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September 22, 2006

The Hon. Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

RE: *ISO New England Inc. and New England Power Pool*, Docket No. ER06-1465-000

Dear Secretary Salas:

Attached for electronic filing in the above-referenced docket is the Motion to Intervene and Limited Protest of the New England Power Generators Association.

If you have any questions or concerns regarding this filing, please feel free to contact me at the address above. Thank you for your assistance in this matter.

Sincerely,

/s/ Angela O'Connor
Angela O'Connor
President
NEPGA

cc: Official Service List

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

**ISO New England Inc. and
New England Power Pool**

Docket No. ER06-1465-000

**MOTION TO INTERVENE, COMMENTS, AND LIMITED PROTEST OF
THE NEW ENGLAND POWER GENERATORS ASSOCIATION**

Pursuant to Rules 211, 212 and 214 of the Federal Energy Regulatory Commission’s (“Commission”) Rules of Practice and Procedure, 18 C.F.R. §§ 385.211, 385.212 and 385.214 (2006), and the Commission’s September 8, 2006 “Combined Notice of Filing,” The New England Power Generators Association (“NEPGA”) hereby submits this motion to intervene, comments and limited protest to the Transition Provisions of the Forward Capacity Market Settlement Agreement (“Transition Provisions”) proposal submitted by ISO New England Inc. (“ISO-NE”) and the New England Power Pool in the above-captioned docket on September 1, 2006 (“September 1 Filing”). NEPGA strongly supports the package of market reforms necessary to implement the Forward Capacity Market Settlement Agreement (“FCM Settlement”) contained in the September 1 Filing. Consistent with the FCM Settlement, the September 1 Filing will terminate the existing ICAP Market and replace it with a transitional mechanism during which fixed capacity payments will be made to all Capacity Resources during what is referred to as the Transition Period, which is the period prior to the implementation of the Forward Capacity Market.

In one respect, however, the Transition Provisions fall short. The error concerns payments made in the Forward Reserve Market during the Transition Period. Rule changes proposed in the September 1 Filing incorrectly deduct capacity payments intended to compensate capacity owners on the basis of “unforced” capacity ratings (“UCAP”) from forward reserve payments clearly based on the actual ratings (often referred to as “Installed Capacity” or “ICAP”) of reserve resources.

By creating a redundant adjustment for forced outages, the error will result in too large a deduction to Locational Forward Reserve Market payments and under compensation of forward reserve resources.

NEPGA requests that the Commission correct this error for the Transition Period so that forward reserve payments are calculated using a consistent definition of capacity during the Transition Period. NEPGA requests that the Commission expeditiously approve the Transition Provisions contained in the September 1 Filing and direct ISO-NE to correct the manner in which it accounts for fixed capacity payments in the Locational Forward Reserve Market.

I. NOTICES AND COMMUNICATIONS

The persons to whom correspondence, pleadings, and other papers regarding this proceeding should be addressed and whose names are to be placed on the Commission's official service list on behalf of NEPGA are designated as follows, in accordance with Rule 203 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.203:

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II. DESCRIPTION OF NEPGA

NEPGA, a nonprofit corporation registered in the state of Massachusetts, is the largest trade association representing competitive electric generating companies in New England. NEPGA's member companies represent approximately 20,000 megawatts (MW) of generating capacity in all six states of the New England region.¹ NEPGA's mission is to promote sound energy policies which will further economic development, jobs, and balanced environmental policy. NEPGA believes that sustainable competitive markets are the best means to provide long-term, reliable and affordable

¹ Background and additional information about NEPGA can be found at: <http://www.nepga.org>.

supplies of electricity for consumers. All NEPGA members are also members of the New England Power Pool (“NEPOOL”), and their generation, reserve, and other services are subject to the control of ISO-NE.

