

STEPHEN L. TEICHLER
DIRECT DIAL: 202.776.7830
E-MAIL: sleichler@duanemorris.com

www.duanemorris.com

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

Re: Devon Power LLC, et al., Docket No. ER03-563-030

Dear Ms. Salas:

On behalf of the NERAM Proponents, enclosed for electronic filing in the above-captioned proceeding is the *Errata to the Statement in Support of the New England Resource Adequacy Market*. On September 13, 2005, the NERAM Proponents filed electronically their *Statement in Support of the New England Resource Adequacy Market* (the "September 13 Filing"). The September 13 Filing inadvertently included the Public Service Company of New Hampshire on the cover page and the signature page. The *Errata* removes the reference to the Public Service Company of New Hampshire on each of those pages. Other than this modification, the *Errata* is identical to the September 13 Filing. The undersigned, on behalf of the NERAM Proponents, respectfully requests that the *Errata* be substituted for the September 13 Filing and apologizes for any inconvenience this may have caused. A copy of the foregoing has been served upon all parties included in the Commission's service list in this proceeding.

Please contact me if you have any questions concerning this filing.

Very truly yours,

/s/ Stephen L. Teichler

Stephen L. Teichler

Enclosure

cc: Service List

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

Devon Power LLC, et al.

)

Docket No. ER03-563-030

**STATEMENT IN SUPPORT OF THE
NEW ENGLAND RESOURCE ADEQUACY MARKET OF
THE MASSACHUSETTS DEPARTMENT
OF TELECOMMUNICATIONS AND ENERGY,
CONNECTICUT DEPARTMENT OF PUBLIC UTILITY CONTROL,
CONNECTICUT OFFICE OF CONSUMER COUNSEL,
NEW HAMPSHIRE OFFICE OF CONSUMER ADVOCATE,
MAINE PUBLIC ADVOCATE,
NSTAR ELECTRIC & GAS CORPORATION,
NATIONAL GRID USA,
NORTHEAST UTILITIES SERVICE COMPANY on behalf of
THE CONNECTICUT LIGHT AND POWER COMPANY and
WESTERN MASSACHUSETTS ELECTRIC COMPANY,
STRATEGIC ENERGY LLC,
ASSOCIATED INDUSTRIES OF MASSACHUSETTS,
THE BUSINESS COUNCIL OF FAIRFIELD COUNTY,
AND THE ENERGY CONSORTIUM**

September 13, 2005

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

Devon Power LLC, et al.

)

Docket No. ER03-563-030

**STATEMENT IN SUPPORT OF THE
NEW ENGLAND RESOURCE ADEQUACY MARKET**

Pursuant to the August 25, 2005 Order of the Federal Energy Regulatory Commission (“FERC” or “Commission”), the NERAM Proponents¹ hereby submit this statement in support of the New England Resource Adequacy Market (“NERAM”) as an alternative to the Locational Installed Capacity (“LICAP”) Demand Curve proposal advanced by the ISO New England (“ISO-NE” or the “ISO”) and recommended in *Devon Power LLC*, 111 FERC ¶ 63,063 (2005) (“Initial Decision”). The NERAM Proponents submit that NERAM will address Reliability Compensation Issues in New England on a region-wide basis and will ensure resource adequacy with greater economic efficiency. In response to the Commission’s August 25, 2005 questions, as shown below, NERAM, when fully developed and implemented, will (1) provide for just and reasonable rates based on a truly competitive supply market, (2) permit New England load to purchase the correct amount of capacity without an unnecessary surplus, and (3) ensure the lowest competitive price and eliminate the need for non-market intervention.

I. BACKGROUND

A. Historical Record.

Resource adequacy has long been the province of the states and local regulatory authorities. The states comprising New England, however, are unique. Notwithstanding their

¹ The NERAM Proponents are included on the signature page of this pleading.

different circumstances, the New England states, in partnership with local utilities, worked cooperatively with the New England Power Pool (“NEPOOL”) in establishing reserve margins, maintaining installed capacity, and sharing resources across the entire region on a least-cost basis.

This structure has achieved its objectives. For at least 40 years, the region has not suffered a single blackout due to lack of installed capacity.² Notwithstanding the efficiencies of a regional approach to resource planning and reserve sharing, various regulatory policies and market forces caused an over-development of installed capacity within New England. Moreover, the cost-of-service format of regulation effectively placed the risk of over-development on consumers rather than on the developer. Within various states, legislators and regulators explored market solutions that would optimize levels of installed capacity by placing investment risks on investors and thereby providing consumer benefits. Several New England states effectuated this objective by requiring utilities to divest generation assets and encouraging development of competitive markets for energy and ancillary services.

