

Forward Capacity Contracts, or: How I Learned to Stop Worrying and Love the Market

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Do we have a truly competitive market?

- “NO!” ELCON review of 3 NE Markets
“Today’s Organized Markets – A step toward competition or an exercise in re-regulation,” 12/04/06
- ELCON is right
- On the other hand, we will not see a truly competitive market for the foreseeable future.
- What’s a poor boy to do?

Generation Reliability

- Historic goal of 1 day shortage every 10 years
 - Goes back at least to 1965 NE Blackout
 - A key driver in forming original power pools
 - EPACT 2005 reaffirms importance of reliability
 - Critical to economic, social activity
 - Need to clear market in real time – no inventories
 - Hard to ration during shortage periods

Some Personal Prejudices

- Some Type of Capacity Market needed
 - Competitive retail contracts typically 1 or 2 years
 - Market power problems in Energy Market potentially severe when capacity tight
 - “Tragedy of the Commons” – public good
- But
 - Capacity is not a product
 - Few Parallels – perhaps highways and bridges

On the Ground in New England

- Devon Case
 - Old Units, Expensive to run, located in constrained area
 - They received RMR contracts but FERC ordered a locational capacity market for longer term fix
- ISO-NE Proposal
 - Monthly capacity market
 - Demand curve
 - Heavy opposition from load and state regulators
 - FERC ALJ recommended adoption

The Settlement Agreement

- Interim Payments
 - Payments of \$3.05 to \$4.10 per kw-mo through 6/2010
 - Payments not location specific
 - Will do little to encourage new generation
 - Essentially a payoff to existing generators

The Settlement Agreement (2)

- Forward Capacity Market
- Hold annual descending clock auctions to procure capacity during the delivery period, 3 years in future
 - Allows new and existing generation to compete
 - Allows price separation where transmission constraints exist*
 - Delivery period 1 year for existing units, up to 5 years for new units

Locational Aspects of FCM

- Determine export constraints based on bids
- Import constraints predetermined
- Treatment of transmission costs to eliminate constraints still unclear
 - Transmission cost rules critical to efficient decision making

Market Failure Provisions

- Restrictions on delist and permanent delist bids
- Inadequate supply
- Insufficient competition
- Local reliability Issues
- Peak Energy Rent (PER) Offset

Will the FCM Work?

- Little to no experience, so time will tell
- Hinges on robust competition for a small amount of new capacity
 - Are enough sites available?
 - Can mechanism be gamed?
 - Are parameters wrongly specified?
- Will know much more in 12 months, but ISO appears optimistic based on inquiries to date