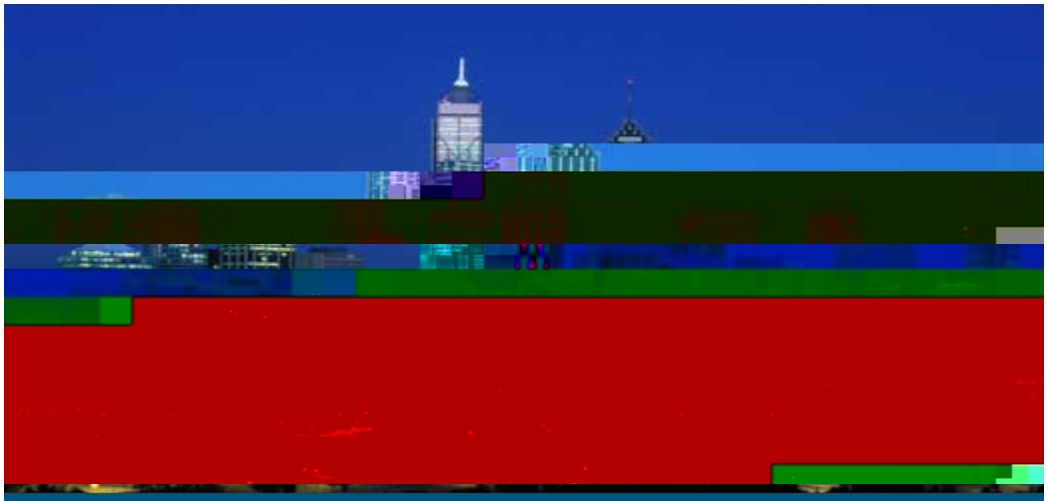
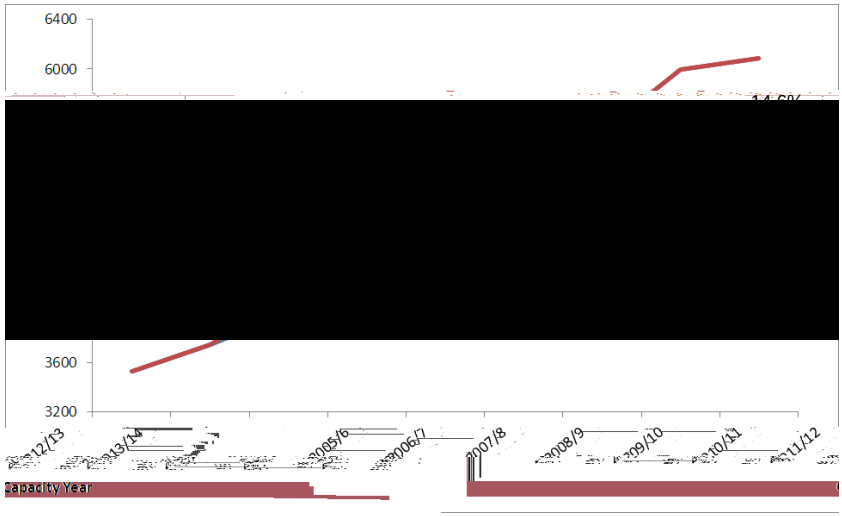


Discussion with the

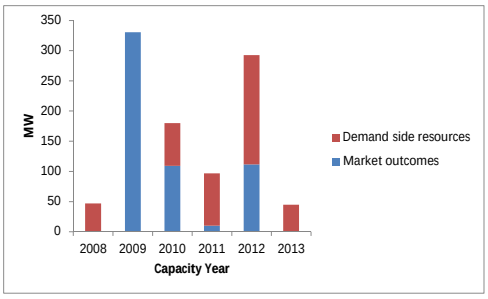
Trend in excess reserve capacity



Many “reasons”, but the RCM is always a factor

	Capacity Year						
Attributed Factor	2008	2009	2010	2011	2012	2013	Total
Schedule 7	536						536

Reduced investment in the WEM has already (apparently) begun



This is to be expected, and is good, given the current level of excess reserve capacity…but

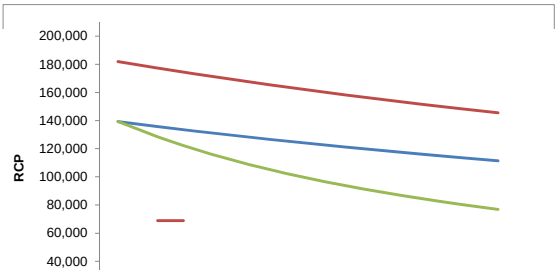
Market-based pricing of capacity credits is not simple

- What is the value horizon (one year, multiple years)?
- What is the reference point (today, next year, three year's hence, longer term)?
- How big is the market (thickness, level of competitive sourcing/dynamics)?
- What is the starting point and how did it get there (transition, fairness, contracting, etc)
- What is the role of forecasting and forecast uncertainty? (who bears?)
- What is the level of accepted exposure to non-market risks?

- The RCM currently bypasses or simplifies most of these, keeping it but imperfect

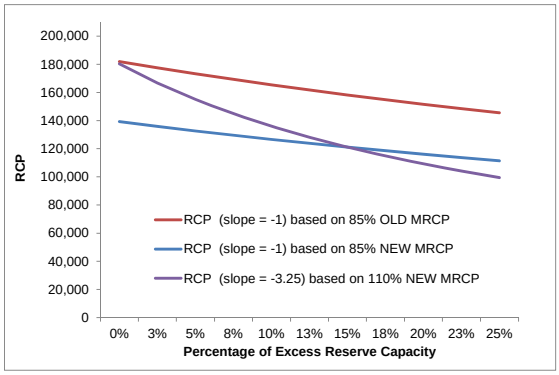
Changing the formula of the RCP can make a significant "pro-market" improvement, even if it does not address every imperfection immediately

Current approach, varying slope



Steeper – more responsive to

Capped by 110% of MRCP



Steeper – more responsive to market conditions

110% of MRCP – is that enough?

The higher the cap above MRCP, the more incentive to bilaterally contract around this exposure.

An "uncapped" and "unbottomed" RCP would drive stakeholders into more contracting to manage risk

This principle is key to the bilateral contracting incentive in modern capacity markets

Comment

- Currently, the RCP is adjusted downward in proportion to the amount of excess reserve capacity that exists.
- A straightforward change would focus on sharpening the administrative price adjustment mechanism to be more responsive to the amount of excess reserve capacity in the WEM.
- An alternative of "spigot control" would go against market-based provision of capacity by new investors, though it would help protect existing generation investors from further potential reductions in CC value
- Consequently, we favour a price-based adjustment either driven by more use of auctions (complex implementation and more volatile value impacts), or a sharpened RCP price adjustment formula
- Th