UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

ISO New England Inc.) Docket No. ER08-633-000

MOTION TO INTERVENE AND COMMENTS OF THE NEW ENGLAND POWER GENERATORS ASSOCIATION, INC.

The New England Power Generators Association, Inc. ("NEPGA") – representing 16 companies and approximately 25,000 megawatts (or over 80 percent) of generation in New England – respectfully submits these comments in response to ISO-NE's results filing for the Forward Capacity Auction ("FCA") for the 2010-2011 power year.[1] NEPGA is not protesting the auction results, but as set forth in these comments, we are concerned with certain aspects of the performance of the market.[2] NEPGA seeks to have the New England stakeholder process evaluate the performance of FCM with respect to these issues.

NEPGA reiterates at the outset its strong support for FCM and appreciation for ISO-NE's diligent efforts to implement the new market design. The initial auction ran smoothly, and FCM represents a significant step forward from the prior capacity market.

The auction results themselves indicate, however, that more work remains to be done. Reforms will be necessary in a few key areas to ensure that – going forward – FCM works as intended to send efficient market signals for capacity. We have identified at least three areas for stakeholders to review based on our observations of the results of the first auction: (1) whether it

---

[1] The comments contained in this filing represent the position of The New England Power Generators Association, Inc. as an organization, but not necessarily the position of any particular member(s) with respect to any statement, concept, issue or position expressed herein. NEPGA's members are BG North America, Boston Generating, Competitive Power Ventures, Con Ed Energy, Dominion Resources, Dynegy, Entergy, Exelon, FirstLight Power Resources, FPL Energy, Granite Ridge Energy, International Power America, Mirant Corporation, NRG Energy, PPL EnergyPlus, and PSEG Power.

[2] The auction was the first FCA in the new Forward Capacity Market ("FCM").

is appropriate to apply the calculated auction parameter for the cost of new entry ("CONE") to certain auction functions when CONE departs significantly from the actual cost of new entry; (2) whether the FCM rules adequately address the true capacity requirements in local regions; and (3) whether demand response is being efficiently and reliably integrated into the markets on a comparable basis with generation.

NEPGA submits that the first auction results indicate inefficiencies in each of these areas that undercut market signals, and that – if left unchecked – very quickly could lead to a lack of confidence or even a breakdown of FCM. We thus request a stakeholder process, consistent with provisions in the settlement agreement, to investigate and address these three areas of concern, resulting in an ISO-NE filing under Section 205 of the Federal Power Act to propose any necessary reforms. The Commission should ensure that any necessary reforms can be implemented by the earliest feasible date. NEPGA commits to continue to work in good faith with ISO-NE and other stakeholders to participate in this stakeholder process to address these key issues.

COMMENTS

I. STAKEHOLDERS SHOULD EXAMINE THE MECHANISMS FOR UPDATING CONE

CONE is a crucial input in FCM. In FCM, CONE is updated based on auction outcomes. Because the price in the first auction was at the floor, CONE will be reset in the second auction from $7.50 to $6.00 kW/mo,[3] *a 20 percent reduction in one year*. This "updated" value almost certainly does not reflect the actual cost of new entry of capacity resources in the New England market. If future auctions also clear at the floor, CONE will very quickly fall to levels so low that FCM could fail. This is a flaw in the rules for updating CONE that should be fixed.

[3] This is pursuant to Section III.13.2.4 of the Tariff at 1st Rev Sheet No. 7311B.

Stakeholders should examine the rules for updating CONE and propose necessary reforms to ensure that it is not reset at artificially reduced levels when applied to auction functions that require a value for CONE that reflects the actual cost of new entry. NEPGA recognizes and does not seek to change the basic bargain of the FCM Settlement, but reforms to CONE are necessary to preserve the viability of FCM.

As designed, the FCA did produce predictable results on price outcomes given the supply/demand parameters of the auction. Even though the capacity price hit the floor, new entry did occur. However, substantial amounts of new capacity entered the market with no price sensitivity, as a result of new capacity resources electing to be treated as existing resources. These new resources shifted the clearing price down by becoming "price takers," as opposed to submitting bids that reflected that resource's actual long-run costs, and thereby had the unintended effect of undermining the method for determining the actual cost of new entry through the auction. While this may not have changed the price outcome of the first auction, it will affect price formation in future capacity auctions because of the rules for updating CONE, among other things.

In the first auction, CONE was set by settlement at $7.50 kW/mo. For all other auctions, CONE is mathematically calculated using the clearing prices of previous auctions. If auction clearing prices continue at the floor, CONE will go down precipitously. In the next auction, ISO-NE states that it will be reset to $6.00 kW/mo. In the third auction, CONE could fall to $4.92 kW/mo, and could fall to $4.33 kW/mo in the fourth auction. This would be happening at a time when construction costs are rising dramatically, and new entry is likely to be needed. These levels of CONE simply cannot sustain FCM.

