

NEPGA Initial Proposal for Alternative Price Rule Reforms

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Role of APR

- Ensure that capacity prices will reflect the price needed to elicit new entry when new capacity is needed.
- In the absence of the APR, the price in the FCA could be depressed ... if enough new capacity is self-supplied (through contract or ownership) by load.
- If owners of these two categories of resources control more new capacity than the amount of new capacity needed in a capacity zone, their low bids could artificially depress the price in the FCA.
- It is reasonable to reset the clearing price to a level that would be expected in a competitive market that needs new capacity.

Devon Power LLC, Order Accepting Proposed Settlement Agreement, 115 FERC ¶ 61,340 (2006) PP 113-114

Principal Weaknesses of Current APR

- Out-of-Market Capacity definition is too narrow
- Large quantity of OOM can have a delayed and/or multi-year effect
- *Any* market-based entry causes APR not to trigger
- Reset price may not reflect economic cost of the required capacity
- Treatment of cleared De-List Bids fails the “no regrets” test

Out-of-Market Capacity Definition

- “New as Existing” exemption for FCA1
 - Allowed 585 MW of new resources to be exempt from OOM treatment
 - No proposed change for FCA1 results
 - But include this capacity in Past Excess OOM capacity
- Rejected De-List Bids
 - Has effect of artificially shifting supply stack and lowering clearing price
- State-Mandated or -Subsidized Resources
 - May include DR or Renewables
 - Entry decision largely independent of clearing price in FCA
- Proposal:
 - Expand definition for of OOM beginning with FCA4
 - Reclassify resources cleared in FCA1—FCA3 for use in the Past Excess OOM metric in the revised APR trigger

Managing Past Excess OOM

- Current APR did not contemplate OOM of such scale that it could meet many years' New Capacity Requirement (NCR)
 - $NCR = NICR - \text{Existing Capacity}$
- Capacity Carry-Forward Rule was designed as a multi-year mechanism to count over-purchases of new capacity in one year towards price-setting in subsequent years, as it is deployed
- A parallel mechanism is needed for OOM Capacity
- **Proposal:**
 - Accept INTMMU proposal to modify 2nd APR trigger
 - $NCR + \text{Cleared Permanent Delist Bids} + \text{Past Excess OOM} > 0$
 - Also exclude Non-Priced Retirements from Existing Capacity

Required Scale of OOM

- OOM Capacity necessarily displaces other market-based new entry
- Displaced entry results in some degree of price suppression
- But current APR only corrects if 100% of market-based new entry
 - If 900 MW NCR is met with 899 MW of OOM and 1 MW from a plant upgrade, APR does not trigger
- **Proposal:**
 - Eliminate 3rd trigger of APR, so any amount of OOM can trigger APR
 - Modify price reset rule so that price increase reflects scale of OOM
 - Small amount of OOM → small effect of APR

Reset price may not reflect market cost of required capacity

- APR was intended to “reflect the price needed to elicit new entry”
- But since the supply curve is not flat, the price needed to elicit *all* the NCR should vary with the quantity OOM Capacity
- Current APR looks only to the next available MW of market-based new supply
 - Too high? OOM Capacity deters competing offers of new supply
 - Too low? 1 MW may be available cheaply, but to meet the ICR served by OOM Capacity with market-based capacity likely requires a higher price
- **Proposal:**
 - Reconstruct the supply stack with competitive offers imputed to OOM Capacity