Investors reacted favorably to the restructuring initiative. In the late 1990s and early 2000s, 30,000 MW of new capacity was placed in the interconnection queue, and between 1999 and end of 2002, 8,000 MW eventually was placed in service. In some cases, however, the confluence of excess capacity and new combined cycle facilities created an environment within which owners of older facilities, or developers that overpaid for assets, were not satisfied with their profits in the market. Within load pockets old, inefficient units needed for reliability were seldom dispatched in economic merit order but had the ability to exercise market power.

² The ISO’s witnesses agreed that New England’s methodology has prevented blackouts. *See* Hearing Transcript at 473:12-19 (Stoft); 2362:9-11 (LaPlante).

Reliability Must Run (“RMR”) agreements were intended to address compensation and market power issues as a “tool of last resort.”³ As competition pressed marginal operators, however, more and more merchant generators fled the competitive market, at least temporarily, and demanded the safe haven of RMRs. As a result, RMRs have come to provide a cost-of-service floor compensation, without a prudence element and, with no limitation on the upside potential under the holder’s market-based rate certificate.

As originally formulated, the New England markets included a capacity market through which surplus capacity would be priced and made available to load-serving entities (“LSE”) that were short on their installed capacity obligations. Problems with the initial capacity market design caused the ISO-NE to return to the pre-restructuring mode of imposing an administratively-determined deficiency charge on LSEs that failed to own or contract sufficient capacity necessary to meet their allocated share of installed capacity. In response to these circumstances, NEPOOL participants began to explore market-based alternatives to the Installed Capacity Market.

The ISO-NE, the New York ISO and PJM, with assistance from the National Economics Research Association (“NERA”), explored Central Resource Adequacy Markets (“CRAM”) as an alternative capacity payment mechanism. In a February 2003 report,⁴ NERA concluded that CRAM would be an appropriate and efficient means of ensuring that adequate capacity was constructed and maintained within the Northeast to meet load growth and to promote reliability.

³ *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077 at P 31 (2005).

⁴ *Central Resources Adequacy Markets for PJM, NY-ISO and NE-ISO Final Report*, February 2003. See <http://www.pjm.com/committees/working-groups/ramwg/downloads/20040226-cram-report-final.pdf>.

However, in response to the Commission's April 25, 2003 order in this proceeding,⁵ the ISO-NE filed its own LICAP proposal in purported compliance with the Commission's Section 206 directive. LICAP was not developed through NEPOOL procedures, was not designed in cooperation with relevant state regulatory authorities, and did not receive an affirmative vote of the NEPOOL Participants Committee. While certain elements of the LICAP proposal were set for hearing, all alternatives to the ISO-NE's proposal were summarily rejected.

B. Development of an Alternative.

Notwithstanding the Commission's exclusion of alternatives from consideration in the instant proceeding, a number of parties nevertheless devoted significant time and resources developing a comprehensive structure that would address both long-term resource adequacy and immediate Reliability Compensation Issues.

The NERAM Proponents began the effort to develop a viable alternative proposal with the following set of objectives, which they believe parallel the Commission's objectives:

- Capacity prices should be set by competition in the market, not set administratively with artificial demand curves;
- Capacity payments should be for specific performance and commitments, and the proposal should avoid payments when there is with no assurance that sufficient resources will be maintained or developed;
- The capacity mechanism should apply throughout the New England region to promote regional resource adequacy and the most efficient and competitive markets;
- The capacity mechanism should be integrated with a Locational Forward Reserves Market to address capacity and locational operating reserves;
- The proposal should promote more Demand Response and energy efficiency; and

⁵ *Devon Power LLC*, 103 FERC ¶ 61,082 (2003).

- The capacity market should support restructuring goals by not shifting ownership risk to customers, but by providing adequate market-based compensation to generators for capacity services.

II. THE NEW ENGLAND RESOURCE MODEL

Through exhaustive discussions, the NERAM Proponents have coalesced around a NERAM proposal that they believe better meets the reliability and compensation needs of New England in a manner that is superior to the ineffective, unnecessarily expensive LICAP demand curve that ISO proposes and that the Initial Decision recommends. The NERAM Proponents' proposal begins from the premise that new entrants must be able to participate fully in the capacity auction, thereby ensuring vigorous competition and the lowest reasonable price for the correct amount of capacity need to assure system reliability. Thus the NERAM model draws on the most desirable elements of (1) the CRAM, (2) the Ancillary Services Market ("ASM") being developed by the ISO, with a Locational Forward Reserves Market ("LFRM"), and (3) the Reliability Options market originally proposed by the Connecticut Parties in this proceeding.⁶

NERAM consists of two parts. One element is a centralized, region-wide capacity market administered by the ISO-NE in which capacity is acquired for prospective periods pursuant to multi-year contractual commitments. The other element is implementation of an ASM, including a LFRM, that will be developed to complement the centralized capacity market.. The specifics of these elements are detailed below.

