Revised

MEMORANDUM

TO: NEPOOL Participants Committee Members and Alternates

FROM: NEPOOL Counsel

DATE: March 5, 2014

RE: UPDATE: Summary of Recent Pleadings in Performance Incentives "Jump Ball" Proceeding (ER14-1050)

This memorandum supplements an earlier NEPOOL Counsel memorandum (dated February 17, 2014)[1] which provided a summary of the initial round of pleadings submitted in response to the January 17, 2014 "jump ball filing" by NEPOOL and ISO-NE of alternative versions of Market Rule changes intended to increase economic incentives for resources to perform during times of operating reserve shortages. This update provides a brief summary of:

1) Answers to protests and comments submitted by various parties relative to both the "ISO-NE Proposal" (also referred to as "PI" or "FCM PI") and the "NEPOOL Proposal"; and

2) NEPOOL's Motion for Discovery of certain materials underlying ISO-NE's February 12, 2014 pleading concerning the limited issue of recent events during the 2013-2014 winter season and ISO-NE's response yesterday to that motion.

All pleadings are available via hyperlink from the NEPOOL Website at: http://nepool.com/Litigation_Reports.php.

I. SUMMARY OF ANSWERS

***Answer of the New England Power Pool Participants Committee ("NEPOOL")*:**

The NEPOOL Answer contains the following main arguments:

- Operational improvements would be achieved more quickly and cost-effectively through the NEPOOL Proposal rather than PI. PI would not have effects on performance until 2018, while NEPOOL's proposed increase to the Reserve Constraint Penalty Factor ("RCPF") values would go into effect in 2014.
- While the proposed RCPF increases are not intended to be the primary basis for new investment, NEPOOL's Proposal to increase RCPF values directed in the real-time market would be more effective than ISO-NE's proposed Capacity Performance Payment Rate ("PPR") directed only to suppliers in the long-term capacity market.
- Such RCPF increases, taken together with other Market Rule changes, will enhance the value of resources in New England without injecting the unacceptable risk of ISO-NE's

[1] As revised to reflect revisions requested by Entergy Nuclear Power Marketing, LLC and the United Illuminating Company, the February 17, 2014 NEPOOL Counsel memorandum is available via hyperlink from the NEPOOL Website at: http://www.nepool.com/uploads/M-ER14-1050_Summary.pdf.

Proposal, making investment to achieve better performance more likely. The proposed RCPF value increases should be implemented now to achieve immediate benefits.

- Availability rather than real-time production of energy and reserves is the right metric for the capacity market and is consistent with other capacity markets across the country. EFORp improves the availability metric and will help to address performance problems identified by the ISO-NE. If the Commission agrees with newly raised criticisms of the EFORp metric and possible adjustments thereto, the Commission should provide direction to ISO-NE and stakeholders that availability is the right performance metric for the New England capacity market and should allow for further discussion and analysis to refine the availability metric and incentives to make them more acceptable and more effective in achieving agreed-upon objectives.
- PI is more likely to exacerbate rather than improve performance issues and long-term reliability. ISO-NE has failed to show how performance issues this winter are causally connected to "flaws" in the FCM.
- ISO-NE's "no exemption" policy is unreasonable and would drive valuable capacity resources out of the market.
- PI would also impede new investment because of the high degree of risk it would inject into the capacity market.

***Answer of ISO New England Inc. ("ISO-NE")*:**

ISO-NE's Answer contains the following main arguments:

- The Commission should accept PI without any modification or delay.
- The Commission "must not be swayed" by the "super-majority" support evidenced by Market Participants of the NEPOOL Proposal, noting that ISO-NE "is responsible for ensuring the reliability of the system, and, given the thoroughness of its design and analysis work in this case, its independent expert judgment should carry significantly more weight than the majority opinion."
- The analysis of NEPOOL's witness Julia Frayer is flawed and unreliable.
- Arguments that many or most resource types would suffer financially under PI are unsupported and incorrect; instead, ISO-NE's consultant calculates that most resources would be financially better off under PI.
- There is no credible evidence that PI would undermine the ability of new resources to secure financing; instead, PI risks would be within the bounds of other risks routinely absorbed and priced by the financial community.
- The NEPOOL alternative proposal would not improve load responsiveness.
- The proposed PPR in the PI design is calculated properly, despite the criticism of ISO-NE's independent External Market Monitor ("EMM"), and its phase-in properly balances practical and design considerations. ISO-NE's EMM is incorrect in arguing that the value of lost load is an appropriate measure given the reliability requirements ISO must meet. A stepped PPR as proposed by the EMM is unnecessary and would add needless complexity to the simple PI design.
- Arguments raised against the market monitoring and mitigation provisions under PI are unfounded and incorrect.

