

ICAP, UCAP, bad CAP, good CAP?

John A.C. Woodley

Morgan Stanley

212-761-5936

john.woodley@morganstanley.com

The Model

- **Electricity is too volatile and must be capped**
- **Price caps lead to underinvestment**
- **Supply shortages will result**
- **So set up a separate capacity market**

Our View

- The best cure for high prices is:

High Prices

Valuation

- **To trade, this “capacity” must transfer a valuable right**
 - Right to export energy
 - Right of primacy during market failure
 - Right to avoid deficiency fee
 - Right to purchase energy at a fixed price

Unintended Consequences

- **Market Makers “bet against” long term viability of the ICAP market:**
 - Forward prices are depressed
 - No viable long term market
 - Even near term market is relatively illiquid
- **Inefficient incentive to new investment**
- **Windfall to incumbents**
- **Suboptimal mix of plant**
- **Boom/bust development cycle**

Putting Money Where Your Mouth Is

- **Three plants built**

- All high heat rate peaking (“pure” capacity)
- Markets without price caps
- No ICAP payments asked or expected