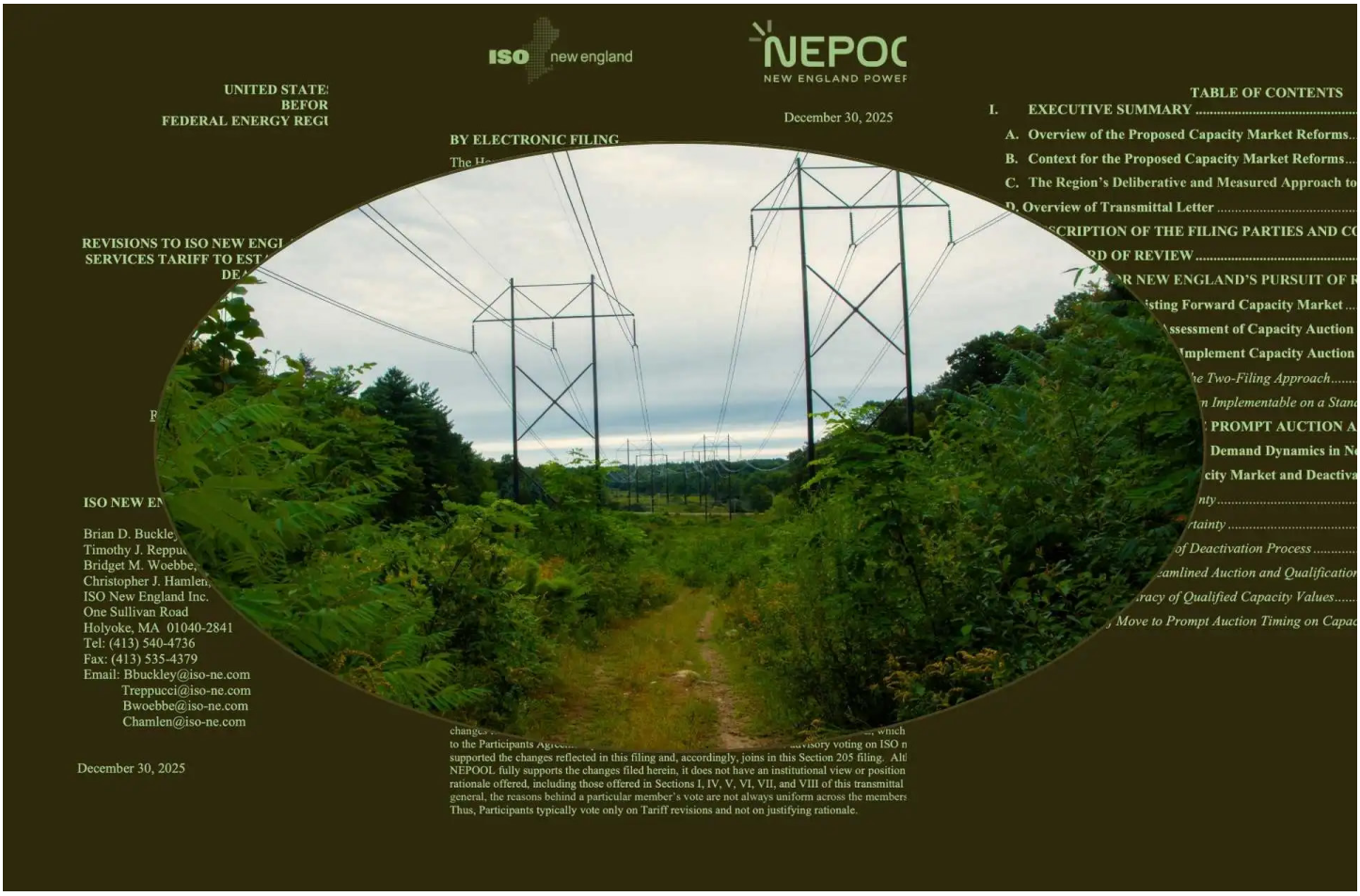
The Forward Market Era is Ending. What Will Take Its Place?

Originally published by Maeve Allsup, Latitude Media, January 12, 2026



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New England is retreating from its decades-long experiment with forward pricing.

In a regulatory filing to the Federal Energy Regulatory Commission in late December, ISO New England officially began to unwind its forward capacity market structure, leaving PJM as the last major market still attempting to make three-year forward auctions work.

Starting in 2028, New England will switch to a "prompt" auction framework, buying capacity just months before the delivery season begins. In a significant departure from the current system, only resources that are already operational will be empowered to bid, leaving the matter of incentivizing new supply to others.

The question of who exactly is going to take on that responsibility, however, hasn't yet fully been answered, said Abe Silverman, a research scholar at Johns Hopkins University.

In restructured markets like New England and PJM, ISOs were tasked with incentivizing new generation through capacity markets. New England's decision, Silverman said, is a "tacit admission" that in the face of massive load growth and uncertainty, those market structures aren't doing what they're supposed to.

"The ISO is basically saying 'we don't want to be the ones to solve this long-term resource adequacy issue,'" Silverman explained. "Instead, some combination of states and some combination of the market is going to have to step in and perform that function."

PJM, widely considered to be the vanguard power market in terms of preparing for the data center boom, is dealing with the same issues that drove New England to change market structure: unreliable forecasts, high costs, and a massive backlog in the interconnection queue that blocked projects from getting over the finish line, regardless of price signal. The last two PJM capacity auctions have cleared at record-high prices. And even so, December's auction came in more than 6 gigawatts short of PJM's reliability target.