III. MOTION TO INTERVENE

NEPGA members own generation in New England and participate in the New England energy, capacity and ancillary services markets. Compensation for forward reserve services will be directly affected by this proceeding. NEPGA members share a common interest in ensuring fair and efficient compensation for forward reserve services. As such NEPGA has a direct and substantial interest in the instant proceeding and its interests may be directly affected by the outcome of this proceeding and cannot be adequately represented by any other party in this proceeding.² Accordingly, NEPGA submits that good cause exists for granting this timely motion to intervene and that its intervention is in the public interest, and should thus be granted.

IV. LIMITED PROTEST

The September 1 Filing contains numerous provisions necessary and appropriate to implement the Transition Period provisions of the FCM Settlement. NEPGA members support ISO-NE’s efforts to implement the Transition Provisions and only oppose how one element of these rules will interplay with rules previously approved by this Commission for the Locational Forward Reserve Market.³ This interplay creates a technical error, which will result in an underpayment to forward reserve resources. As explained in detail in the sections that follow, ISO-NE proposes to reduce forward reserve payments in a manner which incorrectly assumes that each megawatt of forward reserves receives the fixed capacity payment set forth in the FCM Settlement for the Transition Period based on the resource’s installed capacity, even though individual capacity resources will be paid for providing capacity based on their UCAP rating. (UCAP is a specialized capacity rating which

² The positions of the NEPGA organization do not necessarily reflect the positions of each member company.

³ New England Power Pool and New England ISO, 115 FERC 61,175 (May 2006).

decreases the actual capacity of each unit to account for its historical rate of forced outages). The result is redundant reductions in payments to resources providing the valuable reliability service of forward reserves.

NEPGA proposes restating the Transition Period capacity payment deduction from Locational Forward Reserve Market payments in units based on actual capacity ratings before deducting it from forward reserve payments. This calculation would ensure that the forward reserve payments are made at the appropriate level. NEPGA estimates that, while the error in the ISO-NE proposal appears relatively modest, it is likely to result in approximately \$5,000,000 per year in underpayment for forward reserve services. Consistent with the goals of the Locational Forward Reserve Market, the correction would enable the NEPOOL markets to better attract reserve resources where and when they are needed.

A. Capacity Payments for Forward Reserves

Payments for forward reserves are made to owners of reserve resources for providing reserve capability in real-time consistent with their forward reserve obligations as auctioned through the forward markets. Payments are made based on the actual quantity of reserve capacity provided in real-time consistent with these obligations.⁴ Resource owners whose resources do not deliver reserves due to a forced outage are not paid for forward reserves in the hours in which the forced outage occurs. Moreover, resource owners that fail to meet their forward obligations face additional performance penalties of either 1.5 or 2.25 times the rate of forward reserve payment depending on the circumstances of their failure (*i.e.*, Failure-to-Reserve and Failure-to-Activate penalties).⁵ Thus, performance – the delivery of reserve capacity without outage (forced or otherwise) – is fully taken into account in the Forward Reserve Market payment structure. Generators that fail to deliver actual megawatts not only receive no payment for forward reserves but also pay significant performance

⁴ ISO New England, Inc., FERC Electric Tariff No. 3, Market Rule 1, § III.9.8.

⁵ *Id.* at §III.9.7.

penalties. As such, any additional reductions in payment due to generation outages are redundant and unnecessary.

B. The Netting of Installed Capacity Compensation

According to the September 1 Filing, the payment to resources for providing forward reserves during the Transition Period are to be reduced by the “ICAP Transition Payment,” which is a fixed capacity payment established by the FCM Settlement.⁶ In structuring the forward reserve market, ISO-NE explained its reasons for deducting capacity payments from the forward reserve payment:

The Forward Reserve Market is intended to provide incremental compensation related to the additional costs that may be incurred to make available resources that are more flexible operationally than is required of basic ICAP resources. Therefore, the clearing price of the monthly ICAP Supply Auction will be subtracted from the Forward Reserve Market clearing price during the settlement process.⁷

Accordingly, since fixed capacity payments will replace the ICAP auction during the Transition Period, the Market Rule 1 changes included in the September 1 Filing provides that these fixed Transition Period capacity payments be deducted from forward reserve payments.⁸

In making this deduction, however, it is important that the deduction be made in a consistent manner that, per unit of capacity, properly reflects the level of capacity payment available to actual resources. The September 1 Filing fails in this regard. Rather than pay generation owners based on their ICAP rating, the FCM Settlement specifies, “All listed ICAP resources shall receive ... fixed payments, based on their seasonal UCAP ratings.”⁹ (The UCAP methodology reduces actual capacity values to account for historical levels of forced outages.)¹⁰ Since no generator can sustain a zero

⁶ September 1 Filing, Attachment 1 at §§ III 9.8 (b) and III 9.8. (c) [pg. 80].

