

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

ISO New England Inc.

Docket No. ER14-2407-003

REHEARING REQUEST OF ISO NEW ENGLAND INC.

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Pursuant to Rule 713 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (the “Commission”), 18 C.F.R. § 385.713 (2013), ISO New England Inc. (the “ISO” or “ISO-NE”) hereby requests rehearing of the Commission’s Order on Clarification issued on January 20, 2015.¹ The Clarification Order addresses the Motion for Clarification filed by the New England Power Generators Association (“NEPGA”) on October 9, 2014.²

I. EXECUTIVE SUMMARY

A fundamental tenet for the ISO, like the Commission, is that a reliable power system should be achieved through efficient markets wherever possible. In the context of reliability, generally, and winter reliability, specifically, the reformed capacity market with the Pay For Performance (“PFP”) construct will provide the necessary incentives for performance, both on a forward basis and in real-time.

However, PFP is not effective until 2018 and gaps remain in the current capacity market design and in obligations for generators to procure sufficient fuel. Thus, for the last two winters, the ISO and the New England Power Pool (“NEPOOL”) have filed, and the Commission has

¹ *ISO New England Inc.*, 150 FERC ¶ 61,029 (2015) (the “Clarification Order”).

² Motion for Clarification of the New England Power Generators Association, Inc., Docket No. ER14-2407-000 (October 9, 2014) (the “Motion for Clarification”).

approved, winter reliability programs that have provided additional incentives for generators to maintain higher fuel inventories than might have been otherwise procured.

The ISO and stakeholders have been discussing programs to bridge the gap for the next three winters. On January 20, the Commission ordered a market solution for this period. In this request, the ISO asks the Commission to reverse this decision and permit the continuation of the winter reliability program construct, possibly with an expanded scope to encompass other resource types. The reversal is warranted given that, as detailed below, the options for developing a market-based solution in the context of existing obligations are, at best, potentially less effective than the winter reliability programs, and, at worst, less effective, inefficient, controversial and expensive to implement.

II. BACKGROUND

In this section, ISO-NE provides background on the region's reliability challenges and the steps taken to meet those challenges, which include revisions to the Forward Capacity Market ("FCM") and the filing of two winter programs. The ISO also summarizes the regulatory history surrounding the second winter program, which is the subject of this rehearing request.

A. New England's Response to Reliability Challenges

Within the past five years, the ISO and stakeholders have identified and addressed New England's increased reliance on natural gas-fueled generation and deteriorating resource performance during periods of stressed system conditions.³ Most critically, on January 17, 2014, the ISO submitted Tariff changes to implement PFP in FCM.⁴ Effective in 2018, these changes are designed to ensure resource adequacy in a cost-effective manner and reverse the deterioration

³ See Testimony of Peter T. Brandien in *ISO New England Inc.*, Performance Incentive Market Rule Changes, Docket No. ER14-1050-000 (January 17, 2014).

⁴ *ISO New England Inc.*, Performance Incentives Market Rule Changes, Docket No. ER14-1050-000 (January 17, 2014).

in reliability. PFP achieves these dual goals by providing a three-year advance commitment and market-based compensation for providing resources to meet the region's needs. PFP rewards superior performance and imposes financial consequences for failure to perform when scarcity conditions occur during the delivery year. On May 30, 2014, the Commission approved the PFP design and, in addition, ordered increases in scarcity prices.⁵

While work on PFP was underway, it became evident that the region needed to take more immediate action to maintain winter reliability. Specifically, operations during winter 2012-2013 were troubling. Although the winter had been mild, there were a number of instances in which gas-fired generation did not have sufficient fuel to provide energy at or even near the generators' stated capacity. In addition, it was evident that many dual fuel and oil-only resources did not have sufficient fuel to allow for reliable operation during extended and/or repeated periods of cold weather.⁶

As a result, the ISO proposed the first winter program, which paid generators upfront for a portion of the costs of having oil in their tanks during the winter of 2013-2014.⁷ Participation in the initial iteration of the program was disappointing, with generators indicating that they were unwilling to participate in the voluntary program given the risk created by the penalty structure. Consequently, ISO-NE modified the penalty structure to reduce the risk,⁸ and generators responded by participating in the program, doubling the amount of oil in their tanks when

⁵ *ISO New England Inc.*, 147 FERC ¶ 61,172 (2014).

