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BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: : Docket Number  
DEVON POWER LLC, ET AL.: ER03-563-030  
- - - - -x

Commission Meeting Room  
Federal Energy Regulatory  
Commission  
888 First Street, NE  
Washington, DC  
Tuesday, September 20, 2005

The above-entitled matter came on for oral,  
argument pursuant to notice, at 10:05 a.m.

BEFORE: CHAIRMAN JOSEPH T. KELLIHER  
COMMISSIONERS PRESENT:  
COMMISSIONER NORA MEAD BROWNELL  
COMMISSIONER SUEDEEN G. KELLY  
SECRETARY MAGALIE R. SALAS

1 P R O C E E D I N G S

2 (10:00 a.m.)

3 CHAIRMAN KELLIHER: Good morning. We're here  
4 this morning to hear oral arguments in Docket Number ER03-  
5 563-030, concerning locational installed capacity or LICAP  
6 mechanism filed by ISO New England in these proceedings.

7 The Connecticut Parties will include the  
8 Connecticut Department of Public Utility Control,  
9 Connecticut Office of Consumer Counsel, the Attorney General  
10 for the State of Connecticut, and the New England Conference  
11 of Public Utility Commissioners, along with various New  
12 England state commissions, each submitting motions  
13 requesting this oral argument.

14 The Commission Trial Staff will begin today's  
15 agenda with an overview of the history of this proceeding.

16 I'd like to make a few introductory remarks about  
17 why we're here today: Basically, we're here today to solve  
18 a problem. There's a problem in New England's wholesale  
19 power markets that cannot be ignored, namely, the collapse  
20 of generation additions and the threat that proposes to  
21 reliability and just and reasonable wholesale power prices  
22 in New England.

23 In particular, very little new generation is  
24 being added in Southwest Connecticut and Northeast  
25 Massachusetts. At the same time, demand continues,

1 inexorably, to grow.

2 Current reserve margins are barely adequate, at  
3 best, and more severe supply problems threaten just over the  
4 horizon. That is the status quo.

5 If there is a party in today's proceedings who  
6 disagrees that there is a problem on the status quo, this is  
7 your opportunity, perhaps your last opportunity, to make a  
8 convincing argument that the status quo is working and is  
9 just and reasonable. The current record suggests otherwise.

10 I'm concerned that the situation in New England  
11 bears an uncomfortable resemblance to the situation facing  
12 California in the late 1990s. One factor in the California  
13 crisis, of course, was lack of adequate electricity supply.

14 I do not want to see the California crisis  
15 visited upon New England. I do not want to see the  
16 Commission criticized for not acting to assure reliability  
17 and just and reasonable wholesale power prices in New  
18 England.

19 The Commission is convinced there is a problem in  
20 wholesale power markets under the status quo. We have a  
21 duty to act.

22 ISO New England filed LICAP after a lengthy  
23 stakeholder process, as a proposed solution to this problem.  
24 The Commission's role is to assess whether LICAP is a just  
25 and reasonable wholesale rate mechanism that will address

1 the problems that have been identified in the New England  
2 capacity market.

3 We'll also consider in our deliberations, the  
4 alternatives to LICAP that the parties propose. I want to  
5 emphasize that the Commission is extending the LICAP  
6 opponents, an exceptional opportunity to advance workable  
7 alternatives.

8 Doing so is consistent with the directives of  
9 Section 1236 of the Energy Policy Act of 2005, that the  
10 Commission, quote, "carefully consider the views of the  
11 region" in this proceeding.

12 In particular, I want to know if any of the  
13 alternatives provide a greater assurance of entry of new  
14 generating capacity than the LICAP proposal itself.

15 Any approach the Commission takes must complement  
16 regional regulation and recognize regional realities. One  
17 such reality is that New England relies very heavily on  
18 competitive suppliers for its electricity supply.

19 That is the direct result of the region's  
20 decision to order or encourage state-regulated electric  
21 utilities to divest themselves of generation. And we must  
22 bear that reality in mind as we craft a solution.

23 The Commission agreed to hold oral argument,  
24 because it believed doing so would help it make a decision  
25 in this proceeding. In my view, the arguments that will be

1 most persuasive, are those that are based on law and the  
2 facts.

3           Ultimately, law and the facts will govern the  
4 Commission's decision, not other considerations.

5           The Order establishing this oral argument,  
6 specified the timeframes during which we will hear from  
7 proponents and opponents of LICAP, any alternatives. The  
8 Secretary of the Commission, Magali Salas, will be keeping  
9 time to ensure presenters' remarks do not extend past their  
10 allotted times, and we will strictly adhere to the time  
11 limits.

12           This is to ensure fairness that each of the  
13 parties will have an equal opportunity to present their  
14 arguments to the Commission. My colleagues and I may ask  
15 clarifying questions during the presentations. The clock  
16 will continue to run during the questions, and when the time  
17 is up, we will go on to the next group.

18           You will notice a very large clock down here, at  
19 least those of you speaking, presenting, will notice a large  
20 clock, and this clock will -- there will be a yellow light  
21 on the clock in the well, and that light is your warning  
22 that you have one minute remaining.

23           You should begin concluding your remarks at that  
24 point. When the light turn red, that's an indication your  
25 time is up, and you must conclude your remarks immediately,

1 so that we can hear from the next person.

2 I'd like to introduce two staff members who are  
3 assisting us today at the table. Anna Cochrane is the  
4 Director of the Division of Tariffs and Market Development,  
5 East, and Jeffrey Dennis is an attorney in our Office of  
6 General Counsel. Both have been very actively involved in  
7 arranging today's proceeding.

8 Hearing Room 5 is designated as the overflow room  
9 for this proceeding. Hearing Rooms 2 and 7 have been set  
10 aside as breakout rooms available for individual groups to  
11 meet privately during the breaks.

12 According to our schedule, we will break for  
13 lunch at 1:10, and we plan to finish today by 4:30. I  
14 appreciate your attention and look forward to hearing your  
15 arguments. Thank you very much.

16 Do any of my colleagues have any comments they  
17 would like to make?

18 COMMISSIONER BROWNELL: I just join in your  
19 statement, Mr. Chairman.

20 CHAIRMAN KELLIHER: Thank you. Okay, let's  
21 start. Madam Secretary?

22 SECRETARY SALAS: Our first speaker this morning  
23 is Mr. Roger St. Vincent from the Commission Trial Staff.

24 MR. ST. VINCENT: Thank you. With me is co-  
25 counsel Lee Ekman, and, as you know, I'll be providing you

1 with a short overview of this proceeding.

2 As was described by the Chairman, the hearing in  
3 this case to consider ISO New England's locational installed  
4 capacity market, or LICAP, arose from controversy regarding  
5 compensation for generators needed for reliable electric  
6 service in New England.

7 The existing installed capacity market in New  
8 England, or ICAP, presented problems, because it has no  
9 price variation based on location; that its payments don't  
10 reflect differing geographical need.

11 It also contains a so-called vertical demand  
12 curve, which means capacity payments can drop to zero when  
13 there's only slightly more capacity than required.

14 As a result, there's no consistent signal to  
15 invest. Other markets and mitigation policies in New  
16 England do not provide adequate compensation to generating  
17 units in designated congestion areas, or DCAs.

18 In the Fall of 2002, concerns were expressed to  
19 the Commission that the New England market rules and  
20 mitigation policies, including a price cap on the energy  
21 market, rendered some generators needed for reliability in  
22 load pockets, not able to recover their costs.

23 Reliability must-run, or RMR contracts, were seen  
24 with individual generators, to be a temporary band aid, that  
25 is a non-market means that could be used to ensure cost of

1 service type revenues for such generators deemed  
2 indispensable.

3 On February 26th, 2003, NRG Power Marketing and  
4 four of its generators, filed cost of service RMR contracts  
5 covering 1728 megawatts of capacity within Connecticut and  
6 Southwest Connecticut. These four RMR contracts led to this  
7 case.

8 However, problems resulting from the expected  
9 widespread use of RMR contracts in New England, were widely  
10 recognized. Numerous Intervenors urged rejection of these  
11 RMRs and expressed concern that approval of NRG's proposal  
12 would create incentives for other generators to file for RMR  
13 agreements which could have ramifications for Connecticut  
14 and NEPOOL wholesale electric markets.

15 Several Intervenors argued that having a large  
16 percentage of Connecticut's generation under RMR agreements,  
17 could compromise and mute price signals needed to induce  
18 expansion of generation and transmission.

19 The Connecticut Department of Public Utility  
20 Control asserted that the Commission should direct the ISO  
21 to make emergency expedited filings to assure adequate  
22 levels of compensation for generators providing needed  
23 reliability, and to incent the building of infrastructure.

24 Thus, it appeared that unless something was  
25 changed to provide an incentive to expand the

1 infrastructure, RMR agreements would proliferate and would  
2 further exacerbate the existing market's inability to induce  
3 construction of transmission and generating resources.

4 The Commission responded in its April 25th 2003  
5 Order, and the Commission formally found that extensive use  
6 of RMR contracts undermines effective market performance,  
7 resulting in suppressed market clearing prices that further  
8 erode the ability of other generators to earn competitive  
9 revenues in the market, and increased the likelihood that  
10 additional generators will also require RMR agreements.

11 The situation in New England may not allow  
12 supplies and DCAs, an opportunity to recover their costs,  
13 and, finally, that a location-specific capacity requirement  
14 must be in place.

15 In that Order, the Commission stated that the ISO  
16 should incorporate the effect of RMR agreements into a  
17 market-type mechanism, rather than focus on using RMRs, and  
18 directed the ISO to file no later than March 1st, 2004, a  
19 mechanism that implemented location or deliverability  
20 requirements in its ICAP market, so that capacity within  
21 DCAs may be appropriately compensated for reliability.

22 Following the April 25th Order, the New England  
23 stakeholders engaged in a collaborative process to attempt  
24 to agree on an ICAP market design that would accomplish this  
25 goal by:

1           First introducing a locational component to the  
2 ICAP market; second, replacing the existing vertical demand  
3 curve with a downward-sloping demand curve; and, third,  
4 significantly reducing the need for RMR agreements.

5           A collaborative proposal was approved in the New  
6 England stakeholder process by the Markets Committee, and  
7 received a majority, 58-percent vote from the Participants  
8 Committee.

9           However, such proposal requires a two-thirds  
10 majority, and did not pass. Subsequently, the ISO filed its  
11 LICAP proposal in compliance with the April 25th Order.

12           The major difference between the collaborative  
13 offer and the ISO's March 1st filing, was that the  
14 collaborative proposal included price floors for the Maine  
15 and Rest-of-Pool regions.

16           The ISO's LICAP proposal was subsequently  
17 modified prior to and during the hearing. It had at its  
18 core, a downward-sloping demand curve. As modified, it  
19 accounted for transmission constraints by establishing  
20 separate ICAP requirements for five regions: Maine,  
21 Southwest Connecticut, Rest-of-Connecticut, Northeast  
22 Massachusetts, and Boston, referred to as NEAM-Boston, and  
23 the remainder of New England, called Rest-of-Pool.

24           Capacity transfer limits, or CTLs, limit the  
25 amount of ICAP that load-serving entities in one region can

1 purchase from another region. Capacity transfer rights are  
2 allocated to market participants, depending on their  
3 location, to allow them to hedge against congestion costs.

4 A price-setting mechanism was proposed to prevent  
5 market power abuse, a shortage-hours approach was proposed  
6 as a real-time performance measure of generator  
7 availability, and, therefore, eligibility for LICAP  
8 payments.

9 A peak energy rents adjustment or PER adjustment,  
10 would adjust LICAP payments downward by the revenue, less  
11 variable costs that a theoretical benchmark generator would  
12 earn in the energy market to assure that LICAP payments do  
13 not duplicate payments in the energy market.

14 It was this proposal that was the focus of the  
15 hearing in this proceeding, as directed by the Commission.  
16 There were limitations on the scope of the LICAP hearing.

17 Three Orders were issued by the Commission  
18 concerning the ISO's LICAP proposal: The June 2, 2004 Order  
19 setting this case for hearing; a November 8, 2004 Order on  
20 Rehearing and Clarification; and a March 23, 2005 Order on  
21 Rehearing and Clarification.

22 As those of you who are parties to this  
23 proceeding can attest, timing deadlines played a large role.  
24 With over 70 Intervenors and a massive factual record and  
25 extremely complex theoretical models to analyze, the

1 parties, Trial Staff, and the Presiding Judge, were pressed  
2 to establish a full record and give due consideration to the  
3 issues that were set for hearing.

4 The deadline for initial decision was ultimately  
5 set for June 15, 2005, with implementation to take place by  
6 January 1, 2006. The Commission's Orders accepted key parts  
7 of the ISO's LICAP proposal and limited the issues to be  
8 considered at hearing.

9 The June 2nd Order agreed with two concepts in  
10 the ISO's proposal: Separate ICAP regions to reflect  
11 locational differences, and the overarching proposal to use  
12 a demand curve, and, in particular, a downward-sloping  
13 demand curve.

14 The June 2nd Order set the following issues for  
15 hearing: The parameters of the demand curve; the proper  
16 method for calculating CTLs; the appropriate method for  
17 determining the amount of CTRs to be allocated; and the  
18 proper allocation of CTRs.

19 Controversy arose over related issues that were  
20 considered at hearing: The ISO's price-setting mechanism to  
21 prevent market power abuse and the ISO's shortage-hours  
22 approach to generator availability.

23 Controversy also existed over issues that various  
24 parties sought to include in the hearing, that were  
25 determined to be beyond the scope of issues set for hearing,

1 and were not considered. These issues included: Testimony  
2 discussing alternatives to a downward-sloping demand curve;  
3 treating new and existing generators differently under  
4 LICAP; treating individual generators differently, based on  
5 whether they are able to recover their costs or whether they  
6 were actually needed for reliability; changing the  
7 requirements for RMR agreements after LICAP implementation;  
8 and existing restrictions on and obligations of generators,  
9 pursuant to the ISO's Market Rule 1.

10 In the November 8th Rehearing Order, it was clear  
11 that the Commission did not intend that the hearing should  
12 consider alternatives to the overarching framework and  
13 features of the ISO's LICAP mechanism.

14 The March 23rd Order denied further requests for  
15 rehearing, thus, from the June 2nd Order through the March  
16 23rd Order, it was clear that the purpose of the hearing was  
17 not to determine whether to use a downward-sloping demand  
18 curve and separate regions to appropriately value capacity,  
19 but how.

20 Thus, the parameters of the ISO's LICAP demand  
21 curve, were the heart of the hearing. The ISO's demand  
22 curve applies to each of the five regions, based on its  
23 shared objective capability or OC, which is the amount of  
24 capacity needed each year to meet the one-day-in-ten-year  
25 loss of load expectation or LOLE for that year.

1                   In addition, the ISO's reliability standard is  
2                   for capacity to fall below OC, no more than 17 percent of  
3                   the time, based on historic capacity level data for New  
4                   England.

5                   The ISO's proposed demand curve contains various  
6                   parameters, primarily having to do with the amount of  
7                   capacity and corresponding LICAP price and payment at that  
8                   level of capacity. You should have received a chart  
9                   illustrating the ISO's demand curve.

10                  If I can just walk you through it briefly, the  
11                  demand curve parameters include, from left to right: A  
12                  ceiling price, a P-MAX of twice the estimated benchmark cost  
13                  of capacity or EBCC. That's the estimated cost of new entry  
14                  for a theoretical benchmark generating unit.

15                  The P-MAX price is reached at OC, also labeled C-  
16                  MIN, or minimum capacity, to provide a strong investment  
17                  signal to add capacity, if it falls below OC.

18                  SECRETARY SALAS: This your one-minute warning,  
19                  Mr. St. Vincent.

20                  MR. ST. VINCENT: The rest of the parameters, you  
21                  can see for yourself on the chart. It's pretty well  
22                  explained there.

23                  (Laughter.)

24                  SECRETARY SALAS: Can you wrap up?

25                  MR. ST. VINCENT: Yes.

1 (Laughter.)

2 MR. ST. VINCENT: In the year proceeding the  
3 issuance of the IB, the numerous parties in this proceeding  
4 devoted a substantial amount of time and resources to  
5 determining the most appropriate parameters for the LICAP  
6 demand curve.

7 The parties and the Presiding Judge engaged in an  
8 intensive effort to comply with the Commission's directive  
9 that the hearing result in a final LICAP market design that  
10 will appropriately compensate generators needed for  
11 reliability and attract and retain necessary infrastructure  
12 to assure long-term reliability.

13 The record in this case demonstrates that the  
14 parties agreed on very little concerning how best to meet  
15 the Commission's goal, and that each party advanced  
16 positions in the sincere belief that it was acting in the  
17 best interests of the region.

18 There was general agreement that the LICAP  
19 methodology resulting from this proceeding, may strongly  
20 affect the economic wellbeing of New England. Many of the  
21 parties raised important policy questions concerning  
22 resource adequacy and market protection.

23 There efforts produced the voluminous record, but  
24 no consensus on the best way to meet the Commission's  
25 directive. Thank you.

1                   SECRETARY SALAS: Thank you. Our next presenter,  
2 on behalf of ISO New England, is Mr. Clinton Vince. You  
3 have 30 minutes, Mr. Vince.

4                   MR. VINCE: Good morning, Chairman Kelliher,  
5 Commissioners Brownell and Kelly. My name is Clint Vince,  
6 representing ISO New England.

7                   I'm joined today by Kathleen Carrigan, the  
8 General Counsel, Ray Hepper, the Assistant General Counsel,  
9 who will be making our presentation this afternoon, and by  
10 my law partner, Sherry Quirk, who tried the case before  
11 Judge McCartney.

12                   With your permission, I plan to talk about  
13 urgency, reliability, LICAP, and then squarely address the  
14 three vital questions posed by this Commission. Sherry will  
15 be available for any detailed questions that involve the  
16 hearing record.

17                   The core issue presented in this case, has been  
18 challenging every organized market in the electric industry,  
19 and that is, what kind of market structure will send price  
20 signals to incent generation needed for reliability?

21                   The ISO believes strongly that LICAP represents  
22 the best approach for meeting this goal in time. As Ray  
23 Hepper will explain this afternoon, the forward procurement  
24 concept laid out in the alternatives, is potentially viable.

25                   We feel it should receive serious further

1 consideration. The ISO has committed to assist stakeholders  
2 with the development of alternatives, and we'll put our  
3 shoulder into it.

4 We do urge the Commission to continue its  
5 longstanding view that locational price signals are  
6 critical, and to give us that guidance early on.

7 The most important thing that I can say today, is  
8 that the ISO is deeply concerned about timing. The  
9 procedural schedule for LICAP has been delayed twice. Right  
10 now, there is nothing effective in place in New England to  
11 maintain and incent generation needed for reliability.

12 The ISO's Regional System Plan for 2005, reports  
13 that the region will not have sufficient capacity to meet  
14 the installed capacity requirement by the 2008-2010  
15 timeframe, and since it takes two to four years to build new  
16 generation, the ISO anticipates a reliability problem in New  
17 England, if LICAP is not put into effect by next October.

18 For LICAP to be in place in 2006, the Commission  
19 would need to issue an Order, hopefully by next March. The  
20 ISO would then make a compliance filing in April or May, and  
21 the Commission would need to act by mid-Summer.

22 If a better alternative is developed and decided  
23 upon next Summer, which appears to be the earliest realistic  
24 date, it will be late 2007 before rules can be written,  
25 software developed, and the entire market implemented.

1                   COMMISSIONER KELLY: Mr. Vince, can I ask you,  
2 what kind of impact did the Commission's decision to  
3 postpone implementation of a market plan from January to  
4 October have?

5                   MR. VINCE: I think we can meet that -- we can  
6 work within those parameters. As you will hear later, it  
7 will also give us the time, if the Commission concurs, to  
8 follow what we believe was a suggestion by Judge McCartney  
9 to allow us to do a compliance filing that would allow the  
10 Commission and interested parties to further develop the  
11 shortage hours idea. I'll get to that in a minute. We  
12 think we can work within the delay, but we're now beginning  
13 to get tight.

14                   The scenario that I just gave assumes no  
15 litigation at FERC and that everyone agrees with every  
16 detail. Under the forward procurement mechanism with a  
17 three-year timeframe lead, we would not be providing  
18 capacity payments until 2011. I understood, Commissioner  
19 Kelly, your question to be referring to LICAP. If it was  
20 referring to the alternatives, we believe --

21                   COMMISSIONER KELLY: What I was really wondering  
22 was the impact on the region of a delay and having an  
23 effective installed capacity market in place.

24                   MR. VINCE: I think we'll be able to work within  
25 the parameters of the delay, but we would need to move

1       swiftly.

2                       Given the fact that, under the best of  
3       circumstances, a better alternative would likely not be able  
4       to be implemented until 2011, the tough question is what  
5       does New England do from 2006 to 2011? The status quo will  
6       not work. There was a point made in the Chairman's  
7       introduction, and I'd like to address that.

8                       Status quo means we continue with costly and  
9       environmentally dirty RMR plants, with high-cost emergency  
10      RFPs and a flawed ICAP market that does not promote or  
11      retain investment. We will work very hard to determine  
12      whether forward procurement can become a viable alternative.  
13      Right now, LICAP is the only fully developed just and  
14      reasonable solution that's ready to go.

15                      COMMISSIONER KELLY: I have one other question.  
16      When you say that an alternative plan couldn't be  
17      implemented until 2011, do you mean the bid-based auction  
18      plans, that there wouldn't be an auction until 2011?

19                      MR. VINCE: Payments would not begin until 2011.

20                      COMMISSIONER KELLY: Under LICAP, payments would  
21      begin earlier. Would you anticipate that the actual coming  
22      online of generation would be quicker under LICAP than under  
23      an alternative?

24                      MR. VINCE: Yes. We anticipate it would be much  
25      quicker and also that demand response would come on right

1 away, because they'd be paid for it.

2 I should also mention we're concerned about the  
3 reliance on natural gas in New England. This concern,  
4 combined with a lack of strong price signals for  
5 availability, creates real reliability worries. During the  
6 cold snap last year, we saw generators in the capacity  
7 market bid into the day-ahead market, but then the next day  
8 they did not have gas to generate at peak. They did not  
9 procure the gas because the price signals were inadequate.  
10 We need a capacity market that sends the right price  
11 signals. Under the status quo, it's not a question of if  
12 but rather when the confluence of incomplete market design,  
13 load growth, and poorly-maintained generation will lead to  
14 brownouts, blackouts, or a simple and slow death of markets.

15 After more than 2-1/2 years of development,  
16 including a year of litigation, we have an initial decision  
17 by Judge McCartney that supports three of the four critical  
18 features of LICAP and gives us hope that the fourth feature  
19 could eventually be adopted. As you can see from the  
20 briefs, neither load nor the generators have been willing to  
21 meet the other's essential needs. There have been no bridge  
22 builders, only highly-skilled advocates for each party's  
23 self interest.