⁷ ISO New England, Inc. and NEPOOL Participants Committee Joint Filing, Docket No. ER06-613 (Feb. 6, 2006) (Ancillary Services Market Phase II) at 10.

⁸ September 1 Filing, Attachment 1, § III.8.1.

⁹ Explanatory Statement in Support of Settlement and Request for Expedited Consideration and Settlement Agreement Resolving All Issues, Devon Power LLC, *et al*, Docket No. ER03-563-000,- 030, -055, Settlement Agreement at 43 (Mar. 6, 2006).

¹⁰ UCAP ratings are based on to the ICAP ratings of generators, but are reduced to account for forced outages. For example, a generator with a 100 megawatt ICAP rating that experiences forced outages 10% of the time it is called for energy would have a 90 MW UCAP rating.

forced outage rate, the use of UCAP is likely to affect every generator receiving forward reserve payments. By stipulating payments in terms of UCAP, the payments per kilowatt-month stipulated in the FCM Settlement are somewhat higher than they would be if payments were made based on ICAP ratings; however, the capacity deduct for purposes of the forward reserve market should be based on ICAP and not on UCAP. The inconsistency in these rules will result in an underpayment for forward reserve resources. Using the payments listed in the FCM Settlement with no adjustment results in too large a deduction for capacity payments in the forward reserve payment. For example, assuming a ten percent average effective forced outage rate (EFOR_d) in the pool, the \$3.05 payment per kilowatt-month of UCAP that will go into effect this December translates into \$2.745 per kilowatt-month average payment to actual ICAP capacity paid under the FCM Settlement [$\$3.05 \times (1 - 0.10)$] = \$2.745]. Simple application of a \$3.05 deduction in the Locational Forward Reserve Market results in an underpayment of \$0.305 per kilowatt-month (\$3.05 minus \$2.745).

In order to ensure fair and efficient compensation to generation resources, capacity payments should be treated consistently for the Transition Period of FCM as for the deduction in the forward reserve market. In other words, the capacity payments deduction in the forward reserve market should reflect the actual level of payments received by generators used to supply the forward reserves. NEPGA realizes that a resource-specific capacity adjustment could become complicated under ASM Phase II where different resources can be substituted by obligation holders to satisfy their forward reserve obligation. NEPGA, therefore, proposes that the capacity deduction from the forward reserve payment be based on the fixed Transition Period capacity payment times a factor equal to one minus the average effective forced outage rate of all resources (commonly represented as “system EFOR_d”). With this adjustment, both the Locational Forward Reserve Market payment and the deduction made to account for capacity payments made during the Transition Period will be based on consistent units of actual capacity (ICAP).

C. The Error Will Result in Redundant Deductions for Forced Outages

The error made in the September 1 Filing may be more readily apparent when understood as a redundant reduction in payment for forced outages. As discussed above, payment for forward reserves are made on the basis of actual performance and include penalties for non-performance that already include non-payment for forward reserve service as well as significant additional penalties. As described by ISO-NE, penalties are deliberately set “so that the resulting performance penalties are sufficiently high to discourage poor performance.”¹¹

While “sufficiently high” performance penalties are already built into the forward reserve market, ISO-NE’s proposed use of UCAP-based capacity payments for the capacity payment deduction from the forward reserve payment further reduces forward reserve payments based on a performance measure. Use of a UCAP payment rate results in an additional adjustment for forced outages not intended in the forward market design. In effect, forward reserve resources are penalized twice for forced outages: first as intended based on the Failure to Reserve-to-Reserve and Failure-to-Activate Penalties included in the Forward Reserve Market; and a second time in error because the deduction to account for fixed Transition Period capacity payments based on UCAP, which includes a forced outage adjustment.