CONE is used in the FCM for many purposes, including many that require an accurate calculation of CONE. These auction functions will be unintentionally distorted if CONE is mathematically allowed to fall far below the true "cost of new entry." These auction functions rely on a true value for CONE:

First, CONE sets the starting value for the capacity auctions and reconfiguration auctions – at two times CONE. If CONE falls too low, then participants risk the auction starting at prices that are below the true cost of new entry. This could seriously frustrate the ability of the auction to function properly, as well as interfere with the market's goal of providing a structure to "encourage needed new supply resources of all kinds to be built."

Second, CONE is used by the Market Monitoring Unit ("MMU") and in auction qualification thresholds. The MMU must review new capacity offers below 0.75 x CONE, and static, permanent and export delist bids above 0.8 x CONE. Furthermore, all permanent delists are deemed competitive if bids below 1.25 x CONE. Finally dynamic delists in the auction begin as the clock falls to 0.8 x CONE.

These thresholds were intended to allow reasonable bidding flexibility around the true cost of building new generation, or introducing new demand response. As CONE mathematically falls due to auction surplus (and not due to any change in the true cost of new resources), allowing these thresholds to be significantly decreased has many disadvantages, including:

- increasing the MMU's work load to review more bids;
- increasing the MMU's intrusion into the market through mandatory reset of bids, without any underlying market rationale;
- increasing participant workload due to the need to supply detailed bid support documentation for more offers;

- increasing risk because more resources must submit, and be bound to, (static, permanent and export) delist bids submitted to ISO ten months in advance of the auction; and

- reducing auction flexibility and price discovery, because dynamic delists (the principal mechanism under which all existing generation and demand response participate in the auction) cannot start until the descending clock reaches a very low level.

These disadvantages come without any corresponding market efficiency benefit.

Third, financial assurances used to prevent market participants from defaulting on their capacity obligations are tied to CONE. If the financial assurances decline to very low levels, yet the possible replacement capacity in the event of default as we approach the Commitment Period is well above the mathematical CONE, the market could be unduly exposed to default risk. Reliability may also be at risk as parties default on their capacity obligations.

Finally, CONE is used to trigger the need to replace capacity in the reconfiguration auctions. Certain capacity needs identified in reconfiguration auctions will be procured at no more than 1.25 to 1.5 times CONE; failure to obtain capacity at that price will lead ISO to defer procurement to a future reconfiguration auction. If CONE falls too low versus true replacement capacity cost, then ISO may procure insufficient capacity and expose the Pool to reliability risk.

Given the linchpin role that CONE plays in the market, it is essential that it not be reset at an artificially reduced value for the auction functions outlined above. This very quickly would undermine the fundamental principles of FCM negotiated by New England stakeholders.

The purpose for the settlement provisions to update CONE was to take advantage of empirical data as reflected in actual auction results. Auction clearing prices at the floor because of a surplus, however, do not provide useful information about the true value of CONE, particularly given the amount of new entry that bid into the auction as price takers.

Other evidence indicates that the actual cost of new entry is increasing, not decreasing. Both NYISO and PJM recently filed to increase CONE to levels substantially above $7.50 kW/mo.[4] The Connecticut Department of Public Utility Control ("CT DPUC") recently sought project bids for peaking units, and none of the twelve offers submitted in reply had a cost of new entry less than $10.50 kW/mo.[5] The true cost of new entry cannot be in the range of $6.00 kW/mo or lower in New England.

Stakeholders thus should reconsider the mechanisms for updating CONE in circumstances when it needs to reflect the actual cost of new entry. Such changes should be applied to future auctions to ensure that FCM will actually be capable of procuring new entry. NEPGA clarifies that our intent in seeking these reforms is to preserve the viability of FCM, not to change the basic bargain of the FCM Settlement. The parties simply did not foresee the dramatic increase in the actual cost of new entry, nor the precipitous decline in CONE that would result if a substantial number of new capacity resources elected to be "price takers." Stakeholders committed to the success of the new market must address this serious flaw in FCM as soon as possible.

