

New England States Committee on Electricity

To: Vamsi Chadalavada, Executive Vice President and Chief Operating Officer, ISO New England
From: NESCOE Managers
Date: May 2, 2013
Subject: Winter 2013/14 Supplemental Obligation Proposals

The New England States Committee on Electricity (NESCOE) appreciates ISO New England's (ISO-NE) proactive efforts to address fuel unavailability risks for the 2013-2014 winter season. NESCOE understands that proposed solutions remain under development, and further, that ISO-NE is currently incorporating stakeholder and state feedback as it continues to refine its preferred approaches. NESCOE looks forward to continuing to work with ISO-NE and others to address this important near-term challenge.

ISO-NE has identified the need to submit proposed solutions to the Federal Energy Regulatory Commission (FERC) this summer to allow for solution implementation in time for this winter. Accordingly, the time for working through issues and questions identified by states and stakeholders is very short. To ensure that ISO-NE understands and considers NESCOE's perspectives and concerns as ISO-NE continues its work, NESCOE identifies below a number of open issues that emerged at the April 30, 2013 Joint Markets and Reliability Committee meeting (MC/RC) and a few that remain open from earlier communications. In short, while NESCOE supports ISO-NE's objective to enhance system reliability this coming winter and remains open to ISO-NE's general approach, NESCOE has serious reservations regarding some of the supplemental procurement details as presented on April 30th.

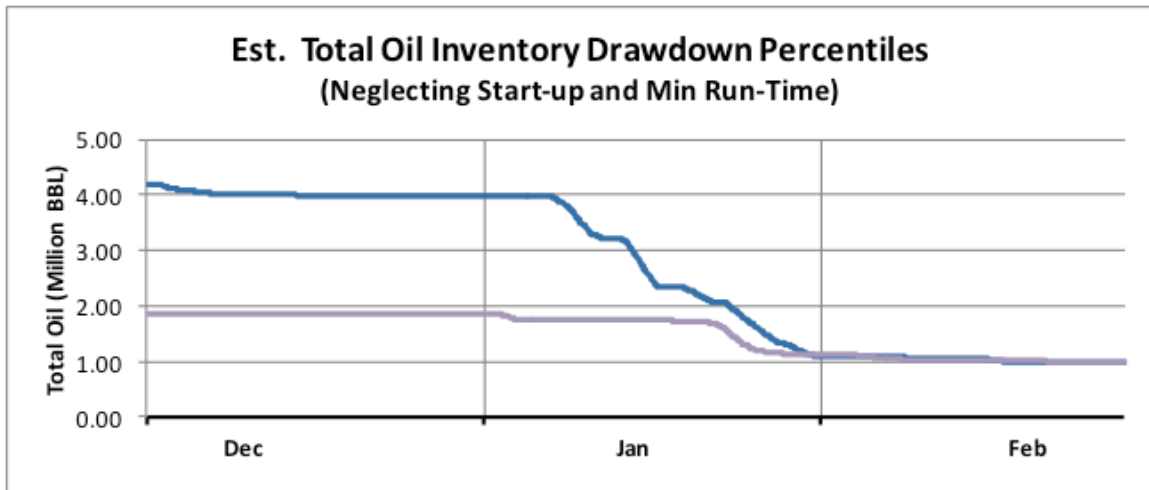
As a threshold matter, it may be helpful to ISO-NE and market participants to understand the screens through which NESCOE assesses proposed supplemental procurement mechanisms. First, consumers must receive reliable electric service at the lowest reasonable overall cost and consistent with state policies. That foundational premise is as applicable in this emergency circumstance as it is every other context. Second, fuel unavailability risks should be mitigated in the first instance through the most resource-inclusive approach reasonably possible under the circumstances. ISO-NE's general preference not to express favor for certain resource types should be applied in this emergency circumstance to the maximum extent feasible. Third, any competitive resource solicitation process should be structured to achieve robust participation. The greater the market participation, the more likely consumers are to benefit from a competitive process and its price pressure. Finally, while the region is relying on out-of-

market mechanisms to solve reliability concerns in this case, minimizing distortion to the competitive wholesale electricity markets is, as ISO-NE has identified, advantageous.