⁶ Winter Operations Summary: January –February 2013, http://www.iso-ne.com/static-assets/documents/committees/comm_wkgrps/strategic_planning_discussion/materials/winter_operations_summary_2013_feb_27_draft_for_discussion.pdf.

⁷ *ISO New England Inc.*, Winter 2013-14 Reliability Program, Docket No. ER13-1851-000 (June 28, 2013).

⁸ *ISO New England Inc.*, Emergency Amendments to Pending Filing Regarding the Winter 2013-14 Reliability Program, (August 9, 2013).

compared to the previous winter. The program proved to be critical to reliability, with generators burning almost all of the program oil in their tanks.⁹

The ISO had not anticipated offering a second program for winter 2014-2015, intending instead to rely on market improvements and the Commission's clarification that generators have an obligation to procure fuel to meet their expected dispatch.¹⁰ However, worse-than-anticipated gas constraints, the retirements of Vermont Yankee and Salem Harbor, difficulties in replenishing oil inventories, and gaps in generator obligations caused ISO-NE to reconsider.

ISO-NE and NEPOOL filed the second program in July 2014.¹¹ In light of previous market improvements and the Commission's order regarding generator obligations, the program was modified from the first version such that generators were paid only for unused fuel at the end of the season, rather than upfront for fuel procurement. In essence, the ISO assumed that generators would meet their obligation to procure fuel, but compensated them for adopting the ISO's assessment instead of their own, possibly less conservative, estimates about how much fuel to procure at the beginning of the winter. The ISO also maintained the provisions for demand resources and added provisions for LNG in order to improve the program's resource-neutrality. The program had the desired effect, with the region well positioned with fuel inventory at the start of this winter. The oil inventory has again been instrumental in allowing the region to withstand the recent severe weather conditions.

⁹ See Testimony of Peter Brandien in *ISO New England Inc.*, Docket No. ER14-2407-000, Winter 2014-2015 Reliability Program Part 1 of 2 at p. 4 (July 11, 2014).

¹⁰ *New England Power Generators Assn., Inc. v. ISO New England Inc.* 144 FERC ¶ 61,157 (August 7, 2013).

¹¹ *ISO New England Inc.*, Winter 2014-15 Reliability Program (Part 1 of 2), Docket No. ER14-2407-000 (July 11, 2014).

B. The Debate About Future Winter Programs

In its July 2014 filing, ISO-NE reiterated that PFP would, after it became effective in 2018, ensure reliable winter operations. Until then, given the worsening gas constraints, generator retirements and issues with the oil supply chain, the ISO predicted that a winter program would be necessary to ensure fuel adequacy in each winter.¹² With reference to these future programs, ISO-NE committed that:

“the ISO and its stakeholders will *evaluate* whether it is feasible to design and implement a market-based solution for the remaining winters before PFP is effective. This evaluation is likely to include the potential costs associated with such a solution and how it would apply to resources that have already cleared in the capacity market and have a current set of obligations.”¹³

In its comments regarding the ISO’s filing, NEPGA asked the Commission to *order* ISO-NE to create a market-based program for future winters to allow for the identification of the economically efficient price for ISO-NE system reliability.¹⁴ In response to NEPGA’s request, the Commission noted that it preferred a long-term, market-based solution, but would “not direct any specific Tariff revisions at this time, as commenters have requested.”¹⁵ Instead, the Commission required ISO-NE to undertake a stakeholder process to develop a proposal to address reliability concerns for future winters, if necessary, and to report to the Commission on progress.¹⁶ The Commission also said that it expected “ISO-NE to abide by its commitment to develop a long-term, market-based solution to address winter reliability issues.”¹⁷

¹² *Id.* at pp. 5, 9.

¹³ *Id.* at p. 9 (emphasis added).

¹⁴ Motion to Intervene and Comments of the New England Power Generators Association, Inc. and Electric Power Supply Association, Docket Nos. ER14-2407-000, -001 at p. 2 (August 1, 2014).