A. Central Capacity Market.

The long-term capacity assurance element of NERAM is founded on three basic elements: (1) a multi-year planning horizon or lead time; (2) a compensation/performance commitment; and (3) the use of an open auction format. The multi-year planning horizon serves

⁶ See Direct and Answering Testimony of Drs. Carl Pechman and Miles Bidwell filed in *Devon Power LLC*, Docket No. ER03-563-030 on November 4, 2004 (Exhibit CT-1) at 76-144.

two key purposes. First, it helps to ensure resource adequacy by obtaining commitments from capacity owners with enough lead time to allow for new capacity to be constructed if needed. Capacity schemes without such lead time can provide incentives for development, but do not provide firm commitments. Second, and very much related, the lead time facilitates reliance on market and competitive forces to establish the price for resource adequacy. With a lead time sufficient to permit new construction, entry into the market will be feasible, and the potential for entry provides competitive discipline on existing generators. Capacity schemes that do not allow sufficient time for new units to compete can place an unreasonable value on capacity if existing capacity is less than the amount determined necessary for reliability. Such schemes—like LICAP—often rely on mitigation and administrative price caps rather than competition to discipline prices and market power. A lead time sufficient to allow for new construction and entry to discipline the market is essential to achieving NERAM’s objectives and establishing the true value of capacity.

The open auction process also serves multiple purposes. First, bidders face substantial uncertainty over the cost of providing resource adequacy. Among other things, bidders and investors are uncertain about potential net revenues from other markets (*e.g.*, energy and ancillary services) and from long-term uncertainty over plant economics and the permanence of the resource adequacy model. An open auction enables bidders to see how competitors value these uncertainties, thereby helping to obtain the best bids. An open auction also establishes all the right incentives for the more efficient bidders to win. Second, the transparency of the open auction process is conducive to attracting new participants because they will believe that incumbents have fewer special advantages. This component is important in a market that relies on new entry to provide competitive discipline. The open auction format enhances the objective

of setting capacity prices by competition in the market because the competitive process is well structured and transparent.

The key elements of the NERAM centralized capacity market are as follows:

- About four years before the capacity supply period, the New England states, in consultation with ISO and stakeholders, would establish the required amount of capacity in the region using established methods and standards.
- Roughly three-and-a-half years before the capacity supply period, ISO would hold a descending clock auction to procure capacity for the supply period.⁷
- The capacity product would be defined by standard, well-specified terms imposing specific obligations on the capacity provider, primarily the responsibility to ensure that the bid amount of physical capacity is available during the supply period. Additional features would include providing for performance security and penalties for non-performance and clearly entitling the capacity provider to sell for its own benefit all energy and ancillary service products and other attributes of the plant. The capacity payments would be made in equal monthly installments over the capacity supply period.
- The capacity supply period would extend for one to three years, beginning three and one-half years following the auction date. New capacity may need longer terms. The length of the committed supply period should be the subject of the proposed stakeholder process.
- The auction would procure the required capacity sufficient to provide resource adequacy on a planning basis. LSEs may contract bilaterally to meet their capacity needs, and some states may authorize their distribution companies to enter into capacity contracts or self-supply. LSEs or distribution companies

⁷ Under the descending clock auction, the auctioneer (*e.g.*, ISO) will announce a price that is high enough to induce potential new entrants to participate. Potential entrants, existing generators, and load (for demand response mechanisms) would respond by offering to provide capacity at the specified price, assuming that the price is high enough to induce more supply than required. The auction administrator would announce the results of the auction, and, after several hours, announce a lower price and ask for new offers. The price should descend in small decrements so that the bidders would have a chance to react to each others' bids. The auction rules would require that all bidders submit bids in each round and forbids any bidder from increasing the total number of MWs offered as the auction proceeds. The auction clock would stop when bidders reduced the amount offered to match the amount required. If there is a surplus of existing generation, the clock would continue to wind down until the price induced some plants to stop offering their capacity in the auction.

would be able to participate in the auction as bidders and capacity suppliers, thus enabling them to self-supply capacity by bidding and winning in the auction.