24 Load parties say no to LICAP, no to FERC  
25 jurisdiction over resource adequacy, no to just and

1 reasonable returns for generators, no to the use of  
2 historical data or the setting of the demand curve, and no  
3 to the ISOs concern about urgency. Generators, meanwhile,  
4 want more revenues from the demand curve and they refuse to  
5 commit to load on issues like performance when needed and  
6 adequate protection against market power. The only real  
7 balance in this proceeding has come from the Commission  
8 Staff, the ISO, and the Presiding Judge.

9 It might be helpful to remind the Commission that  
10 there are four key features to the ISO-LICAP market: First  
11 is a downward-sloping demand curve which is similar but not  
12 identical to the curve approved by this Commission in the  
13 D.C. Circuit for the New York ISO. The clear direction of  
14 this Commission in the June 2nd order was to propose a  
15 market based on a downward-sloping curve. The second  
16 feature is deduction of peak energy rents from LICAP  
17 payments. The third feature is a price setting mechanism  
18 based on total installed capacity. The fourth is an  
19 availability metric based on performance and shortage hours.  
20 It's this last feature that I'd like to just discuss for a  
21 moment.

22 Load parties support us; generators oppose us.  
23 Staff and the ALJ feel that it is conceptually correct but  
24 has flaws and needs further development. The ISO firmly  
25 believes that the shortage hours metric is essential for

1 reliability, but rather than belaboring that issue today, we  
2 urge the Commission to allow the ISO to make a compliance  
3 filing with plenty of chance for involvement by interested  
4 parties. This will provide the further details and  
5 development that the ALJ suggested is needed. We now have  
6 the time with the deferral until October, and this feature  
7 will save load, in our view roughly \$200 million annually.

8 COMMISSIONER KELLY: Mr. Vince, I have two  
9 questions about the demand curve. Can you explain how ISO  
10 New England takes the position that the capacity target  
11 implements the resource adequacy requirements of the region  
12 rather than establishing new ones?

13 MS. QUIRK: If I could, Commissioner, my name is  
14 Sherry Quirk. It does this --

15 CHAIRMAN KELLIHER: Excuse me, is your microphone  
16 on, Ms. Quirk?

17 MS. QUIRK: Thank you, Chairman Kelliher.

18 The ISOs see target, as you'll see on J-13,  
19 establishes a target level of capacity based on the  
20 historical level of capacity that the region has enjoyed  
21 over the past 22 years. Rather than establishing a new  
22 target, what this has done is to provide the region a target  
23 level of capacity that it has experienced over the years in  
24 order to avoid the prospect of regulatory intervention, if  
25 capacity -- installed capacity travels below the target

1 level too often.

2 COMMISSIONER KELLY: Thank you.

3 MR. VINCE: Now to the Commission's three  
4 questions. In essence, the Commission has asked whether the  
5 ISO's LICAP proposal is just and reasonable, whether new  
6 resources will be built with LICAP in place, and whether its  
7 benefits outweigh its costs.

8 The forthright answer to each of these questions  
9 is a simple yes. The Presiding Judge answered the first  
10 question directly, and we put her answer onto a chart  
11 because we felt it was extremely clear and explicit in  
12 finding in favor of the ISO. The Judge stated -- quote --  
13 "it is a determination to the undersigned that the ISO New  
14 England's demand curve proposal considered as a whole is  
15 responsive to the Commission's directive and provides a just  
16 and reasonable result that will appropriately compensate  
17 generators needed for reliability and attract and retain  
18 necessary infrastructure to assure long-term reliability at  
19 the lowest cost to consumers, balancing the interests of  
20 both generators and load in doing so," initial decision at  
21 284.

22 COMMISSIONER KELLY: Mr. Vince, critics of the  
23 proposal say it's too expensive, especially because payments  
24 will be made to existing generators, some of which they say  
25 are already earning excess revenues. What is your response

1 to that criticism?

2 MR. VINCE: Many generators are not earning  
3 adequate revenues at all, and I think that's been the  
4 finding even at this Commission that the current ICAP market  
5 is not just and reasonable. What we need to do is get a  
6 market in place and correct price signals in place so that  
7 we can begin to reduce RMR contracts, so that we can get  
8 demand response in, and so that we can begin again to incent  
9 new generation.

10 COMMISSIONER KELLY: Do you think it's  
11 appropriate to eliminate RMR contracts when the LICAP or the  
12 market mechanism that we order goes into place?

13 MR. VINCE: I think we should do the very best we  
14 can to reduce and lessen RMRs. There may be situations  
15 where certain RMRs will need to be continued, at least for a  
16 period of time. But I think the Commission's guidance in  
17 this direction is exactly right.

18 COMMISSIONER KELLY: Thank you.

19 CHAIRMAN KELLIHER: Mr. Vince, you alluded to  
20 whether or not prices are just and reasonable, sufficient to  
21 support entry. Hasn't the state of the market report, the  
22 ISO New England state of the market report concluded for a  
23 number of years that revenues are inadequate to support  
24 entry? Doesn't that go back to 2002? It's not a new  
25 finding; it goes back a number of years.

1 MR. VINCE: Exactly.

2 CHAIRMAN KELLIHER: I had a question about RMR  
3 contracts under the status quo. There's a debate about the  
4 cost of LICAP and at some point it has to be compared to the  
5 status quo and alternatives. But sometimes there's a notion  
6 that the status quo -- there is no cost under the status  
7 quo. Can you indicate what the cost of the current RMR  
8 agreements are and whether that cost is likely to increase?

9 MR. VINCE: We sure can. That actually comes in  
10 under your third question. Why don't I jump ahead to that?

11 CHAIRMAN KELLIHER: Sure.

12 MR. VINCE: The third question basically covered  
13 costs, benefits and economic impacts. With respect to the  
14 benefits of LICAP, the benefit is that it sends price  
15 signals to maintain current reliability and attract future  
16 investment. And, as the D.C. Circuit and the Commission  
17 noted in approving the New York ISOs downward-sloping curve,  
18 it replaces a highly volatile vertical-demand curve and  
19 binary pricing.

20 In terms of cost, the Presiding Judge found --  
21 quote -- "virtually every party in this case agrees that  
22 long-term costs must equal EBCC on average, which means  
23 paying about \$3 billion each year due to a combination of  
24 net energy market rents and LICAP payments" -- and I  
25 emphasize the word "combination." That figure is at

1 equilibrium. We're at about half of equilibrium right now.  
2 We need to put LICAP into place now to reduce RMRs, allow  
3 maintenance of efficient generation, get demand response  
4 right away, and send the right signals.

5 The Judge determined that all of the load  
6 forecasts on costs were inflated. In the heat of  
7 litigation, load parties claimed that LICAP would cost  
8 nearly \$15 billion. These claims were rejected by the ALJ.  
9 Load has now finally begun to acknowledge what capacity will  
10 really cost. In their submission of September 13th  
11 describing NERAM, Enstar and Connecticut, as you can see on  
12 this chart -- this is the NERAM brief at 14 -- stated that  
13 at equilibrium LICAP will cost \$150 million more annually  
14 than NERAM. Five years or five annual payments times \$150  
15 million is \$750 million, not 14.5 or \$15 billion. And as  
16 Ray Hepper will explain this afternoon, even the \$150  
17 million figure we think is way inflated. It basically  
18 requires load to guess perfectly four years in advance and  
19 to always be right. But the larger point is that capacity  
20 costs a lot of money, whether it's NERAM, NORAM, the status  
21 quo or cost of service, unless of course you're getting it  
22 for free.

23 One thing this Commission process has done, I  
24 think, is flush out a lot of mischief. You can understand  
25 why the political base in New England is inflamed. They've

1       been given some really inaccurate cost information about the  
2       true cost of LICAP.

3               The third part of the Commission's question  
4       number three requested a cost comparison between LICAP and  
5       the status quo, giving the cost of RMRs as an example, and  
6       our response is depicted in two charts.

7               (Charts.)

8               The first chart shows skyrocketing RMR costs or  
9       obligations in terms of millions of dollars. The chart  
10       shows RMRs in effect or requested of over \$840 million in  
11       September of '05, compared to just \$24 million in June of  
12       2003. You can see that RMR obligations are increasing  
13       exponentially. And even if parties disagree with the  
14       precise amount, the order of magnitude is unassailable.

15               The second chart makes the same point with a  
16       comparison of megawatts. There are about 4800 megawatts  
17       currently in place and an additional 4,000 pending before  
18       FERC or the ISO for a total of 8631 megawatts, compared to  
19       just 350 megawatts two years ago.

20               COMMISSIONER KELLY: Mr. Vince, do you have an  
21       opinion on why there are more RMR contracts pending before  
22       FERC?

23               MR. VINCE: There are no good price signals right  
24       now to bring in new market entry. You have these generators  
25       that are not getting enough compensation through the market

1 and they've had to go to out-of-market contracts so that  
2 they can be there in the constrained areas when they're  
3 absolutely needed. The problem is that these are -- some of  
4 them are the least efficient generation and they also  
5 suppress market signals so that new entry's not coming in.

6 COMMISSIONER KELLY: But the existing generators  
7 that are in for applications for RMR are currently getting  
8 market prices, they're currently getting paid for producing  
9 generation?

10 MR. VINCE: Once again, RMR contracts are getting  
11 paid, yes.

12 COMMISSIONER KELLY: The ones that don't have RMR  
13 contracts, are they the ones that are seeking RMR contracts?

14 MR. VINCE: Yes.

15 COMMISSIONER KELLY: And is that because there is  
16 insufficient revenues to cover the cost today?

17 MR. VINCE: Exactly. They're not getting enough  
18 money.

19 COMMISSIONER KELLY: Thank you.

20 MR. VINCE: That's exactly right.

21 COMMISSIONER BROWNELL: But isn't it also true  
22 those RMR contracts are keeping old, inefficient, dirty  
23 plants online that in other circumstances would be retired  
24 and new --

25 MR. VINCE: That's exactly right. That's one of

1 our most critical concerns, Commissioner.

2 COMMISSIONER KELLY: Are you bumping up against  
3 environmental air quality concerns with burning oil in the  
4 area?

5 MR. VINCE: In some areas, we are, yes.

6 COMMISSIONER KELLY: Thank you.

7 CHAIRMAN KELLIHER: Mr. Vince, which regions of  
8 New England are currently bearing the cost of RMR  
9 agreements?

10 MR. VINCE: Southwest Connecticut.

11 CHAIRMAN KELLIHER: And also northeast  
12 Massachusetts?

13 MR. VINCE: Northeast, yes, although their  
14 transmission upgrades will likely come in within the time  
15 frame --

16 CHAIRMAN KELLIHER: Your cost projection going  
17 from, you know, over \$400 million to \$1.3 billion, is that  
18 \$1.3 billion --

19 MR. VINCE: That includes NEMA.

20 CHAIRMAN KELLIHER: Okay. That cost would fall  
21 on southwest Connecticut and northeast Massachusetts?

22 MR. VINCE: Yes.

23 CHAIRMAN KELLIHER: And that's a cost associated  
24 with the status quo?

25 MR. VINCE: That's exactly right.

1                   CHAIRMAN KELLIHER: Assuming the Commission does  
2 nothing, that's what it would look like?

3                   MR. VINCE: Yes.

4                   CHAIRMAN KELLIHER: Now the 15,000 megawatts that  
5 you have, how much of New England's supply does that  
6 represent? Is that roughly half of New England's --

7                   MR. VINCE: Nearly half -- it's a quarter --  
8 excuse me. It's nearly a quarter --

9                   (Simultaneous discussion.)

10                  MR. VINCE: It's half. We're about 30,000.

11                  COMMISSIONER BROWNELL: And that's largely due to  
12 the failure to build transmission and to resolve the  
13 transmission constraints that limit the options,  
14 particularly in southwest Connecticut?

15                  MR. VINCE: Yes.

16                  COMMISSIONER BROWNELL: And we've got some  
17 projects that are due to be completed in 2006-2007 that were  
18 delayed by litigation for many, many years, so that problem  
19 has gotten significantly worse.

20                  MR. VINCE: That's correct.

21                  COMMISSIONER BROWNELL: So the congestion charges  
22 that are alluded to as federal mandates are in fact  
23 congestion charges that are simply reflecting the reality of  
24 the infrastructure region by region, as opposed to other  
25 regions paying the bill for congestion in one area, is that

1 correct?

2 MR. VINCE: That's exactly correct.

3 COMMISSIONER BROWNELL: Thank you.

4 MR. VINCE: The fundamental problem in  
5 Connecticut is inadequate transmission infrastructure.

6 COMMISSIONER KELLY: My understanding is that  
7 Connecticut's planning to build will alleviate this  
8 somewhat, but that they'll still be in a constrained  
9 situation.

10 MR. VINCE: We believe that's true and the  
11 transmission lines are coming on on a phased basis.

12 COMMISSIONER KELLY: Thank you.

13 CHAIRMAN KELLIHER: Mr. Vince, there's an  
14 argument in some quarters that the status quo is actually  
15 operating fine, there's no immediate problem. But couldn't  
16 you look at generation, the pace of generation additions as  
17 somehow a leading indicator of problems to come down the  
18 road?

19 MR. VINCE: Oh yeah.

20 CHAIRMAN KELLIHER: I mean, can you compare --  
21 what was the level of entry in terms of megawatts, say, in  
22 2002-2003 compared to this year in New England?

23 MR. VINCE: If you go from 1999 to 2002 with  
24 restructuring -- and this is a great question, because it  
25 just shows that markets do work when they're not capped.

1 Between 1999 and 2002, the markets attracted 30,000  
2 megawatts in queue, which translated to about 8000 megawatts  
3 coming online. That was all done without a forward  
4 procurement mechanism.

5 What happened is then the markets -- and  
6 investors invested because they thought they could make  
7 money. What then happened is with the price caps, investors  
8 stopped investing. What we need to do is put in the right  
9 price signals and allow generators to be compensated at a  
10 reasonable -- or given at least the opportunity to be  
11 compensated a just and reasonable amount so that we can get  
12 generation back in place in time for the 2008-2010  
13 reliability concern that we've expressed in our regional  
14 report.

15 CHAIRMAN KELLIHER: Initially the capacity  
16 markets were established in New England for reliability  
17 reasons alone, that was the singular focus. You just  
18 referred to the price caps and how, in your view, there's a  
19 greater need for capacity markets in the wake of the price  
20 cap, so you see a relationship between the two. The  
21 Commission established price caps that reduce the revenue  
22 the generators can collect and your proposal is, in effect,  
23 compensating for the Commission's action establishing price  
24 caps?

25 MR. VINCE: Yes.

1                   CHAIRMAN KELLIHER: Now there's different  
2                   rationales for capacity markets. One is reliability; that  
3                   was the one New England had years ago when it first  
4                   established capacity markets. Another is, the one you're  
5                   just suggesting, it's to assure just and reasonable prices  
6                   sufficient to encourage entry. And I suppose a third is  
7                   resource adequacy writ large.

8                   What do you view the primary rationale of your  
9                   proposal today: is it reliability, is it assuring just and  
10                  reasonable rates, is it encouraging entry, is it reliability  
11                  -- can you really separate the two?

12                  MR. VINCE: If I could pick the all-of-the-above  
13                  figure to answer your question.

14                  CHAIRMAN KELLIHER: I thought you might say that.

15                  (Laughter.)

16                  CHAIRMAN KELLIHER: Okay. Thank you.

17                  COMMISSIONER KELLY: Mr. Vince, it's been said  
18                  that under LICAP no generation is forced to be built, so  
19                  there's concern that money would be spent and new generation  
20                  wouldn't respond. How do you respond to that concern?

21                  MR. VINCE: Well, I think first of all that  
22                  concern basically says competitive markets don't work, but  
23                  they've been demonstrated to work in all sectors of our  
24                  economy.

25                  COMMISSIONER KELLY: And in fact, in New England,

1 all of the states have mandated competitive markets, haven't  
2 they?

3 MR. VINCE: That's correct, except Vermont. And  
4 as the example we gave earlier in the 1999 to 2002  
5 timeframe, with uncapped energy and capacity markets, the  
6 markets attracted new entry.

7 COMMISSIONER KELLY: As I understand it, the way  
8 the LICAP mechanism works, because it provides for capacity  
9 payments at an estimated benchmark cost and then deducts  
10 fuel, it doesn't discriminate against the fuel diversity of  
11 new generation. In other words, with the high cost of gas  
12 today, that would be deducted from a capacity payment,  
13 leading one to conclude that gas might not be the best kind  
14 of generation to bring online, is that correct?

15 MR. VINCE: That's true.

16 COMMISSIONER KELLY: Thank you.

17 CHAIRMAN KELLIHER: Mr. Vince, I had a question.  
18 The stated rationale for locational capacity markets is to  
19 encourage generation additions where they're most needed, in  
20 this case, southwest Connecticut and northeast  
21 Massachusetts. If the LICAP proposal -- the prices,  
22 estimated prices in those locations are not significantly  
23 higher than the rest of the pool -- and I have to admit that  
24 is a little surprising to me, given the constraints, the  
25 transmission constraints that exist; I would have expected

1 greater differences.

2 Can you explain why there's relatively little  
3 difference in estimated LICAP capacity payments in southwest  
4 Connecticut and northeast Mass compared to the rest of the  
5 pool?

6 MR. VINCE: The problem in the two areas that you  
7 mentioned is transmission constraints. Commissioner  
8 Brownell probed that issue with her earlier question.  
9 That's a security issue as opposed to a resource adequacy  
10 issue.

11 CHAIRMAN KELLIHER: I can understand there'd be  
12 differences, but it surprises me --

13 SECRETARY SALAS: One minute warning.

14 CHAIRMAN KELLIHER: -- is there's not a greater  
15 difference, frankly. Is it that the cost, the EVCC in  
16 southwest Connecticut and northeast Mass is not much  
17 difference than it is in rest of pool?

18 (Pause.)

19 CHAIRMAN KELLIHER: I mean, under the status quo,  
20 the costs of RMRs are falling on southwest Connecticut and  
21 northeast Mass. There's a concern in rest of pool that  
22 LICAP has an undue effect on them, so that the fact that the  
23 prices, the estimated prices, are not more different to me  
24 is a little surprising.

25 MS. QUIRK: Chairman Kelliher, I think the answer

1 --

2 CHAIRMAN KELLIHER: And we want to stick to the  
3 rules. Is time up or do --

4 SECRETARY SALAS: You have three seconds left.

5 (Laughter.)

6 CHAIRMAN KELLIHER: Do you have a three-second  
7 answer to that?

8 SECRETARY SALAS: That's it. Time's up.

9 MS. QUIRK: We'll address it in rebuttal.

10 CHAIRMAN KELLIHER: Great.

11 MS. QUIRK: If that's okay with you.

12 CHAIRMAN KELLIHER: Yeah, we'll address it in  
13 rebuttal.

14 SECRETARY SALAS: On behalf of United  
15 Illuminating, three minutes, Mr. Philip Nowak.

16 MR. NOWAK: Mr. Chairman, Commissioners, my name  
17 is Philip Nowak, here representing United Illuminating  
18 Company. UI is a public utility providing transitional  
19 standard-offer service to approximately 40 percent of the  
20 retail load in southwest Connecticut.

21 Most interested parties agree that the current  
22 capacity market in New England is hopelessly flawed.  
23 Existing generators are losing money. New generation that  
24 could enhance system reliability is not getting built.  
25 Thus, UI supports the prompt implementation of LICAP. UI

1 believes that it is essential to include a capacity product  
2 as part of the New England bulk power market.

3 While UI has opposed the creation of a separate  
4 southwest Connecticut region for both energy and capacity,  
5 it nonetheless strongly supports the general concept of  
6 LICAP. The Commission should promptly resolve the  
7 outstanding issues regarding the particulars of the LICAP  
8 proposal so that ISO New England can implement LICAP as soon  
9 as possible.

10 Of primary concern, as alluded to by the Chairman  
11 earlier, to UI is the increasing cost and reliance upon  
12 reliability must-run agreements. Based on information on  
13 ISO New England's website, it appears that RMR agreements  
14 will cost Connecticut consumers approximately \$300 million  
15 in 2005. Since June 1st, 2004, RMR agreements for loads  
16 served by UI have totaled \$50 million. If LICAP is not  
17 implemented and, as a result of the delay ordered by the  
18 Commission, UI projects that RMR agreements will cost UI  
19 retail customers approximately \$100 million by the end of  
20 the year 2006.

21 If the current ISO New England model works as  
22 planned, LICAP could reduce annual capacity costs in  
23 Connecticut by \$68 million. That is the difference between  
24 the projected costs of RMR --

25 SECRETARY SALAS: One minute warning.

1                   MR. NOWAK: -- agreements for 2005 plus current  
2                   ICAP payments totaling \$356 million and projected LICAP  
3                   payments of \$288 million. This savings estimate does not  
4                   even take into account the reduction in energy prices that  
5                   should result from implementation of LICAP.

6                   Even if there are costs associated with LICAP in  
7                   the short term, over the long run LICAP has the potential to  
8                   reduce costs and substantially improve reliability in New  
9                   England. LICAP would send the proper market signals to  
10                  encourage investment in new generation, transmission  
11                  infrastructure and load response.

12                  Finally, all of the alternatives to LICAP would  
13                  require further development and extensive stakeholder and  
14                  Commission proceedings before they could be implemented.  
15                  Thus, efforts to develop an alternative would mean even more  
16                  delay, resulting in higher costs for Connecticut consumers  
17                  and further degradation of system reliability.

18                  SECRETARY SALAS: Time.

19                  MR. NOWAK: Thank you very much.

20                  SECRETARY SALAS: Now on behalf of Capacity  
21                  Suppliers, first, Mr. John Estes with 12 minutes.

22                  MR. ESTES: Thank you, Mr. Chairman,  
23                  Commissioners. For the most part, I'm going to lay aside my  
24                  prepared remarks and address your questions that you've  
25                  raised today. Mr. Vince covered a number of the things I

1 was going to cover. But before I get to the curve issues, I  
2 have to just briefly discuss this interesting proposal  
3 called shortage hours you've heard mentioned.

4 I'm not going to take a lot of my time. We've  
5 dealt with this thoroughly in our brief and the Judge dealt  
6 with it thoroughly in her decision. We think shortage hours  
7 actually contradicts the build signal that the LICAP curve  
8 was designed to give, and we talk about that thoroughly. We  
9 think you should affirm the initial decision on that point.  
10 If ISO New England wants to make a further rate filing, they  
11 can do that.

12 With that done, I'd like to get to the heart of  
13 the matter here. I really see two issues in the three you  
14 asked: is LICAP too expensive -- and we don't think it is -  
15 - and will it work? And we think the answer is yes, it  
16 works in New York.