¹⁵ *ISO New England, Inc., and New England Power Pool Participants Committee*, 148 FERC ¶ 61,179 at pp. 13, 16 (2014).

¹⁶ *Id.* at p. 14.

¹⁷ *Id.*

On October 9, 2014, NEPGA filed the Motion for Clarification, in which it asked the Commission to issue an order confirming that the Commission expects ISO-NE “to develop and propose market rule changes based on competitive market principles, rather than another out-of-market mechanism” to address winter reliability needs in 2015-16.¹⁸ In its answer to the Motion for Clarification, the ISO recognized that the Commission generally prefers a market-based solution, as does the ISO, and asserted that PFP would provide the region’s long-term, market-based solution. However, “[i]n the interim, the region must have the flexibility to determine what problem it wants to solve and how much it is willing to pay to solve it.”¹⁹

As ISO-NE explained in its answer, the first step in determining the solution is for the region to identify the objective. As examples, the ISO noted that the objective of the winter programs has been to improve fuel security, while the objective of NEPGA’s proposed market is to compensate generators for reliability during the winter – as discussed below, a broader and vastly more complex goal given the poorly-defined existing capacity obligations.²⁰

In November, while the Motion for Clarification was pending, the ISO began working with stakeholders to identify the objective that the region wanted to meet for the next three winters.²¹ At the November 13, 2014 NEPOOL Markets Committee meeting, the discussion occurred at a high level, with generators reiterating their desire for a resource-neutral, market-based solution, and other stakeholders urging the ISO to either continue the existing winter

¹⁸ Motion for Clarification at p. 3.

¹⁹ *ISO New England Inc.*, Answer of ISO New England Inc., Docket No. ER14-2407-000 at pp. 3-4 (October 24, 2014).

²⁰ *Id.* at p. 2.

²¹ *See ISO New England Inc.*, Informational Filings Related to 2014-2015 Winter Reliability Program, Docket No. ER14-2407 (October 9, 2014, December 8, 2014).

program or forego a supplemental solution. Stakeholders did not coalesce around an objective or a solution.²²

The ISO and stakeholders again discussed the topic at the Markets Committee meeting on December 9, 2014. A group of generators made a presentation urging adoption of a market-based approach and committing to make a specific proposal. The ISO noted that time is of the essence given potential complexities and controversies surrounding design elements, as well as implementation concerns. Again, no consensus emerged, although most comments indicated support for either continuing the existing winter program or foregoing a solution entirely.²³

At the next Markets Committee meeting on January 13, 2015, no solutions were put forth by the generators or any other group, although one participant made a presentation outlining various changes in the markets that could affect the need for a winter program or, at a minimum, the related compensation. At the meeting, the ISO indicated that it was becoming increasingly infeasible to develop a new market in time for the upcoming winter, particularly if there would be an auction mechanism, as such an auction would need to be administered in late summer, ahead of the winter period. ISO-NE stated that, if no consensus emerged on a different objective and solution, the ISO would propose a program based on the framework of the 2014-2015 winter program, the objective of which is greater fuel security, for the winters until the PFP changes take effect.²⁴

On January 20, the Commission issued the Clarification Order, in which it granted NEPGA's motion and directed the ISO to "determine whether a winter reliability solution is necessary for the 2015-2016 winter and future winters, and, if so, develop an appropriate market-

²² *Id.*

²³ See *ISO New England Inc.*, Informational Filing Related to 2014-2015 Winter Reliability Program, Docket No. ER14-2407 (February 6, 2015).

²⁴ *Id.*

based solution through the stakeholder process that can be implemented beginning with the 2015-2016 winter.”²⁵ At the February 11 NEPOOL Markets Committee meeting, the ISO indicated that it was preparing this rehearing request. While a group of generators continued to advocate for a market-based solution, they did not provide a specific solution.

III. STATEMENT OF ISSUES

In accordance with Rule 713(c) (2) of the Commission’s Rules of Practice and Procedure, ISO-NE asserts that the Commission erred in requiring ISO-NE to develop a market-based solution and foreclosing the development of a more effective and efficient temporary solution.

IV. REQUEST FOR REHEARING

ISO-NE respectfully requests that the Commission reverse the Clarification Order given that, as detailed below, the options for developing a market-based solution in the context of existing obligations are, at best, potentially less effective than the winter reliability programs, and, at worst, less effective, inefficient, controversial and expensive to implement.