NESCOE asks ISO-NE to consider the issues below as it continues to develop procurement details for any refined proposals that ISO-NE will present on May 13, 2013.

10-Day Rolling Replenishment – Notwithstanding NESCOE’s concern regarding a supplemental procurement focused solely on oil-fired resources, discussed further below, ISO-NE’s proposed requirement that selected resources must *continually* replenish their fuel supply is overly conservative, unnecessarily expensive, and represents a significant departure from ISO-NE’s needs analysis.

NESCOE understands that ISO-NE’s needs analysis, as noted below, shows that: (a) 4.2 million barrels (M BBLs) of oil are needed at the beginning of the winter, and (b) based on conservative assumptions (coldest weather in last 10 years, 90/10 load forecast), the region would use 3.2M BBLs over the course of the winter, leaving 1.0M BBLs in storage at the end of the season.



ISO-NE Winter 2013 Presentation, April 30, 2013

As described by ISO-NE at the April 30th Joint MC/RC meeting, selected resources would be required to replenish *any* amount of oil used throughout the Winter 2013/14 period, ending the season with the same amount of oil held at the beginning of the 2013/14 Winter period. This structure necessarily means resources will have substantial levels of unused - and unneeded - oil left over at the end of the winter season. This will result in significant upward price pressure as NESCOE expects resources’ bids to seek to recover the costs associated with releasing any unused oil at the end of the Winter 2013/14 program. A requirement that obligates resources to continue fuel replacement, no matter the amount used and no matter when in the winter the use occurs, will significantly and needlessly increase costs ultimately paid by consumers, unless ISO-NE materially reduces the original stated need (or total program quantity) by a corresponding amount. Finally, NESCOE is interested in whether ISO-NE has confirmed with oil

suppliers their ability to supply, and to continually deliver on demand, the substantial oil supply ISO-NE identifies in its replenishment proposal.

10 Consecutive Day Requirement – The proposed requirement to have selected resources maintain the capability to perform at full output on oil for ten (10) consecutive days is overly conservative relative to ISO-NE’s needs statement. Based on the needs analysis, ISO-NE has not demonstrated that selected resources would be needed for ten consecutive days on a 24-hour basis. This requirement would materially increase costs and is disproportionate to the stated need. NESCOE anticipates that resources that bid will need to significantly increase their operational and oil delivery risk premiums and overall carrying costs to ensure that they have a ten consecutive day fuel supply, which would effectively require on-site storage. Additionally, as discussed below, ISO-NE’s intent not to allow units capable of delivering oil-based output for less than ten consecutive days, for example excluding resources that could provide such service for six-eight days, will reduce the level of competition and diversity in the procurement process without a commensurate improvement in reliability.

The ten consecutive day requirement is inconsistent with ISO-NE’s original procurement framework. While NESCOE appreciates that ISO-NE is modifying its approach based on its own advancing thinking and stakeholder feedback, modifications that depart sharply from prior frameworks and that present the likelihood of substantially increased consumer costs are a concern. Specifically, ISO-NE’s March 19, 2013 presentation at the MC/RC meeting described the resource requirement as the need to be sustainable for a duration that is typical of severe winter (or other stressed system) conditions: three to five days, with the ability to replenish this capability (e.g., within the week), or otherwise allowing for reliable operation through successive events. Lastly, the ten consecutive day requirement is excessive in relation to the nature of the underlying cause of the fuel unavailability risks. According to pertinent sections of the problem statement in the March 19, 2013 presentation:

- *Lack of liquidity in natural gas markets during evening and weekend hours have frustrated generators’ ability to obtain gas supplies in real-time in response to ISO dispatch needs.*
- *As a result, gas-fired generators that are run at higher than expected levels are prone to burning through their fuel supply, reducing or eliminating availability later in the day.*

ISO-NE has not demonstrated that a ten consecutive day requirement is necessary to address these types of fuel dependency risks.

