

Non-Commercial Capacity Financial Assurance Improvements



Design objectives and concept overview

Ryan McCarthy

413.540.4071 | RYMCCARTHY@ISO-NE.COM



Today's Focus

- Today's presentation describes the ISO's proposal to enhance the Non-Commercial Capacity Financial Assurance (NCFA) design and introduces key design concepts of the proposed improvements
- The proposed concept is to add a new NCFA element: "trading NCFA" in addition to the existing structure
- A more detailed discussion on the design mechanics will take place at the August 2019 Budget and Finance Subcommittee meeting

BACKGROUND



NCFA and the FCA qualification process determine which projects can participate in an FCA

- Forward Capacity Auction (FCA) qualification and the interconnection process establish a MW quantity and timeframe for when a proposed project can be reasonably expected to be delivered
- NCFA collateral requirements for proposed projects put capital at risk until the proposed project is delivered
- Both qualification and NCFA are intended to ensure that proposed projects are “real” without creating an inefficient barrier to entry

“New” proposed projects have multiple collateral requirements associated with the FCA

- On the fifth business day following qualification for the FCA, participants must post the FCM Deposit based upon their qualified non-commercial MW
- 10 business days prior to the FCA, participants with non-commercial projects are required to post collateral based upon the FCA Starting Price and their qualified non-commercial capacity
- Once the FCA is complete, collateral requirements are recalculated based upon the FCA clearing price and the cleared non-commercial capacity



Example: NCFA associated with the FCA

For a proposed project in FCA 13 with 100MW of qualified non-commercial capacity:

- **FCM Deposit: \$200K.** $\$2/\text{kW} \times 100 \text{ MW} \times 1000$
Deposit x Qualified Non-Commercial Capacity
- **“Pre-Auction” NCFA: \$1.3M.** $\$13.05/\text{kW} \times 100 \text{ MW} \times 1000$
FCA Starting Price x Qualified Non-Commercial Capacity
- **“Post-Auction” NCFA: \$380K.** $\$3.80/\text{kW} \times 100 \text{ MW} \times 1000$
FCA Clearing Price x Cleared Non-Commercial Capacity

Note: These amounts show a changing requirement and are not additive.



NCFA confirms a participant's continued intent to deliver the project

- Additional NCFA installments increase the collateral requirement and thus the financial consequences if the project continues to elect to participate, but does not deliver
- Each subsequent year, ten business days ahead of each FCA, a participant's collateral requirement is increased for any projects that are not delivered
- Additionally, a participant's collateral requirement is increased for each six-month period after the start of the Capacity Commitment Period (CCP) for which the project initially cleared and is not delivered



Example: NCFA increases over time

Building from the example on slide 6:

- **“Post-Auction” NCFA: \$380K**
- **“Pre-second FCA” NCFA: \$760K**
2 installments x \$3.80/kW x 100 MW x 1000
- **“Pre-third FCA” NCFA: \$1.14M**
3 installments x \$3.80/kW x 100 MW x 1000

Assuming the project misses the first delivery period then:

- **Late Delivery 1 NCFA: \$1.52M**
4 installments x \$3.80/kW x 100 MW
- **Late Delivery 2 NCFA: \$1.9M**
5 installments x \$3.80/kW x 100 MW

Additional installments (of \$380K) would be required each six months until the project was delivered or terminated/withdrawn



When a proposed project becomes commercial NCFA is reduced

- As projects with FCA cleared non-commercial capacity achieve commercial operation, participant's collateral requirements are reduced based upon how much of the project is delivered
- Projects that do achieve commercial operation for FCA cleared non-commercial capacity (and are terminated or withdraw from monitoring) forfeit the associated collateral



Participants with delayed projects may also trade out of their CSO

- Participants are able to trade their Capacity Supply Obligation (CSO) in annual reconfiguration auctions (ARAs), monthly reconfiguration auctions (MRAs) or through monthly bilateral contracts
- Depending on market conditions, a participant can incur a gain or loss associated with trading a CSO
- Regardless of the trading outcomes, NCFA is retained until the project is delivered or terminated/withdrawn

Example: Trading a CSO - positive trading revenue

Building on the prior example:

- FCA price and quantity = \$3.80/kW-month for 100 MW (acquire)

Assume the following result in ARA3: a participant decided to trade their project's non-commercial capacity obligation prior to the start of the delivery period

- ARA3 price and quantity = \$1.80/kW-month for 100 MW (shed)

The participant has positive trading revenues as they shed their non-commercial CSO at a lower price than they originally acquired it

- **ARA3 Trading Revenue: \$2.4M**

$(\$3.80/\text{kW-month} - \$1.80/\text{kW-month}) \times 100 \text{ MW} \times 12 \text{ months} \times 1000$

$(\text{FCA Clearing Price} - \text{ARA3 Clearing Price}) \times \text{Cleared Bid} \times 12 \text{ months} \times 1000$

AREAS FOR IMPROVEMENT



Trading revenues weaken incentives to deliver projects or exit market promptly

- Participants may have incentives to stay in the market (and trade out of their CSO) rather than exiting the market
 - Participants that have positive trading revenues in excess of their NCFA have reduced (or no) financial exposure for non-delivery of a proposed project
- The existing NCFA design does not consider potential trading revenues in its collateral calculations
 - Historically, many ARAs and MRAs clear at prices below the associated FCA price for a given CCP resulting in the potential for a participant to have positive trading revenues

Example: Interaction between NCFA and Trading Revenues

- Building upon the prior examples recall that a project that is more than six months late and decides to cover for the period would have the following:
 - NCFA: \$1.90M
 - ARA3 Trading Revenue: \$2.4M
- NCFA equals \$1.90M (forfeited if not delivered) and trading revenues equal to \$2.4M (paid regardless if the project is delivered), which nets to a positive cash flow of \$500K, even if the project does not deliver

DESIGN OVERVIEW



Design Objectives

Objective 1: Ensure that participants with non-commercial projects maintain collateral at risk until the project is delivered

- The net financial obligation of a project should minimally equal the NCFA collected by the ISO

Objective 2: Ensure that participants with non-commercial MW face increased financial consequences for not delivering a project if they clear in additional FCAs

- Participants should be evaluating if they should continue to clear in the auction based upon their ability to deliver the project, not based upon potential trading profits

Proposed design will ensure that collateral is always at risk until the project becomes commercial

- **Proposal:** Increase the total NCFA to include any positive trading revenues made by the participant when trading out of their CSO (i.e., “trading NCFA”) in addition to the existing NCFA (i.e., “base NCFA”)
 - Once the project is delivered, the collateral requirements will be reduced following a similar process to today
 - No changes are required to the existing FCM settlement processes
- The proposed modifications remove financial incentives for participants with non-commercial capacity to remain in the market to trade out of their CSO to capitalize on favorable market conditions
 - The longer the project remains qualified the greater the collateral requirements and increased financial consequences for non-delivery

Example: Interaction between NCFA and Trading Revenues

- Building upon the prior examples recall that a project that is more than six months late and decides to cover for the year would have the following:
 - NCFA (or Base NCFA): \$1.90M
 - ARA3 Trading Revenue: \$2.4M
- **Trading NCFA: \$2.4M**
ARA3 Trading Revenue
- **Total NCFA: \$4.3M.** $\$2.4M + \$1.9M$
Trading NCFA + Base NCFA
- Total NCFA equals \$4.3M and trading revenues equal to \$2.4M, which nets to a negative cash flow of \$1.9M equal to the base NCFA

Proposed design maintains collateral at risk until the project is delivered

- The proposed changes achieve both design objectives since trading revenues can no longer offset NCFA
 1. Ensure that participants with non-commercial projects maintain collateral at risk until the project is delivered
 2. Ensure that participants with non-commercial projects face increased financial consequences for not delivering a project if they clear in additional FCAs

STAKEHOLDER SCHEDULE



Stakeholder Schedule

Stakeholder Committee and Date	Scheduled Project Milestone
Budget and Finance Subcommittee June 7, 2019	Project introduction and discussion
Budget and Finance Subcommittee August, 2019	Introduction to design details and continued discussion
Budget and Finance Subcommittee TBD on date (If needed)	Continued discussions
Participants Committee September or October 2019	Vote on proposed Tariff language