17 Now let's start for the moment to talk about why  
18 we're here and the urgency of the solution. I think most  
19 observers of wholesale organized markets agree that but for  
20 New York, which has a downward-sloping demand curve, the  
21 energy markets don't produce the right price signals. And  
22 it's not just because they're capped. They produce  
23 systematically subdued prices constantly, particularly in  
24 times of crisis.

25 If you look at the rolling blackouts in southern

1 California, you go look at the prices in those days: \$120  
2 or something like that. We can have record temperatures in  
3 New England and the price might loiter at around \$200, never  
4 hits \$1000. So price caps are one thing. Actually there  
5 are a number of systematic problems in the way the price  
6 formation process works. So there's money missing in these  
7 markets in a number of different timeframes.

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1                   Lay on top of that, that we have this vertical  
2 market curve, which is actually pretty much the same thing  
3 that New England has had for 30 years. The way this market  
4 used to work -- and, Chairman Kelliher, you mentioned the  
5 fact that this has been around a long time -- was, you  
6 covered yourself in the bilateral market, or you bought  
7 capacity.

8                   And if you didn't, you paid a charge based on the  
9 cost of a new peaker, plus a penalty. Now, all LICAP does  
10 is, it kicks out that vertical curve. Of course, we have a  
11 little bit more complicated curve now, but in a good way, so  
12 that we've got this kink to smooth out this spikiness, so we  
13 have peaks and valleys.

14                   And that has the obvious salutary effect that  
15 consumers pay less in times of crisis. I mean, do you  
16 really want to stick all the money, you know, in the middle  
17 of a supply crisis? That just exacerbates things.

18                   So we have, as you commented, in approving the  
19 New York curve and in this case, we have more rolling hills,  
20 rather than stark mountain peaks.

21                   Now, the existing market --

22                   COMMISSIONER KELLY: Mr. Estes, is it fair to say  
23 that this proposal would eliminate the possibility of what  
24 happened in California in 2000?

25                   MR. ESTES: It does as much as you can do right

1 now to prevent that. And, you know, I -- I have  
2 observations I'm now going to talk about. I didn't know  
3 whether I would.

4 What other region of the country besides New  
5 England, has chronically bad deliverability of natural gas?  
6 What other region of the country? California has air  
7 emissions limits that are starting to tamp down on  
8 generation.

9 You know, what other region of the country relies  
10 on hydropower from Canada, that can dry up in a dry hydro  
11 year? California.

12 Just like California, actually, it's come to my  
13 attention increasingly as I look through the briefs here,  
14 while load here contracts for periods of months at a time,  
15 or a year at a time, they don't really do long-term  
16 contracts.

17 So they're vulnerable, if gas prices run up.  
18 There's no particular hedge in place over the long term, to  
19 deal with these things.

20 But one thing that would help, is a little more  
21 smoothness in capacity prices, and that helps reduce costs  
22 in the long run, too, because as you pointed out in  
23 approving the New York curve, when you have spikiness, and  
24 you have periods of desert, basically, with an oasis for  
25 revenue, you have to -- if you're an investor you have to

1 price that into your supply, and that increases the cost of  
2 capital for the entire market.

3 And as our witness indicated in his testimony, if  
4 you increase the cost of capital one percent across the  
5 entire generation fleet, you can support another four  
6 percent of generation. I mean, the dollars you wrack up  
7 that way, truly get large.

8 Now, let me talk about urgency for a second.  
9 You'll see this timeline we've handed out. I agree entirely  
10 with what Mr. Vince said. There's no time for the  
11 alternatives now.

12 I actually agree with what he also said, you  
13 know, let's see if one of them can be made to work. It can  
14 come in place at some point in the future, we'll have an  
15 auction in 2007-2008, if the market can be made to work.

16 And that can be a sort of midterm supplement to  
17 LICAP. That's actually pretty much what the PJM market  
18 design is.

19 It's got a downward-sloping demand curve and a  
20 forward procurement model on top of it, and this is exactly  
21 the reasoning, Commissioners and Mr. Chairman, that was used  
22 in the New York ISO case, two years ago -- the exact same  
23 issue was raised, of, don't do LICAP, do what was then CRAM.  
24 And it just shows you that economists thought of that name.  
25 Who calls a product CRAM?

1                   It's really the ancestor of NERAM and NELRAM.  
2 People said, we want that one.

3                   And the Commission said, all we're doing is  
4 modifying the vertical demand curve in this spot deficiency  
5 auction. That doesn't prevent you from contracting  
6 bilaterally or from having an organized forward market.

7                   And that's exactly the answer you should give  
8 here, because we need a solution, starting for the Summer of  
9 2008, or we run into a potential violation of what is  
10 probably the most fundamental reliability criterion of all,  
11 the one-day-in-ten-year standard.

12                   COMMISSIONER KELLY: Mr. Estes, do you anticipate  
13 that your generation will respond to the implementation of a  
14 LICAP and to bring enough generation online by 2008 to solve  
15 the needs?

16                   MR. ESTES: Commissioner Kelly, there are really  
17 two questions there, so let me take the first one first,  
18 which was on my list to answer, anyway. Will LICAP work?  
19 Will people build?

20                   Well, it's worked in New York. Generation  
21 without long-term contract, has been built in New York City,  
22 and load-serving entities have contracted long, to hedge  
23 their risks.

24                   And markets work generally. I mean, it's  
25 actually not the typical way markets work, to go compel

1 someone to enter. We use price signals, usually, to do  
2 that.

3 I'm also here to state, by the way, that if LICAP  
4 goes into place, as we recommend, and it flashes a build  
5 signal, my client, FPLE, will build. I think others will  
6 respond.

7 As to the timeline we have here, I think we're  
8 just about with our backs against the wall, to do something.  
9 A peaker can come in in two years, maybe one and a half or  
10 one, if you're really pressing it, but there's nothing in  
11 the pipeline, to get to your question, Commissioner,  
12 whatsoever in New England right now that will come in in  
13 this timeframe, nothing at all.

14 In 2003, over 3,000 megawatts came in. Now, that  
15 had been developed during the time period when people  
16 thought there was no price cap and people were expecting  
17 meaningful ICAP revenues.

18 So, you know, the market can't now attract that  
19 kind of investment. So, there isn't really any other near-  
20 term solution to this problem but LICAP. And the question  
21 then becomes, which curve?

22 We'll be talking about that through the day, but  
23 there are a couple of other questions that were floated out  
24 there that I wanted to mention.

25 New York has seen retirements. If you prop up

1 older plants at or over the end of their useful life, you  
2 really do warp a lot of market signals. But, you know,  
3 right now, we're about to reach the point where no one is  
4 going to be able to go away, because, if they do, they  
5 instantly shift forward, the prices.

6 That timeline has 500 megawatts of load growth  
7 built into it per year, and a single unit of 500 megawatts,  
8 shifts the potential violation of the one-day-in-ten-year  
9 standard, a whole year, and if we don't have meaningful  
10 payments going to existing supply that is, you know, in many  
11 cases, you know, sort of at the edge or under the edge, and  
12 they see no useful solution in the near term, I submit to  
13 you that you're only sort of pressing the accelerator on the  
14 train that's coming towards you.

15 You have more retirements and eventually the ISO  
16 will say we can't do this anymore, no one can go away, and  
17 that's their RMR sort of spiraling upward point.

18 Now, I guess it's fair to say that if this is  
19 such a horrible problem, why aren't the load-serving parties  
20 upset about it, too, and why do they think they can  
21 parachute in five years from now and solve it?

22 I think what you'll hear is, you'll hear a  
23 proposal that we have these out-of-market solutions, these  
24 expensive GAP RFPs and that type of thing, and more RMR. I  
25 submit to you, Mr. Chairman and Commissioners, that there

1 are several problems with that.

2 Mr. Vince laid out the sort of market problems at  
3 our doorstep. It suppresses prices, it hurts the other  
4 people in the market.

5 There's also the question of the credibility of  
6 the regulatory process, which has a big effect on people's  
7 decision to invest, and can increase the cost of capital and  
8 cause the biggest price increases of all, that way.

9 LICAP, in some form, has been on the drawing  
10 board since 2002. We've been fighting about capacity  
11 markets, actually, I have, for five years. And, you know,  
12 ICAP prices have been zero for most of all of that time.

13 We've had LICAP delayed a couple of times, and  
14 there are a lot of reasons for that. It certainly had a  
15 financial effect on the supply community, but if we stall  
16 LICAP at the finish line now and don't put it in place,  
17 you're going to have to have new entrants building on the  
18 hope that something will be jump-started at the last minute  
19 to give them an investment signal, right when they parachute  
20 in.

21 And there are a lot of reasons to worry that that  
22 won't happen, so you need to put a signal in place ahead of  
23 time, that people can see, that can give credibility, or  
24 else you face a shortfall on the one-in-ten-year criterion.

25 Now, Chairman Kelliher, to your question about

1 prices and how all that works, you'll hear from Mr. Corneli,  
2 sort of an elaboration of a different angle on this, but  
3 LICAP is designed to reflect the one-in-ten-year adequacy  
4 requirement.

5 And the price differentials actually are a  
6 function of one aspect of this case that nobody thought  
7 about. There's software that the ISO uses to figure out  
8 what the price differentials are, and you can think of it --  
9 it's actually very accurate to think of it as an LMP market  
10 with five nodes.

11 And the prices reflect the actual capabilities to  
12 move power within the system, and it just so happens that  
13 when you do the reliability modeling, they argue that it's  
14 in Rest-of-Pool and in Maine and in other places that  
15 support the constrained regions. And that actual aspect,  
16 you know, the price formation tool and how it spreads  
17 dollars, is actually the one thing that wasn't in dispute.

18 Now, the reason you're focusing on Connecticut  
19 and --

20 SECRETARY SALAS: One minute left.

21 MR. ESTES: -- and Massachusetts, is that they  
22 have specialized problems, and there are different ways to  
23 solve that, but my point is, if you don't do something now,  
24 you have load pocket problems, but you have much broader  
25 problems. You have a systemwide shortage, and we think

1 something needs to be done.

2 Existing generators, to leave them out of the  
3 mark here, would be, frankly, repeating the sins of what I  
4 think is the worst failure in economic regulation in  
5 American history, how we dealt with natural gas markets in  
6 the 1960s.

7 All it does is create all sorts of perverse  
8 incentives. It's not -- and as the ISO's witness quite  
9 cagily said, new generators aren't stupid; they'll know one  
10 day they'll be existing, and once they've sunk their  
11 investment, what's to prevent the same thing from happening  
12 to them?

13 There goes their rate of return, there goes their  
14 risk, and, all of a sudden, you've put your finger on the  
15 scale that increases costs more than anything else. With  
16 that, if there are no questions, I'd like to save the rest  
17 of my time for rebuttal.

18 SECRETARY SALAS: Also on behalf of Capacity  
19 Suppliers, Mr. Steven Corneli, five minutes.

20 MR. CORNELI: Thank you, Mr. Chairman,  
21 Commissioners, and Staff. Thanks for this opportunity to  
22 explore this issue in more detail. You've put your finger  
23 already on several of the critical issues.

24 Connecticut has serious reliability needs.  
25 Generation has been under-compensated in the existing market

1 for a long time, and the problem needs to be fixed  
2 immediately.

3 I want to talk here specifically about  
4 Connecticut and the functioning of the demand curve market  
5 there. Connecticut matters a lot. It has 7,000 of the  
6 megawatts in NEPOOL. That's roughly one quarter of the  
7 total amount of generation in the Pool.

8 It's short on generation now, Commissioner  
9 Brownell. It will be short on generation and will be more  
10 short after the transmission plans that are in construction,  
11 are completed, and the record has extensive evidence on  
12 that.

13 This means really two things: It means all 7,000  
14 of those existing megawatts need to be able to operate  
15 profitably for the rest of this decade, at least, and it  
16 also means that about a thousand megawatts of new generation  
17 needs to have economic incentives to come into that market.

18 Both those things are critical, and that's really  
19 what you set this hearing to do, was to solve the short-term  
20 reliability compensation issues of existing generators, and  
21 the long-term reliability compensation issues that prevent  
22 new investment in generation and transmission.

23 LICAP, if it's done right, will solve both of  
24 these things. It will jump-start new investment. It will  
25 incentivize contracts and bilateral building, as in New

1 York, and it will provide the price signals, as Mr. Vince  
2 said, to keep existing generation operating. Both are  
3 needed.

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1                   CHAIRMAN KELLIHER:  The situation in  
2                   Connecticut --

3                   COMMISSIONER KELLY:  Can we eliminate the RMR  
4                   contracts when we put LICAP in place?

5                   MR. CORNELI:  Commissioner, that all depends on  
6                   the nature of the LICAP you put in place, which is what I'm  
7                   about to address here.  In Connecticut, there's particular  
8                   challenges.  The transmission system creates additional need  
9                   for capacity beyond the amount that's identified in the OC  
10                  metric and in the ISO's demand curve.  So we've proposed a  
11                  modification to the demand curves that will solve the  
12                  pricing problem that Chairman Kelliher pointed out, that  
13                  prices are not as high as they would seem to need to be in  
14                  regions that have the shortest supply of generation in  
15                  Connecticut.

16                  The second problem is that the state of  
17                  Connecticut itself has taken the reliability issues facing  
18                  them into its own hands and this summer passed legislation  
19                  that has two purposes:  it would require the state and  
20                  authorize the state to elicit more out-of-market gap RFP-  
21                  type megawatts to resolve the reliability problems but also  
22                  to suppress or move down capacity prices in the anticipated  
23                  LICAP market.

24                  Now we applaud the opportunity to contract for  
25                  new generation in Connecticut -- we think that's appropriate

1 and consistent with a capacity market -- but we're very  
2 concerned about the impact of these additional megawatts  
3 interacting with the ISO's demand curve and suppressing  
4 prices for the 7000 megawatts of existing generation.

5 We estimate, based on the models in this case,  
6 that with the addition of the needed generation, just the  
7 needed generation in Connecticut, prices in Connecticut over  
8 the next three years would average -- revenues, LICAP  
9 revenues, would average under \$4 per kilowatt-month. That's  
10 less than the cost of the least expensive RMR unit right  
11 now. It's also less than the cost of many existing  
12 generators that are efficient and that are needed for  
13 reliability: new peakers, like our Devon units and PPL's  
14 Wallingford units, new combined-cycle units like the Milford  
15 units and the Duke unit, and the critically important dual-  
16 fueled or oil-fueled capacity that helps protect New England  
17 from gas shortages and high gas prices.

18 All of these existing facilities --

19 SECRETARY SALAS: One minute warning.

20 MR. CORNELI: -- the 7000 megawatts in  
21 Connecticut are threatened by the combination of the ISO's  
22 demand curve methodology for those regions and the state's  
23 intention to add significant amounts of additional capacity  
24 that will slide the supply curve to the right and slide  
25 prices further down that demand curve.

1                   We think you can best address this by taking  
2 three steps: First, as you did for New York City and Long  
3 Island, you should shift the demand curves for southwest  
4 Connecticut and the rest of Connecticut to the right, so  
5 that the price will be closer to the long run marginal cost  
6 when all of the needed megawatts for reliability are in the  
7 market. Second, you should take steps to assure that  
8 capacity exports can flow freely to other parts of the  
9 region and help establish more competitive capacity prices  
10 in Connecticut. And finally, you should consider excluding  
11 the existing gap RFP megawatts from the supply curve.

12                   With these steps, the LICAP market and the new  
13 Connecticut state law can work together to achieve the  
14 Commission's goals of attracting new generation --

15                   SECRETARY SALAS: Time.

16                   MR. CORNELI: -- while sustaining needed existing  
17 generation.

18                   Thank you.

19                   SECRETARY SALAS: I believe we have a 10 minute  
20 break, Mr. Chairman.

21                   (Recess.)

22                   CHAIRMAN KELLIHER: Let me make one brief  
23 announcement before we start this panel. We had reserved  
24 time for the Connecticut Attorney General, Mr. Blumenthal,  
25 but I understand that he may not be making an appearance

1 today, but we will reserve a seat for him and a place at the  
2 table for him in the event he changes his mind. But let's  
3 go ahead and proceed.

4 SECRETARY SALAS: For this session, we will start  
5 with the Load Intervenors, and the first presentation would  
6 be by Mr. Randall Speck and Mr. Harvey Reiter for a total of  
7 45 minutes.

8 Proceed.

9 MR. SPECK: Good morning, Mr. Chairman and  
10 Commissioners. We very much appreciate the opportunity to  
11 speak today on behalf of the Load Intervenors, and  
12 particularly on behalf of the state representatives. There  
13 are a large number of state representatives, very diverse  
14 state representatives, who have been very active in the  
15 proceeding from the very beginning.

16 And it's because we take a very strong view that  
17 there is a problem, as the Chairman mentioned, that needs to  
18 be addressed. We are here to try to solve the problem. And  
19 we acknowledge that problem. But we want to solve it in the  
20 best possible way.

21 And for that reason, the Load Intervenors have  
22 unanimously opposed LICAP. And I think that's very  
23 significant, that every one of the Load representatives --  
24 those state representatives as well as the distribution  
25 companies and a large number of industrial users and other

1 users, have all opposed LICAP. As the Commission has  
2 recognized in several of its decision, states play a  
3 prominent role in the area of resource adequacy and we take  
4 that responsibility very seriously. As you indicated, Mr.  
5 Chairman, in the recent Energy Policy Act, the Congress  
6 recognized that the Commission should give careful  
7 consideration to the states' position in this matter.

8 In light of the resource adequacy issues as well  
9 as the costs, the states have taken a very active role in  
10 every aspect of this proceeding and have presented a great  
11 deal of testimony. And indicative of that interest and that  
12 concern by the state representatives, a number of the state  
13 commissioners are here today, and I would like to at least  
14 recognize them: Paul Afonso, the chairman of the  
15 Massachusetts DTE, Jack Goldberg, commissioner at the  
16 Connecticut DPUC, David O'Brien, commissioner for the  
17 Vermont Department of Public Service, Kurt Adams, chairman  
18 of the Maine Public Utility Commission, Tom Getz, chairman  
19 of the New Hampshire Public Utilities Commission. All of  
20 them are here today to express their support for the Load  
21 position -- I'm sorry, Commissioner Judson from  
22 Massachusetts is also here; I wasn't aware he was here.

23 The ISO and the Capacity Suppliers have talked a  
24 great deal about the need to assure reliability and to avoid  
25 the costs of blackouts or interruptions in service. The

1 Load representatives, however, are the ones who are most  
2 concerned about those issues of reliability and continuation  
3 of service. They are the ones who will suffer any economic  
4 consequences from a supply interruption.

5 Given that, however, we still believe we only are  
6 required to pay the just and reasonable costs of assuring  
7 that kind of capacity and resource adequacy. While  
8 protecting reliability, the states and other load  
9 representatives may not be required to pay too much for  
10 capacity, either paying for too many megawatts or paying too  
11 much for each individual megawatt that is supplied.

12 In our time this morning, Mr. Reiter and I will  
13 discuss the reasons why the LICAP demand curve simply will  
14 not work and certainly will not assure reliability at a just  
15 and reasonable cost, and we're going to focus, particularly  
16 in my presentation, on the three questions that the  
17 Commission asks.

18 In summary, LICAP will not produce just and  
19 reasonable wholesale capacity prices, LICAP will not  
20 encourage generation investment when generation investment  
21 is needed, LICAP does not open the market to new investment  
22 in generation, even with the fabulous returns that are  
23 provided in LICAP -- in the ISO's LICAP proposal. LICAP  
24 will not assure that customers are provided with necessary  
25 electric generation capacity or reliability. LICAP

1 substantially increases costs compared to the status quo; as  
2 ISO itself recognizes, the costs will be about \$2.3 billion  
3 more under LICAP than under the status quo in the first five  
4 years. And LICAP provides no appreciable benefits and will  
5 create adverse economic consequences. For those reasons,  
6 the state parties and the load representatives oppose LICAP  
7 as it's been proposed by ISO. That doesn't mean though that  
8 we don't recognize the problem, and this afternoon we will  
9 talk about alternatives that we believe will better address  
10 the issues.

11 Mr. Reiter.

12 MR. REITER: Mr. Chairman and Commissioners,  
13 thank you again. I will reiterate what Mr. Speck has said:  
14 we appreciate the opportunity to address the Commission both  
15 on the question of the reasonableness of the LICAP mechanism  
16 and, this afternoon, on alternatives to that mechanism. As  
17 Mr. Speck has said, we agree that there is an issue of  
18 resource adequacy. The markets unaided simply won't produce  
19 adequate capacity. The question before the Commission is  
20 how best to address that question, not whether LICAP must be  
21 adopted in some form in order to address resource adequacy.

22 There are a couple of points I would like to  
23 make. While I'm speaking on behalf of NECPUC, I've been  
24 authorized to say that the views I'm going to discuss this  
25 morning are also the views of other Load representatives.

1 We all share a concern about LICAP and whether it is the  
2 right solution.

3           There are three points I would like to address.  
4 Let me first say, Mr. Speck and I will try to divide up and  
5 not duplicate our responses to the three questions the  
6 Commission has posed. And Mr. Speck will address in  
7 particular the comparison of LICAP's costs to the costs of  
8 continued reliance on must-run agreements. In other  
9 respects, though, there will necessarily be some overlap in  
10 what we have to say.

11           But there are three points I'd like to  
12 demonstrate hopefully to the Commission's satisfaction that  
13 I think will address the remaining questions you posed.  
14 What I hope to demonstrate in the time this morning is a  
15 couple of things. First, our position that LICAP won't  
16 work. It's a non-reciprocal scheme under which generators  
17 are paid billions of dollars with no corresponding  
18 obligation either to build or to keep existing generation  
19 running.

20           You shouldn't approve this mechanism on the basis  
21 that it's a market mechanism. It isn't. The Commission's  
22 decision and, in fact, a decision we agree with that there  
23 needs to be some resource adequacy mechanism in place is  
24 itself a determination that the markets unaided won't  
25 produce an outcome that provides reliable service to

1 consumers. So you shouldn't approve LICAP on the basis that  
2 it's a market mechanism.

3 And the last thing I'd like to discuss is our  
4 concern that even if you believe a LICAP-type curve will  
5 elicit supply and provide reliable service, our position is  
6 that the LICAP mechanism the ISO has chosen builds in layers  
7 upon layers of overinsurance and, therefore, provides  
8 reliability if it works, but only at excessive costs to  
9 consumers.

10 Let me take my first point, that LICAP won't  
11 work. This is a concern we had at one of the questions  
12 posed this morning was well aren't you simply saying -- you  
13 say LICAP won't work, that's a failure of the market. And  
14 if we want payment for services rendered, that's really just  
15 a statement that we don't believe markets respond to price  
16 signals.

17 I think the answer to that was found in the  
18 record. We put on a witness, Mr. Steve Fedder, who was a  
19 former chairman of the Michigan commission and who worked  
20 with the Fitch credit rating agency. And he made a couple  
21 of points and they're up on the board here. But I think  
22 that they're pretty critical.