- Assertions that PI would not improve, or would worsen, reliability are unsupported and incorrect.
- Continued assertions that PI imposes "penalties" indicate a fundamental misapprehension of the proposed two-settlement system.

With its Answer, ISO-NE included testimony from Robert Mudge of the Brattle Group critical of comments asserting that PI would adversely affect the financing of capacity resources and critical of the analysis performed by NEPOOL's witness, Julia Frayer. Mr. Mudge makes the following conclusions: (1) The claims of those who testified that PI would adversely affect financing are not supported by any real quantitative analysis; (2) Ms. Frayer's attempts to provide that analysis are not valid because her analysis is not supported by either (a) the authority she cites to support the relationship between debt yields and expected interest coverage ratios or (b) her illustration of capacity revenues potentially available to new generation under the PI mechanism; and (3) The incremental risk to cash flows posed by PI appears to be within the bounds of other risks routinely absorbed and priced by the financial community. Thus, the statements of the various intervenors in the proceeding that new generation projects could not be financed, or would be financed only at "excessive cost", are not only without basis, they are contrary to a reasoned examination of this specific issue.

***Answer by Connecticut and Rhode Island*[2]:** Connecticut and Rhode Island's Answer reiterates their support for the NEPOOL Proposal, calling it "the efficient way to incentivize real-time performance improvements." Connecticut and Rhode Island assert that the NEPOOL Proposal would provide for transparent, efficient scarcity prices that reflect the value customers place on reliable energy service. Connecticut and Rhode Island argue that the NEPOOL Proposal better aligns with broadly accepted economic theory set out in the comments of the EMM, Dr. David Patton, in this proceeding: (1) the incentive for real-time performance is most efficiently provided through price signals in the energy and operating reserves markets; (2) customers' value of reliable electric service is the proper economic benchmark for any shortage pricing initiative to incentivize improved performance; and (3) shortage pricing should vary with the reliability risk, so that the incentives to perform increase as shortages become more severe and the risk of disconnecting firm load becomes more likely. In support of the Answer, Connecticut and Rhode Island submit supplemental testimony from Jonathan Falk responding to comments filed by Dr. Patton, the EMM. Falk agrees with Dr. Patton that "the proper measuring stick for shortage pricing must reflect electric customers' value of electric service, which necessarily includes the value of losing service when supply is exhausted." Falk concludes that most of the suggested changes to the NEPOOL Proposal offered by the IMM "are reasonable and improve outcomes for customers." On the other hand, Connecticut and Rhode Island contend that "the concerns that the EMM has raised with the ISO-NE's Proposal are structural, not easily remedied, and inconsistent with customer interests." Should the Commission decide that changes proposed by the EMM are necessary to make the NEPOOL Proposal preferable to ISO-NE's Proposal, Connecticut and Rhode Island ask the Commission to direct ISO-NE to submit a compliance filing with the EMM's suggested improvements to the NEPOOL Proposal.

[2] "Connecticut and Rhode Island" consist of the following entities: the Connecticut Public Utilities Regulatory Authority, the Connecticut Office of Consumer Counsel, George Jepsen, Attorney General of the State of Connecticut, the Connecticut Department of Energy and Environmental Protection, the United Illuminating Company and the Rhode Island Public Utilities Commission.