- In order to bid in the auction, prospective capacity suppliers would need to meet financial and development qualifications to provide reasonable assurance that if they won at the auction they would be available during the contract period. Substantial penalties would be assessed for non-performance with contract obligations.
- Demand Response would be eligible to provide capacity and to bid in the auction. It may be necessary to have a separate auction for a reserved portion of the capacity nearer to the supply period in order to enable Demand Response to participate.
- Competition would be the primary force to control market power and discipline price. The auction would contain a qualification stage that would provide for initial binding commitments that would be used to assess the adequacy of competition. So long as there was adequate competition, there would be no price mitigation or administrative price cap. An administered price would apply only in the event that there was not sufficient qualified supply to hold a competitive auction. (If supply qualified to bid in the auction was less than the amount of capacity to be acquired, there would be no effective competition.)
- In order to phase in NERAM, and depending on the term of the commitment, 100 percent of the first tranch of capacity may be acquired in the initial auction under contracts of staggered terms. For instance, under a three-year commitment term, 1/3 of the capacity would be under three-year commitments, 1/3 under two-year commitments, and 1/3 under one-year commitments. Thereafter, an auction may be conducted annually to procure the capacity coming off the one-year contracts in addition to capacity needed for the applicable three-year commitment period. The obligation for a given year may be met through three sets of contracts and, hence, load will pay a blended three-year price. Regardless of the length of the commitment period, the first auction would be held no earlier than July 1, 2006 for the Power Years beginning with 2009.

In addition to the foregoing, NERAM would adopt certain features proposed by the ISO-NE in conjunction with LICAP. The NERAM Proponents agree with the ISO-NE that capacity and reserve payments should only be made to those that show up when needed. Accordingly, NERAM would include an availability calculation using the shortage hours proposal developed by ISO-NE for LICAP.

B. Ancillary Services Market.

While the maintenance of installed capacity is important, the NERAM Proponents recognize that a shortage of quick-start, flexible operating reserves in various locales is the more substantial contributor to Reliability Compensation Issues in New England. Accordingly, and as an integral part of the NERAM proposal, the NERAM Proponents propose to work with the ISO-NE to develop an ASM that will complement the long-term capacity adequacy of NERAM. A LFRM would be a key component of the ASM. The LFRM would provide price signals for resources that can specifically address locational peaking needs (for example, local second contingency coverage) and provide operating flexibility. These resources would include transmission and demand, as well as quick-start generation.⁸

The ISO-NE estimates that the annual cost of its currently proposed LFRM--which would displace nearly all RMR contracts—would be \$245 million. The locational aspect of LFRM will produce higher compensation for resources located in load pockets, and will likely produce short-term prices higher than would be generated through ISO-NE's LICAP proposal. Accordingly, the NERAM Proponents believe that LFRM, as a complement to the region-wide capacity market, will provide targeted investment signals and will, in fact, eliminate the need for RMR agreements.

Any LFRM proposed should be designed to be compatible with the capacity element of NERAM. LFRM would presumably be intended to address operating reserves on a locational basis and the NERAM capacity suppliers would be entitled to retain net revenues from the

⁸ We emphasize that RMRs arose primarily to provide local, second-contingency coverage. As ISO-NE itself has noted: "separate zones should be defined for locational reserves, in order for locational reserve requirements to be effective and replace much of the need for Reliability Must ("RMR") resources." See "*Review of PUSH Implementation and Results*," filed by ISO-NE on December 4, 2003 in Docket No. ER03-563-002, Transmittal Letter at 3.

LFRM. Those net revenues could be considered when bidding, thereby enhancing the competitiveness in the NERAM auction of those units that can provide Locational Forward Reserves. In this way, a LFRM could be designed to work together with NERAM.

III. ADVANTAGE OVER LICAP

A. NERAM Is Market-Based.

The NERAM model, properly implemented, would reveal the competitive and efficient market price for resource adequacy. The planning horizon should enable new entrants to provide competitive discipline. Administrative price caps would be a last resort and, in all likelihood, unnecessary. The voluntary nature of the market, combined with the specified lead time between the auction and the supply period, should not cause the clearing price for capacity to drop near zero as a result of modest capacity surpluses because NERAM would increase the elasticity of the supply curve. The auction and lead time with competitive entry would achieve the objective that capacity prices be set by competition in the market—and not set administratively with demand curves. This is a crucial difference between the NERAM and ISO's LICAP demand curve.

While LICAP is called a capacity “market” with a “demand curve,” it is in fact an administratively-determined price matrix. The construct is not a mechanism that facilitates trades between willing buyers and willing sellers, but rather is a charge predicated upon the “demand” of a single entity that bears no financial consequence for the quantity demanded and a vertical supply curve derived from a numerical aggregation of all available megawatts of capacity in the region. The price of capacity under LICAP is not set through the unfettered interplay of market forces and, hence, competition may not be relied upon to keep installed capacity prices within the zone of reasonableness.

