UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

ISO New England Inc. and	**)**	**Docket Nos. ER14-1050-000**
New England Power Pool	**)**	**ER14-1050-001**
	)	

MOTION TO INTERVENE AND COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION IN SUPPORT OF ISO-NEW ENGLAND'S PAY FOR PERFORMANCE PROPOSAL

Pursuant to Rules 212 and 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission[1] ("FERC" or the "Commission"), and the Commission's Notice of Extension of Time,[2] the Natural Gas Supply Association ("NGSA") hereby respectfully moves to intervene in the above-captioned proceedings. The NGSA also hereby submits its comments supporting ISO-New England's Pay For Performance proposal, which is designed to achieve improved performance by electric generators through a performance incentive structure within the Forward Capacity Market ("FCM").

NGSA is a trade association which represents integrated and independent companies that produce and market domestic natural gas. Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy, and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. customers.

Members of NGSA produce and market natural gas to gas-fired power generators throughout the United States, including in the New England market. Absent actions to correct existing power market flaws in New England, the natural gas industry could be

[1] 18 C.F.R. §§ 385.212 and 385.214 (2014)
[2] *New England Power Pool and ISO New England Inc.*, Notice of Extension of Time, Docket Nos. ER14-1050-000 and ER14-1050-001 (Jan. 23, 2014).

subjected to inaccurate claims concerning the reliability of natural gas supply simply through association. Thus, we have a strong interest in supporting well-functioning wholesale power markets that provide an incentive for gas-fired power generators to make investments that are required for electric reliability and to meet New England's long-term energy needs. As such, NGSA has a substantial interest in these proceedings.

The natural gas market is remarkably successful and reliable. Thanks to the shale gas revolution, there is ample supply of natural gas to meet the country's demand for natural gas as long as adequate infrastructure is in place to deliver those supplies. Natural gas marketers, producers, and pipelines consistently help customers reliably meet their service requirements through a spectrum of gas services and fuel procurement strategies. Yet, the gas industry's ability to meet power customer service requirements must be supported by investment in adequate gas infrastructure, advance supply arrangements and other services, which, in turn, must be supported by competitive power market structures. Because New England's current power market structure does not adequately value the performance provided by such investments, New England cannot be assured that generators will be able to perform reliably, particularly during periods of system stress.

I. COMMUNICATIONS

Any communications with respect to this pleading and this proceeding should be addressed to:

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II. EXECUTIVE SUMMARY

Immediate action is required to correct power market imperfections in New England so that region can reliably meet its long-term energy needs through a competitive market. In its January 17, 2014 filing, ISO-NE asserts that current market flaws are "posing serious threats to the operation of the system" and the current market structure provides little incentive for generators to secure more economic and reliable fuel arrangements or undertake other investments required for capacity resources to be available to perform when called upon.[3] Among other things, these market flaws have resulted in an inability to secure adequate natural gas infrastructure and services to meet the region's gas-fired power demands, which are the central issues that must be addressed with respect to gas/electric coordination.[4]

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[3] *See* ISO New England Inc. and New England Power Pool, Filings of Market Rule Changes to Implement Pay for Performance in the Forward Capacity Market, Transmittal Letter, Docket Nos. ER14-1050-000, *et al*. at 3 (Jan. 17, 2014) ("Pay For Performance Filing").

[4] In Docket No. AD12-12-000, FERC has undertaken a comprehensive review of the issues associated with power markets' greater reliance on natural gas. To date, much of the discussion has focused on requests by generators and utilities for changes to the existing scheduling and operations in the natural gas industry. However, finding solutions that permit the power industry to secure needed gas supplies, infrastructure and services should be the priority of both FERC as well as the gas and power industries.

New England has been the principal focus of a host of federal and state conferences, regional forums, and stakeholder meetings over the past several years on the issue of how to resolve reliability issues in that region. However, these discussions have yet to deliver tangible market design improvements in capacity resource performance. In that vein, NGSA appreciates the efforts of ISO-NE to develop the proposed FCM Pay For Performance intended to address the electric reliability situation in New England.

Conceptually, ISO-NE's Pay For Performance proposal is based on solid market principles that can begin to improve the effectiveness of market signals that encourage generators to exercise options that economically and reliably meet their power obligations.[5] Some of those options may include, but are not limited to, installing dual-fuel capabilities, entering into bilateral contractual arrangements with other power suppliers, securing gas services from natural gas or LNG suppliers, arranging advance gas supply services from gas marketers, as well as securing pipeline capacity on a firm basis where available. If implemented appropriately, the Pay For Performance concept will help address some of the serious electric reliability and economic concerns in New England by: (1) implementing a market-based solution that provides the price signals required to incent more reliable performance through investment by generators; (2) ensuring resource neutrality; and (3) providing clear market rules.