***Answer of the Maine Public Utilities Commission and the Maine Office of the Public Advocate (collectively "the Maine Public Parties")*:** The Maine Public Parties urge the Commission to accept the changes to RCPF values proposed by NEPOOL over ISO-NE's Proposal. With respect to FCM PI, the Maine Public Parties take issue with the ISO's claim that the risks under PI are manageable and are unlikely to increase costs. The Maine Public Parties argue that ISO-NE fails to recognize that supplier's may hedge and price according to the level of risk. Thus, "any hedge will take the high risk level of PFP into account and will supply such hedges at premium prices." The Maine Public Parties further argue that both the ISO-NE and the EMM failed to account for the effect that ISO-NE's proposal will have on price signals to load. The Maine Public Parties contend that the shortage pricing aspect of ISO-NE's Proposal "provides no incentive for either price responsive demand or for increased load participation in the day-ahead market." The Maine Public Parties assert that the NEPOOL Proposal would enhance, rather than mute, such price signals.

***Limited Answer of Exelon Corporation, EquiPower Resources Management, LLC, Essential Power, LLC, Dynegy Marketing and Trade LLC, and Casco Bay Energy Company, LLC (collectively, the "Indicated Generators")*:** The Indicated Generators submitted their Answer for the limited purpose of responding to and clarifying points raised by ISO-NE regarding the role of risk in the forward markets. In their Answer, the Indicated Generators argue that "ISO-NE's analysis significantly understates the potential risk faced by suppliers and overstates the ability of resources to hedge the potential risk" and provide explanatory examples in support of their position. They further argue with examples that ISO-NE's belief that only a "small subset" of resources in New England would include risk premiums ignores the real world experiences that must be considered by suppliers when "gauging the level of risk they are willing to assume and the cost at which they are willing to participate in the Market."

***Answer of GDF SUEZ Energy Marketing NA, Inc. ("GDF SUEZ")*:** GDF SUEZ repeats its request that the Commission to accept ISO-NE's Proposal and explains why the Commission should reject the various exemptions proposed by parties in this proceeding "with the possible exception of the proposed transmission outage exemption." GDF SUEZ justifies the addition of a transmission exemption as part of ISO-NE's Proposal for FCA9 because ISO-NE and transmission operators "can and do control the extent of outages on these facilities, not because capacity sellers do not have such control." GDF SUEZ urges the Commission to reject other proposed exemptions, including the following: planned generator maintenance outage exemption; self-schedule being denied; posturing exemption; force majeure exemption; ISO-NE dispatch instructions exemption. GDF SUEZ believes that the ISO-NE's Proposal for FCA9 generally addresses the two EMM recommendations of (i) approving a Capacity Performance Rate of $2,000; and (ii) creating a method of distinguishing greater value for more severe reserve deficiencies. GDF SUEZ observes that ISO-NE's proposed phase-in of the PPR applies a $2,000 rate in FCA9 and leaves opportunity to revisit the PPR rate for subsequent FCA's. GDF SUEZ notes that the second EMM recommendation could be addressed by eliminating the PER deduction and allowing the existing tiered RCPF's to distinguish between thirty-minute reserve deficiencies and ten-minute reserve deficiencies. As to other EMM proposed revisions, GDF SUEZ argues that such "suggestions" may be taken up after FCA9, but should not delay adoption of ISO-NE's Proposal for FCA9.

***Answer of Entergy Nuclear Power Marketing, LLC (“Entergy”)*:** Entergy characterizes ISO-NE’s Proposal as being a “radical, new ‘strict liability’ standard of performance” and views NEPOOL’s Proposal as doing “too little to address pressing reliability concerns caused by poorly performing capacity resources”. Entergy seeks a “middle ground” between the two proposals and proposes exemptions for events outside of the capacity resource’s control. Entergy believes that there is “strong and diverse” support for a compromise position of adopting ISO-NE’s Proposal “but with reasonable exemptions for events outside of management’s control”, including exemptions for: electric transmission outages; force majeure events; scheduled outages approved by ISO-NE; and the inability to comply with an ISO-NE dispatch instruction due to offer or operational parameters. Along with the implementation of a demand curve that the Commission is requiring, Entergy also calls for reforms in the energy and ancillary services market including “remedying price suppression caused by reliability must-run units and uneconomic regulated capacity and expanding the winter reliability program to include other fuels besides oil (such as nuclear)”.