A. Developing a Market-Based Solution in the Context of Existing Obligations

The reliability issues that exist currently are directly related to the insufficiency of generators’ obligations, some of which are defined in FCM and others in a Commission order.²⁶ Moreover, the related penalties and incentives may be inadequate. PFP resolves the resulting reliability issues by starting with a clean slate, on which it comprehensively defines generators’ obligations and compensates them for meeting these obligations.

Short of starting over or systematically plugging each of the gaps between PFP and the existing capacity market, both of which are infeasible in the short-term, there are two market-based approaches to improve the sufficiency of the existing structure. As discussed below, one

²⁵ Clarification Order at p. 10.

²⁶ *New England Power Generators Assn., Inc. v. ISO New England Inc.* 144 FERC ¶ 61,157 (August 7, 2013).

approach is to add obligations and related incentives, and the other is to enhance incentives for existing obligations.

1. Adding Obligations

To address reliability issues, NEPGA proposes layering obligations on top of the existing structure. Specifically, NEPGA would compensate generators for providing a broad service like “reliability” or “availability.” The breadth of the obligations is appropriate; in order to fit within a market construct, the obligations must be broad enough to be provided by a wide array of resources. For example, the obligation created by the current winter programs – measurably improved fuel inventory – is too narrow to create a comprehensive market structure, as it can only be met by a limited number of entities. Moreover, fuel adequacy is not a uniform product. Like Blackstart and VAR, fuel adequacy, as a stand-alone item, is difficult to accomplish through a market-based solution.

While the breadth of NEPGA’s proposed objective is appropriate in theory, it is inefficient to propose a comprehensive “reliability” or “availability” market on top of the current framework, which includes existing obligations and compensation for meeting those obligations. Moreover, the development of a new, broad market would be controversial, resource-intensive and expensive, as was the development of the PFP rules. The costs of such a market exceed the purely financial; in addition, there will be significant time spent in the stakeholder process on the more controversial aspects of the program, there will likely be a protracted regulatory process and litigation, and the implementation effort will displace other project priorities. Put simply, the effort will be equivalent to a smaller-scale version of PFP, which, by 2018, will have required a number of years, scores of regulatory filings and millions in implementation costs to

put in place.²⁷ The ISO does not believe that it is prudent to replicate these efforts for a market that will be scrapped in three years.

The controversy will arise given the lack of agreement outside of the generation sector on the need for a new market. Accordingly, the ISO expects that NEPOOL participants and state regulators will dispute the many potentially contentious features of a new market. These include the application of the Peak Energy Rent rules, proposed exclusions that will (like the current FCM rules) forgive failures to perform, and differences in opinion regarding an appropriate penalty structure.

There are also complexities that have not been fully discussed with regard to the structure of the market. If it is voluntary, the region runs the risk of insufficient participation, as occurred in the first iteration of the 2013-2014 winter program; absent another round of emergency amendments, the region will be left with reliability concerns and questions about whether the resulting clearing price is just and reasonable. If the program is mandatory, there will be difficult issues to resolve regarding whether offers should be reviewed and potentially mitigated, whether a demand curve is required, and how to treat previously-cleared capacity resources.

The effort to implement a new market would also be significant, as it would entail the development of an auction mechanism, a penalty structure, and a set of performance criteria, all on an extremely tight time frame. Specifically, full program implementation must occur by August, in order to have time to run an auction, produce results, and give stakeholders time to prepare to supply the product beginning in December. To accommodate this schedule, other projects would certainly have to be displaced. ISO-NE has already analyzed its Wholesale

²⁷ See *ISO New England Inc.*, Docket No. ER14-1050-000, all party filings and submissions.

Markets Project Plan to assess projects that would be deferred.²⁸ These include, at a minimum, efforts in 2015 related to the Generation Control Application and Coordinated Transaction Scheduling projects. Deferral of these projects will have a ripple effect on projects scheduled in 2016 and beyond, including projects that target improved price formation in the energy market.