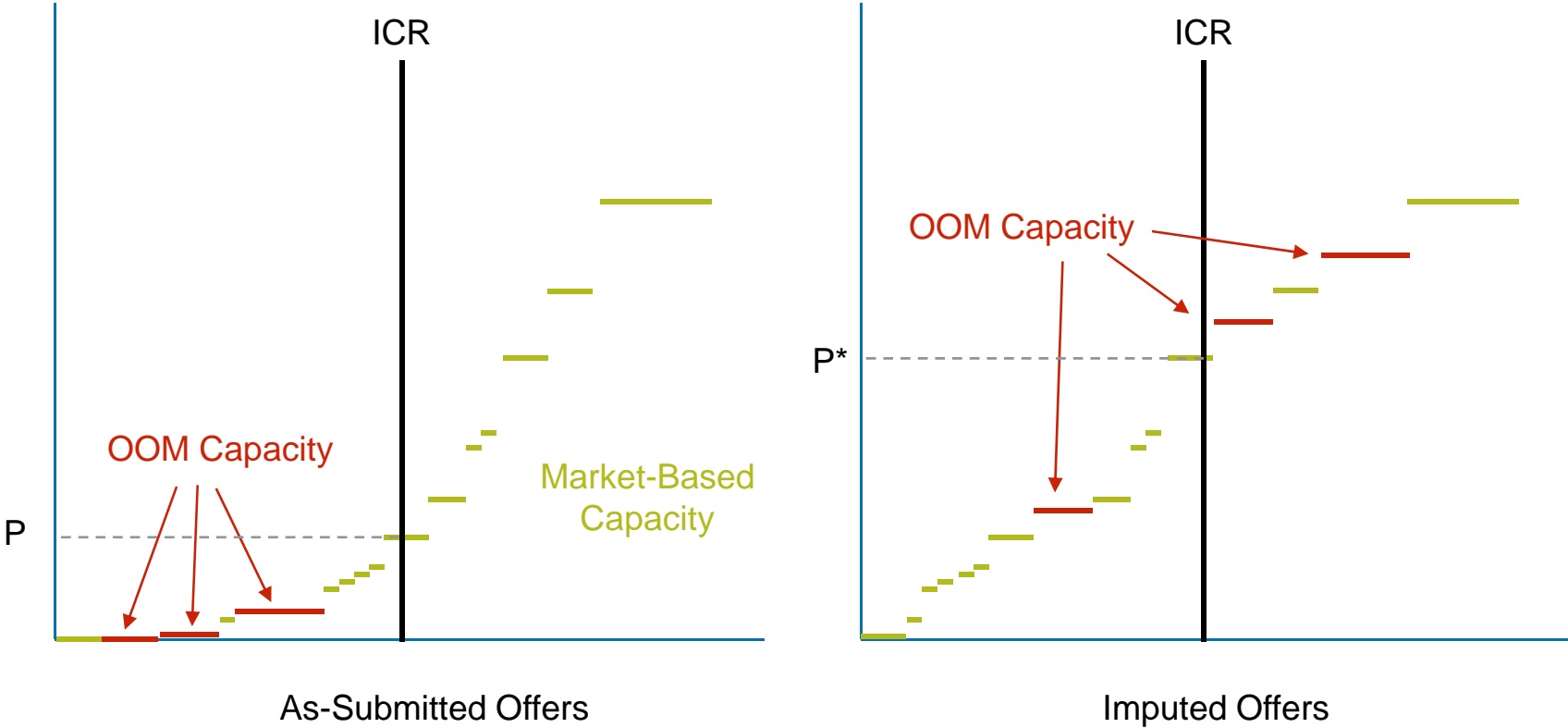
Imputing Prices to OOM Capacity

- INTMMU would develop estimated of competitive capacity offer price for all OOM Capacity
- Estimate based on best available information; in sequence:
 - Resource-specific cost and revenue projections
 - Competitive offers from similar, market-based resources
 - Technology-specific cost and revenue projections
 - CONE (only if no other approach is possible)

Clearing the FCA with Imputed Offers

- Capacity Supply Obligations assigned by FCA conducted with as-received offers
- Auction Manager notes price at which the FCA would have cleared had each OOM Resource exited at its imputed offer
- Final Capacity Clearing Price set to this “but for” price

Graphical Example of Re-Cleared FCA



Treatment of “Between” De-List Bids

- Current APR has no treatment for “between” De-List Bids
 - Bids from existing resources that are accepted, but at a price below the final clearing price after action of APR
- Results in distorted incentives for bidding
 - De-List Bid should reflect going-forward costs net of expected earnings
 - But if APR *might* be invoked, existing resources want to stay in to get the APR-set price
 - Could lead to *insufficient* de-list bids offered to clear the FCA
- **Proposal:**
 - Borrow pro-rationing rule from the Transition Period
 - Total capacity payments fixed at $ICR \times P^*$
 - De-List Bids cleared below P^* are reinstated at owners’ option (adding quantity Q)
 - Effective price set at $(ICR \times P^*) / (ICR + Q)$

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