Setting of reference level – Separate from the ten consecutive day requirements, ISO-NE has proposed an additional eligibility requirement for storage capability. This minimum eligibility requirement is a fuel oil storage capability reference level at five days of operation at a maximum sustainable level. This requirement may be a barrier to participation for many potential resources, especially dual-fuel units. Specifically, this minimum eligibility requirement is likely to have the effect of excluding from

participation those units with smaller - yet still meaningful and useful - storage capability. This requirement would also appear to exclude units that maintained fuel oil storage levels of one-third or more in prior years. It is reasonable to expect this provision to increase program costs unnecessarily by limiting the level of participation and reducing competition.

LNG Participation Opportunity – ISO-NE has expressed concerns about the implications on competitive markets if liquefied natural gas participates in a supplemental procurement. Consistent with ISO-NE’s general preference not to favor fuel sources, and the benefits of broad resource participation, ISO-NE should consider LNG an eligible fuel in any procurement and then evaluate whether any specific LNG-based proposal will have an undue impact on the competitive markets. If ISO-NE structures a solicitation to include LNG as a potentially useful resource, ISO-NE might receive LNG proposals to analyze for comparative economics and attendant effects on competitive wholesale markets.

DR Participation – Assuming additional demand-side resources (DR) can be procured at a reasonable price, NESCOE supports procuring such additional resources that do not already have a CSO. However, NESCOE does not agree with ISO-NE’s proposal to *only* procure additional DR that does not currently have a CSO. The number of existing resources that do not have a CSO and resources that could be acquired in time for winter 2013/14 (if any) would likely be limited - and more expensive - than existing resources with a CSO. ISO-NE’s approach does not take maximum advantage of existing DR resources. Although different from the value that incremental new resources would bring, resources that currently have a CSO would provide additional value in terms of expanded service if they could be called outside of OP4. Such expanded service could also likely be procured at a significantly lower cost than other alternatives.

NESCOE understands that ISO-NE believes that there are technical limitations to their existing DR systems. Nonetheless, NESCOE urges ISO-NE to develop interim solutions to these difficulties, in an effort to include existing demand resources that currently have a CSO in its proposed Winter 2013-2014 Demand Response Program.

Need for Cost Analysis – NESCOE appreciates the urgency with which ISO-NE is addressing the fuel unavailability risks and that proposed solutions are still in formation. However, given the fast track schedule to accommodate a FERC filing in the next few months, the need for potential cost analysis at the nearest possible time is important. Any such cost analysis will be highly subjective and based on assumptions, however, a range (high, medium and low) of possible cost outcomes will provide states and stakeholders a valuable directional view of the anticipated program costs. Understanding the cost sensitivity associated with various assumptions will also help narrow the areas that require ongoing focus.

Clarity, Timeframes & Additional Process – While solution details are a work in progress, the remarkably short time frame until final decisions about solutions heightens concerns about the lack of clarity on some fundamentals. For example, there is a near-

term need for information regarding how the quantity of fuel derived in ISO-NE's needs analysis relates to ISO-NE's proposed total procurement program quantity and whether pricing will be megawatt hour-based or quantity of fuel-based.

And, while NESCOE appreciates that ISO-NE answered many of its prior questions on the needs statement, other information, such as sensitivities to certain assumptions (what if a 50/50 forecast was used, for example) would be extremely helpful to states' efforts to be comfortable with ISO-NE's need determination. It would be similarly helpful for ISO-NE to explicitly connect its finding of need to its specific solution proposals or, the connection between the needs assessment and the reference level, the consecutive ten-day requirement, and the 10-day rolling replenishment requirement.

The current schedule assumes one meeting approximately a week from today and a meeting one month later. ISO-NE expects a committee vote shortly thereafter. NESCOE suggests additional process or opportunities for discussion. Additional process would likely increase the possibility that when ISO-NE submits a filing to FERC, states have sufficient information to be able to express reasonable confidence in ISO-NE's recommended approach under the circumstances. If there is any way NESCOE can be helpful to ISO-NE as it moves its ideas forward, please let us know.