UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

	)	
ISO-New England Inc. and	)	Docket No. ER22-1528-000
New England Power Pool Participants Committee	)	

MOTION TO INTERVENE AND COMMENTS
OF THE
ISO NEW ENGLAND'S EXTERNAL MARKET MONITOR

Pursuant to Rules 212 and 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission, 18 C.F.R. §§ 385.212 and 214 (2019), Potomac Economics respectfully moves to intervene in the above-captioned proceedings.

ISO New England ("ISO-NE") and the New England Power Pool ("NEPOOL"), together the "Filing Parties", filed proposed tariff revisions regarding a renewable exemption from ISO-NE's Minimum Offer Price Rules ("MOPR"). Potomac Economics is the External Market Monitor ("EMM") for ISO-NE and is responsible for monitoring the electricity markets and evaluating potential rule changes that impact these markets.

I. NOTICE AND COMMUNICATIONS

All correspondence and communications in this matter should be addressed to:

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II. COMMENTS

The Filing Parties made this filing to propose changes to the MOPR provisions in ISO-NE's Transmission, Markets and Services Tariff ("ISO-NE Tariff"). The intent of the changes is to accommodate the plans of the New England states to facilitate the entry of large quantities of clean resources in the coming years, defined as "Sponsored Policy Resources", as well as to eliminate the application of the MOPR to resources that are highly unlikely to be entering to artificially suppress capacity market prices. In these comments, we discuss our evaluation of the key aspects of the proposal, including the proposed exemptions, the proposed transmission period, and the buyer-side incentive test to be applied to resources that would not qualify initially for an exemption.

A. Proposed MOPR Exemptions

The filing proposes to exempt resources from potential mitigation under the MOPR that would not likely be intended to suppress capacity prices. In particular, the filing proposes MOPR exemptions for:

- Sponsored Policy Resources;
- Resources with a capacity of 5 MW or less ("de minimis resources");
- Passive demand-response resources; and
- Competitive entrants that are not receiving and will not receive out-of-market revenues from a load serving entity ("LSE") or a state.

The filing also proposes to exempt resources that are receiving support from an LSE that can demonstrate that it does not have an incentive to exercise buyer-side market power in order to lower prices. We discuss this exemption separately in Section D of these comments.

In order to accommodate Sponsored Policy Resources previously, ISO-NE developed and implemented the "Competitive Auctions with Sponsored Policy Resources" provisions, or "CASPR." These provisions are economically sound and reasonable, but rely on the willingness of existing resources to retire as the policy resources enter. While we believe it is premature to conclude that the CASPR provisions are ineffective or unreasonable, they have not facilitated the entry of any policy resources to date. Additionally, the large volume of the Sponsored Policy Resources that are planned in the near future would require a large quantity of resource retirements to be facilitated by CASPR.[1] Therefore, we support ISO-NE's proposal to modify the MOPR to exempt Sponsored Policy Resources because applying the MOPR to large quantities of resources that are nevertheless entering is costly and inefficient.

We also support the other exemptions listed above because the MOPR should only be applied to strategies or actions that are intended to suppress capacity prices. It is not reasonable to apply them to entrants that would not materially affect the capacity market outcomes, such as the de minimis resources, or for the MOPR to serve as an inefficient barrier to competitive entrants that are investing based on their capacity revenue expectations and not receiving any out-of-market revenues.

B. Other Changes Needed Ensure Adequate Performance of the FCM

The proposed changes to the MOPR will significantly affect the revenues that developers and owners of existing resources should expect in the future and, in doing so, affect the performance of the market in satisfying the region's reliability needs. To ensure the FCM will perform well in the future, we have recommended that ISO-NE pursue two essential changes to

[1] As detailed in ISO-NE's filing, the New England states have expressed plans to promote the entry of 10.6 GW of Sponsored Policy Resources by 2030 through already-authorized procurement plans, and state RPS and other targets will require much larger amounts going forward.

its market that are discussed in this section: (1) reflecting the increased financial risk efficiently in its capacity demand curves, and (2) improving its accreditation of capacity resources.