While Pay For Performance has the potential to improve the functioning of the power market in New England, this program alone is not likely to fully resolve the underlying reliability and economic issues, particularly given the timeframe in which new investments are required. As such, in addition to the pending proposals, FERC, ISO-NE, and its

[5] *See* Pay For Performance Filing at 21 ("The Pay For Performance design adheres to three fundamental market design principles that characterize efficient, competitive markets.").

stakeholders must continue to consider solutions that will resolve the current gas infrastructure constraints without delay.[6] Additionally, we believe the Commission must play a more significant role in ensuring that all appropriate actions are taken to correct underlying market flaws. In fact, at this stage, broader actions beyond simply acting on the two alternative submissions will likely be required.

The New England Power Pool ("NEPOOL") also has submitted its own alternative proposal in this "jump-ball" proceeding.[7] In contrast to ISO-NE, NEPOOL has proposed incentives in the Real-Time, hourly market by setting a higher rate in the real time energy market during periods of reserve deficiencies for Energy and Ancillary Services, as well as changing the way availability is currently measured in the FCM.[8] NGSA has not had the opportunity to fully review the specific details of NEPOOL's proposal and therefore, we will not comment on its merits (or concerns, if applicable) herein.

III. FLAWS IN NEW ENGLAND'S MARKET STRUCTURE MUST BE ADDRESSED TO REDUCE THE REGION'S VULNERABILITY TO SYSTEM RELIABILITY RISKS

As explained in the two alternative filings, both ISO-NE and NEPOOL share the concern that the existing market structure in New England does not provide sufficient incentives to influence market behavior to address current reliability performance risks. ISO-NE believes the existing FCM performance incentives are too weak and are ineffective in providing competitive market signals to generating resources to undertake the contracting

[6] NGSA's support for ISO-NE's Pay For Performance concept is based on the unique circumstances in New England. Given the vast differences in power markets, similar proposals may not necessarily be the most appropriate means to address market issues in other regions.

[7] *See* ISO New England Inc. and New England Power Pool, Filings of Performance Incentive Market Rule Changes, Docket Nos. ER14-1050-000 and ER14-1050-001 (Jan. 17, 2014).

[8] *See id.*

and investment required to improve performance levels that will maintain reliable system operations.[9] As detailed below, NGSA agrees with this assessment.

In the past year, NGSA has observed debates between ISO-NE and gas-fired generators over the extent of advance fuel arrangements required to satisfy capacity performance requirements under the tariff. Also, according to ISO-NE, there have been periods of system stress in which a significant number of generators have failed to respond to dispatch instructions consistent with their commitment to provide such service in their supply offers.[10] Such inadequacies have resulted in ISO-NE instituting non-market-based mechanisms, such as spending $75 million on its winter procurement program (largely to pay for oil fill at oil-fired generating units), to ensure reliability for this winter.[11] Continued reliance on uneconomic, non-market-based mechanisms to address short-term reliability situations only serves to weaken market signals required for generator investment in longer-term solutions.

Additionally, the current structure provides incorrect and inefficient signals to market participants by paying all parties the same amount to perform regardless of their contribution

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[9] *See* Pay For Performance Filing at 3 ("In the current FCM design, capacity payments are poorly linked to resource performance. In many cases, capacity resources are being paid for simply existing, rather than for actually performing when they are needed. With the linkage between payments and performance broken, there is little incentive for resource owners to make investments to ensure that their resources will be ready and able to provide energy and reserves when needed. The lack of such investment is posing serious threats to the reliable operation of the system.").

[10] *See* FCM Performance Incentives, ISO New England at 1-2 (Oct. 2012), *available at* http://www.iso-ne.com/committees/comm_wkgrps/strategic_planning_discussion/materials/fcm_performance_white_paper.pdf ("[e]mpirical analyses of generating unit performance indicate that, at times of high system stress, a significant share of the region's generating fleet fails to respond to ISO dispatch instructions according to their offered capabilities.").

[11] *See* ISO New England Settlements Issues Forum: Q4 2013 Meeting (Dec. 11, 2013), *available at* http://www.iso-ne.com/stlmnts/qrtly_stlmnts_mtrls/settlements_quarterly_webex_12_11_2013.pdf. *See also* Naureen S. Malik, *Boston Beats New York with Record Power Price Premiums: Energy*, Bloomberg News, Jan. 17, 2014, *available at* http://www.bloomberg.com/news/2014-01-17/boston-beats-new-york-with-record-power-price-premiums-energy.html.

to supporting the system's energy and operating reserve requirements.[12] During scarcity periods, resources that do not provide energy or operating reserves are paid the same for their capacity as generating resources that support the system requirements through supply of energy and operating reserve. Moreover, under the existing structure, generators that are routinely dispatched and asked to perform face greater risk of penalty than generators dispatched less often due to their economics and/or their lack of flexibility to come on line in the time required. Such market structures create perverse disincentives for power suppliers to invest in more reliable and economic operations.[13]