23 He pointed out that even under the LICAP curve --  
24 which is simply a modified curve from the existing ICAP  
25 curve, which has no real slope -- that generators have an

1 incentive to create capacity shortages because there's such  
2 a huge payoff for capacity shortfalls. The curve is very  
3 sensitive -- not as sensitive as the current ICAP curve, but  
4 very sensitive to changes in prices. So there's a big  
5 payoff for generators if capacity is withheld. On the other  
6 hand, new generators don't fare so well because the capacity  
7 mechanism is short-term in nature. It's monthly; there's no  
8 long-term commitments made under it.

9 And so Mr. Fedder testified that the small  
10 changes in generation levels have an enormous impact on the  
11 revenues generators perceive they will receive and investors  
12 perceive they'll be able to earn if they invest in new  
13 generation. And it's --

14 COMMISSIONER KELLY: Mr. Reiter, doesn't that  
15 depend on whether or not a particular generator has market  
16 power? I mean, would they be able to withhold -- in what  
17 way would it advantage them if it was a competitive market?

18 MR. REITER: Well, I think the problem, your  
19 Honor -- or --

20 COMMISSIONER KELLY: That's okay.

21 (Laughter.)

22 COMMISSIONER KELLY: I've just been elevated.

23 MR. REITER: -- is that there are market power  
24 problems. In New England, there's load pockets with high  
25 concentration. The possibility for collusion will be --

1 there's at least a greater risk that they will be pursued.  
2 I'm not saying that generators can withhold; the Commission  
3 will police this. But there's a greater incentive for this  
4 to occur. And, at the same time, there's much less -- much  
5 greater risk for new generators to come online, because they  
6 don't have a long-term commitment. The existing generators  
7 can get paid immediately and they get paid a lot immediately  
8 if capacity falls to lower levels.

9 COMMISSIONER KELLY: But new entrants could get  
10 paid that, too, and wouldn't that stream of revenue attract  
11 them? And even though the stream of revenue is one a month-  
12 by-month basis, that stream of revenue will be in place  
13 under a long-range plan so that there could be assurance  
14 that they would get paid and yet they'd still bear the risk  
15 that they wouldn't --

16 MR. REITER: Here's what Mr. Fedders said about  
17 that: he said well, you know, generators and investors who  
18 are thinking about investing can look at this curve and they  
19 have to make a decision whether several years out they'll be  
20 on a point on the price curve that will provide them with  
21 sufficient revenues. If they guess right, they'll hit it  
22 big under this proposal.

23 But the risk -- and what he said is that  
24 investors don't think that the risks are low enough to make  
25 this investment, because they may guess wrong. And if

1 they're wrong by just a little bit, the payoff is much lower  
2 under LICAP. It's still got a slope and it's very sensitive  
3 to slight differences in price. He also said in his  
4 testimony that generation products won't even get  
5 investment-grade ratings without long-term commitments.

6 What did the ALJ's decision have to say about any  
7 of this? Well, we don't know what the Judge thought because  
8 there's no discussion of Mr. Fedders' testimony at all in  
9 the decision. There's a reference to the fact that he was a  
10 witness, and that's the end of the discussion of his  
11 testimony.

12 COMMISSIONER BROWNELL: When you say investors,  
13 is Mr. Fedder representing any named investors? Is he the  
14 only source of investment advice that you've gotten?  
15 Because there are, in fact, investors who've spoken on  
16 behalf of LICAP-type models. So I just want to be clear,  
17 Mr. Fedder and the Fitch rating agency represented his point  
18 of view, large numbers of investors, other investors, what,  
19 tell me?

20 MR. REITER: This was his expert opinion.

21 COMMISSIONER BROWNELL: Okay. Thank you.

22 MR. REITER: And I will say --

23 COMMISSIONER BROWNELL: That's all I need.

24 MR. REITER: Let me follow-up on this,  
25 Commissioner Brownell. He was the only witness who

1       addressed the basic question of whether LICAP would work.  
2       His testimony, to be sure, represented his view and it ought  
3       to have been analyzed.  If he's right, or even if there's a  
4       significant risk that he's right, then the Commission is  
5       obliged to consider alternatives to LICAP.  Because they,  
6       the Commission, as I think Chairman Kelliher said -- and we  
7       agree -- there's a problem that needs to be fixed.

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1                   So, if LICAP isn't the solution, there needs to  
2 be a solution.

3                   COMMISSIONER BROWNELL: Let me be clear. I didn't  
4 say we weren't considering alternatives. We're here  
5 considering alternatives.

6                   You said "investors." I was trying to clarify  
7 how many investors had addressed this issue, and you  
8 answered that question. Thank you.

9                   COMMISSIONER KELLY: Mr. Reiter, I had a question  
10 about the RMR contracts. Would you agree that the  
11 proliferation of RMR contracts in the region and the  
12 expectation that there will be more, if we don't take  
13 action, is a signal that the existing market, including the  
14 existing revenues available, are inadequate to pay to keep  
15 even today's generation online?

16                   MR. REITER: I think that proliferation of RMR  
17 contracts is a signal of a problem. And, in fact, it's one  
18 of the reasons we've suggested we ought to explore  
19 alternatives to provide for supply adequacy.

20                   Now, Mr. Speck will discuss in more detail, the  
21 specific question you've posed in the Notice about the  
22 effect of reliability, must-run type agreements.

23                   COMMISSIONER KELLY: Well, that leads me to  
24 another question. That is, when you said earlier that this  
25 is going to cost, even by the ISO's or the RTO's estimate,

1       \$2.3 billion, then I take it that you expect that somehow,  
2       some way, the region is going to have to pay more than  
3       they're paying now, if they're not providing enough revenues  
4       now to keep generation online.

5               MR. REITER: I think that's right. We've agreed  
6       that there needs to be some mechanism, both to provide  
7       adequate compensation to existing generators and incentives  
8       for new generation. We're in agreement on that.

9               COMMISSIONER KELLY: Okay. So we're looking at a  
10       revenue increase or cost increase in order to solve this  
11       problem, no matter what?

12              MR. REITER: I don't know the magnitude of it,  
13       but it's certainly --

14              COMMISSIONER KELLY: Unless somebody is going to  
15       do it for free, I guess.

16              MR. REITER: But I would say this, and this gets  
17       me to my last point about the ISO's particular choice of  
18       curves. And it bears emphasis that the way the ISO designed  
19       its mechanism, informs us, I think, about the nature of the  
20       thought process that it used to decide, and, we think, to  
21       over-insure.

22              The ISO hired its consultant and said -- and it  
23       gave very simple instructions, I think, too simple  
24       instructions. It said, we've met or exceeded objective  
25       capability, 17 times in the last 21 years. Go out and

1 design a mechanism that will meet or beat objective  
2 capability, 83 percent of the time.

3 That was the sum and substance of their direction  
4 to him. He didn't know how much reliability such a  
5 mechanism would produce. He didn't know how much  
6 reliability the marketplace would actually want at the  
7 prices that were set, and most importantly, he didn't know  
8 at the time he designed the mechanism, how much reliability,  
9 even objective capability produced.

10 He thought at the time he designed this  
11 mechanism, that it could produce a reliability level of  
12 anywhere from one day in ten years to one day in 20 years.  
13 So at the time he designed this mechanism, he was apparently  
14 satisfied that it would be adequate for consumers, but the  
15 ISO, later on in the proceeding, said, well, we think that  
16 one day in ten years is the right target.

17 Over time, coincidentally, their mechanism  
18 satisfies that objective. One of the problems -- and I  
19 think this is a big problem with the mechanism -- is that  
20 the curve itself is based on the premise that their very  
21 model won't work.

22 Let me explain what I mean by that. I think the  
23 answers come from questions the ISO answered in the  
24 proceedings below. The ISO, I think, is pretty --

25 COMMISSIONER KELLY: Just to clarify, when

1 you're talking about this, the curve, are you talking about  
2 the capacity target or the choice of capacity target versus  
3 objective capability, or are you talking about the slope?

4 MR. REITER: I think the primary driver of cost  
5 is the C-Target. What they've done in setting up this  
6 target, is to -- they've said, we've built in several layers  
7 of protection.

8 CHAIRMAN KELLIHER: Mr. Reiter, just to be clear,  
9 you don't object to the use of a curve? You object to the  
10 parameters of a proposed curve?

11 MR. REITER: Well, we do object to the use of the  
12 LICAP curve. And you'll hear --

13 CHAIRMAN KELLIHER: Any curve at all?

14 MR. REITER: I think you will hear in the  
15 afternoon, the views of the parties' approaches, but I think  
16 that we are opposed to the LICAP curve. I think you will  
17 find that all of the proponents of the alternatives, talk  
18 about a single-price auction method, which is quite  
19 different from a LICAP curve.

20 But the ISO --

21 CHAIRMAN KELLIHER: I want to get back to one of  
22 the points you made earlier, that I let go. That's the  
23 inclusion argument or the market -- that generators would  
24 have an incentive to withhold.

25 First of all, we have much stronger authority to

1 prevent that under the new Energy Policy Act. We have very  
2 significant penalty authority, which we've lacked up to this  
3 point.

4 But also, can't load-serving entities guard  
5 against that by simply contracting long-term, bilateral  
6 contracts?

7 MR. REITER: I think that there is some --

8 CHAIRMAN KELLIHER: They can reduce their  
9 exposure to short-term LICAP markets, certainly.

10 MR. REITER: Yes, they can. I think the problem  
11 with that protection is that it's limited somewhat by the  
12 floor that the LICAP curve puts on prices, and so it may  
13 make it more difficult to fully guard against these types of  
14 cost through bilateral contracting.

15 I think you'll hear in the alternatives this  
16 afternoon, that they also contemplate bilateral contracting,  
17 so, on that score, I think there's no difference between  
18 LICAP and the alternatives that are being considered.

19 I mentioned that the ISO's LICAP curve shoots for  
20 a C-Target in excess of objective capability. And their  
21 rationale is pretty simple.

22 We want to overshoot the mark, so that we don't  
23 fall below it very often. But that assumes --

24 COMMISSIONER KELLY: Mr. Reiter, it's my  
25 understanding that that curve and that C-Target, was derived

1 from an analysis of the past history of the region. Would  
2 you agree with that?

3 MR. REITER: It was, and that's exactly the  
4 problem, Commissioner, and that's why I say that their  
5 mechanism is based on -- their curve is based on the  
6 assumption that the mechanism won't work. They've based  
7 their curve on the expectation that the volatility in  
8 capacity addition, will be exactly as it has been over the  
9 21-year period that they have chosen, which includes --

10 COMMISSIONER KELLY: I understand that they also  
11 base it on not only the lumpiness of new generation coming  
12 online, but also the fact that demand continues to grow, and  
13 to take that into account, as well.

14 MR. REITER: Well, of course, I think demand will  
15 continue to grow. The problem, though, is that in shooting  
16 for their target, they're shooting for a target in excess of  
17 expected demand by a big amount, over five percent.

18 And I think that if you look at what they say,  
19 they say, is the LICAP designed to provide investors and  
20 generators, greater assurances that they will be compensated  
21 adequately? And I think their answer is yes.

22 And if you ask them, do you expect that with this  
23 greater assurance, volatility in annual levels of installed  
24 capacity will decline, they will say, yes, that's the  
25 purpose of this mechanism.

1                   COMMISSIONER KELLY: Do you have an estimate of  
2 the difference in cost on an annual basis to the region, if  
3 the curve was drawn at objective capability, versus C-  
4 Target?

5                   MR. REITER: I don't have that number at hand. I  
6 think Mr. Speck may, but it's significant. I think even  
7 small differences, even above objective capability, would  
8 result in differences under LICAP of several billion dollars  
9 over the next few years.

10                  I mentioned that the ISO expects that its curve  
11 will reduce volatility of installed capability. Their  
12 answer would be, yes, that's what we set out to do, and  
13 that's what we really think LICAP will do.

14                  And then if you ask them the question, so have  
15 you designed your LICAP curve to reflect these expectations,  
16 the answer would be no.

17                  How are prices set? Their answer would be, well,  
18 we've designed the curve based on the assumption that  
19 volatility in capacity levels will be just as high as they  
20 have been for the last 21 years.

21                  Doesn't that mean that consumers will have to pay  
22 more than they would, if the curve had been designed to  
23 reflect the ISO's own expectations? The answer is yes.

24                  It's a violation of Ratemaking 101. It's as if  
25 you had a company that said, well, we sold X-number of

1 kilowatt hours last year, we expect to sell twice as many  
2 this year, but we're going to design the rates based on the  
3 level that we experienced in the past, because we want to be  
4 really sure that we're going to recover all of our  
5 revenues.

6 I think the Commission would say, that's not a  
7 proper way to design your rates. You've got to base them on  
8 your reasonable expectation of future conditions. They tied  
9 their mechanism to historical levels, and then asked  
10 customers to pay for capacity on the assumption that the  
11 very mechanism they designed to reduce volatility, won't  
12 work.

13 COMMISSIONER KELLY: But isn't the alternative of  
14 designing it, based on a forecast of 20 years into the  
15 future, even more problematic?

16 MR. REITER: I'm not sure --

17 COMMISSIONER KELLY: You don't look at past  
18 experience and take your lessons from the past, but you just  
19 start today and estimate the future, and what's your basis  
20 for estimating the future? It seems to me that the past and  
21 past experience, should have a significant -- play a  
22 significant role in designing.

23 MR. REITER: I think we agreed with that,  
24 Commissioner, but what we said was, you would have to make  
25 adjustments, if you're going to accept the LICAP curve.

1 You're going to have to make adjustments, based on  
2 reasonable changes that you expect to occur in the future.

3 The ISO itself says, we expect volatility will  
4 decline, so they should use judgment and make some  
5 expectation that, well, okay, we know what historical  
6 variation was, and it should be somewhat less. And the  
7 logical thing to do, would have been to make some expert  
8 judgment about that change and reflect it in the mechanism.

9 We know, for example, that part of the period  
10 they chose, especially the latter end, involved a period in  
11 which there was no real regulation of capacity prices, and  
12 we had exuberant investment that resulted in large  
13 surpluses. That's added into the --

14 COMMISSIONER KELLY: At the hearing, did the  
15 parties suggest changes or known and measurable changes? I  
16 guess we aren't talking about known and measurable, because  
17 it's hard to have a known and measurable change.

18 MR. REITER: No, but they would be the equivalent  
19 of Period II changes in electric utility ratemaking at FERC,  
20 where you project -- you make reasonable projections of the  
21 future. That's not limited to known and measurable, like  
22 you would on gas pipeline rates.

23 But we did present testimony, several of the  
24 parties did, on what a reasonable assumption would be about  
25 standard deviation from the objective capability figure,

1 going forward.

2 And even small changes -- and I think Mr. Speck  
3 will talk about that -- have dramatic impacts on the prices  
4 consumers would pay.

5 COMMISSIONER KELLY: So, if we wanted to look at  
6 that, it's in the record?

7 MR. REITER: Yes.

8 COMMISSIONER BROWNELL: So, can I get back to the  
9 Chairman's question, which maybe he understood the answer  
10 to, but I didn't?

11 You don't object to all demand curves, albeit  
12 that there are some alternatives out there that do not  
13 include them, but you want a demand curve that, in your  
14 belief, more accurately reflects what might happen? Is that  
15 correct?

16 MR. REITER: No, not exactly, Commissioner.

17 COMMISSIONER BROWNELL: Do you support no demand  
18 curve? It's pretty straightforward.

19 MR. REITER: No, I think we aren't supporting a  
20 demand curve.

21 COMMISSIONER BROWNELL: Okay.

22 MR. REITER: And if I could just briefly sum up,  
23 we do support a resource adequacy mechanism. We think that  
24 if the Commission is to go the LICAP route, then they need  
25 to make adjustments to the curve.

1                   We don't think it will work, for the reasons that  
2 Mr. Fedder stated in his testimony, but if you are to go to  
3 a resource adequacy mechanism based on a LICAP type model,  
4 then we think we've presented in the record, the adjustments  
5 to that curve that would minimize the harm to consumers.

6                   CHAIRMAN KELLIHER: But just to be clear, you  
7 think, with some adjustments to the demand curve, that LICAP  
8 can produce just and reasonable prices?

9                   MR. REITER: No, I don't think we're comfortable  
10 with that. We think that you can minimize the harm and make  
11 it less unjust, but our position is that the LICAP mechanism  
12 is an unreasonable mechanism.

13                   CHAIRMAN KELLIHER: Do you support a mechanism  
14 that would result in unjust and unreasonable rates? That's  
15 something you support?

16                   MR. REITER: No.

17                   CHAIRMAN KELLIHER: But you've advanced some  
18 changes to the demand curve, right?

19                   MR. REITER: We advanced some to say, if you're  
20 going to go that route, then at least you can make it less  
21 harmful. I think that's essentially our position. This is  
22 the only way to come close to being reasonable.

23                   Our basic position is that there are alternatives  
24 that the Commission should explore, that would better solve  
25 the problem for consumers.

1                   CHAIRMAN KELLIHER: Alternatives to a demand  
2 curve?

3                   MR. REITER: Yes.

4                   CHAIRMAN KELLIHER: But alternatives to not have  
5 a capacity market?

6                   MR. REITER: No, no. I think -- and you'll hear  
7 this later this afternoon -- we are talking about a capacity  
8 market, and the one that better replicates competitive  
9 conditions.

10                  I think, just briefly, that no capacity adequacy  
11 mechanism is really a purely market mechanism. They all  
12 involve the recognition that the market won't satisfy supply  
13 adequacy concerns without some intervention by the  
14 Commission.

15                  That said, we think there are alternatives that  
16 will better address that solution, and we'll discuss those  
17 in detail this afternoon.

18                  CHAIRMAN KELLIHER: To be clear, you think some  
19 intervention by the Commission is necessary?

20                  MR. REITER: Yes.

21                  CHAIRMAN KELLIHER: Some action is necessary?

22                  MR. REITER: Yes, we agree with that.

23                  CHAIRMAN KELLIHER: Now, at the earlier panel, we  
24 talked about how there is different rationales for a LICAP  
25 or capacity market. One is to assure reliability. That was

1 the initial rationale in New England.

2 If you view it from that perspective, how do you  
3 think the ISO New England proposal measures up? Does it  
4 meet the one-in-ten-year standard?

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1                   MR. REITER: We think there's not assurance that  
2                   it will deliver on capacity additions for the reasons that  
3                   Mr. Fedder stated in his testimony, that investors, absent a  
4                   long-term commitment, simply won't build new capacity. It  
5                   will spend a lot of money and it may elicit some supply  
6                   response, but we're not--

7                   CHAIRMAN KELLIHER: Have they built -- has LICAP  
8                   resulted in generation additions in New York? Has it worked  
9                   in New York?

10                  MR. REITER: I don't think that it has but I  
11                  don't think there's any record evidence in this case on that  
12                  question. That's an issue, for example, that might be  
13                  explored at the supplemental hearing --

14                  CHAIRMAN KELLIHER: Right. But I just want to --  
15                  I can see the argument that LICAP as proposed by ISO New  
16                  England you don't think would support generation additions,  
17                  but is your argument more broadly that LICAP can never  
18                  induce generation additions? And that seemed to beg the  
19                  question what's the experience been in New York.

20                  MR. REITER: Well I guess I don't know what the  
21                  experience has been in New York, but our expectation is that  
22                  a LICAP-type mechanism wouldn't work. I mean, if you price  
23                  it high enough, at some point generators would come in, but  
24                  then the question is is that at a cost that's excessive to  
25                  ratepayers.

1                   CHAIRMAN KELLIHER: I'm curious when you use just  
2 and reasonable whether you use it in the same sense that we  
3 use it. Do you think a rate that is insufficient to support  
4 entry could be just and reasonable? Do you think a rate  
5 that is close to a confiscatory rate or a rate that  
6 guarantees underrecovery of costs is just and reasonable?

7                   MR. REITER: No, Mr. Chairman, I don't. And if  
8 the Commission would not object, I would turn the remainder  
9 of the time over to Mr. Speck.

10                  CHAIRMAN KELLIHER: Thank you.

11                  MR. SPECK: Thank you, Mr. Chairman.

12                  If I could have the chart that represents the  
13 ISO's demand curve, I'll go immediately to that.

14                  This is the same demand curve that ISO has  
15 proposed. And with regard to the cost questions, I think,  
16 if I may, I'm not sure that the microphone's going to pick  
17 me up, but I'd like to walk over to the board, if I may.

18                  Optimally, if we were looking for the right just  
19 and reasonable price, the lowest effective cost that  
20 nevertheless pays generators their just and reasonable  
21 costs, that would be right here where EBCC coincides with  
22 OC. In other words, there you would get the technical level  
23 of reliability that is necessary and you would pay  
24 generators the cost of new entry. That's where you want to  
25 be.

1                   Now I think it's quite apparent from ISO's curve  
2                   that they have added, as Mr. Reiter indicated, they've added  
3                   many layers of additional costs in order to provide what  
4                   they called robustness. One of them is, for instance, to  
5                   double the EBCC at this level of OC. That's exactly at the  
6                   level of technical reliability that traditionally has been  
7                   used in New England.

8                   COMMISSIONER KELLY: Mr. Speck, as I understand  
9                   it the ISO New England designed the target demand curve,  
10                  capacity target to enable over time for that point to be  
11                  reached.

12                  MR. SPECK: That's correct. And we believe there  
13                  are alternatives, which we'll talk about this afternoon,  
14                  that will achieve that every time, so that you don't have to  
15                  adjust for what I would call a variability premium. And  
16                  they have added a variability premium that consists of this  
17                  standard deviation, is driven by this standard deviation  
18                  and --

19                  COMMISSIONER KELLY: I would assume that the  
20                  region doesn't want to be below the 17 percent.

21                  MR. SPECK: We don't want to be below OC.

22                  COMMISSIONER KELLY: Right. Is that 17  
23                  percent --

24                  MR. SPECK: 17 percent of the time in the last 21  
25                  years we have been below. So it's not a catastrophe. There

1 was never an instance of a blackout, as ISO has suggested,  
2 during that entire time period.

3 COMMISSIONER KELLY: But you were happy with the  
4 degraded reliability or you're --

5 MR. SPECK: There was not any degraded  
6 reliability.

7 COMMISSIONER KELLY: So you're happy with a lower  
8 -- being lower than objective capability.

9 MR. SPECK: ISO has said it is perfectly fine  
10 under their model --

11 COMMISSIONER KELLY: I mean as the consumers in  
12 the region are you happy with that?

13 MR. SPECK: That is not unacceptable. But I  
14 don't think we even have to go there because, as we'll  
15 discuss this afternoon, the alternatives enable us to  
16 predict directly what level of capacity we need and to pay  
17 exactly that cost, the cost of new entry.