The centralized NERAM based on a descending clock auction is in fact a market.⁹ While the quantity demanded is fixed, suppliers will compete among themselves to be selected as suppliers and will do so on the basis of price. If capacity is plentiful, the value of capacity will be in the lower range. As available capacity nears the Objective Capacity (now called “Installed Capacity Requirement”), the price will increase to the value of new entry. These results will occur autonomously without the need to determine, and re-determine, EBCC or a capacity “target” or fret over whether the “demand curve” should have kinks and knees or whether standard deviations are too high or low. With actual competitive forces at work, the market may be relied upon to keep prices within the zone of reasonableness. Accordingly, NERAM will produce prices that are just and reasonable.

B. NERAM Balances Payments with Performance.

The firm, binding commitment would ensure that the counterparty (*e.g.*, LSEs, distribution companies, or ISO) pays for specific performance and would avoid making payments with no advance commitment that sufficient resources will be developed and committed to the market. Substantial penalties would apply for non-performance of commitments made in advance. Qualification requirements and financial security would weed out speculative projects.

Until completion of currently planned transmission upgrades in Connecticut and Massachusetts, any capacity payment that is not tied to specific reliability-enhancing performance does not provide value to customers and cannot be considered just and reasonable. So long as it is impossible to add significant new generation in a constrained region, a capacity payment to existing generators for doing what they would do anyway is neither necessary nor

⁹ The competitive market assumes adequate rules to prevent the exercise of market power.

appropriate. During the transition period between the auction and the beginning of the supply period, however, customers in constrained locations will continue to pay for capacity on a locational basis through RMR agreements and Gap RFP contracts. During a transition period, some generators needed for reliability would continue to be eligible for RMR treatment, provided that there are appropriate rules to prohibit gaming. These payments – focused in the constrained areas of Connecticut and NEMA/Boston – provide an incentive for completion of transmission upgrades and development of new local resources and ensure that compensation payments to generators produce enhanced reliability. Because generators needed for locational reliability would be eligible for RMR treatment, if any transition mechanism providing capacity revenues prior to the implementation of NERAM is deemed necessary to ensure long-term resource adequacy benefits that are not satisfied by the existing capacity market and a future ASM, such transition payments must be uniform across the region and netted from RMR treatment for those eligible generators.

C. NERAM Places Market Risk on Merchants.

LICAP is designed to pay every generator the cost of new entry when installed capacity exceeds Installed Capacity Requirements by 5 per cent. As such, LICAP will effectively enshrine excess capacity while providing a cost-of-service floor price for merchant generation. Moreover, generators incur no obligation in return for a fully remunerative floor price. They are not obligated to build new capacity, to show up when needed, to commit for more than one month, or to accept a ceiling price limit on their energy sales.

A goal of NERAM is to support restructuring objectives by not shifting ownership risk to customers, while providing compensation to generators for capacity services. This objective may be accomplished through a one to three year commitment period (with the length of the

commitment period and its application to new entrants to be determined in a stakeholder process). A longer contract period may lock customers in to a specified level of capacity payment and may be construed as shifting long-term ownership risks to customers, contrary to restructuring objectives. It is important to recognize that ownership risks, defined primarily as the risks of the value of the investment over the long term, do not go away if not borne by customers. They are simply borne by asset owners. Under NERAM, prices should reflect the risk allocation and the risks that asset owners bear, and a one-year or three-year commitment period would achieve the goal of not shifting ownership risks to customers.

NERAM properly values existing capacity with forward-looking attributes that will ensure that capacity gets built when needed pursuant to commitments that balance investor and consumer interests. With a four-year forward look, prospective capacity needs may be timely identified with a sufficient margin to permit construction of new facilities to meet demand when needed. The stakeholder process should consider the length of the commitment period for new entrants that will be necessary to secure or support financing while not shifting the capacity risk from investors to ratepayers. Moreover, a forward look will minimize excess capacity, thus, maintaining the value of existing capacity at the higher end of the spectrum.

D. NERAM Optimizes Capacity.

A reserve margin is essential to maintaining system reliability. However, reserve capacity is not expected to operate regularly and may not earn sufficient income in the energy market to encourage new entry. Consumer savings in the capacity market come from assuring that the amount of reserve capacity supported by the capacity procurement approach meets the reliability needs of the region efficiently and without excess, and includes a mechanism to maintain reserve levels over time as demand grows.

LICAP eschews efficiency for largesse. At the optimal amount of capacity, LICAP produces a capacity price that is twice the estimated cost of new entry, thus producing a powerful incentive for existing producers not to construct new capacity and to establish barriers to the entry of new suppliers. LICAP is intended to maintain capacity at a level 5 percent above what is needed. At a price equal to the cost of new entry this excess would cost consumers approximately \$150 million annually.