IV. THE PAY FOR PERFORMANCE CONCEPT CAN BEGIN TO IMPROVE PRICE SIGNALS FOR INVESTMENT IN THE NEW ENGLAND POWER MARKET

To incent more reliable performance, ISO-NE has proposed the Pay For Performance concept, which provides additional compensation to those that exceed their capacity performance obligations during a Capacity Scarcity Condition.[14] All capacity sellers will continue to receive the base payment that is set by a single-auction clearing price in the capacity market. In addition, during Capacity Scarcity Conditions, generators that do not satisfy their capacity performance obligation (i.e., supply their prorated share of system energy and operating reserve needs) will make capacity performance payments that are then transferred to generators that provided more than their capacity performance obligation. All sellers under Pay For Performance will be asked to provide the same capacity product and thus, a generator will then calculate its risk of under-performance when pricing its bid in future capacity auctions.

[12] *See* Pay For Performance Filing at 4.

[13] *See id.*

[14] *See id.* at 15-16.

Conceptually, ISO-NE's proposal is based on solid market-based principles that are likely to provide the foundation for more reliable and economic performance by generators in New England. If implemented appropriately, Pay For Performance should lead to material market improvements by: (1) implementing a market-based solution that provides the price signals required to incent more reliable performance through investment by generators; (2) ensuring resource neutrality; and (3) providing clear market rules. These three components of Pay For Performance are explained in more detail below.

(1) Provides a Market-Based Solution that Incents More Reliable Generator Performance

ISO-NE has crafted a market-based mechanism in which the capacity performance rate provides generators with the price signals required to induce market behaviors to more reliably perform, replicating the type of market signals participants would see in a pure energy market but for the "missing money" problem driving the need for capacity markets.[15] The greater revenues associated with over-performance combined with the financial risk exposure associated with under-performance should both work to effectively motivate suppliers to take actions to reduce their risk by improving their physical performance. Based on accurate market signals, generators are then free to select the options that best meet their needs to improve their performance in the most cost-effective manner whether through investment in dual fuel, gas supply or transportation agreements, LNG, demand response or bilateral agreements among generators, among other things.

In contrast, generators currently do not receive additional compensation if they invest in reliable fuel sources to ensure their ability to perform.[16] In fact, it is possible that

[15] *See id.* at 4-5.

[16] *See id.* at 10.

generators that make such investments will actually price themselves out of the market if their capacity bid reflects such increased costs of investment. For this reason, the current structure does not provide sufficient compensation for generators to invest in the level of performance that may be required, such as dual-fuel capabilities, firm gas transportation and supply arrangements, or fast-responding demand response.[17]

Under the current capacity market structure, some flexible, economic generators, such as gas combined cycle, are routinely scheduled to support the system while other less economic, less flexible resources are called upon much less frequently yet they are all paid the same amount to perform regardless of the extent to which they actually support the system energy and operating reserve requirements. This sends incorrect signals to market participants.

(2) Ensures Resource Neutrality

ISO-NE proposes that, under Pay For Performance, all types of generation will be held to the same standard of performance and will be subject to the same rate with no exceptions.[18] Compensation is not dependent on which technology is used; it depends solely on whether the product is delivered. If different resources are treated differently (for example, the Winter Procurement Program), the fundamental market-based concept will be compromised and will not send the market signals required to meet the intended objectives of this proposal.

[17] One of the primary issues that must be decided as the Commission considers the ISO-NE and NEPOOL proposals is whether it is appropriate to link performance with a generator's capacity market obligation. From NGSA's perspective, "available" capacity is meaningless if it cannot be relied upon to perform when most needed, and it is illogical to provide capacity payments to those that cannot provide the services required by the ISO to maintain grid reliability. If the capacity committed in auction cannot reliably perform, one must ask if the capacity market actually provides the desired reliability and true value to consumers.

[18] *See* Pay For Performance Filing at 18, 21.

(3) Provides Clear Market Rules

The Pay For Performance proposal would clearly delineate each participant's obligations as well as the risks and rewards of participating in the FCM.[19] Such transparency will allow all market participants to understand what is expected of them with respect to their capacity commitment. As a complaint filed against ISO-NE in 2013 demonstrated, the power market rules and obligations for performance in New England have been ambiguous and subject to a high degree of interpretation, which led to a great deal of uncertainty for all market participants.[20] Also, this lack of clarity surrounding a participant's obligation resulted in instances in which ISO-NE felt compelled to resort to non-market actions to assure system reliability, further dampening market signals for economic long-term investments.