18 COMMISSIONER KELLY: And you're going to talk  
19 about that this afternoon?

20 MR. SPECK: Yes.

21 Now if you look at ISO's curve though, the areas  
22 in which they have added a variability premium -- there are  
23 three of them -- one is they have doubled the EBCC cost when  
24 capacity equals OC. That cost alone, as we'll discuss this  
25 afternoon, is about \$2.7 billion over five years.

1           The second way in which they've added a premium  
2           is to increase the C target 5.4 percent above OC. That, as  
3           we've indicated, is \$150 million a year, \$750 million over  
4           five years.

5           This area here, where we also believe is a  
6           variability premium, unnecessary, that adds about \$75  
7           million a year, about half of this cost.

8           This cost, where you're paying for capacity out  
9           to 115 percent of OC, 15 percent above the technical level  
10          of reliability that's necessary -- keep in mind, too, that  
11          OC is historically 12 to 23 percent above the level of peak  
12          load. So you've got peak load down here some place or down  
13          here some place, and here's where OC is. And now they're  
14          saying we should continue to pay when it's 115 percent of  
15          OC.

16                 COMMISSIONER KELLY: So is your position that the  
17          curve submitted by the RTO provides for more capacity than  
18          is necessary in the region?

19                 MR. SPECK: More capacity than is necessary at a  
20          higher price than is necessary.

21                 This by the way, this triangle here is \$136  
22          million annual. So all of these, taken together, are a huge  
23          premium that is added to the cost unnecessarily and we  
24          believe that creates an unjust and unreasonable rate.

25                 COMMISSIONER KELLY: Do you also disagree with

1 their conclusion that the C target provides for meeting  
2 objective capability on average over time, or do you agree  
3 that that is what it's designed to do?

4 MR. SPECK: That's what it's designed to do, but,  
5 again, it's unnecessary. We don't need to look at only the  
6 historical record. As Mr. Reiter indicated, there was  
7 evidence in the record about adjustments that needed to be  
8 made. There were an infinite number of judgments that ISO  
9 made in compiling that 21-year record. If I could just have  
10 the next chart.

11 One of them -- let me just describe one, and that  
12 is the use of 21 data points over the 21 year period. ISO  
13 used one data point for each year, whatever the peak load  
14 month was for that year. And that produced this curve,  
15 which is the same curve that we were just looking at a  
16 moment ago, and it had these characteristics for the various  
17 parameters.

18 ISO made a judgment that 21 data points was the  
19 correct number. Rather than looking at two data points in  
20 each year, which they had, they produced that data, they  
21 ignored the other -- the winter peak versus the summer peak.  
22 If you'd used just those 42 data points instead of the 21  
23 data points, you get a slightly different curve. It's  
24 lower. And it has different parameters. Just from that one  
25 tiny change. The cost of that, though, to load over five

1 years is \$3.1 billion. This curve is incredibly sensitive  
2 to minor little changes that are then going to cost load a  
3 tremendous amount.

4 COMMISSIONER KELLY: Well can I ask you, Mr.  
5 Speck, the alternative way of handling -- well, first of  
6 all, this is a demand curve, it's not a requirement. It's a  
7 pricing point; it's not a requirement.

8 MR. SPECK: It's a pricing point that is going to  
9 set the cost, though, even for bilateral contracts.

10 COMMISSIONER KELLY: Once you get to C target or  
11 below C target, then what you're really saying, are you not,  
12 is that shortages are likely to begin. I mean, the  
13 alternative, if we were to change this slope -- and I  
14 suspect we could change that based on the record if we  
15 thought we needed to. The alternative is in real time if  
16 there are shortages then the customers will be in the market  
17 to buy short-term presumably at a higher price. So aren't  
18 we trading off -- it's not as if if we move the curve  
19 consumers are going to feel no price. Because if, in fact,  
20 there is a shortage, then they'll have to pay a price at the  
21 time the shortage reveals itself.

22 MR. SPECK: The question is what price are they  
23 going to have to pay. And we believe that ISO's curve is  
24 certainly not the right curve. As Mr. Reiter indicated, we  
25 don't believe any of these curves are going to work. But to

1 do the least damage, you should choose a curve that at least  
2 is not going to hurt consumers as much.

3 COMMISSIONER KELLY: In the short term.

4 MR. SPECK: In the long term as well. We're  
5 talking about the long term as well.

6 COMMISSIONER KELLY: But aren't we really  
7 speculating as to what the long term will be? Because do we  
8 know whether we're going to run into a shortage or not?

9 MR. SPECK: ISO has predicted over the next five  
10 years and all of the modeling that has been done indicates  
11 that at the end of that five-year period we still have a  
12 surplus of capacity. In other words, we are still on the  
13 other side of the target.

14 COMMISSIONER KELLY: Although it's -- is it in  
15 every location?

16 MR. SPECK: In every location.

17 COMMISSIONER KELLY: And in all the --

18 MR. SPECK: Every region.

19 COMMISSIONER KELLY: -- load pockets?

20 MR. SPECK: In every load pocket.

21 COMMISSIONER BROWNELL: Southwest Connecticut?

22 MR. SPECK: In southwest Connecticut.

23 COMMISSIONER BROWNELL: By their own estimation,  
24 Connecticut says they're short in 2006.

25 MR. SPECK: The problem is not a shortage of

1 installed capacity. The problem in southwest Connecticut is  
2 one of security. And that has been emphasized, I think, in  
3 the record quite extensively.

4 The real problem in southwest Connecticut is not  
5 a lack of installed capacity. There is, as ISO's own  
6 analyses show, there is a surplus of capacity in southwest  
7 Connecticut predicted for the next five years. The problem  
8 is a lack of transmission. And the transmission constraints  
9 are what is preventing Connecticut from adding new  
10 generation at this point in southwest Connecticut at all.

11 Let me go to the second question -- let me make  
12 one other point. With regard to ISO's demand curve, based  
13 on simply rational behavior by individual market  
14 participants, individual generators, without any collusion  
15 and without market power they are going to have an  
16 incentive, a very strong incentive to drive that price --  
17 drive the capacity to OC so that the price will be twice  
18 EBCC. Our greatest concern about ISO's demand curve is that  
19 it will permit existing generators to drive that capacity  
20 level to OC and peg the price essentially at twice EBCC.

21 And there are -- and there's an extensive record  
22 on this --

23 COMMISSIONER KELLY: Why do you believe that  
24 there's won't be any new entrants?

25 MR. SPECK: Your Honor, as I was just starting to

1 say, there is an extensive record that the process available  
2 to existing generators for interconnections and for getting  
3 in the queue for application process will -- it's a  
4 completely transparent process. Existing generators will be  
5 able to manipulate that process, we believe, in a way that  
6 will keep new entrants out. It will create sufficient  
7 uncertainty for new generation that they will not enter the  
8 market.

9 As Mr. Reiter had indicated, there's a tremendous  
10 amount of uncertainty to begin with. And we believe there  
11 are elements of the market that permit existing generators  
12 to essentially take advantage of that and to peg the price  
13 at two EBCC. And there we're going to be paying a huge  
14 premium, twice the cost of new entry.

15 It's these kinds of factors: pegging the price  
16 at two EBCC, the great sensitivity of the demand curve to  
17 minor little changes and tweaks, that we think is going to  
18 give investors a lot of concern and, as a result, there's  
19 going to be very little investment that will take place.

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1                   COMMISSIONER BROWNELL: Could I just ask you to  
2 clarify for me? So what you're saying is that under really  
3 any scenario that does attract new generators that the  
4 interconnection rules and process and queuing process at the  
5 ISO is so fundamentally flawed that it won't work?

6                   MR. SPECK: No, Commissioner. I'm not suggesting  
7 that at all.

8                   COMMISSIONER BROWNELL: Just under this  
9 circumstances it won't work?

10                  MR. SPECK: In the alternatives that we'll  
11 propose this afternoon there will be great certainty for new  
12 generation. New generation will be able to be able to  
13 compete directly with existing generation.

14                  And in the proposal by ISO, new generation has  
15 to, as Mr. Reiter indicated, predict three years in advance  
16 what the price is going to be and what the circumstances are  
17 going to be, how existing generators are going to act  
18 between now and then, what the increases in load are going  
19 to be during that period of time. There's a great deal of  
20 uncertainty.

21                  We can reduce that uncertainty and therefore  
22 reduce the cost that load has to pay for capacity through  
23 the alternatives that we're going to discuss this afternoon.  
24 And I don't think that the alternatives imply the same  
25 concerns about the transparency of the interconnection

1 process or the application process that are implied by the  
2 demand curve.

3 COMMISSIONER KELLY: Mr. Speck, given our new  
4 penalty authority, and given the fact that we have new  
5 authority to monitor market manipulation, do you think that  
6 existing generators would run the risk of pretty clearly, I  
7 think, attempting to manipulate the market for the  
8 possibility that they might make more profit, given the  
9 costs that could occur to them?

10 MR. SPECK: First of all, monitoring is going to  
11 be very, very difficult under those circumstances. And,  
12 second, those kinds of mitigation measures, I think, add to  
13 the level of uncertainty of the whole process and I don't  
14 think they're likely to satisfy investors.

15 CHAIRMAN KELLIHER: Mr. Speck, you are drawing  
16 some conclusions about LICAP that seem to be inherent to  
17 locational capacity markets themselves rather than ISO New  
18 England's proposal per se.

19 Again, what has been the experience in New York?  
20 You conclude broadly that LICAP will discourage new  
21 generation from being built, period, or exclamation mark,  
22 but has that been the experience in New York?

23 MR. SPECK: Well, I'm not an expert in New York  
24 but my understanding from the reports that have come from  
25 New York is that the jury is still out there as to whether

1 that has actually--the demand curve in New York has  
2 stimulated new investment or not.

3 And it remains to be seen I think whether that  
4 experiment has worked or not.

5 CHAIRMAN KELLIHER: But do you think the LICAP  
6 itself conceptually is not workable?

7 MR. SPECK: The demand curve, as ISO has  
8 proposed it, we believe is not workable.

9 CHAIRMAN KELLIHER: As ISO has proposed it?

10 MR. SPECK: It will not work --

11 CHAIRMAN KELLIHER: It will not work, and it  
12 can't be fixed?

13 MS. SALAS: One minute left.

14 MR. SPECK: It can't be fixed within the context  
15 of the LICAP demand curve. That's correct.

16 Let me just talk very briefly about RMR  
17 agreements. I've only got about 30 seconds, but ISO has  
18 greatly exaggerated the likely RMR agreements that will  
19 result from the status quo. If you did nothing about  
20 capacity markets. Now we're not suggesting that you stick  
21 with the status quo.

22 CHAIRMAN KELLIHER: Are they exaggerating the  
23 current cost of RMR agreements or the projected costs?

24 MR. SPECK: They're exaggerating the projected  
25 cost, at least in terms of the costs that are approved by

1 the Commission. They are exaggerating those.

2 MS. SALAS: Time.

3 MR. SPECK: I'm sorry.

4 MS. SALAS: Next Mr. John Coyle with 5 minutes.

5 MR. COYLE: Good morning Mr. Chairman,  
6 Commissioners. I'm here on behalf of Wellesley, Reading &  
7 Concord. We're a Massachusetts municipal light plants,  
8 municipal utilities. We remain vertically integrated by  
9 choice. Our business model has always involved procurement  
10 of adequate capacity resources to bear our share of the  
11 region's objective capability requirement.

12 Let me start with a little refresher about what  
13 we're looking at when we're talking about a one day and 10-  
14 year standard. We're talking about the Northeast Power  
15 Coordinating Council's resource adequacy design standard  
16 which says that your system needs to be designed, on average  
17 -- underscore "on average" to meet that one day and 10-year  
18 resource adequacy -- the one day and 10-year loss of load  
19 probability. Okay.

20 When you look at -- and if somebody could take  
21 down Question 3 and get me back to Mr. Speck's drawing of  
22 the curve, I'd be grateful. When you look at the  
23 redundancies that are built into this curve, what you can  
24 see is, as Mr. Speck said, we're being tasked for, paying  
25 for levels of capacity on average that are significantly in

1 access of the levels required to meet that standard.

2 Now Chairman Kelliher started the morning session  
3 talking about two things. You wanted to hear precedent and  
4 you wanted to hear facts. Let me give you a few. The first  
5 problem that you have with this demand curve is that the  
6 short-term focus of auction markets for both LICAP and for  
7 retail supply in New England are the real problems with  
8 promoting long-term investment and new capacity. Neither  
9 produces any guaranteed, long-term financable revenue  
10 stream. Long-term bilateral contracts supported by the  
11 availability of long-term transmission rights are an  
12 important part of the solution to lacking generation  
13 investment and LICAP promotes neither.

14 LICAP's locational focus creates incentives  
15 through existing generators to erect roadblocks to new  
16 investment. Commissioner Brownell was asking the question,  
17 and Commissioner Kelly also, about entry -- don't we have  
18 entry? Load pockets, by definition, are densely populated  
19 areas. Take Boston -- the Boston suburbs -- it's very  
20 difficult to build new power plants in there. I would  
21 suggest to you, and the Commission has, in fact, recognized  
22 in past cases -- notably the Northeast Utilities merger  
23 decision -- that it is extremely difficult to site new  
24 generation in densely populated urban areas and that  
25 incumbent merchant generators, the people who benefit most

1 from the ISO's LICAP proposal, control most of the available  
2 sites.

3 Take a look at this curve between CK and Cmin or  
4 Pk and Pmax. The slope is 20 to 1. What does that mean? A  
5 1 percent reduction in supply yields a 20 percent increase  
6 in price. A 1 percent in supply yields a 20 percent  
7 deduction in price. That is a not a recipe for new entry.  
8 That is a recipe that constrains price as it constrains  
9 supply at best. And I say at best to the level of objective  
10 capability. If you are going to use a demand curve, which,  
11 as I think someone pointed out earlier, you can -- El Con v.  
12 FERC in the D.C. Circuit says you're free to use it. Do I  
13 think it's the optimum market design? No. It's a rate  
14 schedule as you said.

15 COMMISSIONER KELLY: So, Mr. Coyle, how are those  
16 load pockets going to be served in the future?

17 MR. COYLE: How are they going to be served in  
18 the future?

19 COMMISSIONER KELLY: If no one can build  
20 generation there.

21 MR. COYLE: Commissioner Kelly, incumbent  
22 merchant generators control the sites. They will build the  
23 generation when the price gets right. When is the price  
24 going to be right? When it's at two times EBCC or  
25 thereabouts under this curve.

1 MS. SALAS: One minute warning.

2 MR. COYLE: What does that mean? Just to go back  
3 to focus on what Commissioner Kelliher wanted to focus on.  
4 Are we looking at just and reasonable rates? When you are  
5 at two times the benchmark cost of capacity at objective  
6 capability, you are paying, load is paying. You're not  
7 paying because you don't live there. Load is paying a 70 to  
8 80 percent rate of return. You don't need to charge that  
9 kind of a return to incent in.

10 COMMISSIONER KELLY: Let me ask you, once the  
11 load comes on, the price falls. So are you saying that  
12 they're going to -- even if they wait -- even if all the  
13 facts are correct, when they come on the price is going to  
14 fall and they aren't going to be getting twice EBCC.

15 MR. COYLE: No. As load is added, the incentives  
16 created by that sharp slope -- the 20 to 1 slope to withhold  
17 supply ensure that at best only incremental generation  
18 needed exactly to bring load to --

19 MS. SALAS: Time. Time, Mr. Coyle.

20 MR. COYLE: If you're going to fix one thing, fix  
21 that.

22 MS. SALAS: Next, Mr. Speck again. Mr. Jaffe.  
23 I'm sorry. Go ahead -- with 5 minutes.

24 MR. JAFFE: Good morning Mr. Chairman, members of  
25 the Commission. My name is Kenneth Jaffe and I represent

1 National Grid USA, whose distribution company serves over  
2 1.7 million customers in New England. I want to make clear  
3 at the outset that National Grid believes the Commission  
4 should not adopt a reliability mechanism based on the LICAP  
5 demand curve approach. We do favor a mechanism to address  
6 the problem in New England, but believe that alternatives  
7 that will be discussed this afternoon and that can be flush  
8 out through further proceedings represent a far superior  
9 approach. But, if the Commission is determined to adopt a  
10 LICAP demand curve approach despite its serious and  
11 pervasive flaws, it should keep two things in mind. First,  
12 the Commission must ensure that the demand curve mechanism,  
13 if adopted, incorporates mechanisms to set the price  
14 properly, to guard against the exercise of market power and  
15 to require suppliers who are paid to provide capacity  
16 actually to perform when called upon.

17 National Grid supports the ISO's proposed price-  
18 setting mechanism as well as the shortage hour proposal as  
19 absolutely necessary components of the LICAP mechanism.  
20 Second, the Commission must ensure that the LICAP demand  
21 curve mechanism does not pay suppliers too much for capacity  
22 that is not needed to met the regional reliability standard.

23 Unfortunately, the demand curve parameters  
24 proposed by the ISO, and adopted in the initial decision,  
25 fail this basic test. Not only will the ISO's demand curve

1 cost too much, but it won't work. And rather than repeat  
2 all of the theoretical material that's been discussed  
3 earlier and that is in the record I would just like to refer  
4 you to one of the statements made in the preceding panel by  
5 one of the representatives of capacity suppliers who spoke  
6 about a proposal in Connecticut to require forward  
7 procurement and who expressed concern about the impact of  
8 the additional megawatts that that forward procurement  
9 mechanism would bring on the market.

10 Now I don't think that it's surprising that a  
11 supplier in the market would express concern about the  
12 addition of additional megawatts. But I think the  
13 Commission should reflect on the fact that the suppliers are  
14 quite comfortable with the LICAP mechanism. They don't  
15 think it will draw additional megawatts to the market and I  
16 think you should take them at their word. The high payment,  
17 Commissioners, produced by the ISO's demand curve result  
18 primarily because that proposal was not designed to achieve  
19 the long-standing regional reliability standard of one day  
20 in 10 years on average. Instead, it was designed to  
21 replicate a selective averaging of the historical capacity  
22 surpluses produced by the old system of cost-based  
23 regulation.

24 Now later, during the course of the proceeding,  
25 the ISO christened its view of history as a new long-term

1 liability standard. But this standard never existed. It  
2 was never employed in the region. It was newly minted  
3 during this proceeding for the sole and specific purpose of  
4 providing an after-the-fact justification for ISO's  
5 proposal. Now it simply makes no sense to use excess  
6 capacity margins produced by cost-based regulation and the  
7 high cost of those excess capacity margins were a key factor  
8 in bringing us all here today in moving towards competitive  
9 markets. Setting those conditions up as a target for a new  
10 reliability mechanism just means we've done all this for  
11 nothing.

12 I would also point out that --

13 COMMISSIONER KELLY: Mr. Jaffe, does National  
14 Grid propose that that curve be changed and is it in your  
15 testimony?

16 MR. JAFFE: It is in our testimony. We proposed  
17 a curve that was based on the one day in 10 years standard.  
18 It proposed a curve that would produce, if a demand curve is  
19 the chosen approach, one day in 10 years. It would do so at  
20 significantly lower cost. And we urge the Commission again,  
21 if the demand curve approach is the way you chose to go, to  
22 give serious consideration to that curve and the other  
23 demand curve parameters that do focus on the only  
24 reliability mechanism or the only reliability standard that  
25 really has been employed.

1                   With the 20 seconds left, I would just like to  
2 refer to one additional point that we've been talking about  
3 -- load pockets. The solution to load pockets, as has been  
4 expressed, is transmission reinforcement. And one of the  
5 features of the LICAP proposal is that it deters  
6 transmission reinforcement.

7                   MS. SALAS: Time is up, Mr. Jaffe. Time is up.

8                   MR. JAFFE: Thank you.

9                   MS. SALAS: On behalf of Connecticut Attorney  
10 General, Mr. Speck again.

11                   MR. SPECK: Mr. Blumenthal was not available to  
12 be here today and so I am taking his time instead. The load  
13 group has agreed that that would be the allocation of the  
14 time.

15                   I know the Attorney General did want to talk a  
16 little about the economic impacts of the ISO LICAP --

17                   CHAIRMAN KELLIHER: It would have been nice to  
18 have been formally notified by the Attorney General's  
19 office. To learn that he was not going to appear when he  
20 was not physically present -- and you can just pass that  
21 along. It would be worth noting.

22                   MR. SPECK: Well, thank you, Mr. Chairman.

23                   I think there's really no dispute that LICAP, as  
24 ISO has proposed it, is going to cost over the next five  
25 years between \$13 and \$15 billion. The question really is

1 what offsets should be made against that for costs that will  
2 be saved from the status quo, from continuing the status  
3 quo.

4 First of all, we don't believe that the  
5 comparison with the status quo is the appropriate  
6 comparison. We really should be comparing with other  
7 alternatives that will achieve the reliability required and  
8 will compensate generators adequately but at much lower  
9 costs. And so that's really the proper comparison. But I  
10 think the general consensus is that LICAP's demand curve  
11 will cost about \$13 to \$15 billion.

12 Just by way of comparison, the recent threaten  
13 closure of the Grotton Submarine Base in Connecticut was  
14 expected to cost the state of Connecticut about \$2.5  
15 billion, and that's about 20 percent of the total five-year  
16 cost of LICAP. And that was going to cost Connecticut about  
17 20,000 jobs. So the increase in cost is clearly going to be  
18 translated into a loss of jobs and an effect on the economy  
19 in Connecticut. And that is emphasis, I think, by the --

20 COMMISSIONER KELLY: Mr. Speck, do you have a  
21 detail of how you arrived at the \$13 billion?

22 MR. SPECK: The \$13 billion is actually a number  
23 that the CEO for ISO gave to the Boston Globe shortly after  
24 the initial decision. It was their estimate at that point.  
25 They said it would cost about \$13 billion. It's in the

1 headline of the Boston Globe.

2 COMMISSIONER KELLY: Well, in this proceeding  
3 today, the number is \$2.3 billion.

4 MR. SPECK: That's the incremental cost that ISO  
5 claims based on their analysis of RMR agreements. And their  
6 analysis is that RMR agreements, as Mr. Vince indicated, are  
7 going to skyrocket in costs.

8 COMMISSIONER KELLY: So you're not saying that  
9 the consumers in Connecticut are going to be paying \$13  
10 billion more?

11 MR. SPECK: They will be paying \$13 billion but  
12 it may not be the net number. The question is what the net  
13 number is.

14 COMMISSIONER KELLY: So what's the net number?  
15 In fact, there were people who testified earlier that in  
16 parts of Connecticut the net number is going to be projected  
17 to be negative.

18 MR. SPECK: In southwest Connecticut -- and here  
19 I'm speaking, I guess, against the interest of my own  
20 clients. But, in southwest Connecticut the net number may,  
21 in fact, go down. But overall in New England it's going to  
22 go up. It's definitely going to go up. Our estimate is  
23 that it's much greater than --

24 COMMISSIONER KELLY: Then why is the AG concerned  
25 about the cost if the cost is actually going to go down in

1 Connecticut?

2 MR. SPECK: No. 1, we don't think it's going to  
3 work the way that ISO had projected. No. 2, we think ISO's  
4 projections are probably wrong. We're going to continue to  
5 have RMR agreement and LICAP.

