Electric Power Supply Association
Advocating the **power** of competition

A RESOURCE ADEQUACY REQUIREMENT
THE BARE ESSENTIALS

The Electric Power Supply Association (EPSA)[1] enthusiastically supports the Commission's initiative to standardize the design of the nation's wholesale electricity markets, including the implementation of a properly designed, long-term resource adequacy program. Ideally, a resource adequacy requirement will ensure adequate generation capacity and obviate the current regime of over-mitigation in short-term, price-capped markets. If structured properly, a resource adequacy program will balance the needs of both the short- and long-term markets by promoting the development of infrastructure needed for reliable transmission system operation, even in a market that utilizes mitigation measures that can suppress competitive market price signals.

It is well established that intrusive price intervention distorts price signals, which then inhibits market operations, delays investment in needed infrastructure and hampers the transition to fully competitive markets. A well-functioning resource adequacy program may alleviate some of the negative impacts of mitigating short-term markets by: (i) focusing the proper level of attention on necessary long-run marginal cost recovery; and (ii) providing compensation outside the energy and ancillary services markets to incent and maintain investment decisions. For these reasons, a resource adequacy program is an integral and necessary component of any market mitigation strategy.

The interplay between mitigation and resource adequacy is critical. If Load Serving Entities (LSEs) can simply look to the mitigated real-time market instead of making longer-term commitments in advance, any advantage to an adequacy requirement is lost. For many LSEs, particularly the traditional utilities, paying even a substantially high penalty for a few hours a year may be significantly cheaper than committing to longer-term resource contracts. Careful analysis confirms that while price volatility is normal even in well-functioning markets, high volatility occurs in only a very few hours a year.[2] Penalties triggered by extreme or emergency real-time market conditions do not send the correct signals for longer-term resource adequacy commitments and, if history is permitted to repeat itself, public outcry will then result in additional mitigation, even though the basis for the price run-up was the LSEs' own decision not to obtain sufficient capacity and energy to supply their markets.

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[1] EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. These suppliers, who account for more than a third of the nation's installed generating capacity, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers.

[2] "Still Waters Run Deep: Research on price volatility in short-term electricity markets and the implications of that research for the FERC's Standard Market Design," Boston Pacific Company, Inc. (2002), located at www.epsa.org, at 2.

In order to implement a resource adequacy program, there will be some need for enforcement and commitment certification. Penalties alone, especially those based on the real-time market, are not adequate. While a penalty structure can, theoretically, work to induce certain behavior, penalties will have to be very high to incent LSEs' adequacy commitments. If the penalty for not fulfilling a requirement is triggered only by supply deficiencies during real-time emergencies or constraints, LSEs will hedge against the much more substantial costs of long-term resource commitments by incurring only a few hours of high penalty costs.

A better focus of the resource adequacy requirement would be incentives for buyers and sellers to enter into market based solutions for capacity and energy to achieve the benefits associated with maintaining, building and/or contracting for those necessary resources.

Fundamentals of resource adequacy:

- Resource requirement plans must recognize both the short- and long-term markets' role in ensuring balance and reliability, as short-term markets send important real-time prices while long-term markets offer risk management against price volatility and supply shortages.
- Resource adequacy programs must be based on long-term planning standards, not real-time balancing or short-term market needs.
- LSEs must be able to develop a resource adequacy portfolio, which may include long-term, bilateral supply contracts as well as proven demand side resources that reflect the linkage between load and supply and balances the risk of future capacity needs.
- Any resource adequacy approach must provide an opportunity for a revenue stream that allows existing and new generators sufficient cost recovery to incent new investment and maintain existing supply resources.
- Penalties in the real-time market, unless precipitously high, are unlikely to be an effective tool to enforce resource adequacy requirements.
- Generators must be paid for the full range of services provided to the market.
- Resource acquisition by vertically integrated, regulated utilities must be conducted through a competitive solicitation, evaluated by an independent party, with equal treatment of affiliate and non-affiliate bids. New entrants cannot be disadvantaged in either wholesale or retail markets.
- As resource adequacy programs progress, a liquid and transparent secondary market should emerge to accommodate regions with increasing retail competition, where neither new entrants nor competitive incumbent LSEs are assured of a customer base into the future.
- Non-jurisdictional entities should not be grandfathered under their current Order No. 888 tariffs, as these tariffs do not include a resource adequacy requirement. In order to develop a functional resource adequacy program, all LSEs should fulfill the requirements.
- Credit issues must be addressed due to the long-term nature of resource adequacy contracts and plant financing issues.