

England's highest historical peak demand in July 2011. In order to meet New England's more immediate and future resource needs, the DAM, RTM, FCM and ancillary service markets should be modified to ensure that commodity risk, capacity risk, and contributions to reliability are appropriately valued in the markets. The ISO-NE's proposed change to the RTM to allow for intra-day hourly reoffers is one such prudent change and a good first step towards properly reflecting competitive prices in the energy markets. NEPGA, therefore, strongly encourages New England stakeholders and the Commission to afford the ISO-NE's proposed hourly reoffer change immediate attention. The ISO-NE's proposed change to the RTM, and other similar changes, will allow the most efficient and reliable resources, regardless of fuel or resource type, to meet New England's consumer demand and operational needs.

The LDCs and Pipelines, in a post-Technical Conference letter filed with the FERC on September 6, 2012, ("Letter Comments") stated that gas-electric coordination "issues will not be resolved unless additional pipeline capacity is added in the region."² While NEPGA members have differing views on whether additional pipeline capacity is part of the solution, more study to gain a better understanding of the fuel supply issues is prudent. To the extent there is a resource adequacy issue in New England, new pipeline capacity is *not* the only possible solution. Improved competitive electric market price signals, not Commission (or Pipeline and LDC) prescription of pipeline capacity, must be employed to drive efficient market-determined solutions. Proper electric market price signals would better enable the market to access whether additional pipelines, other fuel sources such as dual fuel facilities, or greater utilization of LNG capability and natural gas pipelines coming from Canada.

At the conclusion of the Technical Conference, FERC Commissioner Cheryl LaFleur asked participants to define short-term and long-term success. As noted by Commissioner LaFleur, there was participant consensus that success will be measured both in the short and long-term by the extent to which the region most efficiently achieves system reliability. Enhanced market-based solutions will provide the most efficient solutions to New England's system reliability needs in order to achieve those measures of success.

II. Appropriate Market Mitigation Should Be Applied

As was highlighted in NEPGA's remarks at the Roundtable, sound market design is critical to a well-functioning marketplace. Sound market design requires a combination of market rules and market mitigation practices that allow for proper price formation. A market participant's legitimate costs and risks must be allowed to be reflected in the marketplace in order for the market to establish appropriate market clearing prices. For example, the energy market does not operate efficiently when market mitigation denies dual-fueled generation the ability to timely bid at back-up oil prices, or prohibits certain costs (*e.g.*, the cost of pipeline delivery rights) from being reflected in offers. Overly aggressive market mitigation mutes the

² Letter Comments at 3.

price signals necessary to efficiently procure resources that provide reliability benefits. Inaccurate price formation caused by such market mitigation will continue if generators are unable to reflect their reasonable risks margins and costs in their offers.

The ISO-NE Internal Market Monitor (“IMM”) evaluates energy market supply offers in order to protect against uncompetitive bidding. The IMM will measure a supply offer against the resource’s Reference Levels and apply tighter thresholds where there is less competition in the relevant area. Should the supply offer exceed the Reference Level by a certain amount, the IMM will mitigate the offer if the IMM finds that the market clearing price increased by a certain amount due to the supply offer. Obviously, if the IMM does not account for all actual physical and financial factors in setting the Reference Level, it is inaccurate, unjust and unreasonable for the IMM to presume that the outcome is not competitive and prevent such prices from occurring.

Reference Levels based on natural gas price indices fail to reliably account for the full volatility in natural gas prices and the fact that many transactions for gas fuel take place long after the period in which the index value was established, thereby resulting in over-mitigation of reasonable, risk-adjusted bids for natural gas-fired plants. For example, under constrained area mitigation a resource’s offer is subject to mitigation if its offer exceeds its Reference Level by the lower of 50% or \$25.³ It is not uncommon for an increase in natural gas prices to cause an offer to exceed the 50% bandwidth, rendering an otherwise economic and reasonable bid subject to mitigation. The Reference Levels based on natural gas price indices, therefore, replace a generator’s actual cost-based offer with an administrative formulation of those costs, adversely affecting the generator’s attempt to make a competitive offer as well as sending muted signals impacting market-wide responses. The Reference Levels also fail to account for the inherent imprecision of calculating marginal cost-based offers. In the PJM RTO, a 10% adder is customarily added to cost-based offers to account for such bid imperfection.⁴ The ISO-NE IMM’s mitigation of offers that, with a reasonable margin for variability, would not otherwise be mitigated, artificially suppresses energy market prices below competitive levels adequate to compensate generators for their true costs.