II. STAKEHOLDERS SHOULD EXAMINE WHETHER LOCAL CONCERNS ARE ADEQUATELY ADDRESSED IN THE FCM RULES

The administration of the first FCA has highlighted areas that require additional consideration regarding local capacity needs. These include: (1) the determination of Local

---

[4] PJM's request to increase its CONE was denied, largely based on PJM's failure to adequately consult with stakeholders prior to filing as required by its tariff. *See PJM Interconnection, L.L.C.*, 123 FERC ¶ 61,015 at P 30 (2008). That order stated, however, that "none of the intervenors dispute that the cost of constructing a new gas turbine facility has increased significantly since PJM last calculated the CONE in 2005," and invited PJM to refile after appropriate consultation with stakeholders. *Id*.

[5] *See DPUC Review of Peaking Generation Projects*, Docket No. 08-01-01, Prosecutorial Unit, Joint Testimony of Ellen Cool, Boris Shapiro, Michael Lints, Jack Elder and Richard Levitan, Exh. B. http://www.dpuc.state.ct.us/dockcurr.nsf/6eaf6cab79ae2d4885256b040067883b/82f6fbec089e3249852574250062bb4e/$FILE/PreFiled%20Testimony%2008Apr08%20PRO.pdf

Sourcing Requirements; and (2) the evaluation of delist bids of resources that are interconnected to a local transmission system. In both cases, stakeholders should examine whether local reliability concerns are appropriately taken into account and whether these decisions need additional transparency.

A. Local Sourcing Requirements And Transmission "Security" Analyses

One area of significant concern with the first auction results was the apparent ineffectiveness of some of the rules used to implement the locational capacity market. Given current supply and demand parameters in New England, it was not surprising that the market cleared at the floor price of $4.50 kW/mo across the region. Upon closer inspection, however, it appears that there may be a disconnect between the rules used to calculate locational capacity needs – called the "Local Sourcing Requirement" – and the amount of capacity actually needed and relied upon by ISO-NE to reliably operate the system. This disconnect creates market inefficiencies and perpetuates out-of-market payments.

The situation in Connecticut in the first auction demonstrates the problem, although the same thing could happen in any constrained zones in the future. ISO-NE's tariff (Market Rule 1) provides that "the Local Sourcing Requirement shall represent the minimum amount of capacity that must be electrically located within an import-constrained Load Zone."[6] ISO-NE's testimony demonstrates that there is a binding capacity constraint in Connecticut that was known prior to the auction. Yet application of these detailed rules did *not* identify Connecticut as a separate capacity zone. Instead, Connecticut was deemed to have more capacity than necessary to meet Local Sourcing Requirements. Specifically, 8,037 MW of capacity cleared the auction in

[6] Market Rule 1, ISO New England Inc., FERC Electric Tariff No. 3, 1st Rev Sheet No. 7307B.

Connecticut, compared to the Local Sourcing Requirement of 7,117 MW (7,017 MW of Location Sourcing Requirement plus 100 MW Administrative Export Delist).[7]

In "surplus" circumstances such as those deemed to be existing in Connecticut in the first auction, generators typically would be expected to be permitted to delist, but this was not so.[8] ISO-NE maintains that it could not allow capacity within Connecticut to delist "while simultaneously ensuring the reliable operation of the bulk power system in Connecticut."[9] Thus despite resources clearing the auction far in excess of the Local Sourcing Requirement and a decision that Connecticut should not be a separate capacity zone, units were not allowed to delist because of reliability concerns in Connecticut. Market participants were not informed about the effect of these reliability issues prior to the running of the auction.

The reason for this inefficiency is that the Local Sourcing Requirement does not fully take into account the way that ISO-NE actually ensures locational reliability. The Local Sourcing Requirement is determined by a probabilistic analysis of multiple hypothesized operational scenarios. In addition to this broad analysis of resource adequacy, ISO-NE conducts an additional transmission "security" analysis. As in the past, the transmission security analysis also considers the input of the local transmission owners on the need to dispatch a specific generation resource to resolve concerns on the bulk power system within the transmission owners' respective franchise service areas.[10]

---

[7] The Existing Resources that cleared included 531 MW of new resources that elected existing treatment.

[8] *See* Forward Capacity Auction Results Filing Attachment C, Testimony of Stephen J. Rourke, ISO New England Inc., Docket No. ER08-633-000 (filed Mar. 3, 2008).

[9] *Id.* at 2:28-29.

[10] *Id.* at 6:8-9. As discussed below, this review by ISO-NE and the transmission owners does not consider the reliability on the local, non-bulk transmission and distribution systems of the transmission owners.

The probabilistic adequacy analysis used to set the Local Sourcing Requirement is a much less restrictive analysis than the transmission security analysis.[11] For example, the reliability adequacy analysis allows the use of all emergency actions up to the shedding of load, and thus typically requires less generation in a zone. The transmission "security" analysis, on the other hand, avoids using *any* emergency actions, and thus typically requires more generation in a zone.