NERAM is predicated on acquisition of the amount of capacity needed to satisfy the NERC standard of one loss-of-load event in ten years. Since NERAM is a region-wide forward market, the lumpiness that LICAP is designed to address is avoided. Hence, NERAM will permit the amount of installed capacity to be optimized to the precise load needed to meet the generally accepted NERC standard.

E. NERAM Obviates Market Power In The Capacity Market.

ISO-NE originally proposed a LICAP mechanism in which the demand curve was fixed, and suppliers would be free to submit price offers or decline to make capacity available to the market. On reflection, however, the ISO-NE recognized that its transparent inelastic price curve would facilitate anti-competitive conduct, and would be particularly susceptible to abuse within load pockets, which are characterized by very high Herfindahl-Hirshman Index (“HHI”) values. As a necessary and proper cure, the ISO-NE modified its proposal to provide that neither supplier bids nor supplier decisions to simply sit out of the market (*i.e.*, delist) would have any role in establishing LICAP prices.

In contrast, NERAM anticipates a region-wide capacity requirement and capacity market. This approach has desirable features. A region-wide market is likely to result in competition between efficient scale units and, hence, lower prices. A region-wide market is less likely to

result in situations where the addition of a new unit causes a long-lasting surplus—and resulting depressed price—in the location of the addition. The NERAM approach recognizes the benefits of the broader capacity market while addressing the need for capacity in certain load pockets through the LFRM, RMR agreements and gap RFPs. This is in recognition that not all capacity needs to be delivered to all load in NEPOOL during all hours. With a single regional market for capacity, export-constrained zones with some amounts of capacity that could not all be used to meet reliability needs in NEPOOL in all hours will need to be addressed. This is a practical concern that would need to be resolved in the stakeholder process and integrated into the broader NERAM framework.

By the time of the first capacity supply period (*i.e.*, three-and-one-half years after the first auction in late 2006 or 2007), significant transmission upgrades in New England will have been completed. Based on ISO's analysis, at that time, there will be no binding transmission constraints in the capacity markets, and capacity prices will have equalized across the New England region. Because NERAM relies on disciplining prices through competitive forces and competitive entry, it will be difficult to apply it to locational markets where the scale of entry is small and where a new large unit may be needed infrequently. Competitive forces would work most efficiently when the market encompasses an entire region and entry by new efficient scale units is practical. In small capacity markets, it is likely that new units would be added infrequently. It would also be likely that in these markets, once a unit was added, it would be a long time before another unit was needed in that area. Thus, NERAM would apply on a region-wide basis to promote regional resource adequacy.

F. The Locational Reserves Aspect of NERAM Will Incent Construction of the Appropriate Kind of Capacity.

The record in this case conclusively demonstrates that there is no shortage of installed capacity in New England. Indeed, it is the abundance of capacity that is exerting such keen competitive pressure on suppliers, leading several new, efficient facilities to seek RMRs. There is no doubt, however, that: 1) NEPOOL suffers from a deficiency of operating reserves; and 2) the current market structure is not conducive to providing adequate compensation for seldom run capacity needed for reliability. LFRM will be designed specifically to address those issues. Moreover, the locational aspect of ASM and the limited class of resources eligible to participate will produce a two-tier pricing structure in which incentive prices will go to the resources needed to be developed while competitively-priced capacity payments will be available to units that are currently recovering most, if not all, of their cost of operations from the energy market.

A theoretical underpinning of hourly priced wholesale markets was the concept that consumers, seeing high interval prices, would cut demand during peak periods and thus reduce the need for peaking capacity. LICAP undercuts this conceptual signal by loading most cost into a fixed component that cannot be avoided by customers' choice. LFRM will allow demand to participate in the market through Asset Related Demand bids and thereby reduce peak demand and associated capacity requirements.

The creation of reserve zones will serve the locational aspect of LICAP, but in a manner that will target incentive payments to the capacity that actually poses Reliability Compensation Issues. With each zone responsible for indigenous reserve capacity to meet projected requirements, price separation will occur and reserves located in regions in which they are most needed will receive prices commensurate with their value.

G. NERAM Will Minimize RMR Contracts.

The ISO-NE makes no claims that LICAP will eliminate RMR contracts in the near-term. Indeed, the ISO-NE affirmatively disclaims any intention to force generators to accept LICAP payments in lieu of RMR revenue. The record in this case shows that LICAP prices will be below the fixed cost rate under most existing RMR contracts for at least five years. In fact, one supplier recently filed an unexecuted RMR seeking fixed cost payments for a new facility well in excess of \$8.16/kw-month, the theoretic equilibrium point on the LICAP curve.