6 COMMISSIONER KELLY: I think it's unfair to the  
7 public to use a number this big in a misleading way. So I  
8 would appreciate it if you would make it clear so that we  
9 aren't inflating fears and anxieties -- that they aren't  
10 looking at a \$13 billion rate increase next year.

11 MR. SPECK: Well, we don't know what the rate  
12 increase is going to be. That's the concern.

13 MS. SALAS: One minute warning.

14 MR. SPECK: In our analysis of the projected RMR  
15 agreement they're not going to skyrocket in quite the way  
16 that ISO has projected. If you look at their numbers  
17 carefully, most of that is speculation about what's going to  
18 happen in the future.

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1                   COMMISSIONER BROWNELL: Mr. Speck, there's also a  
2 fair degree of speculation about the 10-year delay in  
3 building transmission. And while you're into Phase I and  
4 Phase II is approved, there are still lots of debates going  
5 on, including the Attorney General saying that that all has  
6 to be buried as well. So I think that some of this problem  
7 is unique to Connecticut because they've chosen not to build  
8 transmission as some of the other testified. So let's be  
9 clear. And I agree with Commissioner Kelly, let's not bandy  
10 about costs that we can't calculate and we can't  
11 demonstrate. That's also been a problem in Connecticut.

12                   MS. SALAS: Time's up. Next is Mr. Rogers.

13                   MR. ROGERS: Good morning Mr. Chairman and  
14 Commissioners. My name is Joseph Rogers. I'm chief of the  
15 Utilities Division of the Massachusetts Attorney General's  
16 Office and I'm appearing here today on behalf of Attorney  
17 General Thomas Riley.

18                   Under Massachusetts law the Attorney General is  
19 the legal representative of Massachusetts' retail,  
20 residential, commercial and industry electric customers.  
21 I'm here today to talk about some of their concerns. In our  
22 opinion the ISO proposal will produce the largest retail  
23 rate increase in the history of New England, including  
24 potential rate increases of between 21 and 24 percent over  
25 the next five years in the Boston NEMA area. That does not

1 include distribution, transmission, energy increases. This  
2 is going to have a devastating impact on the commonwealth.

3 There is evidence that this plan that the ISO has  
4 proposed will not result in new generations in the  
5 timeframes needed. LICAP payments are only incentives.  
6 This money will go to generators without any requirement or  
7 commitment for them to build.

8 CHAIRMAN KELLIHER: Excuse me, Mr. Rogers. You  
9 said that you didn't think LICAP would result in generation  
10 additions in the timeframe needed. ISO New England had this  
11 chart and they were showing what they think are the  
12 timeframes needed and part of their argument was LICAP is  
13 the only proposal that can actually get generation built in  
14 the timeframes needed.

15 MR. ROGERS: As a practical matter, Mr. Chairman,  
16 as Mr. Jaffe and Mr. Coyle indicated, in the Boston NEMA  
17 area there is basically two generators that control all the  
18 sites. These generators are not going to be building  
19 anything because to the revenue loss for building new plants  
20 will be such that it's not an economic decision. And, as a  
21 practical matter, we cannot sit here today and say that we  
22 can. We will have to fight these increases in any way we  
23 can. We're not prepared to accept the level of rate  
24 increases that is proposed by the ISO. That would be an  
25 economic catastrophe. I think that the Commission, in good

1 faith, have come up with some alternatives. We filed an  
2 alternative in this case back in March 2004 and we're still  
3 waiting for our day in court. That was based on a demand  
4 curve that required people to actually build transmission --  
5 excuse me, generation.

6 The commonwealth of Massachusetts is also engaged  
7 in a huge transmission expansion plan. We're spending  
8 hundreds of millions of dollars, both NSTAR and National  
9 Grid, to improve the transmission in the Boston NEMA area.  
10 We're not unwilling to pay. What we're not willing to pay  
11 for is generic subsidies. We're willing to pay for plants  
12 that actually get built. And, until that occurs, I would  
13 consider this nothing but a bailout.

14 CHAIRMAN KELLIHER: Under the status quo, do you  
15 think there is some reason for the Commission to act? Or do  
16 you think the status quo is in the commonwealth's interest?

17 MR. ROGERS: I think that resource adequacy is a  
18 matter for the state -- for the Department of  
19 Telecommunications and Energy and for the local distribution  
20 companies.

21 CHAIRMAN KELLIHER: Your recommendation is that  
22 we take no action and that somehow generation will start  
23 getting built in New England.

24 MR. ROGERS: Well, if you believe in markets,  
25 then you should believe that when the price rises generators

1 will be incentivized to build plants. What we have here is  
2 --

3 CHAIRMAN KELLIHER: You're arguing we should rely  
4 on markets. You're arguing we should lift the price caps?

5 MR. ROGERS: I think that's an issue that should  
6 be addressed in, perhaps, a stakeholder proceeding or  
7 further proceeding in this matter.

8 CHAIRMAN KELLIHER: Do you think we should  
9 consider raising the price cap.

10 MR. ROGERS: That's right. Along with a number  
11 of other options that the NPUC and some of the commissions  
12 have provided as well as the alternatives filed in this  
13 proceeding.

14 MS. SALAS: One minute.

15 CHAIRMAN KELLIHER: Do you recognize there's a  
16 cost to the status quo to the commonwealth -- the RMR  
17 agreements are a cost of inaction.

18 MR. ROGERS: The RMR agreements are largely  
19 overstated. I'll give you a specific example. The ISO  
20 wanted us to pay \$170 million for Salem Harbor. They filed  
21 an RMR with the Commission for about 80 to \$90 million. We  
22 settled the case for 6.75. I think that every time we raise  
23 objections to the ISO's proposal they come back with spin  
24 and sort of fear tactics. So I think that we have a problem  
25 with peaking capacity in the Boston metropolitan area. We

1 have sufficient baseload and intermediate capacity. So we  
2 should be focusing our solutions on peaking capacity and  
3 allowing the free-flow of electricity through expansion of  
4 the transmission system.

5 CHAIRMAN KELLIHER: Thank you.

6 COMMISSIONER KELLY: Mr. Rogers, would you --

7 MR. ROGERS: We're running out of time.

8 COMMISSIONER KELLY: Yes. I have a question both  
9 for you and for Mr. Coyle about -- my concern is about  
10 generators who would manipulate the market by withholding  
11 sites and whether you don't think that market manipulation  
12 or market power. And, if it is market power, the Commission  
13 should remove their market-base rate authority and have them  
14 be cost-based.

15 MR. ROGERS: I'd be happy if the Commission did  
16 that because we have a problem that the sites around Boston  
17 have been in operation since the days of Thomas Edison and  
18 there's no sites available with the water and the  
19 transmission access.

20 COMMISSIONER KELLY: Here's a point I would like  
21 to leave you with -- Mr. Chairman, would you like to address  
22 this in rebuttal?

23 CHAIRMAN KELLIHER: One more.

24 COMMISSIONER KELLY: The Commission does have  
25 authority, under its market-based rate authority, to

1 constrain prices if those prices are being imposed through  
2 some sort of market power, including control of the land.

3 MR. ROGERS: The HHI in the Boston area is over  
4 3000. So that, in and of itself, we do not have a  
5 comparative market in Boston. And maybe some day when -- in  
6 a couple of years when we have sufficient transmission  
7 capacity, that would change. But I would hope the  
8 Commission would keep an eye on what's happening in all  
9 these load pockets in New England.

10 MR. COYLE: Do I get to respond?

11 CHAIRMAN KELLIHER: I'm afraid not. We have to  
12 move along. Thank you.

13 MS. SALAS: Mr. Roberti with 5 minutes.

14 MR. ROBERTI: Thank you Mr. Chairman and  
15 Commissioners. My name is Paul Roberti. I'm an assistant  
16 attorney general from Rhode Island. I am here on behalf on  
17 Attorney General Patrick Lynch and the 1,050,000 citizens  
18 from the state. If there's any message I can leave you with  
19 today it is that unlike the Commission and unlike the  
20 capacity suppliers and ISO New England, it's the consumer  
21 advocates and the load representatives that are the public  
22 hearings that have been systematically occurring in the face  
23 of the high natural gas and oil prices.

24 I'm going to leave these transcripts with the  
25 secretary and I'd like to forward the rest of the

1 transcripts from the rest of the hearings we have about the  
2 desperation of consumers right now struggling to cope with  
3 rising electricity prices. In the face of these higher  
4 prices, in the face of the effects of Hurricane Katrina, we  
5 cannot afford to gamble with additional experiments in  
6 trying to create markets. If there's any evidence that  
7 should have come out of this proceeding, it is that the  
8 market is not working. That it does not work. That even --  
9 you heard the statement that even with the removal of  
10 energy caps, generators will not build. The message is to  
11 promote rate increases that will come out of this LICAP  
12 scheme without any evidence that additional generators will  
13 be constructed -- additional construction of generation is a  
14 huge gamble and is more akin to the failures that occurred  
15 in California. We will end up with an economic crisis and  
16 now may be the time to send a message to states that they  
17 may need to revisit the electric restructuring initiatives.  
18 And that they may need to require the load-serving entities  
19 to actually go out and get back in the business of  
20 generation because that may be the only way to hedge against  
21 the problems in the failure of the market to respond.

22 COMMISSIONER BROWNELL: A lot of comments have  
23 been made that the market won't respond. But, besides Mr.  
24 Feder from Fitch, what evidence have you seen or what  
25 evidence, more importantly, would you like to see that the

1 market would respond? What is it that would get you  
2 comfortable to any proposal that the market will respond?

3 MR. ROBERTI: I think that a lease-cost approach  
4 to building additional generation is what is necessary.  
5 Electricity is an essential product for the consumers of  
6 Rhode Island. We can't afford the --

7 COMMISSIONER BROWNELL: So is gas, by the way.

8 MR. ROBERTI: And so is gas. And, as you know,  
9 this Commission, natural gas is now is priced at the cost of  
10 a barrel of oil. Where is the additional infrastructure for  
11 natural gas? Where are the new oil refineries over the last  
12 30 years that have not been built. And to head down this  
13 path and promote the same type of cost increases and price  
14 volatility is not in the public interest, particularly when  
15 you're going to allow additional revenue to go existing  
16 generators that will allow these generators to earn super-  
17 normal returns on equity. It's inappropriate and it is  
18 contrary to the Federal Power Act.

19 CHAIRMAN KELLIHER: Mr. Roberti, I believe your  
20 office opposed the development of gas infrastructure in  
21 Rhode Island. We had a proposed LNG import facility in  
22 Rhode Island that I believe the Attorney General vigorously  
23 opposed and we ended up rejecting it because we didn't find  
24 that it passed muster under our safety standards. But it  
25 just seems slightly inconsistent.

1                   MR. ROBERTI: It is not. Because, as you know,  
2 the industry has responded. There are a number of LNG  
3 infrastructure proposals like the Neptune Project --

4                   MS. SALAS: One minute.

5                   MR. ROBERTI: -- the Accelerate Project, the  
6 Broadwater Project.

7                   CHAIRMAN KELLIHER: So your concern is  
8 volatility. That was something you cited your concern is --  
9 price volatility. My understanding is that's one rationale  
10 for capacity market is to reduce price volatility. And the  
11 state of Rhode Island could certainly require load-serving  
12 entities in the state to contract on a bilateral, long-term  
13 basis to buy power and buy power in capacity. So, if the  
14 state wants to avoid volatility, it's within its  
15 jurisdiction to do so. If you decline to exercise that  
16 jurisdiction and volatility results --

17                   MR. ROBERTI: We may well need to do so, but the  
18 question is, are we able to entirely eliminate the effects  
19 of two the EBCC or any of these cost increases if we do  
20 that? And, under this current scheme, we may not be able to  
21 insulate our ratepayers from the effects of this LICAP  
22 without any corresponding benefit.

23                   CHAIRMAN KELLIHER: Do you think there's a  
24 problem under the status quo that requires us to take some  
25 action? Or do you think, like your colleague, we should

1 consider removing the price caps.

2 MS. SALAS: Time's up.

3 MR. ROBERTI: I think the approach should be a  
4 lease-cost approach.

5 CHAIRMAN KELLIHER: Thank you.

6 MS. SALAS: Next Mr. O'Brien with 5 minutes.

7 MR. O'BRIEN: Thank you.

8 I come to you today as a commissioner from  
9 Vermont in a somewhat of a unique role where I report  
10 directly to the governor of the state and part of the state  
11 government administration. But also in rate cases for the  
12 Utility Commission or Public Service Board in Vermont.  
13 We're also odd in the sense that we are not part of the  
14 deregulated system that is being debated here this morning.  
15 And I'm also here to talk, to some degree, representing the  
16 four states that have put forth an alternative that will be  
17 discussed later today.

18 I actually very much appreciated the Chair's  
19 pointed questions at the outset of the hearing. I think you  
20 have to cut through the fog of complicated issues and really  
21 ask basic questions. Is the status quo acceptable? I'm  
22 here to tell you very clearly from the perspective of  
23 regulators, no, the status quo is not acceptable. We  
24 absolutely appreciate the need for a viable capacity  
25 mechanism that works. We respect the need for generators to

1       earn a reliable return and have a revenue stream that  
2       supports that investment. You can do that a number of  
3       different ways. It certainly used to work under cost of  
4       service sort of return and perhaps it can work on a market  
5       mechanism. The question is which one and how much does it  
6       cost?

7                       We respect the role of the ISO. We understand  
8       the very tough job that they have. It's unfortunate, in  
9       many respects, that we are in opposition to them on this  
10      proposal because we know that they've got a tough job. It's  
11      not lost on us in the states that when the blackout of 2003  
12      happened it generally stopped at the border of New England  
13      and we kept our lights on for the most part. And we don't  
14      think that that was a coincidence. We think that was a  
15      reflection of their ability.

16                      But I think it's important from the states's  
17      perspective to give you our perspective on cost, which  
18      you've heard from some of the other speakers this morning,  
19      and how important keeping costs down is critical to our  
20      economies to compete nationally and internationally. Let's  
21      face it, we're in a global economy today and we cannot  
22      afford to be the high-cost part of the country. My previous  
23      time -- my career prior to coming to public life, which is  
24      just recently, relatively speaking, was in economic  
25      development in a small rural part of Vermont and trying to

1 hold onto jobs and retain investment is very, very  
2 difficult. And I can tell you that I came to my job knowing  
3 that our customers are employers who are very cranky about  
4 the cost of electric rates. And I can tell you that in the  
5 state of Vermont, over the span of the 1990s, we paid a \$2  
6 billion premium based on our rates being above the national  
7 average. So what you need to take away from this discussion  
8 this morning is not that we don't understand something has  
9 to be fixed and something has to be done, but there's a  
10 question of at what price. And also, does that high price  
11 result in the outcome that we seek? That's a very important  
12 message that I hope you take out of this.

13 We, as regulators, are united in our concern  
14 about the LICAP proposal. Make no mistake by the fact that  
15 there's two different alternatives that have slight  
16 variations on the NERAM or CRAM proposal. We are both  
17 trying to find the right answer and we just could not find  
18 consensus, although we spent a lot of time trying to get  
19 there and it's unfortunate. But we still think that these  
20 two alternatives take us more along the path that we'd like  
21 to see happen.

22 I very much appreciate the Commission's pursuit  
23 of what's the right number and I very much don't like to see  
24 people scared by numbers that are accurate or inaccurate  
25 rather. And, if \$13 million is inaccurate, I'm not here to

1 be able to articulate whether that is or not.

2 MS. SALAS: One minute.

3 MR. O'BRIEN: Whether it's 2.3 or it's 13  
4 billion, we have to be clear that New England is not a low-  
5 cost part of the country or the world, for that matter. And  
6 that we have the course of opposition, and you've heard from  
7 consumer advocates in the states, is a reflection of the  
8 fact that we are finally putting our hands up and saying  
9 when does the increase cost -- when do we start to get  
10 competitive? When does this curve start to turn? That is  
11 why you're hearing this chorus. And it is very rare that  
12 New England states sing with such harmony on an issue.  
13 That's rare based on the meetings I've attended in the last  
14 two years. It's a rare thing and I think it speaks volumes  
15 about how we see this issue. Because of the position we're  
16 in, I just think this Commission has a responsibility to go  
17 very cautiously in trying to implement the right answer.  
18 Thank you.

19 MS. SALAS: Time's up Mr. O'Brien.

20 MS. SALAS: This is your rebuttal time Mr.  
21 Chairman. And, first, on behalf of the ISO New England, 12  
22 minutes Mr. Vince.

23 MR. VINCE: Thank you. The opportunities for  
24 rebuttal are so plentiful it's going to be hard to take them  
25 at proper order. I appreciate the measured tones of the

1 commissioner from Vermont. I do want to attack directly the  
2 cost projections of some of the other parties.

3 We had a five-week hearing before an  
4 administrative law judge. The best evidence that these  
5 parties have been able to present when questioned by the  
6 Commission about cost is an out-of-record Boston Globe piece  
7 that, in fact, said, if read carefully, that the CEO, Gordon  
8 Wheely, told the Globe that NECPUC said the cost was \$13  
9 billion. The allegations of cost of unseemly in this case.  
10 We ought to stick to the record.

11 Judge McCartney wrote a measured decision, not  
12 given to hyperbole. But, when it came to cost projections  
13 of load, she said they were inflated and unsupported, and  
14 she was right. Trying to pin load down on price caps,  
15 costs, reliability, market power is like trying to pin jelly  
16 to the wall. Basically, we have confidence under the new  
17 rules of this Commission that market power will not be  
18 tolerated and our price-setting mechanism goes a long way  
19 toward a bomb-proof method of predicting that type of market  
20 power by listing all of the existing generators in the  
21 region and taking away the power generators to come in and  
22 manipulate through delisting.

23 With your permission, I'm going to use a couple  
24 of the charts that my colleagues from the load parties have  
25 used. We've been told that at two times EBCC generators are

1 not going to find a way to come into the market. That is  
2 nonsense. It's not supported by the initial decision. It's  
3 not supported by trial staff and it's not supported by the  
4 actual testimony in this case.

5 We heard that there was only one witness that  
6 talked about investment. That's untrue. Every ISO witness  
7 put in testimony that this market will work. You have heard  
8 the generators's representatives in person tell you earlier  
9 this morning that if LICAP is put in they intend to build  
10 and that's what the presiding judge held and that's what the  
11 staff supported.

12 If you take a look at this chart here, 21 data  
13 points versus 42. Let's talk about what wasn't discussed  
14 when this chart was presented. What's the bases for 21 data  
15 points? It's 21 years of historical, empirical evidence.  
16 It's found by Judge McCartney in her initial decision. Why  
17 is it 21? Because there were 21 annual peaks. So the peaks  
18 used are what actually occurred. What is the bases for 42  
19 data points? There is no empirical basis for that the  
20 initial decision so heard. Staff was concerned about adding  
21 spring and winter and other peaks because they said it might  
22 create inaccuracies and staff was right and the judge  
23 accepted that.

24 We have a few charts of our own for rebuttal.  
25 This is what National Grid said in its briefs on exceptions.

1 At page 16, they said the initial decision undercuts  
2 reliability, economic assistance. It won't work. It's  
3 unlikely to incent new capacity because generators won't  
4 build. This is what they said on page 22 of their brief  
5 "that it will work so well that we made a mistake by not  
6 decreasing target capacity because the capacity variability  
7 will be suppressed."

8 We used 21 years of the best historical data  
9 available -- the only data that the presiding judge in this  
10 case found was empirical. When you read the initial  
11 decision, you will see that she made a statement, having  
12 carefully looked at every witness on the stand and received  
13 the testimony, that no other load party presented empirical  
14 data. That's not a small point. That's as showstopper in  
15 terms of evidentiary presentation and meeting your burden of  
16 proof.

17 We heard an incredible statement that there's not  
18 really a reliability problem in New England estimated out  
19 and some discussion about surplus for lots of years. This  
20 what the ISO New England regional system plan for 2005  
21 states. This comes out of the executive summary developed  
22 in the stakeholder group. It is the only italicized  
23 paragraph in the entire executive summary. It has been  
24 provided to everyone. What it says is "taken together, the  
25 results of the installed and operable capacity analyzes

1 demonstrate that New England will face an increased risk of  
2 operating capacity with less capacity than needed by 2008."  
3 The results also show that the region will not have  
4 sufficient capacity to meet the IC requirement in the 2008-  
5 2010 timeframe, depending on load growth, weather  
6 conditions, generator performance and attrition and the  
7 conditions in specific load pockets such as Connecticut.

8           Because the timeframe for building new generating  
9 resources is about two to four years, the analysis  
10 highlights the urgent need for new generating resources in  
11 New England, page 9 -- "you can depend on that." This chart  
12 simply gives a transcript cite to the point I made earlier  
13 where Judge McCartney found "no party contesting the use of  
14 historical data as a foundation -- that's a justified slip I  
15 think -- as a foundation for determining the appropriate  
16 parameters of the demand curve has offered anything  
17 empirical as opposed to theoretical to use in its place" --  
18 initial decision at paragraph 122.

19           Judge McCartney would ask witnesses on the stand  
20 "your doctorate -- what is your support for the opinion  
21 you've just rendered." They would say, well, it's my expert  
22 opinion. She would say but what supports that? What  
23 empirical evidence? What they did was they cherrypicked.  
24 They made guesses and the judge reported that in the initial  
25 decision with great care. This is a 289-page initial

1 decision and it's rigorous.

2 MR. VINCE: The initial decision at paragraph 280  
3 makes another critical point. "Demand curve proposals  
4 resulting in a shortage of capacity actually holds a greater  
5 risk and area potentially more expensive to consumers  
6 because the cost of blackout during a shortage of capacity  
7 is greater than the cost of building a smaller amount of  
8 extra capacity. The ISO points out that its witness staff  
9 observed that 4.5 percent decrease in capacity over the long  
10 run saved less than 1 percent of retail cost, but it  
11 quadruples the blackout rate. That is in the record.

12 This Commission asked three critical questions of  
13 the parties. Is the LICAP proposal just and reasonable?  
14 The judge said yes -- paragraph 284. The staff agreed.  
15 Will generators build? The generators have just told you  
16 that they will. Judge McCartney agreed at paragraph 284,  
17 the staff at paragraph 234. Commissioner Kelly's earlier  
18 question to Mr. Reiter that the stream revenue being  
19 adequate is exactly right. Investors will read the revenue  
20 stream and they will do what they do in all competitive  
21 markets. They'll invest.

22 There was a question about market power that I  
23 think all of the Commissioners zeroed in on. That this  
24 Commission will not allow market power. And, if the states  
25 feels that some thing is eschew, they have the power to do

1 their own competitive auction. They could do collaborative  
2 auctions or do them by themselves as Connecticut's doing.  
3 They can do demand response and a lot of other things.

