

Capacity Market Advocates Review of Progress

Presented to
CAISO Market Surveillance Committee
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On Behalf of Capacity Market Advocate Group

Capacity Market Advocate Working Group

Ad hoc group of market participants (IOUs, generators, importers, ESPs) that believe a capacity market is the best solution to resource adequacy and are interested in accelerating consideration of capacity market mechanism in California.

Working together to review and understand capacity market options and develop consensus
Build on CPUC's RA process and integrate into ongoing market development

Why Capacity Market

- Overcomes energy market mitigation
 - Price caps, Lack of scarcity pricing and retail price signals, uncompensated MOO, lack of adequate long-term contracting
- Provides structure to capacity procurement
 - Market power mitigation, facilitates transactions, market price signals, solves binary pricing
- Improved incentive for new infrastructure
 - Incentive for LSEs to contract, direct cost recovery mechanism for new merchants
- Resolves many problems w/RA program
 - Liquidity, market power mitigation, load migration, stranded capacity costs, potential bypass of RAR obligations, potential cross-subsidies

Consensus Issues

1. A centrally administered capacity market is necessary in California.
2. The capacity market design should support and facilitate bilateral contracting.
3. The capacity requirement should be established and publicly stated several years in advance.
4. Separate capacity requirements should be established for defined transmission constrained locations and non-transmission constrained locations.
5. The CAISO (or some other independent entity) should administer the capacity market.
6. Specific procedures should be established to qualify physical generation including imports, and dispatchable demand resources as eligible to meet the capacity requirement.
7. Capacity market design should be as simple and uncomplicated as possible to accomplish goals

Primary Open Issues

- Market Timing – Month ahead or 4 years forward
- Pricing mechanism – downward sloping or vertical demand curve
- Energy rent offset – implicit or explicit, magnitude and timing
- Performance incentives – whether and how to maximize availability

Market Timing Consensus

- Requirement should be established and publicly available several years in advance
- Timing trade-off – monthly will result in greater contract diversity, more flexibility, more bilateral risk allocation. 4 year ahead likely to have more capacity directly committed to residual market
- 4 year forward demonstrates reliability commitment, but can result in less self-supply
- Month ahead reliant on long-term bilateral contracts for new resources

Pricing Mechanism Consensus

- Sloping demand curve necessary for month ahead market timing, less so for 4 year forward because of potential new entrants
- Need to look at different scenarios for all models – market manipulation concerns
- Different treatment for new and existing resources (multi-year contract for new) is a potential concern but may be needed to overcome barriers to entry
- Must resolve locational issues

Revenue Adjustment Consensus

- Required to set price for sloping demand curve
- Based on proxy unit characteristics, not actual unit operation
- Adjustment based on historic data (e.g., year before delivery) better than forecast
- Formula, not price, fixed 4 years in advance
- Ex post adjustment, based on current period price, not desirable.

Performance Incentives

- How much is needed
- Interaction with energy markets – multiplying penalties
- Need for scarcity pricing
- Positive incentive versus penalty
- Who bears risk, can it be hedged

Secondary Open Issues

- Form of obligation – annual peak or seasonal peak
- Self-supply mechanism
- Treatment of imports
- Credit requirements
- Non-jurisdictional LSEs

Next Steps

- Prepare analysis document
- Submit to CPUC RA proceeding
- Propose process/schedule

Alternatives to CM

- Bilateral capacity trading – no central mechanism
 - Concerned about MPM, binary pricing, verification, load shifting, stranded costs
- Energy Only approach
 - Concerned about political/regulatory realities, volatility, optics
- Vertical integration
 - Been there, done that, have the ratepayer-borne stranded costs to prove it