V. FERC MUST REJECT EFFORTS TO COMPROMISE THE FUNDAMENTAL MARKET PRINCIPLES THAT UNDERPIN PAY FOR PERFORMANCE AND IMPLEMENT THE PROPOSAL WITHOUT DELAY

While there are potential benefits to be gained under the Pay For Performance concept, there are various ways in which the mechanism could fall short of its intended objectives if fundamental principles are compromised. The likelihood of achieving the intended goals of Pay For Performance depends heavily on whether the specific details of the design hold true to market-based principles.

NGSA believes it is most appropriate for the Commission, in conjunction with filed comments from the direct stakeholders and market participants in New England, to decide on the specific design that should be adopted under the Pay For Performance proposal. For that reason, NGSA is not weighing in on the individual merits of the specific details, such as the

[19] *See id.* at 21, 49.

[20] *Complaint and Request for Expedited Consideration of the New England Power Pool Generators Association*, Docket No. EL13-66-000 at 58 (May 17, 2013).

appropriate level to set the performance capacity rate or the number of allowed exemptions. However, the specific design of the concept that is ultimately approved will dramatically impact the overall effectiveness and success of ISO-NE's proposal.

We understand that there may be some limited circumstances in which it is appropriate to ensure that performance capacity payments (penalties) do not become inordinately excessive, particularly in those instances in which there may be sustained performance issues (e.g. stop/loss provisions). However, to maintain an effective market-based approach, which is the foundation for success of the Pay For Performance proposal,[21] all market participants must be held to the same standards to the maximum extent possible. Each exemption granted will progressively weaken the market signals that are needed to create the proper incentive for improved generator performance. Also, exemptions shift cost responsibility to other sellers without additional compensation. Thus, the Commission should limit the number of exemptions granted to the maximum extent possible.

Also, delayed timing of implementation can work to undermine the intended objectives of Pay For Performance. As ISO-NE has stated in its filing, New England's system reliability is already in a state of crisis and, for that reason, immediate action is required.[22] Yet, to lessen the cost impact, ISO-NE has proposed a seven-year transition period prior to requiring generators to be subject to the full performance payment rate deemed necessary to induce the correct market behaviors.[23] Given that each year's auction for capacity commitments becomes effective three years after the date of the auction, under this seven-year transition, parties will not be subject to the full effective rate until 2024 –

[21] *See* Pay For Performance Filing at 21.

[22] *Id.* at 10 ("New England is experiencing fleet-wide performance issues…the problems are so pervasive that they threaten the ISO's ability to operate the system reliably.").

[23] *Id.* at 43.

more than a decade from now. While there may be very valid justifications for allowing a phase-in to ease the cost of transition for suppliers and consumers, such transitions must be weighed against the significant reliability and economic risks associated with prolonged delays in sending the right market signals. The significant market flaws that exist today must be corrected as soon as possible.

VI. MARKET IMPROVEMENTS CAN MITIGATE COSTS ASSOCIATED WITH GREATER SYSTEM RELIABILITY

Certainly, there will be costs associated with improving reliability in New England and those costs will have direct financial impacts on market participants as well as consumers. Yet, any consideration of the financial impacts must also be balanced against the possible adverse consequences that could occur absent effective measures to ensure reliability in New England.

In addition to increased system reliability in New England, the Commission should also consider the cost benefits associated with implementation of Pay For Performance. First, it is possible that the region will incur lower costs for natural gas if Pay For Performance eventually creates market behaviors that lessen current pipeline capacity constraints.

Second, if ISO-NE has greater confidence that generators will run when called upon, they will be less likely to commit additional units, which will allow generators to more readily receive competitive market prices.[24] Similarly, overall regional costs associated with Pay For Performance may be reduced due to less reliance on non-market mechanisms in

[24] When ISO-NE lacks confidence in performance, they will at times over-commit resources, creating out-of-merit situations that can, in turn, inflate energy clearing prices relative to otherwise competitive market levels.

which ISO-NE procures additional generator commitments to address performance uncertainty, such as last year's Winter Procurement Program that cost $75 million.[25]

VII. CONCLUSION

Conceptually, ISO-NE's proposal is based on solid market-based principles that can provide the foundation for increased reliability in the New England power market. If implemented appropriately, Pay For Performance should help to address the serious concerns associated with electric reliability by instituting a market-based solution to incent investments by generators that help them perform more reliably and economically. Therefore, we believe that the Commission should accept ISO-NE's proposal without delay while continuing to seek ways to build upon that foundation to solve the lack of adequate gas infrastructure in the region. NGSA encourages the Commission, to the extent possible, to limit the number of exemptions as exemptions shift responsibility to other capacity sellers.

Respectfully submitted,

/s/ *Patricia W. Jagtiani*

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[25] *See supra* n. 7.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon those parties on the official Service List compiled by the Secretary in this proceeding.

Dated Washington, D.C. this 12th day of February, 2014.

/s/ *Patricia W. Jagtiani*