4 MS. SALAS: One minute.

5 MR. VINCE: Then I know I have less than 60  
6 seconds to make a comment about E(4)(d) and shortage hours.  
7 We urge you to allow us to make the compliance file and we  
8 think it's real important. E(4)(d) is easily gained. It's  
9 an engineering formula rather than a market metric. It  
10 costs about \$200 million more annually than shortage hours.  
11 So, if we're right, that's a big savings. If we're wrong,  
12 you can reject it.

13 The final thing I'll say is political bodies and  
14 consumer groups don't support LICAP, but I promise you they  
15 will not support brownouts or blackouts either. They simply  
16 have not presented a viable, market-based plan for dealing  
17 with reliability problems that would come or could come as  
18 soon as the Year 2008.

19 MS. SALAS: Time's up.

20 MR. VINCE: Thank you.

21 MR. ESTES: Mr. Chairman, Commissioners, my  
22 colleague, Mr. Wentworth has graciously agreed to cede me  
23 two of his 5 minutes and I'm going to directly to the  
24 "surplus" question. Surplus is actually not, in the end,  
25 when you look at the record, the right term. But I wanted

1 to start with this particular chart here because my favorite  
2 factoid about this chart is that no witness said that this  
3 was the right curve -- not a single one.

4 Connecticut didn't put up anybody to say let's  
5 use 42 data points. All that happened was Mr. Speck argued  
6 it in his brief and he collected information about what  
7 quantity would result from different outcomes. There's not  
8 a single witness in the record that said this was the right  
9 thing to do. And, when witnesses were cross-examined about  
10 it -- staff and ISO witness -- they said it was exactly the  
11 wrong thing to do. So this, I think, is so discredited that  
12 it wasn't even offered and you should set it aside.

13 The way to think about Ctarget is as follows. In  
14 vertically integrated utilities over time it's never been  
15 the case. In a command and control type situation where  
16 you've got a single decisionmaker saying let's build now.  
17 We see load coming in -- take southern companies -- that  
18 they've ever been able to hit Ctarget right on. Our witness  
19 put in evidence in the record that looked historically at  
20 different regions to look at the variability of capacity  
21 levels over time and the best he found was about 3 percent  
22 that was sold.

23 Now New England has had more variance than that  
24 historically. It's a relatively small system. And, if you  
25 look, by the way, at variance and load pockets, you'll find

1       it even vacillates more because a 4500-megawatt load pocket  
2       -- is it going to add 50 megawatts each year? It can't do  
3       that? That's not cost-effective. Sometime you need big  
4       units. So this is not like a cruise control on a car where  
5       you can just set on a particular point and hit every year.  
6       That's what the experience of the utility industry has shown  
7       around the country. We had a trial about many issues, but  
8       much of it was devoted to this point. And, as Mr. Vince  
9       properly pointed out, frankly the load witnessed crumbled on  
10      this point and the judge found their testimony was  
11      subjective and unsupported. It was essentially their expert  
12      guesstimate about what would happen under a market structure  
13      that frankly most of the time they were attacking.

14                You had this peculiar dichotomy. They say LICAP  
15      won't work. But, when it comes to estimating this one  
16      variable, it will work so well that it betters the record of  
17      hitting exactly your target better than anything we've ever  
18      seen. And we'll talk more about that this afternoon because  
19      their new proposal is being oversold on that point, too.

20                Reliability, blackouts. What does it mean to set  
21      OC? What does it mean to meet the one day in 10 years  
22      standard? Well, that's an annual planning standard and the  
23      only witness with any background on this subject in the  
24      trial was Mr. O'Plant who's done reliability planning for 10  
25      years or so, dating back to NEPOOL, and his view of this

1 whole question was you strive to meet that standard every  
2 year. Now, if we tried to build a system that met it 100  
3 percent of the time, you know, that would be pretty  
4 expensive and sometimes you fall short.

5 So what they did -- what ISO did is they built a  
6 tool that would track their sort of historic record on this.  
7 If they tried to better it, you can bet your life we would  
8 have heard quite a lot of dispute about this.

9 What we have here though is we have load trying  
10 to lower the bar. They want to skate much closer to the  
11 line and pass the line of reliability. And, if you ask them  
12 when they designed their curves how often did they think  
13 they had to meet the 1 in 10 year standard -- we asked this  
14 questions of their witnesses. It's okay to miss it every  
15 other year, as long as it's on average over time over a 10-  
16 year period or whatever, you're okay. That's not the way  
17 this standard is applied in the real world and that's what  
18 Mr. O'Plant had to say. You try and meet it every single  
19 year and you know you can't do that so you realize you'll  
20 fall short. But load curves are designed to fail that test  
21 more often than historically was the case. And I'd like to  
22 bring up the appendix A from our brief of opposing  
23 exceptions now and show you something. Standard deviations  
24 -- it's kind of a funny term. I swore I wasn't going to use  
25 it and I just did. Standard deviation is not something you

1 can set like setting the ROE for a utility because it's not  
2 externally imposed. It's going to be whatever the system  
3 does -- this electric system. It's probably peculiar to  
4 different regions, too. What's going to happen over time?  
5 And, if you get it wrong, as Dr. Stoft memorably  
6 demonstrated at trial, you really have messed up. If you  
7 overestimate it slightly, you may have cost a little bit of  
8 extra capacity to be built. But, if you get it wrong,  
9 you've created an unreliable state. What we have here is  
10 straight from the record and it takes the curves that  
11 everybody sponsored -- curves though, I guess, I've heard  
12 today that no one on the load side really wants to put in  
13 place. So I'm not quite sure how much of this rebuttal I  
14 should do. But every single one of their curves has an  
15 assumption embedded in it that says, oh, we're going to have  
16 a much lower standard deviation than we ever had in the  
17 past.

18 Question? This is expert guesstimation. What if  
19 they're wrong? What if the ISO and history are right?  
20 Well, the answer gets pretty ugly. The best was made in  
21 Vermont's witness, who actually didn't sponsor a curve, but  
22 we sort of cobbled together from what he said. He doesn't  
23 meet the 1 day in 10-year standard, but about a little less  
24 than three-quarters of the time. You go down from there,  
25 Mr. Hamal, the NGrid witness, meets it actually just a

1 little over half the time. You go down to Mr. Coyle's  
2 witness, Mr. Wilson, he was the champ. He misses it over  
3 three-quarters of the time. And I think Dr. Stoft testified  
4 that his curve, if he was wrong on standard deviation, some  
5 of his other things would have something like 42 blackouts a  
6 year or something like that. There's a bar chart and  
7 actually could not rise high enough to fit Dr. Wilson in it.

8 So what load wants you to do is approve a market  
9 that is designed to skate closer to the edge. And I believe  
10 it's accurate to look at this curve as essentially a tool to  
11 meet the existing reliability criteria. I submit you can't  
12 give ISO New England a tool that is not designed to work on  
13 this front.

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1                   Now I'm going to say for the afternoon, this  
2 thing about nobody building -- because it's really  
3 comparative between the two curves -- their curves would  
4 have the same outcome. They're wrong; I'll explain that  
5 later.

6                   One final thought -- and I'm going to leave E-40  
7 aside, read our briefs. If you look at loads curves --  
8 excuse me, their models for this afternoon, if you ask them  
9 how much they'll cost, it's going to be well a little under  
10 \$3 billion. They'll save \$150 million, maybe a little more.  
11 Over five years, their own market designs tell you it's  
12 about a \$15 billion problem. There's no free lunch here.  
13 There's no way to avoid incurring those costs. The only  
14 question is when you start paying.

15                   And what we've heard here is a design to start  
16 paying in five years after we're past the leading and the  
17 trailing edge of the window that ISO New England says in  
18 their expert judgment we have to hit. That's not  
19 responsible -- that's not responsible regulation and I  
20 respectfully ask you not to take that course. Now I wonder  
21 if this reflects my two minutes or not?

22                   SECRETARY SALAS: No, you still have five more  
23 minutes now, starting now.

24                   MR. ESTES: Oh, excellent.

25                   (Laughter.)

1                   MR. ESTES: Then I will talk about Mr. Fedder and  
2 I will address the questions that you guys asked. He's not  
3 the only witness who addressed this. The ISO witnesses  
4 addressed it and so did one of my witnesses, one Tom Boland,  
5 who worked for Citibank for 30 years and who was for a long  
6 time their senior go or no-go lending decision person. He  
7 said well we have to tweak a few things about the LICAP  
8 proposal. The shortage hours was one of them, because it's  
9 very spiky and risky. But he said well, yeah, this is  
10 actually financable. So you have conflicting opinions on  
11 the record at best. And the Judge swept all that away,  
12 saying this is a just and reasonable outcome. The ISO put  
13 that text up for you to see.

14                   Now I'm also struck listening to the comment  
15 about harmony among the states, and I can't help but point  
16 out that for something like five years now virtually every  
17 load-serving entity in virtually every state government has  
18 fought against any capacity market whatsoever. So there's a  
19 history here to this battle. This is about the third battle  
20 in what is really a war.

21                   And so you have to look carefully at the opinions  
22 that you're being presented with and look at the facts  
23 underlying them. And I think what you've seen this morning  
24 is you've seen Load basically recycle all the arguments that  
25 they offered to the Judge and that were --

1 SECRETARY SALAS: 30 seconds left.

2 MR. ESTES: How much?

3 SECRETARY SALAS: 30 seconds.

4 MR. ESTES: -- that were rejected by the Judge  
5 and not -- and precious little effort to try and explain why  
6 the criticisms were wrong. We had a trial on all this. You  
7 know, the curve that we supported and the ISO supported --  
8 with my reservations, which I'm not talking about one, and  
9 you really need to look very carefully at the record because  
10 the answers to all of your questions are there.

11 With that, I'll turn it over to Mr. Wentworth.

12 MR. WENTWORTH: Good afternoon, Mr. Chairman.  
13 I'm here on behalf of Duke Energy, which has an interest in  
14 the southwest Connecticut generation, the Bridgeport energy  
15 generator, and my focus, as was Mr. Corneli's earlier this  
16 morning, is to discuss a little bit about southwest  
17 Connecticut. There's not a surplus of capacity in southwest  
18 Connecticut; we need to be clear about that.

19 And while it is true that the amount of installed  
20 capacity in southwest Connecticut exceeds that region's  
21 share of objective capability, OC does not take into account  
22 the additional capacity needed for reliability due to the  
23 transmission constraints there. And when you take into  
24 account that additional capacity and layer it onto the OC  
25 requirements which you end up with in southwest Connecticut

1 is a situation that is in dire straits. Right now,  
2 Southwest Connecticut needs approximately 107 percent of OC  
3 and, even so, they're right on the edge. And you've heard  
4 the testimony and the statements from ISO about what we can  
5 expect in Southwest Connecticut in the future.

6 And that is why we need LICAP. If you adopt  
7 LICAP, generators will build. They're building in New York  
8 and they're building in New York City and Long Island right  
9 now with the price signals that the New York demand curve is  
10 giving them.

11 In addition, and a point not really addressed by  
12 the other load entities and state regulators here, is the  
13 fact that generators have a track record of building in New  
14 England. They've built before in 1999 to 2002, and when we  
15 get the price signals right with the LICAP demand curve,  
16 they will build again. So it's important. LICAP is needed  
17 now in Southwest Connecticut, as well as the rest of New  
18 England for the reasons that we have put forth today. And  
19 LICAP needs to be sending the build signal in Southwest  
20 Connecticut right now as well.

21 Now one of the points that we want to take up is  
22 something that was raised in the brief statement in support  
23 of NERAM and was an issue at the hearing and was touched  
24 upon today by some of the participants relating to the issue  
25 about there's really no reason to have LICAP because you

1 can't build in Southwest Connecticut.

2 And the answer is that the --

3 SECRETARY SALAS: One minute.

4 MR. WENTWORTH: -- record in this proceeding  
5 shows that you can build new generation in Southwest  
6 Connecticut and that a LICAP price that provides the  
7 appropriate price signal will incent new generation.  
8 Testimony from the ISO and from other Capacity Supplier  
9 witnesses showed that a total of between 250 megawatts and  
10 575 megawatts could be added in Southwest Connecticut before  
11 completion of the transmission upgrades there. In addition,  
12 the record established that much of this could be very small  
13 aero-derivative type generation that could provide the quick  
14 start generation capability that the ISO's recent RSP report  
15 indicated they need. So generation can be built in  
16 Southwest Connecticut.

17 Adopting LICAP will also spur the development of  
18 other types of capacity resources, most importantly demand  
19 side response and transmission solutions. Most importantly,  
20 LICAP right now would provide appropriate compensation for  
21 the generation in Southwest Connecticut that is there right  
22 now and providing reliability and needs that compensation.

23 SECRETARY SALAS: I'm sorry, Mr. Wentworth.  
24 Time.

25 MR. WENTWORTH: Thank you very much, Mr.

1 Chairman.

2 CHAIRMAN KELLIHER: With that, that ends our  
3 morning session -- here it is in the afternoon -- ends our  
4 morning session, and we will resume promptly at 1:45. That  
5 may force you to experience our own unregulated monopoly,  
6 the Sunrise --

7 (Laughter.)

8 CHAIRMAN KELLIHER: -- Cafe.

9 (Whereupon, at 1:10 p.m., the conference was  
10 recessed, to reconvene at 1:45 p.m., this same day.)

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AFTERNOON SESSION

(1:48 p.m.)

CHAIRMAN KELLIHER: Our afternoon session now begins. Madam Secretary?

SECRETARY SALAS: The first presenter for the afternoon session is Mr. Scott Strauss, for 15 minutes.

MR. STRAUSS: Mr. Chairman and Commissioners, I'm here today on behalf of the Connecticut Municipal Electric Energy Cooperative, known as CMEEC, and the Massachusetts Municipal Wholesale Electric Company, known as MMWEC.

MMWEC and CMEEC join in thanking the Commission for scheduling an oral argument, in part, to consider alternatives to the ISO's LICAP proposal.

My purpose today is to focus on the process through which alternatives to LICAP should be considered, once today's oral argument is completed. The Commission must, in our view, establish the parameters of a going-forward process, if the parties are to have a fair opportunity to develop alternatives responsive to the August 25th Notice, and if the Commission is to fulfill its statutory obligations to ensure that the resource adequacy mechanism adopted in this proceeding, is just and reasonable, and to carefully consider objections to LICAP.

The process proposal that I'm going to outline, was filed with the Commission last week by MMWEC and CMEEC,

1 joined in by the municipal systems in Wellsly, Reading, and  
2 Concord, Massachusetts.

3 The proposal enjoys the support of the New  
4 England Conference of Public Utility Commissioners, the  
5 Connecticut Department of Public Utility Control, the  
6 Connecticut Office of Consumer Counsel, the Connecticut  
7 Attorney General, Northeast Utilities Service Company, and  
8 the Business Council of Fairfield County.

9 The Massachusetts Attorney General has submitted  
10 a process proposal that is, in all pertinent respects,  
11 identical to the one that I'm going to describe. At the  
12 outset, I want to highlight NHPUC's support for this  
13 proposal.

14 The New England states are fully in agreement on  
15 the appropriate process for consideration of alternatives to  
16 LICAP. Mr. Chairman and Commissioners, we are pleased that  
17 alternatives are finally having their day in court, but a  
18 day in court is simply not going to get it done.

19 While today is a necessary first step, in our  
20 view, an afternoon's oral argument is insufficient. Now,  
21 there are several reasons why a process that begins today,  
22 rather than ends today, is absolutely essential.

23 First, let me start by telling you what you  
24 already know: Until now, there has been no consideration in  
25 this proceeding, of alternatives to the ISO's LICAP

1 proposal, because the Commission foreclosed that  
2 consideration and the Administrative Law Judge struck from  
3 the record, testimony that addressed alternatives.

4 So other than the argument today and the pre-  
5 argument submissions, there is no record developed on any  
6 alternative. In our view, the Commission's statutory  
7 obligation to ensure that whatever mechanism is adopted, is  
8 just and reasonable, cannot be fulfilled, absent full  
9 consideration of alternatives, and that consideration cannot  
10 occur, absent the proper process.

11 Second, last week's submissions and today's  
12 presentations, are in response to a Notice that was issued  
13 roughly three weeks ago. Therefore, potential alternatives  
14 are understandably still somewhat in the development stage.

15 Mr. Vince strongly noted this morning that load  
16 had not made a showing a viable alternative. Well, first of  
17 all, alternatives were in the record; they were stricken  
18 from the record.

19 And second of all, the ISO well knows that it  
20 takes some time to develop an appropriate proposal for  
21 resource adequacy and that they change over time.

22 COMMISSIONER BROWNELL: May I just ask you a  
23 question, Mr. Strauss? There was a reference this morning  
24 to a two and a half year stakeholder process. Were these  
25 alternatives fully vetted during that process, or are these

1 different than those that were discussed?

2 MR. STRAUSS: I believe others will discuss the  
3 specifics. My understanding is that they are somewhat  
4 different than what was vetted in the process.

5 COMMISSIONER BROWNELL: Thank you.

6 COMMISSIONER KELLY: Were the concepts the same?

7 MR. STRAUSS: I don't know the answer to that  
8 question.

9 COMMISSIONER KELLY: Well, my understanding is  
10 that there were similar concepts developed, early on,  
11 beginning in 2003, if not before, and they were discussed by  
12 the participants in the process, and that there was no  
13 agreement, that everyone was quite fractured.

14 Earlier today, we heard an oral argument from  
15 some representatives of the states that said the states are  
16 all over the place on ways to approach this problem.

17 So, given that, my question is, why would we  
18 think now that there's any hope of any consensus?

19 MR. STRAUSS: There are two reasons,  
20 Commissioner: First of all, we're informed by the LICAP  
21 process. We've had a fair and full examination of the ISO's  
22 proposal.

23 Second of all, to date, the Commission has not  
24 mandated consideration of alternatives. The dynamic will be  
25 different in the settlement process, going forward.

1                   The dynamic now will be that alternatives are to  
2 be considered, and perhaps to be considered on an equal  
3 footing with the ISO's LICAP proposal. So we believe that a  
4 settlement process going forward with that directive and a  
5 delay in the current schedule for any implementation of  
6 LICAP, will create a dynamic that will enable settlement in  
7 this process.

8                   COMMISSIONER KELLY: Not a delay from the October  
9 implementation?

10                  MR. STRAUSS: No, no, and I'm going to outline  
11 that -- absolutely not, no.

12                  The third reason we would ask for the opportunity  
13 for further process, is that we'd ask you to compare this  
14 afternoon's two and a half hours of oral argument, with the  
15 inquiry that's been conducted to date on the ISO's proposal  
16 -- a transcript of more than 4,000 pages, testimony from 46  
17 witnesses, nearly 600 exhibits admitted into evidence.

18                  I assure you -- and I believe on this point, I  
19 speak for everyone on this side of the table -- we're not  
20 asking for a repeat of that. But we are asking for  
21 considerably more in the way of process than simply the  
22 dialogue today.

23                  Fourth, we believe that the Commission's August  
24 10th Order granting oral argument, and the August 25th  
25 Notice identifying areas for inquiry, contemplate an

1 additional process. The August 25th Order raises questions  
2 seeking assessments of impacts, costs, and benefits of both  
3 the LICAP approach and alternative approaches.

4 Determining whether a proposed resource adequacy  
5 mechanism will provide assurance of capacity and  
6 reliability, without imposing unreasonable costs or creating  
7 other negative economic impacts, is complicated and fact-  
8 intensive.

9 We believe the Commission would not fulfill the  
10 sense of Congress that objections be carefully considered,  
11 if the inquiry were limited to the pre-argument submissions  
12 and today's oral argument transcript.

13 So, for those reasons, we are proposing a two-  
14 stage process, going forward: In the first stage, we'd ask  
15 that the Commission initiate a stakeholder process and  
16 announce a tentative completion date for that process. The  
17 date we've proposed is January 20, 2006.

18 The purpose of the process is fourfold: First,  
19 to allow parties to present their alternatives to each  
20 other; second, to receive comments and input; third, to  
21 further refine and develop their proposals; and, fourth,  
22 hopefully to facilitate agreement on a proposal that would  
23 meet the needs of the region, and, hopefully, to lower costs  
24 in a more effective manner. As you've heard this morning,  
25 there is a great deal of controversy about LICAP.

1                   Now, there was reference this morning to the  
2 stakeholder process. I'd point out that the stakeholder  
3 process that was held in New England, did not involve the  
4 LICAP proposal that's in front of you today.

5                   That proposal was -- there was a proposal filed  
6 by the ISO in March of 04. It was substantially rewritten  
7 in testimony that was filed in August of 04.

8                   It was the modified again when the mitigation  
9 measures were changed during the course of the hearing, and  
10 it was modified again when the ISO moved from what it called  
11 critical hours, to a shortage hours proposal.

12                   So that proposal has undergone a great deal of  
13 development in the course of that proceeding. The  
14 stakeholder process that we're proposing, has been outlined  
15 in our papers, and I'd just like to highlight a few key  
16 points here.

17                   The process would be open to all parties to the  
18 case, including market participants, state agency and  
19 commission representatives and others. It's not intended to  
20 be limited to NEPOOL participants. That's not the purpose.

21                   The process would be managed, as we presented it,  
22 by a Commission-appointed Settlement Judge, and, before any  
23 appointment was made, we'd like the litigants to be given  
24 the traditional opportunity to try to pick a Settlement  
25 Judge, a neutral.

1           To ensure that there would be widespread  
2 participation, we'd ask that the Commission provide  
3 resources to the Judge to allow for the scheduling of  
4 meetings in the greater Boston area.

5           Fourth, as part of the process, we'd ask that the  
6 ISO be tasked with providing technical assistance to those  
7 trying to develop alternatives. I think I heard this  
8 morning from the ISO's attorney, that that was something  
9 that the ISO was willing to do.

10           Fifth, the process would end no later than  
11 January 20th, at which time the Settlement Judge would  
12 report to the Commission on whether the process should be  
13 extended or shut down. We've proposed a final shutdown date  
14 of February 1st of 06.

15           The reason for that date is that we believe it's  
16 essential, if there's not going to be a settlement, that we  
17 move immediately to the second stage of the proceeding,  
18 which I will outline.

19           Following the completion of Stage I, and,  
20 assuming no settlement, we'd propose that the Commission do  
21 two things: One, establish a date certain for the  
22 submission of LICAP alternative proposals; and, two,  
23 initiate an expedited hearing before a Judge to allow  
24 consideration of those proposals.

25           The purpose of the hearing would be to develop an

1 on-the-record evaluation of the justness and reasonableness  
2 of proposed alternatives to the ISO's LICAP proposal. This  
3 hearing, as we've described it in our papers, would occur as  
4 Phase II of the current case, so there would be a single,  
5 consolidated record established across both phases of the  
6 case.