New England, which hasn't yet had major data center growth but which has been grappling with increasing renewables penetration, concluded the three-year forward market was too blunt an instrument for the needs of its evolving grid. That region has had the luxury of watching PJM struggle, Silverman said, and of learning from it. Now, the ISO is effectively stepping off the "firing line" of having to send politically unpalatable price signals.

For PJM, the path forward is less clear. The grid operator is simultaneously trying to manage parallel processes to fix its interconnection queue (which is not accepting any new applications until April), resolve the load forecast uncertainty plaguing its capacity auctions, and figure out how to implement co-location and flexibility for data centers — all while facing immense pressure over high prices for ratepayers.

That all makes ducking out of the resource adequacy business more challenging, Silverman said. PJM has essentially become the poster child of the challenges of building out the AI economy, particularly when it comes to ensuring ratepayers don't foot the bill for data center buildouts. That said, he suspects that PJM officials are watching New England's rollout closely, in advance of their own retreat.

"It largely comes down to the question of who's taking responsibility for being wrong," he said. "ISO New England doesn't want to be stuck having to send highly uncertain price signals into a market when we know [forecasts] are wrong…they've effectively ducked the issue. If you're PJM, you're probably a little bit jealous."

PJM is Getting Serious

In some ways, the ISOs are now solving a problem that they themselves created, said Julia Hoos, head of the eastern U.S. at Aurora Energy Research. A string of past market reforms, usually in response to high clearing prices, eroded developer trust in capacity markets, particularly in PJM, Hoos explained. The pattern taught merchants that the market would be allowed to operate as planned when prices were low, but not when they were high.

As a result, high prices stopped being a reliable signal for developers to build, she added. Now, instead of tweaking the market yet again, the instinct is to "throw it all aside and start from scratch."

Hoos pointed to PJM's 2025 recap, published last week, in which the ISO pointed to the creation of a "sub-annual capacity market senior task force" to explore moving to a seasonal capacity market framework for the 2028-2029 delivery year. Doing so, it said, would lead to more accurate price signals, among other benefits. "I thought that was striking," Hoos said, adding that it wasn't clear in prior years that PJM was taking a potential restructuring all that seriously.

The ISO's decision to highlight potential auction reforms may be a nod to the fact that high auction prices are inevitable in a capacity market structure when demand is rising so fast.

When the market is in a shortage condition, prices will go up regardless of how much new supply is needed and what type of load it's powering, explained Brent Nelson, managing director of markets and strategy at Ascend Analytics. That creates a fundamental efficiency problem: You end up overpaying for the existing fleet in an attempt to create a new one.

The only way to get around that is to separate revenue for new sources from the existing generation fleet, Nelson told Latitude in December. Relying on the capacity auction for existing generation only, the ISO could keep prices more stable for ratepayers. Meanwhile, new steel in the ground is funded through targeted mechanisms like state-sponsored solicitations and direct bilateral contracts.

It's a nascent concept that effectively splits the grid into two tiers: a market that pays to keep the lights on now, and a policy-driven engine that builds the grid for tomorrow. According to Silverman, this split is essentially what New England is proposing — and is what PJM will probably have to turn to eventually too.

"We're going to have to take the costs of serving data centers and give it to [them] directly," he added. That can't be done in the current forward-capacity market construct.

A Collaborative Backstop

As for who exactly will fill the resource adequacy gap left by the ISO, New England has until 2028 to figure it out. The ISO plans to file the second phase of its reforms — covering seasonal accreditation and winter reliability — by the end of this year.

Silverman is betting on states collaborating on long-term contracts to backstop costs. That's more easily accomplished in New England, where states have a "history and tradition" of working together on procurement. PJM, meanwhile, is the largest market in the country, with 13 states and the District of Columbia, and has the added complexity of data centers already transforming load profiles.

Hoos points to utilities as the entities most likely to step up in the ISO's place. While most markets globally have been trending towards liberalization, the data center boom is pushing U.S. markets towards re-verticalizing.

"The United States is the only place that I'm hearing more and more of these conversations of vertically integrating back up to the utilities, where each utility is being pushed to make those decisions again," she said.

The Flexibility Question

Margarita Patria, a principal at Charles River Associates in Boston, also expects ISO-NE's decision to have ripple effects. In ditching the forward auction, New England is re-orienting from paying for capacity to paying for reliability, Patria said.

In PJM, which is already short on capacity, paying for reliability is much messier than it is in an oversupplied market like New England. Overhauling the capacity design runs into unresolved questions about how to count co-located generation, and whether flexible load can really be relied on to ramp down at peak, Patria said.

FERC and NERC are still hashing out how to treat large loads and enforce flexibility commitments, including in an ambitious DOE-ordered proceeding focused on fast-tracking data centers. PJM, for its part, has become the testbed for co-location and flexibility, via orders from FERC and its own ongoing, often contentious, internal proceedings.

In the meantime, high capacity prices in PJM are flowing through to ratepayers. Ironically, in Virginia, ratepayers in close proximity to "Data Center Alley" may actually be less exposed to PJM capacity spikes, because Dominion is vertically integrated, and can earn capacity revenues to help offset wholesale market costs. Meanwhile, ratepayers in New Jersey with wires-only utilities are getting hit with the direct flow of PJM prices.

That dynamic creates intense political pressure to make changes to market design even before PJM has fully answered the question of what, exactly, it is planning for in terms of data center load profiles. "It would be good to have [flexibility] figured out before you make changes to the capacity market," Patria acknowledged. "But the time to make changes to the capacity market is running short."