NERAM will promote elimination of RMRs. With an indigenous sourcing requirement in the LFRM, LSEs may be required to pay existing resources capacity prices up to the cost of new entry. Older resources with costs higher than the cost of new entry would be phased out as LSEs would sponsor construction of new, efficient facilities in lieu of maintaining more costly facilities to satisfy their resource requirements.

H. NERAM Will Allow Bilateral Solutions To Capacity Requirements.

Among the flaws of the dysfunctional California market documented by the Commission was its obviation of bilateral contracts as a means of meeting energy requirements. While unlikely to prevent the same magnitude of risk, LICAP carries forward the negation of bilateral contracts as a means to meet capacity requirements. With a transparent demand curve, resource owners will not contract for installed capacity at prices less than LICAP, and hence the bargained-for aspects of bilateral contracts will be thwarted.

Bilateral transactions are intended to be an integral part of NERAM to permit LSEs to self-supply their own generation or as a way for an LSE to hedge against a potentially higher resource price in the centralized auction. Resources obtained through self-supply or bilateral contracts must be offered and selected in the centralized auction to be counted toward meeting an

LSE's resource obligation, and thus provide a hedge against the resource price determined in the centralized auction. With a competitive auction format, neither load nor supply would know with certainty what the forward price of capacity will be. Hence, each will have an incentive to enter bilateral contracts to hedge its risks. In discussing the California melt-down, the Commission lauded the role of bilateral contracts in the energy industry and indicated that they should be the backbone of a restructured California energy market. NERAM recognizes the central role that bilateral contracts play in the electric industry; LICAP does not.

I. NERAM Will Support Retail Choice.

NERAM would further serve restructuring goals by supporting retail choice. One issue that arises with retail choice is the difficulty in achieving resource adequacy when no entity has assured load several years in the future. Under this NERAM alternative, the financial assurances to resource adequacy providers are made by central buyers who can charge the LSEs that are serving load at the time for the cost of resource adequacy. This obviates the need for LSEs - which most often have no assurance that they will be serving load in the future - to make forward commitments.

J. NERAM Supports Resource Diversification to Meet Capacity Requirements.

NERAM, unlike LICAP, can accommodate the participation of Demand Response. On a practical basis, many Demand Response providers are unable to make forward commitments needed to ensure adequacy. To address this consideration, a portion of the capacity needed for Demand Response that is anticipated to be available may be reserved, accepting the risk that it will materialize at a reasonable price. With respect to energy efficiency, NERAM would enhance deployment of economically efficient conservation investment because it would provide

a market-based forward price signal for resource adequacy. Load would face such a price signal and could factor this signal into evaluation of long-term conservation investment.

IV. PROCESS

The NERAM Proponents believe that this framework and other details could be further developed into a complete system that would achieve the Commission's and New England's objectives. Further development of the framework and other details will include qualification criteria, credit criteria, precise methods for assessing the adequacy of competition, the method for assessing charges on LSEs, performance requirements and penalties and obligation conditions. Although it will be a substantial task to develop these details, the NERAM Proponents believe that there are strong advantages that would arise in fleshing out the specifics for NERAM.

By proposing NERAM as an alternative to LICAP for the purpose of oral argument, the NERAM Proponents are not offering this proposal for an up or down vote by the Commission predicated upon the extant record. NERAM is a viable alternative to LICAP, but must be given the same period of gestation and development accorded to the LICAP proponents before it may be considered ripe for definitive Commission action. Accordingly, the NERAM Proponents support the process proposal put forth by CMEEC/MMWEC. For the Commission to reject NERAM based on the existing record would not constitute reasoned decision making nor would it comport with the sense of Congress.

V. CONCLUSION

In sum, the NERAM approach comprehensively addresses the Commission's concerns about Reliability Compensation Issues. The NERAM proponents believe that this model can be practically developed and successfully implemented in New England. As the Commission has

correctly framed the issues: (1) NERAM will provide for just and reasonable wholesale power prices in New England by establishing a truly competitive capacity market that will encourage new entrants to participate on an equal footing with existing generators; (2) NERAM will enable New England to purchase the correct amount of electric generation capacity or reliability to meet applicable standards without procuring an unnecessary surplus; and (3) NERAM will procure capacity at the least-cost, competitive price and will, when fully implemented, displace RMR agreements. Because NERAM will permit load to pay the lowest competitive price for only the necessary level of capacity, customers will pay substantially less than the \$13 billion five-year cost estimated under a demand curve that cannot satisfy the Commission's objectives. Most importantly, under NERAM, customers will be satisfied that their resource adequacy payments in fact produce the expected and required level of resource adequacy. In all these respects, NERAM would be far superior to the Initial Decision's demand curve mechanism, and the Commission should set a course to develop this proposal through the recommended stakeholder process.

