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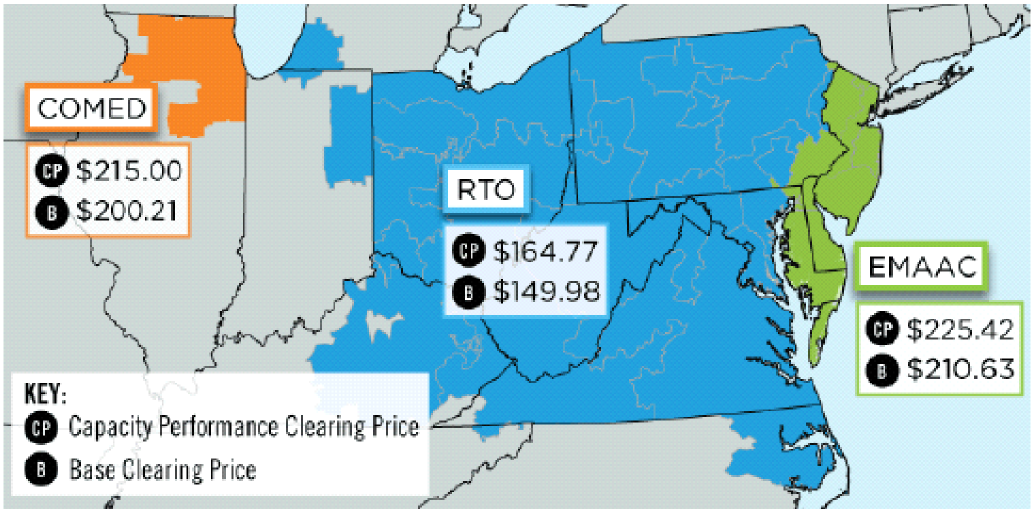
PJM capacity prices clear 'right smack' on expectations

By Peter Marrin

The results of PJM Interconnection LLC's latest base residual auction for delivery year 2018/19 were surprisingly not surprising, as prices at most locations cleared very close to expectations even though the auction was the first to include the highly controversial "capacity performance" product.

The 2018-2019 delivery year clearing price for capacity performance resources, which include generation, demand response and energy efficiency, is $164.77/MW-day for all of PJM except the ComEd region in northern Illinois and the Eastern MAAC delivery area made up of Public Service Electric and Gas Co., Jersey Central Power & Light Co., PECO Energy Co., Atlantic City Electric Co., Delmarva Power & Light Co. and Rockland Electric Co.

PJM capacity clearing prices for delivery year 2018-2019



Source: PJM Interconnection

Prior to the auction, a survey conducted by SNL Energy reflected expectations ranging from $120/MW-day to $200/MW-day for the capacity performance, or CP, product in the RTO zone with a tighter consensus range of about $160/MW-day to $170/MW-day.

PSE&G is a subsidiary of Public Service Enterprise Group Inc., JCP&L is a unit of FirstEnergy Corp., Exelon Corp. owns PECO, Atlantic City Electric and Delmarva Power are subsidiaries of Pepco Holdings Inc., and Rockland Electric is a subsidiary of Consolidated Edison Inc.

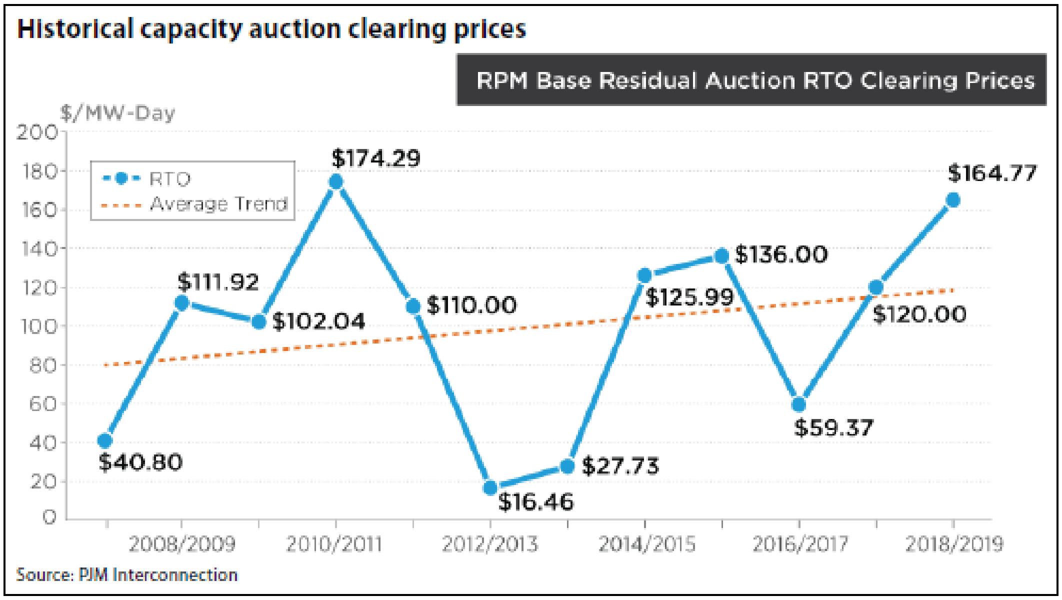
"My reaction was very positive to how close, or how consistent with expectations, this auction came. If I look at some of the analyst predictions prior to the auction, the $165/MW-day price for the RTO was pretty much right smack in their ranges of what they were expecting," Stu Bresler, PJM's senior vice president of market services, said in an Aug. 21 media briefing.