Finally, despite the inefficiency, effort and expense of such a market, it may not provide the same reliability benefits as does the current winter reliability program. If participation is too limited, the exemptions too numerous, or the incentives and penalties too few, the market will not produce the desired results. Given the PFP development process, it is logical to assume that the region will not agree on a suitable structure of exemptions, incentives and penalties; for this reason, as well as the concerns outlined above about the inefficiency of layering obligations on top of the current structure, ISO-NE abandoned plans to develop a “light” version of PFP to bridge the gap until 2018.²⁹

2. Enhancing Incentives

The second means of improving the existing structure is to further strengthen the incentives for existing obligations. For example, the region could increase Reserve Constraint Penalty Factors (“RCPFs”), which set the proxy reserve market clearing price when available reserves are insufficient or the cost of sufficient reserves exceeds the RCPFs. Notably, as the reserve and energy markets are co-optimized, when RCPFs are triggered, energy market prices will increase as well.

An advantage of increasing RCPFs is the relative simplicity of software and Tariff

²⁸ See <http://www.iso-ne.com/markets-operations/markets-development/wholesale-markets-project-plan>.

²⁹ *ISO New England Inc.*, Winter 2013-14 Reliability Program, Docket No. ER13-1851-000 at p. 5 (June 28, 2013) (“As a transition between the Winter Reliability Project and the FCM performance incentives project, the ISO intends to propose a scaled-down version of the performance incentives project to purchase a fuel-neutral, winter-based reliability product for the winters of 2014-15 through 2017-18.”)

changes, which will create less disruption to other project priorities. In fact, of the market options that the ISO has studied over the last few years, an increase to RCPFs is the only one that has development and implementation costs that are proportional to its life span, and that strengthens incentives for real-time performance during winter scarcity conditions.³⁰

On the other hand, this proposal may not provide the same assurances of “fuel in the tank” as the current winter program. While the current winter program targets and compensates the needed short-term behavior, the RCPF solution relies on resource owners’ judgment regarding the appropriate actions to take in anticipation of a few potential high-priced periods, which are unpredictable due to a variety of system conditions. This is of concern under the current capacity market design, which provides exemptions to resources under various circumstances.

B. The More Effective and Efficient Alternative

In the event that the Commission grants this request for rehearing, the ISO would work with stakeholders to develop an expanded version of the current winter program, which has been proven to be a cost-effective interim means to assure fuel inventory while the ISO completes development and implementation of the full PFP market-based solution.

The ISO would maintain the structure that has evolved as a result of market improvements and the Commission’s order regarding generator obligations, in which generators are paid only for unused fuel at the end of the season, rather than upfront for fuel procurement. The narrow objective will still be to compensate generators for adopting the ISO’s, rather than their own, estimates about how much fuel is needed at the beginning of the winter. This

³⁰ *ISO New England Inc.*, 147 FERC ¶ 61,172 at pp. 108-109 (2014).

objective recognizes that, unlike PFP, the current structure, with its insufficient obligations, incentives and penalties, may not support robust fuel procurement.

In its second iteration, the winter program maintained participation by demand resources and added provisions for LNG in order to improve the program's resource-neutrality. In order to continue to improve program participation and resource neutrality, the ISO will commit to discuss with stakeholders ways in which the winter program could be expanded from prior versions to include payments to all resources that can supply the region with fuel assurance; in other words, ISO-NE will work to enhance the current program structure to compensate resources such as coal and nuclear units in addition to the oil, LNG and demand resources that have participated in the past. This expansion would more closely resemble a market-based solution in terms of being available to a majority of resources, while meeting the objective of ensuring fuel adequacy in a targeted, efficient, time-limited manner.

V. CONCLUSION

For the reasons stated herein, ISO-NE respectfully requests that the Commission grant rehearing of the Clarification Order. If rehearing is granted, ISO-NE will file an expanded version of the winter program. If rehearing is not granted or the Commission does not act by June 1, the ISO will propose an increase in RCPFs. To prepare for these alternative filings, ISO-NE will discuss the two solutions with stakeholders.

Respectfully submitted,

ISO NEW ENGLAND INC.

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Dated: February 19, 2015

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Commission Secretary in these proceedings.

Dated at Holyoke, MA this 19th day of February, 2015.

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