Respectfully submitted,

/s/ Paul G. Afonso

Paul G. Afonso
Chairman
Massachusetts Department of
Telecommunications and Energy
One South Station
Boston, MA 02110
(617) 305-3500

/s/ Andrew O. Kaplan

Andrew O. Kaplan
General Counsel
Massachusetts Department of
Telecommunications and Energy
One South Station
Boston, MA 02110
(617) 305-3500

/s/ Mary J. Healey

Mary J. Healey
Connecticut Consumer Counsel
Joseph Rosenthal
Office of Consumer Counsel
Ten Franklin Square
New Britain, CT 06051
Tel: (860) 827-2906
Fax: (860) 827-2929
Mary.Healey@po.state.ct.us
Joseph.Rosenthal@po.state.ct.us

/s/ Donald W. Downes

Donald W. Downes
Chairman
Connecticut Department of Public Utility
Control
10 Franklin Square
New Britain, CT 06051
(860) 827-2801

/s/ Randall L. Speck

Randall L. Speck
Kaye Scholer LLP
901 Fifteenth Street, NW
Washington, DC 20005-2327
Tel: (202) 682-3510
Fax: (202) 682-3580
RSpeck@KayeScholer.com
Attorney for the Connecticut Department of
Public Utility Control

/s/ Phyllis E. Lemell
Phyllis E. Lemell
Assistant General Counsel
Northeast Utilities Service Company
107 Selden Street
Berlin, CT 06037
Tel: (860) 665-5118
Fax: (860) 665-5504
lemelpe@nu.com
Attorney for Northeast Utilities Service
Company on Behalf on the Connecticut Light
and Power Company and Western
Massachusetts Electric Company

/s/ Lisa J. Thibdaue
Vice President Regulatory and Governmental
Affairs
Northeast Utilities Service Company
107 Selden Street
Berlin, CT 06037
Tel: (860) 665-5883
Fax: (860) 665-4853

/s/ Stephen L. Teichler
Stephen L. Teichler
Stephanie A. Conaghan
Duane Morris LLP
1667 K Street, N.W., Suite 700
Washington, D.C. 20006-1608
Tel: (202) 776-7830
Fax: (202) 776-7801

/s/ Ellen Angley
Ellen Angley
James Daly
NSTAR Electric & Gas Corporation
One NSTAR Way, NE210
Westwood, MA 02090
Tel: (781) 441-8006
Fax: (781) 441-8078

Attorneys for NSTAR Electric & Gas
Corporation

/s/ Thomas G. Robinson
Thomas G. Robinson
Colin Owyang
National Grid USA
25 Research Drive
Westborough, Massachusetts 01582
Tel: (508) 389-2562
Fax: (508) 389-2463

/s/ Kenneth G. Jaffe
Kenneth G. Jaffe, Esq.
Jamil Nasir, Esq.
Alston & Bird LLP
601 Pennsylvania Avenue, N.W.
North Building, Tenth Floor
Washington, D.C. 20004-2601
Tel: (202) 756-3154
Fax: (202) 654-4884
Counsel for National Grid USA

/s/ Julie Coletti
Julie Coletti, Esq.
Assistant General Counsel
Strategic Energy LLC
Two Gateway Center
Pittsburgh, PA 15222

/s/ Angela M. O'Connor
Angela M. O'Connor
Vice President of Energy Policy
Associated Industries of Massachusetts
222 Berkeley Street
Boston, MA 02117
(617) 262-1180

/s/ Anne Ross

Anne Ross
New Hampshire Office of Consumer Advocate
21 South Fruit Street, Suite 18
Concord, NH 03301
(603) 271-1172

/s/ Stephen G. Ward

Stephen G. Ward
Eric Bryant
Public Advocate, State of Maine
112 State House Station
Augusta, ME 04333
Tel: (207) 287-2445
Fax: (207) 287-4317

/s/ Roger F. Borghesani

Roger F. Borghesani
Chairman
The Energy Consortium
24 Hastings Rd.
Lexington, MA 02421-6809
(781) 862-0888

/s/ Joseph McGee

Joseph McGee
Business Council of Fairfield County (formerly
Southwestern Area Commerce and Industry
Association of Connecticut, Inc.)
One Landmark Square, Ste. 230
Stamford, CT 06901-2679
Tel: (203) 259-3220
jmcgee@sacia.org

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 Secretary in this proceeding by U.S. Mail.

Dated at Washington, D.C. this 13th day of September 2005.

/s/ Stephen L. Teichler
Stephen L. Teichler

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