***Answer of Dominion Resources Services, Inc. (“Dominion”)*:** Dominion urges the Commission to accept NEPOOL’s Proposal as just and reasonable over ISO-NE’s Proposal because it: “(1) addresses current deficiencies in the pricing of energy and reserves in Real-Time; and (2) seeks to improve the ‘availability’ metric through incremental reforms to the [FCM] without fundamentally redesigning the existing resource adequacy construct.” Dominion details several “flaws” in ISO-NE’s criticism of NEPOOL’s Proposal, noting that ISO-NE: evaluated NEPOOL’s Proposal in a vacuum, incorrectly alleges NEPOOL’s market reforms would not incent improved resource performance, and presents a flawed quantitative critique. Dominion states that ISO-NE’s Proposal would go too far in transforming the already tested FCM into a three-year forward market for energy and reserves. Dominion further argues that ISO-NE’s Proposal would distort the price signals sent to load. Lastly, Dominion argues that comments submitted to date seeking exemptions to ISO-NE’s Proposal illustrate that the FCM PI approach is unjust and unreasonable.

***Answer of the NRG Companies* (“NRG”):** Offering further support for the NEPOOL Proposal, NRG rebuts a number of assertions made by ISO-NE in its February 12 pleadings. Of note, NRG first observes that ISO-NE’s Proposal is not similar to two-settlement market design found in the energy markets and that its design would undermine efficient dispatch by introducing uncertainty and failing to provide appropriate price signals to the load side of the market. Next, NRG contends that ISO-NE’s reliance on the Analysis Group’s September Impact Assessment and the testimony of Mr. Paul Hibbard and Dr. Todd Schatzki of the Analysis Group to support its positions that (i) RCPF values in the NEPOOL Proposal “will not materially improve performance and investment”; and (ii) that ISO-NE’s Proposal will not result in significant risk premiums, is misplaced. Of note, NRG argues that the September Impact Assessment and the Hibbard/Schatzki testimony and the September Impact Assessment provide only “snapshot estimates” of clearing prices and incorporates dated, questionable or erroneous assumptions regarding participating resources, reserve costs and portfolio bidding by capacity suppliers. Finally, NRG argues that NEPOOL’s scarcity pricing proposal coupled with an availability based metric is a much better market design to support investment. In this regard, NRG notes that any perceived flaws with the EFORp component of the NEPOOL Proposal "can easily be remedied".

II. SUMMARY OF NEPOOL'S MOTION FOR DISCOVERY AND ISO-NE RESPONSE

Simultaneously with its Answer, NEPOOL filed a motion for discovery and discovery requests. NEPOOL is seeking information from the ISO regarding the ISO's assertions that this winter's operations of the New England system prove that PI is needed immediately. NEPOOL argues that, even in the absence of a hearing, the Commission has discretion to rule that discovery is warranted on the grounds that it will assist its deliberative process. Problematically for every other party in this proceeding and the Commission, it is ISO-NE alone, not the market participants, that has custody and control of the information and market data concerning all of the recent market changes and the recent events of this winter. NEPOOL requested expedited consideration of its motion, and for a ruling no later than March 7, 2014, with ISO-NE producing the information sought by the data requests no later than March 21, 2014.

In response to NEPOOL's discovery motion, ISO-NE filed an Answer on March 4, 2014 asking the Commission to reject NEPOOL's request as inappropriate, inaccurate and unnecessary, claiming that if ISO-NE must respond to discovery, it must also have the opportunity to propound discovery on NEPOOL, all but guaranteeing a contested proceeding and litigation. ISO-NE contends that the FERC Rules of Practice and Procedure generally contemplate discovery only in the context of a hearing, and discovery here would be inconsistent with longstanding Commission precedent. ISO-NE maintains that the vast majority of its proposal is based on years of data and submitted analysis, and not on recent events it cites in its earlier pleading, and that information of recent events is only "ancillary to NEPOOL's prosecution of its case and the Commission's disposition of the matter." Further, ISO-NE asserts that NEPOOL is misleading in suggesting that additional information of winter operations is necessary because "it has already provided such information to stakeholders" at the February 7, 2014 Participants Committee meeting. ISO-NE also argues that the there is no need for this data because ISO-NE and NEPOOL agree that current market incentives need to be improved. Lastly, ISO-NE claims NEPOOL is on "a fishing expedition, pure and simple" and states that the discovery requests themselves are "extremely broad and burdensome" and should, therefore, be denied.