The results of the transmission security analysis are not reflected in the Local Sourcing Requirement. As such, these factors are not considered in making the decision whether to create a separate capacity zone.[12] The Local Sourcing Requirement thus can indicate that a separate zone is unnecessary even as the secondary "security" analysis – using a much more restrictive methodology – determines that local problems exist. This creates a fundamental disconnect. The transmission security analysis can prevent delisting even as the reliability adequacy analysis fails to create a separate zone. This effectively conscripts the affected units into providing additional reliability services without any locational price signal.

This "partial" – and decidedly imbalanced – consideration of local issues in the Local Sourcing Requirement creates inefficiencies such as those seen in Connecticut in the first auction, and which are likely to be replicated in other constrained zones in future auctions. A separate capacity zone for Connecticut was deemed unnecessary under the Local Sourcing

---

[11] One reason for this disconnect is that the ISO-NE's Transmission Security Analysis attempts to avoid emergency conditions at the 90/10 peak load level, whereas the Installed Capacity Reserve and Local Sourcing Requirement calculations rely on relief during emergency conditions to meet a probabilistic peak load distribution with a probability of dropping firm load 1 day in 10 years.

[12] A Capacity Zone is the geographic sub-region in the New England Control Area that is determined by the ISO based on an identification of transmission limits that may bind in the FCA. Settlement Agreement Resolving All Issues, § 11.III.A., Devon Power LLC, Docket No. ER03-563-000 (filed Mar. 6, 2006).

Requirement criteria, yet under the security analysis, units were deemed to be essential for local reliability and could not delist. The lack of a separate capacity zone denied any chance for locational pricing in Connecticut even though it was known in advance that constraints would exist and knowable in advance that units would not be permitted to delist. Must-run units (that cannot delist), moreover, will have to rely upon out-of-market payment mechanisms, precisely of the kind that the locational pricing mechanism of FCM was designed to eliminate.

B. Units Providing Local Non-Bulk Transmission And Distribution Support

Another area of concern is the scope and transparency of the reliability review process conducted in conjunction with the FCAs. While ISO-NE originally asserted that this reliability review process would be identical to the review process conducted when a unit proposes to retire or mothball under Section I.3.9 of the Participants Agreement, it has since become clear that the review provides no opportunity for local transmission/distribution impacts to be discussed and addressed by affected parties. There are serious consequences if a unit's permanent delist bid is accepted, including termination of the unit's interconnection rights and prohibition from any future participation in the FCM. If ISO-NE's reliability analysis permits the permanent delisting of a unit subsequently found to be required to meet local reliability needs, the options of the unit and the affected transmission owner will be severely and unfairly limited.

A key problem here is the lack of transparency. Whereas reliability reviews conducted in accordance with Section I.3.9 of the Participants Agreement allow the unit owner to attend and participate in the reliability committee meeting when its unit is discussed, only ISO-NE and transmission owners participate in the FCA reliability review process. The results of the review are not made public until after the auction is cleared. Given the very serious consequences of the reliability determinations made as part of the FCA reliability review process, and its potential

effect on the outcome of future auctions, the lack of transparency to the non-transmission owner market participants is troubling.

NEPGA is aware that ISO-NE stakeholders are currently considering revisions to the tariff language governing reliability determinations and the review of proposed plans under Section I.3.9. In light of the experiences outlined above with the real-life application of the reliability review process conducted as part of the FCA and the lack of transparency associated therewith, NEPGA strongly believes that stakeholders should reconsider the reliability review process under FCM to ensure that all of the reliability needs of the power system (both bulk and local) are adequately considered with appropriate input from all affected parties.

* * * * * *

In both of the areas highlighted above, stakeholders should examine whether reforms are necessary to ensure that local capacity needs are adequately considered and accommodated in the administration of an FCA. Stakeholders should examine whether the decision to create a separate capacity zone should more fully take into account local reliability issues. Reliability reviews should be more inclusive and consider local needs in addition to the needs of the bulk power system. Increased transparency and consideration of local transmission needs should permit more efficient results to come out of the auction process, better ensure reliability, and bring FCM in closer harmony with the Commission's goals.

III. STAKEHOLDERS SHOULD EXAMINE THE INTEGRATION AND COMPARABILITY OF DEMAND RESPONSE RESOURCES

Stakeholders should also examine the FCM rules related to demand resources to review whether demand resources have been appropriately integrated into the market. One key issue will be whether demand resources are treated on a comparable basis with generation.

