Frequently Asked Questions on Vesting Contracts

Q(1) What is the policy objective of the vesting contracts?

The policy objective of the vesting contracts is to curb the market power of the large incumbent generators in order to promote efficiency and competition in the electricity market for the benefit of consumers.

Q(2) Why use vesting contracts to control market power?

Before vesting contracts were introduced in 2004, electricity prices were capped to limit the impact on prices by gencos with market power. With market power, gencos can potentially keep electricity prices near or at the average price cap regardless of the balance between supply and demand.

Potentially high pool prices due to market power would remove any incentives for consumers to buy from the Pool even if offers from electricity retailers are not attractive.

With vesting, 55% of the market volume is settled on the basis of fixed prices, thus reducing the incentives on generators to distort pool prices.

Q(3) How would contestable and non-contestable customers benefit from the implementation of vesting contracts?

With market power, gencos can potentially keep pool prices high. Vesting contracts control market power and reduce the ability of the gencos to influence prices.

Retailers consequently have to offer contestable consumers attractive retail contracts to retain market share. If retail contracts are unattractive, contestable consumers may choose to switch away from the retailers and buy electricity directly from the pool, despite the volatility risks. Retailers are unlikely to want to lose market share by pushing contestable consumers to buy from the pool.

Q(4) How does the vesting regime control market power?

We illustrate this with an analogy.

Suppose there are two gencos. Genco A and Genco B has each 2 MW to sell.
Total demand is 3 MW. There is excess capacity.

After buying 2 MW from Genco A, consumers have no choice but to buy the remaining 1 MW from Genco B. Genco B therefore has the ability to set prices at the pool. With an average price cap, Genco B can at most set a price at or near the average price cap.

To control this market power, we can vest both gencos at 1 MW each. Vesting requires each of Genco A and Genco B to sell 1 MW. The two gencos now have to compete to sell the remaining 1 MW to the consumers. Neither genco is in a position to push up pool price.

Q(5) How is vesting price derived?

The vesting price is reviewed every 2 years taking into account the long run marginal cost (LRMC) of the most efficient technology that accounts for at least 25% of our system demand and the policy objective of the vesting regime.

At this time the most efficient generation technology is the CCGT (combined cycle gas turbine).

Q(6) Can we have information on how the vesting price is set?

Determination papers on the formula and parameters used for determining the vesting price for the applicable time period are available for download at EMA's website, www.ema.gov.sg. SP Services will calculate the vesting price quarterly according to the procedures set out by EMA. The details are given in the document "EMA's procedures for calculating the components of vesting contracts" at EMA's website, www.ema.gov.sg. Information on the quarterly vesting price will be posted on the Open Electricity Market website (www.openelectricitymarket.sg).

Q(7) Are there other ways to curb market power?

EMA had consulted extensively and explored other ways to curb market power.

One option would be to divide our gencos into smaller gencos. This will effectively remove market power. This was an option in the UK where each of their gencos has a portfolio of several power stations. In Singapore, however, a genco is one power station that cannot be physically divided.

Other options like dividing the gencos by leasing out their capacity had also been considered but were found to be not feasible. Such options had been tried in other jurisdictions and had not worked well.

The conclusion was that vesting contract is an effective way to control market power.

Q(8) Is vesting price a mandatory price to be passed through to contestable consumers?

No. Vesting price is the settlement price for the part of demand that is vested.

To supply contestable consumers, retailers must make a commercial decision as to whether to buy electricity on contracts (and if so at what terms) or purchase electricity from the pool.

Q(9) Electricity demand fluctuates throughout the day. How does the vesting regime accommodate peak and off peak conditions?

A larger proportion of demand is vested at peak hours and a smaller proportion vested during off peak hours.

Q(10) Why are non-contestable consumers required to pay the vesting price? If pool price is low, does it mean non-contestable consumers who pay vesting prices are being over-charged?

Pool price is volatile, and depends on electricity supply and demand and the gencos bidding behaviour. There are times when the pool price is higher than the vesting price. With vesting, SP Services will buy electricity for non-contestable consumers at vesting price. This arrangement thus has the benefit of protecting non- contestable consumers from fluctuations in the pool price.

Q(11) As a contestable consumer, does the vesting regime affect my flexibility in negotiating a contract with our retailers?

The vesting regime does not prescribe the type and nature of retail contracts consumers may enter into.