1. Accounting for Increased Financial Risk in the FCM

An important consequence of eliminating the MOPR is an increase in the financial risk for resource owners. We evaluated this risk and how it should be accounted for in the market, producing a report that describes our assessment for ISO-NE and its participants.[2]

The capacity market is designed to provide efficient incentives for the investment needed to satisfy resource adequacy needs. In other words, as capacity margins fall and new investment is needed to satisfy New England's resource adequacy requirements, an investor must find it attractive to invest in a new resource. This requires that the investor expect future capacity revenues to cover its "Cost of New Entry" less revenues expected from the energy and ancillary services markets (i.e., "net CONE). As the volatility of future capacity revenues increase, the risk facing the investor and its net CONE increase.

One key factor that increases future revenue volatility and risk is out-of-market investment in resources that are subsidized and result in a capacity surplus. Large quantities of such investments are planned by various states in New England to achieve decarbonization goals. The status quo MOPR moderates the price effects of such investment, reducing the associated risks to private investors in new resources. Accordingly, elimination of the MOPR provisions is likely to increase the risk facing merchant investment in New England. The purpose of this study was to recommend a change in the capacity market to account for this increased risk.

Higher financial risk affects key parameters that are used to determine the sloped capacity demand curves. The height of the demand curve depends on the Net CONE of a generic

[2] See report "EMM Evaluation of Changes in the Minimum Offer Price Rule on Financial Risk in New England", November 2021, available here.

potential new entrant. The height is set to motivate investment needed to achieve a target level of reliability. Higher price volatility increases investment risk, which raises the cost of capital. Consequently, the Net CONE of the reference unit increases as price volatility increases.

Most CONE estimates are based on historical returns required by investors in regions with competitive wholesale markets that are not substantially affected by out-of-market subsidies or where such effects are mitigated by a MOPR. Hence, these estimates understate the returns an investor would require to cover the risks of investing in a market without a MOPR and high levels of policy-driven investment. Our study for ISO-NE estimated that its net CONE value underlying its capacity demand curves would need to increase 16 percent to reflect the additional market risks associated with eliminating the MOPR.

ISO-NE has expressed its intention to file for such an increase. It is essential that the ISO and NEPOOL follow through on this intention because the reasonableness of the proposed changes in this docket and the competitive performance of the FCM depend in part on addressing this issue.

2. Improving the Accreditation of Capacity in New England

The other essential change to the capacity market in New England relates to how capacity resources are accredited. Capacity accreditation determines the amount of megawatts a resource may offer and be compensated for in the capacity market. An efficient capacity market should provide the same level of compensation to all resources that provide comparable reliability benefits. Current capacity accreditation methods over-value several resource types, including generators with long lead times, large units, units with shared fuel supplies, intermittent resources, and energy-limited resources.

The use of inefficient capacity accreditation approaches for some resource types increases the cost of satisfying reliability criteria over time. Capacity accreditation based on each resource's incremental effect on reliability is known as marginal capacity accreditation. In general, the marginal value of a particular type of resource will tend to fall as its penetration increases. Marginal capacity credit is key to providing efficient incentives for numerous important investment decisions in the coming years. These include:

- Investing in a diverse mix of renewables and avoiding oversaturated technologies;
- Adding storage to renewable generating facilities;
- Augmenting the duration of storage projects over time;
- Retiring inflexible generators and replacing them with flexible ones;
- Adding back-up fuel storage to a gas-fired generator; and
- Encouraging investment in innovative dispatchable zero-emissions technologies.

Current accreditation methods do not provide efficient incentives for these investments. Hence, we have recommended that the ISO develop capacity accreditation rules based on each resource's marginal reliability value. This is particularly important because some of the resources that will be the most over-accredited under ISO-NE's current rules are the Sponsored Policy Resources. Because they are over-accredited, they will have a larger adverse effect on capacity clearing prices and the incentives for existing resources needed for reliability to remain in operation when the MOPR is eliminated.

ISO-NE has begun working on this issue, but the necessary accreditation improvements are likely still years away. This is one of the principal justifications for the proposed transition period discussed in the next subsection.

C. Proposed Transition Period

To mitigate the inefficient price suppression that may occur if the MOPR is eliminated immediately before the implementation of the improvements described in the previous subsection, the filing proposes a two-year transition to implementing the proposed changes to the MOPR (referred to as the Transition Mechanism). Under this proposal, the MOPR and the current CASPR mechanism would remain in place for the next two Forward Capacity Auction cycles (i.e., for FCA 17 and 18), but would include exemptions of up to 700 MW of Sponsored Policy Resources.

