

Incremental Capacity Auction: Participation Mode – Preliminary Decisions

Comment on the IESO October 18-19 Presentation

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On October 18, 2018, the IESO presented its preliminary decisions regarding the Incremental Capacity Auction (ICA). The Market Surveillance Panel (MSP) has reviewed the material and appreciates the opportunity to submit comments on a few of the early decisions.

According to early estimates (“Brattle Report”), the Market Renewal project will provide \$3.4 billion in benefits, with about \$2.5 billion of that figure stemming from the ICA component alone.¹ As such, design decisions made with regards to the ICA have the greatest impact on the benefits of Market Renewal. These comments are motivated by a desire to ensure, to the greatest extent possible, that the ICA achieves the full value of its estimated benefits.

The MSP’s areas of concern are focused, primarily, on: multi-year commitments, any additional mechanisms that may be used to support capital intensive projects and the risk of double-counting and overlapping incentives between the ICA and the Industrial Conservation Initiative (ICI).

1. Multi-Year Commitments.

- The IESO is proposing that the ICA include Multi-Year Commitments (MYCs) for new build resources, with a maximum term of five years or longer (“five-plus”).² The IESO has in previous presentations expressed concern over long-term commitments, noting that they reduce the effectiveness of price signals, hinder the ability of the ICA auction to respond to changing market conditions and create an uneven playing field for new versus existing resources.³ The IESO also noted that a number of capacity auctions – including NYISO and MISO – have attracted enough resources to meet reliability needs without having to rely on multi-year commitments.⁴ Other system operators were able to attract new capacity to meet system needs prior to constructing new generators.⁵
- The Brattle report found that in PJM, the system operator was able to add more than 46,000 MW of new capacity – mostly new gas-fired generators – on a fully merchant basis.⁶ PJM has done so with a maximum commitment period of three years. The MSP recognizes there is a range of commitment periods, with some system operators, such

¹ The Future of Ontario’s Electricity Market: A Benefits Case Assessment of the Market Renewal Project

² Incremental Capacity Auction; Participation Model -- Preliminary Decisions, October 18 and 19, page 24

³ December 4, 2017 presentation, page 95.

⁴ December 4, 2017 presentation, page 99.

⁵ December 4, 2017 presentation, page 100.

⁶ The Future of Ontario’s Electricity Market: A Benefits Case Assessment of the Market Renewal Project, page 64

as NYISO, having implemented commitment periods as short as six months, while in Great Britain it is as long as 15 years.⁷

- The MSP’s concern is that the rationale and justification for the move towards longer-term MYCs has not been adequately addressed. The decision to move forward with the “five plus” MYCs opens the door to a longer-than-average commitment period compared to neighbouring jurisdictions. The MSP has not seen a detailed analysis to support the need for such an approach, and notes that the longer the commitment period, the more significant the risk faced by ratepayers. A principal purpose of the ICA auction was to achieve efficiency in procurement by shifting risks from ratepayers to bidders, an efficiency that may be reduced as the duration of commitment is extended.

2. “Other” Mechanisms to support capital intensive projects

- When discussing hydro resources and the ICA, the IESO noted that large, capital intensive assets will be built through “other mechanisms.” The IESO discussed this issue previously when it was asked to “consider an explicit statement that nuclear and large hydro may need alternative mechanisms.”⁸ The MSP recognizes that the ICA is intended to be an incremental market and not to procure large capital-intensive assets. But we ask the IESO to clarify what these mechanisms are and how – and when – they will be used. Large, capital projects – like nuclear plants or large hydro dams – have the ability to fundamentally alter the province’s wholesale market by adding a significant amount of new capacity all at once. Such additions will impact prices realized for new, incremental capacity procured through an ICA. If the process for procuring such assets is competitive and technology-neutral, specifying characteristics of the power generated rather than the method, the risk of inefficient procurement is reduced as is the risk to participants in the ICA.
- The overhanging risk of large-scale assets being built through ‘other’ non-competitive means may create greater uncertainty for investors and reduce the efficiency – and benefit – from an ICA. The MSP is concerned that the combination of out-of-market payments to large-scale generators and long (‘five-plus’) MYCs may reduce the benefits of the ICA. The Brattle Report raised these concerns, noting that the “benefits of a capacity auction and any market-based clean energy mechanism will be greater if more of the system-wide investment costs are recovered through these competitive mechanisms.”⁹

3. The interaction between the ICA and the Industrial Conservation Initiative (ICI)

- The potential for overlapping incentives for loads between the ICI and the ICA – and the potential for “double counting” – is also of concern for the MSP. The ICI is intended to encourage large consumers to lower their consumption during peak periods and reduce

⁷ A Case Study in Capacity Market Design and Considerations for Alberta, page 22

⁸ Incremental Capacity Auction: Stakeholder Engagement Phase 2 – Options Meeting #1 August 16, 2017, page 10

⁹ The Future of Ontario’s Electricity Market: A Benefits Case Assessment of the Market Renewal Project, page 72

the need to invest in new, peaking generation capacity. It is, essentially, a capacity product. But that policy may be redundant if large loads participate in the ICA, in which case they will be bidding against other large loads to reduce – at a competitively determined price – capacity during peak periods. If they are successful in the ICA, will demand reductions that reduce GA payments because of the ICI be allowed to satisfy commitments under the ICA? If that is the case, the MSP is concerned that certain loads will be paid twice for the same MW reduction – once from the ICA and again from the reduction in GA payments for the following year. The MSP has in the past raised concerns about how the combination of demand response programs and the ICI program create some redundancy, concluding that that some customers were being compensated twice for the same reduction.¹⁰ The MSP believes this “double counting” may become more pronounced with the introduction of the ICA and suggests that the IESO consider reforms to the ICI or ensure that only resources that are unable to participate in the ICA or the Day-Ahead Market be eligible for the ICI.

¹⁰ Monitoring Report on the IESO-Administered Electricity Markets for the period from May 2011 – October 2011