Dual-fuel resources face potential over-mitigation for other reasons, specifically with respect to the IMM’s use of a lower gas-based Reference Level when a dual-fuel unit would more prudently run on higher priced oil. A resource must justify the use of the higher-cost oil by demonstrating, in part, that natural gas was unavailable, even when a generator’s choice to operate on oil was an economic decision (*e.g.*, opportunity to release gas for resale intraday), not an availability decision. Otherwise, the IMM will use the lower, natural-gas based reference level for its mitigation determination. The ISO-NE mitigation rules, therefore, prohibit generators from making an economic decision based on fuel type, interfering with both gas and electric markets and the efficient allocation of fuels to the uses that value them most highly.

³ ISO-NE Markets and Services Tariff, § III.A.5.5.2.

⁴ See *e.g.*, PJM Operating Agreement, Sch. 1. §6.4.2.

The IMM's recent adoption of new mitigation provisions in concert with its automated market mitigation in the RTM, absent improvement of the Reference Levels, further exacerbates the problem. For example, at the same time the IMM commenced automated mitigation, it expanded the application of the Pivotal Supplier Test and adopted a new test that could mitigate offers that do not set the Locational Marginal Price, *i.e.*, have no market impact. Recent IMM reports on mitigation frequency show that mitigations have increased significantly since the IMM began automated mitigation. Indeed, the IMM imposed a monthly average of 40 mitigation events from April-August 2012 (*i.e.*, since automated mitigation commenced) versus a monthly average of seven mitigation events from January-March 2012 (*i.e.*, pre-automated mitigation). This significant increase in mitigation events at the very least raises the possibility, if not strongly suggests, that these new measures are resulting in the over-mitigation of energy supply offers. Such over-mitigation penalizes suppliers attempting to provide system reliability when their offers reflect their legitimate higher costs, rather than attempts at market manipulation, leading to decreased confidence in the market and possible reliability problems to the extent that it imposes disincentives to new capacity to enter the market.

III. Any Supplemental Procurement Should be Resource-Neutral

At the Technical Conference ISO-NE repeatedly affirmed its belief that markets should operate in a fuel- and technology-neutral manner. NEPGA applauds this statement and wholly supports that philosophy. ISO-NE, however, also proposed to implement a "temporary" supplemental procurement mechanism to assure sufficient levels of firm liquid fuel (*i.e.*, oil or LNG) inventory or access to no-notice, variable take, firm gas supply. The ISO suggested that other generator characteristics outside of the definition of the FCM product definition (*e.g.*, start-time, availability, and dispatch flexibility) may also serve as proper generation characteristics for a supplemental procurement mechanism. ISO-NE stated that such a procurement would be limited to liquid fossil fuel generation.

A number of resources with a variety of fuel, technology and locational attributes can serve as a hedge against potentially short natural gas supplies, yet are not compensated for those reliability benefits today and may not be included in the forthcoming supplemental procurement design. The markets can and should send price signals to generators, both to compensate existing generation for the reliability it provides and to incent the most efficient future reliability solutions. Dual fuel generation or storage, as well as other types of resources, *e.g.*, unsubscribed nuclear, coal, oil or hydro generation capacity, can each provide reliability benefits in the event of gas supply shortages, and all should have the same market opportunity to do so. Artificially limiting participation in a supplemental procurement market to specific resources, when other types of resources may provide the same extent of firmness, is discriminatory, and compromises the efficiency of the market.

Should the New England stakeholders adopt a supplemental procurement of resources, it should send the appropriate price signals to procure efficient market-based solutions for the

supplemental performance desired. The ISO-NE's proposed short-term supplemental procurement should be fuel and technology neutral, as the rest of the competitive marketplace is intended to be. Any supplemental procurement should therefore not be limited to liquid fossil fuels but should also recognize the potential comparable operational capabilities of other resources.

IV. Centralized Resource Planning Leads to Inefficient Cost Structures and Allocations

Roundtable participant United Illuminating ("UI") proposed a system-wide gas transportation planning process, pursuant to which the ISO, or some other entity, would run contingency analyses to determine where new gas infrastructure is needed to relieve capacity constraints, *i.e.*, an integrated resource planning ("IRP")-like planning process. This proposal pre-supposes the solution to any potential reliability issue in New England (*i.e.*, new pipeline infrastructure), therefore inhibiting the consideration of other potentially more efficient and less costly solutions. Given those limitations, and the benefits of identifying reliability solutions through market mechanisms, New England should not address its reliability needs through an IRP-like planning process.

There is potential value in analyzing and gaining a better understanding of the limitations and inefficiencies in the existing gas transportation infrastructure. For example, a gas contingency analysis could add useful information in establishing the necessary electric capacity reserve margin. However, IRP-like planning based on any such analyses is inefficient and impractical. Indeed the Pipelines cautioned that a New England-only IRP is not possible because regional/interstate pipeline operating considerations are not region-specific but instead are operated on an inter-regional or national basis. According to the Pipelines, IRP-like planning would need to take into account inter-regional, national, and international operational considerations. The Pipelines also object to socialized cost allocation of pipeline investments, because such a funding mechanism deviates from their historical contract-based investment and financing model. Using the Pipeline's historical model, the Natural Gas Suppliers can serve as a conduit for gas market and contract-based financing, *i.e.*, suppliers and marketers can contract for pipeline capacity as the basis for pipeline financing. If combined with market rules that allow participants to price the risks and costs associated with such contracts into their electric market offers or secondary level of contracting, a contract-based financing model would more efficiently procure reliability resources than an IRP-like planning process where that solution is the most efficient.