Although implementation of the complementary change to the net CONE value and the capacity accreditation rules would ideally be implemented at the same time as the proposed MOPR change, we recognize that these changes are not feasible in the near-term. We also believe that implementing these complementary changes years after the MOPR changes would raise substantial concerns in the short-term regarding the economic incentives facing existing resource owners and the ability of the FCM to retain needed resources.

Therefore, although implementing the Transition Mechanism is not ideal, it is a reasonable means to address these efficiency concerns and to help support the performance of ISO-NE's capacity market while the essential improvements to capacity accreditation and the capacity demand curves are developed and implemented.

D. Buyer-Side Market Power Incentive Test

As described above, the proposed changes in the MOPR provisions include exemptions for several different types of resources. The proposal does not eliminate the MOPR entirely because it is still needed to protect the market from uneconomic investment by large LSEs that may benefit from lower capacity prices and state subsidies of uneconomic conventional resources (i.e., not clean or renewable resources).

The proposal would apply buyer-side mitigation to resources receiving state subsidies that do not qualify for an exemption as a Sponsored Policy Resource or a de minimis resource. However, resources supported by an LSE rather than by a state may provide "incentive rebuttal" evidence showing that they would not benefit sufficiently from lower capacity prices to potentially be exercising buyer-side market power. In principle, we applaud the Filing Parties' objective to avoid mitigating new resources that cannot plausibly be used to exercise market power. However, we do not support the proposed incentive rebuttal provision in practice.

Under the proposed incentive rebuttal proposal, the project sponsor may "demonstrate that the LSE would be unlikely to realize a material, net financial benefit from any reduction in clearing prices that may result from entry of the resource into the FCM." Ultimately, the ISO's internal market monitor ("IMM") will have to review the LSE's evidence and conduct the test described in the proposal.

In practice, it will be extremely difficult for the IMM to accurately evaluate this incentive in the multiple years after the new resource enters the market. In order for such a test to be reasonable, it must include all factors that may affect the incentives of the LSE, including all physical and financial assets, transactions, and contracts that would ultimately contribute to the financial results of the LSE's investment in new resources. Additionally, the IMM will have to establish that no state funding or subsidies are being received indirectly by the LSE, which would confound the test.

We believe a much more reasonable approach to achieving the objective of the proposal would be to apply "conduct and impact" tests that are analogous to all other mitigation tests imposed by the ISO. This approach would retain the current conduct test, which compares the costs of the new resource relative to the prevailing capacity price. This approach could then be coupled with an estimate of the adverse capacity price effects of all resources sponsored by the LSE that fail the conduct test. This impact test would provide an adequate basis for imposing mitigation just as it does in the energy and ancillary services markets. This approach would eliminate all of the practical concerns described above and in the comments of the ISO's IMM.

III. CONCLUSION

As the EMM for ISO-NE, we recognize the concerns raised by the Filing Parties in this proceeding and have engaged in extensive discussions with ISO-NE in the development of these proposals. We believe the proposals reasonably address the Filing Parties' concerns assuming the ISO ultimately implements the necessary changes to its capacity accreditation rules and its capacity demand curves that we discuss in these comments. The Transition Mechanism should provide sufficient time for the ISO to develop and implement these complementary market changes prior to eliminating the MOPR. This will alleviate the adverse economic impacts and risks to reliability of implementing the MOPR changes immediately. Therefore, we respectfully recommend that the Commission approve the proposed changes to the MOPR provisions filed by the Filing Parties.

Although it does not raise major concerns, the proposal would be improved by eliminating the proposed incentive rebuttal provision and either relying exclusively on the existing conduct test or supplementing the conduct test with an impact test to determine when non-exempt resources should be mitigated.

Respectfully submitted,

/s/ David B. Patton

David Patton
President
Potomac Economics, Ltd.

April 21, 2022

CERTIFICATE OF SERVICE

I hereby certify that I have this day e-served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated this 21st day of April 2022 in Fairfax, VA.

/s/ David B. Patton