D. Suppliers of Forward Reserves Cannot Simply Correct for this Error in Their Offers

During development of the forward reserve market and the Transition Provisions, some NEPGA members realized the error of simply applying UCAP rates to the forward reserve payment formula and offered proposals to correct the error. Those proposals were not adopted, and while voicing concerns about this technical error, most NEPGA members ultimately supported adoption of the package of the Transition Provisions at the Participants Committee since the majority of the rules were satisfactory and the entire package requires Commission approval before December 1, 2006.

¹¹ Ancillary Service Market Phase II at 12.

From the larger policy perspective NEPGA members viewed it imperative that the Transition Provisions move forward and did not want to oppose the rules in the vote at the Participants Committee on the basis of this technical error.

During the discussion in the stakeholder process, some viewed this error as minor because participants could, in theory, simply adjust their forward reserve offers to account for this extra deduction. UCAP rates are calculated based on past forced outage rates, thus the impact of the error could be calculated and forward reserve offers adjusted accordingly. However, it is inappropriate to rely on adjustments of market participant behavior to correct errors in market design. Market participants should not be expected to back into good market design. Instead, the market should be designed correctly and appropriately from the start in order to meet its important reliability goal of attracting new capacity when and where it is most needed.

The error is a technical detail with significant implications, but there is rather simple fix, described in detail below, to adjust the design prior to the December 1, 2006 implementation date of the Transition Provisions.

E. A Simple Correction that Sends the Right Signal

As discussed above, the September 1 Filing proposes to subtract the Transition Period capacity rates based on \$/kW-month of UCAP from the clearing prices in the forward reserve market, which are based on \$/kW-month of ICAP. While this approach suffers from a redundancy in accounting for forced outages, it also is deficient simply based on basic algebraic principles. The two numbers are not based on the same units. The error is analogous to subtracting degrees Fahrenheit from degrees Centigrade. The calculation does not make sense without first applying a conversion factor to ensure consistent units.

In order to correct this technical error in the Transition Provisions, NEPGA proposes an adjustment. Rather than simply using the fixed Transition Period capacity payments provided for in

the FCM Settlement as the basis for the capacity payment deduction from the forward reserve payment, the fixed Transition Period capacity payments provided for in the FCM Settlement should be translated into payment rates based on actual capacity (ICAP). Specifically, these capacity payment rates should be multiplied by a factor equal to one minus the effective average forced rate for the NEPOOL system (*i.e.*, $1 - \text{system EFOR}_d$) before being subtracted from the forward reserve payment. The result would be in terms of \$/kW-month of actual capacity (ICAP), which can then be deducted from the forward reserve prices cleared in the forward reserve market. Methods used to calculate system EFOR_d should be the same as those employed in the current (soon to be eliminated) ICAP market. By restating the payment into consistent units of actual capacity (ICAP), forced outages would be taken into account only once – based on actual outages and the associated Failure-to-Reserve and Failure-to-Activate penalties, thus setting forward reserve payments to appropriate and intended levels.¹²

V. CONCLUSION

WHEREFORE, for the foregoing reasons, NEPGA respectfully requests that the Commission grant its Motion to Intervene and Limited Protest and grant the relief requested therein.

Dated: September 22, 2006

Respectfully submitted,

/s/ Angela O'Connor
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¹²Capacity payments made during the transition would, of course, still be made based on units of UCAP, thus adjusting that payment based on performance as stipulated in the FCM Settlement. Only in the context of the capacity payment deduction from the forward reserve payment would the capacity payment value be converted to units of ICAP.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document on each party named in the official service list in this proceeding.

Dated at Washington, D.C., this 22nd day of September 2006.

/s/ Ana V. Alberdi
Ana V. Alberdi