, 5x lower than PJM.
  • Fee to transact on ICE: $8.02 on average, which is significantly less than on PJM.
Why is this a problem?

• The membership should be concerned about the impact this may have on the INC/DEC market during this upcoming winter period.

• This could impact:
  
  – Market competition and liquidity.
  
  – Fee levels for not only INC/DEC players, but other market participants as well.
Market Competition/Liquidity

- Will there be any significant volume left in the INC/DEC market at these credit levels?
- Will the volume come back in the wake of this uncertainty?
- ISO-NE 2010 SOM Report:
  "Virtual transactions in the Day-Ahead Energy Market play an important function, generally increasing liquidity, improving commitment, and limiting the exercise of market power. Virtual positions act to converge the day-ahead and real-time prices, and, in so doing, reduce the need for supplemental commitments in real time and the uplift costs associated with these positions. The imposition of a high level of transaction costs may threaten the viability of virtual transactions in the Day-Ahead Energy Market, with potentially serious implications for the performance of the market."
Market Competition/Liquidity

• ISO-NE 2011 SOM Report:

"The IMM is concerned with the continued decline in the volume of virtual trades where virtual transactions are needed to provide an adequate level of liquidity in the Day-Ahead Energy Market. Analysis suggests a relationship between the allocation of Net Commitment-Period Compensation charges to virtual transactions and the observed decline in trading activity (see Section 3.1.2.5). The IMM recommended in the 2010 Annual Markets Report that the ISO revise the market rules so that real-time NCPC charges do not prevent virtual transactions from providing the benefits of improved liquidity in the day-ahead market. The IMM continues to support this recommendation."
Proposal

- Keep the current construct in place for Jan/Feb 2015 with the following change:
  - Broaden the sample size
    - Include not only Jan/Feb 2014, but also Jan/Feb 2013 and Jan/Feb 2012.
    - Still includes Jan/Feb 2014 data.
- Requiring an update to FERC on progress on the long term INC/DEC credit review by June 30, 2015.