One obvious conclusion from the first auction is the market's ability to attract demand-side resources. A total of 2,554 MW of capacity from demand resources secured Capacity Supply Obligations in the auction. Of that amount, about 1,188 MW came from New Demand Resources, with additional new (*i.e.*, not currently existing) resources choosing to be classified as Existing Demand Resources in the first auction.[13] Public interest in end-use efficiency and demand response and the inclusive regional stakeholder process has allowed the region to develop several demand resource programs since the markets have been in place.[14] These programs, while not strictly based on market revenues, have enabled the technology and communications infrastructure to evolve and are an important part of the market's evolution.

Consistent with NEPGA's comments pertaining to wholesale competition in regions with organized electric markets in the Commission's docketed ANOPR, the Commission in its subsequent proposed rulemaking stated that markets should "accommodate the characteristics of demand response resources but must not have the effect of creating an undue preference for demand response resources vis-à-vis other resources."[15] With that general tenet in mind, the Commission proposed a series of market requirements to "ensure that demand response is treated comparably to other resources."[16]

---

[13] ISO New England Inc., Forward Capacity Auction Results Filing at 5-6, Docket No. ER08-633-000 (filed Mar. 3, 2008).

[14] In addition to the Forward Capacity Market, New England's electricity markets facilitate demand participation in several ways. One often overlooked but important way demand participates in the market is through the day-ahead energy market. Load-serving entities can submit bids day-ahead that limit the price they are willing to pay for energy day-ahead (often referred to as "Price Sensitive Bids" or "Price Capped Demand Bids"). These bids allow the load to identify the maximum day-ahead price that they are willing to pay for energy. Compliance Report on Day-Ahead Load Response Program at 5, ISO New England Inc., Docket No. ER04-1255-000 (filed Aug. 31, 2007).

[15] *Wholesale Competition in Regions with Organized Elec. Mkts.*, Notice of Proposed Rulemaking, 122 FERC ¶ 61,167 at P 64 (2008).

[16] *Id.* at P 26.

With the completion of the first capacity auction, it is time for stakeholders to evaluate whether FCM provides demand resources with any preferential treatment over generation and whether any rule changes are in order. Demand resources, like any other resource, should be treated and compensated based upon the value they bring to the bulk power system in New England. Reliability dictates that New England develop a market that properly compensates all eligible resources within the market so as to send the market signals necessary to maintain grid reliability and strong economic viability. In order to achieve optimal deployment of energy efficiency and demand response, these demand-side resources must be valued and obligated in the markets comparably with supply resources.

The substantial amount of demand resources responding to the first FCA highlights the challenge of ensuring comparable treatment and the lowest cost to customers while maintaining a reliable system. Given the heavy influx of demand response in FCM, the integration and comparability of demand response is ripe for stakeholder review.

MOTION TO INTERVENE

NEPGA is the largest trade association representing competitive electric generating companies in New England. NEPGA's member companies represent approximately 25,000 megawatts of generating capacity throughout New England. NEPGA's mission is to promote sound energy policies which will further economic development, jobs, and balanced environmental policy. In furtherance of that mission, NEPGA supports properly designed competitive markets that enable all resources to participate and contribute to a reliable and affordable resource mix. A balanced playing field for all resources fosters competition in the wholesale power markets consistent with sound economic principles, long-standing national policy and the Commission's core responsibilities.

NEPGA submits that its intervention in this proceeding is in the public interest and that no other entity can adequately represent its interests. NEPGA requests that all further correspondence, communications and other documents relating to this matter be served upon the individuals listed in the signature block below.

CONCLUSION

NEPGA respectfully requests that the Commission grant its motion to intervene and direct a stakeholder process to address the three issues set forth above, to result in an ISO-NE filing under Section 205 of the Federal Power Act. The goal of this process should be to permit implementation of any necessary reforms as soon as practicable.

Respectfully submitted,

John N. Estes III
Paul F. Wight*
Skadden, Arps, Slate, Meagher & Flom LLP
1440 New York Avenue, N.W.
Washington, D.C. 20005-2111
(202) 371-7323

Attorneys for the
New England Power Generators Association, Inc.

Christopher P. Sherman*
General Counsel
New England Power Generators Association, Inc.
141 Tremont Street, Sixth Floor
Boston, MA 02111
617-902-2354
csherman@nepga.org

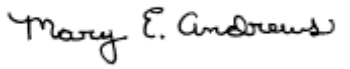
*Designated for Service

April 17, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have on this day caused to be served a copy of the foregoing upon all parties on the service list in this proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Washington, D.C., this 17th day of April, 2008.



Mary Andrews
Skadden, Arps, Slate, Meagher & Flom LLP
1440 New York Avenue, N.W.
Washington, D.C. 20005-2111
(202) 371-7646