V. NEPGA Supports a Gas/Electric Focus Group Consistent With the NEPOOL Working Group Structure

The LDCs and the Pipelines have proposed the creation of a working group of sector representatives to meet periodically to discuss and solve New England reliability needs.⁵ In their Letter Comments, the LDCs and Pipelines asked the Commission to order stakeholders to convene such a working group. NEPGA welcomes the opportunity to participate in a forum with the LDCs, Pipelines, States, Suppliers, and other interested stakeholders, to improve upon pipeline, generator, and ISO-NE coordination and communication. Any effort to improve coordination and communication at a regional level on these issues does not necessitate a Commission directive or approval. Instead, stakeholders should convene a working group, if any, as a focus group based on the NEPOOL working group model. Such a process has already begun and NEPGA looks forward to playing an active role as discussions continue.

NEPOOL and the ISO-NE often form working groups as they deem necessary to assist them in carrying out appropriate activities, and to provide advice and recommendations to ISO.⁶ NEPOOL working groups are open to all eligible NEPOOL Participants and their invited guests, which eligible Participants include gas industry representatives.⁷ The NEPOOL stakeholder process and working groups also have regular and active participation from representatives of state public utility commissions and Attorneys General, and welcome all parties with legitimate interests in the topic and who are committed to working collaboratively. Working groups do not typically vote on working group matters, but instead, through a process of education and evaluation, seek to achieve consensus recommendations on issues the working group has been tasked to address. The NEPOOL working group structure and authority, therefore, closely mirror the working group structure and authority contemplated by New England stakeholders to date. These NEPOOL working group characteristics would serve the proposed working group well by providing a collaborative forum where participants seek to achieve consensus with the purpose of advising or recommending beneficial actions.

Notably, the New York Independent System Operator (“NYISO”) recently established a stakeholder Electric Gas Coordination Working Group within its stakeholder process.⁸ According to the NYISO, its working group has worked well as a forum for greater inter-industry education, communication and coordination, for example, with respect to the scheduling of gas infrastructure maintenance outages.⁹ New England appears to be following the NYISO’s prudent lead by creating a working group based on the NEPOOL working group open to all interested parties. In recent weeks, representatives of the New England Generators, LDCs,

⁵ See Letter Comments.

⁶ NEPOOL Participants Agreement, §§ 5.3, 8.2.1.

⁷ The Commission approved the ability for any member of the gas industry to seek membership in NEPOOL as a Gas Industry Participant. FERC Docket No. ER11-2686 (February 18, 2011). Gas Industry Participants may participate in all NEPOOL stakeholder meetings. *Id.*

⁸ *Comments of the New York System Operator, Inc.*, FERC Docket No. AD12-12 (March 30, 2012).

⁹ *Id.* at 2.

Pipelines, and PUCs have been discussing the structure and forum for a working group. The representatives have tentatively agreed to convene a focus group co-sponsored by NEPOOL and the Northeast Gas Association. NEPGA supports this agreement, as the focus group will be an open forum pursuant to which stakeholders will seek to reach consensus on gas-electric coordination, consistent with the NEPOOL working group model.

VI. Conclusion

New England has long relied on competitive markets to meet New England's reliability needs because competitive markets identify the most efficient solutions to those needs and foster innovations that benefit consumers. New England should continue to allow the markets, not centralized resource planning, to identify reliability solutions, because the competitive markets are uniquely capable of achieving the success Roundtable participants agreed to, namely, reliability and efficiency. Stakeholders and the ISO-NE should make necessary changes to the DAM, RTM, and FCM, to send appropriate price signals, allow for true price and risk profile bidding, and provide for just market mitigation practices. All market solutions, whether short-term or long term, should be resource neutral in order to allow the markets to identify the most efficient reliability solutions. The FERC need not order New England stakeholders to convene a working group, because New England stakeholders have agreed to form a focus group consistent with the NEPOOL working group model. NEPGA looks forward to maintaining strong engagement with the natural gas industry and policymakers in efforts to improve any potential challenges in the ever evolving markets.

Respectfully submitted,

**NEW ENGLAND POWER GENERATORS
ASSOCIATION, INC.**



Dan Dolan, President
Bruce Anderson, Director, Mkt. and Regulatory Affairs
New England Power Generators Association, Inc.

September 28, 2012