Bresler also highlighted that even the breakout zones — EMAAC and ComEd — were not unexpected and reached levels that some had anticipated. At a clearing price of $225.42/MW-day at EMAAC, Morgan Stanley's forecast of $225/MW-day was closest to the actual results. ICF International was closest to the actual clearing price of $215/MW-day at ComEd. ICF had pegged ComEd at $180/MW-day or higher.

"I really think that the results were very consistent with both ours and what I had been seeing as analysts' predictions," Bresler said, adding, "I think the discount between capacity performance and base capacity products was not as big as the analysts had expected."

The base capacity product is not obligated to adhere to the same strict performance expectations as the CP product. As a result, most analysts surveyed by SNL Energy prior to the auction were calling for clearing prices for the base capacity product in a range of $50/MW-day to $100/MW-day. However, in most cases, the base capacity product cleared at a discount of only $15/MW-day compared to the CP product. This equates to a $149.98/MW-day clearing price for base capacity in RTO, a price of $210.63/MW-day in EMAAC and a price of $200.21/MW-day in ComEd.

Capacity markets are volatile by nature, with RTO clearing at $136/MW-day in the 2012 auction, falling to $59.37/MW-day in 2013 and returning to $120/MW-day last year. However, the upcoming BRA was especially hard to forecast given the introduction of the new CP product.



"Two consecutive cold winters with natural gas interruptions and the rapid pace of coal retirements have put considerable pressure on the system," PJM CEO Terry Boston said in a statement. "Clearly, PJM had to act decisively with the introduction of Capacity Performance to ensure firmer fuel supplies and other improvements for the continued reliability of the grid."

The annual base residual auction, or BRA, is a key component of PJM's forward capacity market, known as the Reliability Pricing Model. This year's BRA procured capacity three years out for the delivery period June 1, 2018, to May 31, 2019.

After an unprecedented delay in this year's auction, PJM held the BRA between Aug. 10 and Aug. 14 but did not release results until Aug. 21. The auction was originally scheduled for May 11-15.

This year's auction was the first to include the controversial CP product, which was the cause for the delay. Born from the poor power plant performances during the polar vortex cold snap in 2014, the CP product, which was designed to reward top-performing generating units and punish underperforming resources, was conditionally approved by FERC on June 9. After the commission issued a deficiency letter for the original proposal, PJM was forced to defer the annual auction, which is usually held in mid-May.

"The response to this auction and to the call for Capacity Performance is another strong indication that our markets are delivering both the resources we need for the future and innovative solutions to the problems we face today," PJM Executive Vice President Andy Ott said. "The stronger requirements for Capacity Performance represent an insurance policy for consumers against capacity shortages and dramatic price spikes."

Overall, the auction procured 166,837 MW of capacity, which represents a 19.8% reserve margin.

The auction attracted more than 3,500 MW of new generation, including more than 2,900 MW of new generating units and more than 500 MW of uprates to existing generating units.

A total of 11,084 MW of demand response was procured, 1,484 MW of which is Capacity Performance. Energy efficiency totaled 1,247 MW, with 887 MW being Capacity Performance.

Renewables resources, such as wind, solar and hydroelectric, clearing in the auction totaled 14,347 MW of nameplate capacity.

Transition auctions up next

In the coming weeks, PJM will hold two transition auctions as part of its "glide path" in the shift to the new CP regime.

The first auction, which aims to procure 60% of the capacity requirements for the 2016/17 delivery year as capacity performance, will be held Aug. 26-27, with results posted Aug. 31. The second transition auction, which will cover 70% of requirements for delivery year 2017/18 with the CP product, will run Sept. 3-4, with results to be posted Sept. 9.

As with the BRA forecasts, pricing expectations for the transition auctions vary greatly. For delivery year 2016/17, which saw an initial clearing price of $59.37/MW-day in the 2013 BRA, prices could clear at a range of $120/MW-day to $130/MW-day, according to UBS Securities, or as high as $165/MW-day, according to analysts at Macquarie Capital (USA) Inc. A price of $165/MW-day would be 50% of net cost of new entry, or CONE, which serves as the price cap for the first auction.

While UBS also sees prices for delivery year 2017/18 clearing in a $120/MW-day to $130/MW-day range, analysts with Macquarie said in a June 26 note to clients that they see prices for delivery year 2017/18 clearing as high as $210/MW-day, also the price cap for that auction. The cap of $210/MW-day reflects 60% of net CONE for the delivery year.

"The critical question remains how much is the minimum that a generator would be willing to tolerate around accepting the more stringent penalty structures under CP," UBS analyst Julien Dumoulin-Smith wrote.

In a July 16 email, he said that the second transition auction "clearly has the most upside given tighter supply/demand."