7 While the hearing would be limited to the  
8 consideration of LICAP alternatives, the briefs could  
9 address the global question of which of the alternatives  
10 proposed in either Phase, if any, is just and reasonable,  
11 and, therefore, suitable for implementation by the  
12 Commission.

13 And, finally, to accommodate an expedited  
14 Commission ruling on the merits, the ISO's role would be  
15 limited to compiling a full and complete record on the  
16 alternatives -- I'm sorry, not the ISO, the ALJ's role  
17 would be limited to a full and complete record, and post-  
18 hearing briefs would be filed directly with the Commission.

19 COMMISSIONER KELLY: Mr. Strauss, as I understand  
20 the alternatives, an overview of them -- and I know we'll  
21 hear about them in more detail soon -- none of them would be  
22 implemented right away.

23 This process anticipates a consideration of  
24 alternatives. What's the proposal for dealing, in the short  
25 term, with ISO New England's capacity issues?

1                   MR. STRAUSS: Well, in the short term, we believe  
2 that on the table now or soon to be, is a proposal for a  
3 locational forward reserves market, which we believe will  
4 address some of the problems that LICAP seeks to address.

5                   COMMISSIONER KELLY: That in NERAM?

6                   MR. STRAUSS: Well, it's mentioned in NERAM, but  
7 it will soon be in front of the Commission, as filed by the  
8 ISO.

9                   COMMISSIONER KELLY: As a separate --

10                  MR. STRAUSS: That's correct, as a separate  
11 proposal, which will provide a measure of relief. I think  
12 what I meant to say is that it's mentioned in NERAM. It's  
13 not going to be -- so that's one short-term issue.

14                  You raised this morning, the question of what  
15 happens to the skyrocketing RMR costs in the meantime, and  
16 we're very concerned about those as well, although we  
17 believe that the forecasts of doom this morning, are a  
18 little bit overstated for the following reasons:

19                  One, the Commission has recently announced in the  
20 Bridgeport Energy proceeding, a new facilities cost test,  
21 which will limit, we believe, the generators that ultimately  
22 end up with RMR agreements.

23                  Second, in almost virtually every case, the  
24 Commission has set for hearing, the proposed RMR agreements  
25 and the rates, so they often end up very different than what

1 the companies initially propose. The impacts change  
2 tremendously.

3 Mr. Rogers mentioned this morning, the Salem  
4 Harbor case, and that's one example.

5 Third, in the way in which the structure works  
6 now, companies do not have to seek permission to shut down  
7 before they come in for RMR agreements. Were that process  
8 to be changed, we suspect that there would be fewer RMR  
9 agreements, going forward.

10 And, finally --

11 COMMISSIONER BROWNELL: So you think that  
12 companies should be allowed to shut down, or should not be  
13 allowed? I'm not sure what you mean by that.

14 MR. STRAUSS: No, no, no, Commissioner. What I  
15 said is that they shouldn't be permitted to seek an RMR  
16 agreement until they have demonstrated that they are truly  
17 at the end of their rope and, as a last resort, are seeking  
18 a shutdown. That's all I'm saying.

19 COMMISSIONER BROWNELL: Okay.

20 MR. STRAUSS: I'm not suggesting that I'd like to  
21 see them shut down, if they are needed, nor suggesting that  
22 that should happen, but merely that that would propose a  
23 kind of check or balance in the system for what ultimately  
24 becomes an RMR agreement.

25 COMMISSIONER BROWNELL: So let's just say we

1 don't buy the numbers in terms of RMR this morning, but, in  
2 fact, there is some cost associated with it, largely that  
3 people aren't crazy about.

4 But you are agreeing that RMR stay in place until  
5 whatever alternative is fully implemented; is that correct?

6 MR. STRAUSS: Well, I think that the locational  
7 forward reserve proposal will make a difference and will  
8 change some of the economics for some of those RMR units.  
9 And I think that the facility cost test will change the  
10 dynamics for some of the RMR units, and the hearings will  
11 change some of the economic costs.

12 But pending wherever we end up at the end of the  
13 day on that process, we may have to see some RMR agreements  
14 for a period of time, yes.

15 COMMISSIONER BROWNELL: Okay.

16 COMMISSIONER KELLY: It would be an  
17 extraordinarily truncated proceeding to try to go to hearing  
18 on the alternatives and still meet the October date. On the  
19 other hand, we do have a fully developed record on LICAP.

20 What about a process that said, if settlement  
21 doesn't work, then we'll end the process and we'll decide  
22 the case on the basis of the record we have?

23 MR. STRAUSS: You could certainly go that way,  
24 but I think that that would give us a very -- not much of an  
25 opportunity to make much of a record on the estimated

1 impacts of any alternatives, how they would function,  
2 whether they would function better than LICAP would  
3 function, whether they meet some of the concerns that were  
4 raised with respect to LICAP.

5 I'd point out that --

6 COMMISSIONER KELLY: Well, my thinking is that if  
7 there isn't enough buy-in in the settlement process to come  
8 up with some sort of critical mass of people supporting it,  
9 like in the Northeast RTO stakeholder process, why should we  
10 even consider it?

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1                   MR. STRAUSS: I think you can't make that  
2 decision until the stakeholder process is in. I think the  
3 Judge will be in a position to tell you whether there's been  
4 coalescence around perhaps a single alternative, which is  
5 one thought we're hoping might happen in that process. I  
6 can't represent to you today that it will happen because we  
7 haven't had it and we really haven't had time.

8                   But we're thinking that what will come out of  
9 that settlement process is either one alternative or perhaps  
10 two alternatives, and that the hearings would be limited to  
11 those. You are correct, it would be an extremely truncated  
12 and expedited proceeding, there isn't any question about it,  
13 although as we know the stakes are extraordinarily high and  
14 it's very important to get as full a record as we can.

15                   SECRETARY SALAS: One minute.

16                   MR. STRAUSS: That's one of the reasons that  
17 we're pushing so hard to have some kind of a process beyond  
18 the settlement process that gives us a little bit of an  
19 opportunity.

20                   The other thing I would say is that when the  
21 ISO's proposal was finally done evolving, the actual time we  
22 spent litigating the actual completed in-place proposal as  
23 the ISO has presented it now I suspect wasn't all that much  
24 longer than the kind of truncated timeframe that we're  
25 proposing for these alternatives. And we think that having

1 a judge there to compile a record that would be briefed  
2 directly to the Commission again would cut down on the time.

3 In conclusion, I simply want to thank the  
4 Commission for the opportunity to appear on this important  
5 matter and present a proposal that we think meets the needs  
6 of the region, as well as your objectives and statutory  
7 obligations. Thank you very much.

8 SECRETARY SALAS: Mr. Afonso for two minutes.

9 MR. AFONSO: Thank you. Mr. Chairman,  
10 Commissioner Brownell, Commissioner Kelly, I'm Paul Afonso,  
11 chairman of the Massachusetts Department of  
12 Telecommunications and NGR Public Utilities Commission. I  
13 am joined today by my colleague, vice-chairman Goldberg of  
14 Connecticut and Judith Justin of Massachusetts in  
15 introducing a NERAM proposal. You'll surely hear from James  
16 Daly from NSTAR and Randy Speck, counsel at Kaye Sholer for  
17 Connecticut on the parameters of the proposal and how they  
18 fit into the objectives that you set forth today. Mr.  
19 Chairman, at the beginning of today's program, you said we  
20 had been afforded an exceptional opportunity. You are  
21 absolutely correct, Mr. Chairman. An exceptional  
22 opportunity mandates an exceptional response on the part of  
23 all stakeholders here today.

24 And I'm here to affirm you -- and I heard the bit  
25 of skepticism in the question from Commission Kelly on the

1 issue of can we do this, can we work together to get to a  
2 resolution. I'm here to affirm that proposition that we at  
3 the state level will work together, we'll work quickly,  
4 we'll work intelligently to do precisely that, if afforded  
5 the opportunity, and I hope we will be afforded that  
6 opportunity.

7 SECRETARY SALAS: One minute.

8 MR. AFONSO: Brother Vince in his opening  
9 comments read a litany of no's, no's, no's, and a fair  
10 point, but I'm here to say yes to that process and I hope  
11 we're afforded that opportunity.

12 There is one thing that I will not cede to the  
13 ISO, I will not cede to any other stakeholder, and that is  
14 the proxy for consumers. We report to our governors, who  
15 report to the people of the Commonwealth of Massachusetts  
16 and all the states here. I assure you, I absolutely assure  
17 the Commission that the issue of reliability, economic  
18 development, and the safety of our families, along with just  
19 and reasonable rates, can and must co-exist. You're  
20 correct, Mr. Chairman, this system is not working. We must  
21 find a way to provide this opportunity for our communities.

22 And I would say, Mr. Chairman, I'm grateful  
23 you've held this meeting today, while the World Series  
24 Boston Red Sox are still in first place, because had you  
25 held it tomorrow, I'm not sure.

1 (Laughter.)

2 MR. DALY: The Redskins won yesterday, too.

3 SECRETARY SALAS: Next, Mr. Daly, with 15  
4 minutes.

5 MR. DALY: Thank you very much, Mr. Chairman,  
6 Commissioners. Thank you for this opportunity to present to  
7 you an alternative. It is -- for those of us who have  
8 worked in this area of developing locational installed  
9 capacity markets and other mechanisms, it is refreshing to  
10 be able to talk about something different other than LICAP.  
11 We hope you'll enjoy the discussion.

12 You've heard from our chairman, Paul Afonso, at  
13 the DTE. I will explain what the NERAM process is and then  
14 I'll hand it back to Randy Speck, who will explain to you  
15 really the answers to your three questions and how we move  
16 forward with NERAM to the degree not already addressed. You  
17 should have before you a presentation called The Alternative  
18 to LICAP, NERAM -- New England Resource Adequacy Markets.  
19 I'm on page three, and basically we list the proponents of  
20 the proposal that we have before you.

21 We had a very short time to actually put this  
22 together. In the three weeks that -- we've been working  
23 very hard the past three weeks to develop as broad a  
24 consensus as possible and we thought it was incumbent upon  
25 us to try and develop as broad a consensus as we could. I

1 won't list all the parties here, but you can see the major  
2 representatives of the two states most affected by RMR  
3 agreements and, indeed, what may appear to be shortages of  
4 capacity, whether it's in 2009 or -10 or whenever. I'd like  
5 to talk to those specific needs as well.

6 We think a fairly broad-based proposal and a  
7 similar proposal coming up later by the rest of the New  
8 England states which differ on this proposal somewhat but  
9 there's a huge degree of overlap, we believe, which further  
10 reinforces our desire to look at an alternative to LICAP.

11 As way of background, looking on slide four of  
12 the New England capacity markets, we have a 40-year history  
13 of a loss of load due to installed capacity or to a shortage  
14 of installed capacity. We think that's a tremendous record.  
15 We further wanted to restructure our industry in '97, and  
16 one of the key underpinnings of that and the reason I  
17 mention it here is that we wanted to move the risk of  
18 generation ownership from consumers to generators, who would  
19 be compensated for taking that risk. That was a requirement  
20 coming out of a vertically-integrated regime which tended to  
21 overdeliver on capacity -- and you've heard much about the  
22 excesses of the past this morning.

23 We believe it was a successful operation in that  
24 at one point we had some 30,000 megawatts of capacity  
25 proposed in the interconnection queue to come online.

1 Obviously, everybody knew not all of that capacity would,  
2 but eventually about 8000 megawatts of capacity did come  
3 online. And I mention here that it was mostly combined  
4 cycle units, because, realizing that, on top of existing  
5 baseload generation, you'll realize that there's a certain  
6 form of capacity that is actually needed in New England in  
7 the nearer term, and that is locational forward reserves,  
8 peaking capacity, reserve capacity, call it what you wish.

9           The reality is now in New England we have excess  
10 until about 2009, 2010, depending on what your load  
11 forecasts are for capacity per se to meet the reserve  
12 requirements of the entire region. However, we are in need  
13 of forward reserve capacity -- which is the root cause, we  
14 believe, of the market power issues that arise as a result  
15 of RMR agreements, we have generation in certain load  
16 pockets that have market power and can demand those RMR  
17 agreements.

18           The solution we see is a need for transmission  
19 upgrades, which various speakers have talked about and are  
20 on the way. We are spending hundreds of millions and  
21 billions of dollars over the next few years in building  
22 transmission upgrades. But we also think we need to add  
23 operating reserves, not because we just need capacity but  
24 that's the type of capacity, quick start capacity, that we  
25 need in these load pockets and then we can tell units that

1 are demanding RMR agreements that we may not need them for  
2 reliability because we have our new capacity in place.

3 The decision to sequence these markets we should  
4 tell you was a deliberate decision, we believe, to get a  
5 broad based capacity solution in place and then forward with  
6 locational reserves. If we had flipped the market the other  
7 way to put these in place first, the outcome and the  
8 negotiations on locational forward reserves would, I  
9 believe, be very different.

10 COMMISSIONER KELLY: Mr. Daly, it's my  
11 understanding that the locational forward reserves provides  
12 for payment that covers only operation but not fixed costs,  
13 is that correct?

14 MR. DALY: That's not correct. The locational  
15 forward reserves market is currently underdesigned, but the  
16 discussions involve a fairly significant payment that would  
17 cover all of capacity costs, including operating, return on  
18 and of capital, et cetera. So the discussions around the  
19 design of that market, which we believe need to be  
20 accelerated, will fully compensate that capacity for the  
21 service they provide.

22 COMMISSIONER KELLY: Do you think that having  
23 that forward reserve market will solve the RMR problem?

24 MR. DALY: Largely, yes. We're proposing here  
25 that we need to keep RMR until we get that capacity market

1 in place and perhaps we will need to keep it a little bit  
2 longer, depending on the specific instances. But we think  
3 we will largely solve the RMR problems with the specific  
4 type of capacity that's needed for contingency.

5 COMMISSIONER KELLY: And what about in the long  
6 run, without a locational mechanism in NERAM?

7 MR. DALY: This is the point of debate. We're  
8 saying locational mechanisms are satisfied through the  
9 locational forward reserves coupled with any RMRs that we  
10 may need to keep in place for a period of time. That is a  
11 relatively small marketplace that needs to be locational.  
12 The broader market of capacity in New England -- which has  
13 been the capacity market for the last 40 years or so -- has  
14 been a broad-based regional market. Some of us -- most of  
15 us on this proposal would like to maintain that, but we  
16 understand our colleagues in other parts of the states who  
17 have surpluses have somewhat of a different opinion on that,  
18 and we think that's grounds for debate.

19 COMMISSIONER KELLY: And why would you want to  
20 maintain it?

21 MR. DALY: We think the broader New England  
22 capacity market is a better market in terms of being able to  
23 administer it from your point of view, it reduces market  
24 power ability, it allows us to add larger more efficient  
25 generating units without depressing prices in small zones

1 and, as I said, causing the market power issues that we've  
2 talked about throughout the RMR debate.

3 COMMISSIONER KELLY: Why wouldn't you want to  
4 have access to the existing generation that are in the  
5 generation-rich states, or why wouldn't you want to have a  
6 plan that provided for that?

7 MR. DALY: I'm sorry, I don't quite understand  
8 your question.

9 COMMISSIONER KELLY: You want -- does your plan  
10 take into account an ability to access those generation-rich  
11 states and have that generation imported into yours?

12 MR. DALY: Yes, and if we have to have  
13 transmission upgrades -- which we think they may be needed -  
14 - we will look at the economics of providing those. Most of  
15 New England is not constrained and historically has not been  
16 constrained. It's a more radial system than some of the  
17 other PJM and New York that you deal with. So constraints  
18 in New England are not binding all the time and, indeed,  
19 under the ISO demand curve we saw that once the transmission  
20 upgrades went in place, prices converged over all the  
21 subzones, so they weren't binding at all. And we think that  
22 debate as to what degree of locational is needed, how you  
23 plan for transmission upgrades to eliminate them if needed,  
24 it may not be economic to do it, is a debate that we need to  
25 have.

1                   COMMISSIONER KELLY: And who would administer  
2 this market?

3                   MR. DALY: ISO would administer a centralized  
4 capacity market.

5                   COMMISSIONER KELLY: And would there be a  
6 contract at the end?

7                   MR. DALY: There would be a tariff in place that  
8 ISO would need to administer, approved by yourselves.  
9 Entities could contract bilaterally, load-serving entities,  
10 to satisfy their needs. Any residual needs that are not met  
11 through that marketplace would be subject to the pricing of  
12 the ISO central-administered marketplace.

13                   COMMISSIONER KELLY: Would you make a capacity  
14 payment?

15                   MR. DALY: There would be a capacity payment to  
16 generators, yes, both in the bilateral market and in the  
17 NERAM market.

18                   There's one key issue -- I think we're diverging  
19 from the script a little, though I find the conversation  
20 beneficial -- is that LICAP is a monthly market scheme which  
21 sets prices and then buyers and sellers transact at those  
22 prices. This is a forward market, multi-year market. We  
23 look three years forward for capacity additions that can  
24 occur within that timeframe, because that's when you can get  
25 it built. And you heard that from generators this morning,

1 that's the lead time they need.

2 With those additions, we are specifically  
3 planning for capacity. It's not that we're hanging around  
4 until 2010 tweaking a market scheme that hopefully will  
5 deliver capacity. We are putting and looking to put in  
6 place a market scheme that will actually deliver the  
7 capacity that we contract for in the forward time period and  
8 for a contract period that runs either one to three years  
9 beyond that initial procurement. So we're looking four to  
10 six years out in terms of capacity needs and actually  
11 putting in place a compensation mechanism that is market-  
12 driven, not administratively determined to deliver that  
13 capacity in the timeframe that we need it.

14 It's not as, we've seen one big chart circulating  
15 this morning by the Capacity Suppliers with two vertical  
16 bars that show nothing happening until 2009 or -10 under  
17 various proposals. We are looking to put this in place next  
18 year when it gets approved possibly for auctions starting in  
19 the planning period 2007 forward for delivery into the 2010  
20 period. We're also providing in a shorter timeframe the  
21 locational forward reserve capacity which is actually needed  
22 very soon. We could do with it today. So that's the  
23 capacity mechanism. We, too, are concerned that this  
24 process has taken a long time to get here and that is not  
25 actually delivering the capacity that we think we need, but

1 we think this mechanism would do it.

2 COMMISSIONER BROWNELL: So you've said the design  
3 work was a work in process and the settlement process will  
4 be a work in process. That's a pretty aggressive timetable  
5 to implement what is essentially -- let's just call it a new  
6 plan for purposes of discussion. Can the ISO and all the  
7 market participants support the changes that will be needed  
8 in terms of tariff changes, software changes, all the kinds  
9 of things that go into something of this magnitude?

10 MR. DALY: Well I think the ISO can better  
11 respond to that question, but I don't think it's any more  
12 complicated than what they're looking to put in place today.  
13 There has been a lot of groundwork done by NERA in  
14 developing this C-RAM report, so it's not exactly -- there  
15 is work to be done, but it's not exactly blue sky. There  
16 has been some serious work done on it. As for systems at  
17 implementation, I don't believe it's any more complicated  
18 than what they're proposing under LICAP, although they've  
19 had the benefit of two years of development on LICAP. But I  
20 don't think the scheme for LICAP has been set for very long,  
21 so they haven't had that long to actually spend on  
22 resources, but I think they can better answer that.

23 COMMISSIONER BROWNELL: We'll wait.

24 COMMISSIONER KELLY: As I understand it, under  
25 the NERAM proposal, the ISO would have to come up with a

1 price to start the bid. How would that price be derived and  
2 how will the costs -- what do you anticipate the costs to be  
3 relative to the LICAP demand curve? Because presumably the  
4 reason we're going through this consideration of  
5 alternatives is because you want a lower cost.

6 MR. DALY: Exactly.

7 COMMISSIONER KELLY: And how do we -- do we have  
8 -- how much assurance do we have that it'll be lower cost?

9 MR. DALY: On page 12 of this presentation, we  
10 flipped through a lot of the mechanics. So on page 12, we  
11 identified three specific cost areas. Because the LICAP  
12 scheme is an administrative price-setting curve, we can  
13 understand what the prices are under various levels of  
14 objective capability or installed capacity requirements, so  
15 we can estimate the price of it. That's why it's been that  
16 easy for us to do it through this case.

17 So we can compare -- the NERAM scheme is market  
18 based so you have to make assumptions about what market  
19 prices clear at. What we've done is identified three main  
20 areas where we think this scheme differs from LICAP and have  
21 identified savings relative to it. One is the obvious one  
22 that has been talked about earlier today but somewhat  
23 mischaracterized is the -- we don't procure 5.4 percent  
24 above OC; we procure OC. So that's a savings sure and  
25 certain. And at the cost of new entry, that amounts to

1       about \$150 million a year, \$750 million over a five year  
2       period. That's one level of savings.

3                   COMMISSIONER KELLY: If the demand curve for  
4       LICAP was moved to OC instead C target, what were the costs  
5       -- how will the costs compare?

6                   MR. DALY: Well the next level of savings is the  
7       ISO New England curve pays two by EBCC versus this, which  
8       would pay -- we see no reason for it to be more than new  
9       entry, cost of new entry would set the price.

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1 Under the ISO scheme, they were below 17 percent  
2 at the time, which is about once in very five years, so  
3 you'd save one by EBCC every five years, which amounts to  
4 \$2.7 billion.

5 COMMISSIONER KELLY: But if the move the demand  
6 curve in LICAP, would it be similar?

7 MR. DALY: If the moved the demand curve in  
8 LICAP, there would be one -- if you're trying to get to the  
9 dollar amount that might equate --

10 COMMISSIONER KELLY: Yes, apples and apples.

11 MR. DALY: -- there would be a huge difference  
12 that you're left with. Under LICAP, you pay and hope the  
13 capacity shows up; under this scheme, you're contractual  
14 bound to have it there. And that's the huge difference.

15 And we can debate market prices, et cetera, but  
16 if we take a market mechanism -- and that's the final part  
17 of our --

18 COMMISSIONER KELLY: One last question: Why  
19 should we just have one price for the entire region? Why  
20 not have locational prices, given that there are different  
21 costs in serving or building in different areas?

22 MR. DALY: Well, we've had a market scheme in  
23 which we've had region-wide capacity prices before, that got  
24 construction of generation into the market, so we believe  
25 that's valid.

1                   We think that the debate as to whether it needs  
2                   to separate locationally, is one we'd like to have in the  
3                   stakeholder process. Now, we're not excluding it, but we  
4                   see benefits for regional markets.

5                   COMMISSIONER KELLY: Thank you.

6                   SECRETARY SALAS: Time is up.

7                   MR. DALY: Thank you.

8                   SECRETARY SALAS: Now, Mr. Speck, for seven  
9                   minutes, and you have reserved three for rebuttal, correct?

10                  MR. SPECK: Yes, thank you.

11                  I just want to briefly answer the Commission's  
12                  three questions that they posed to the Load Group, or with  
13                  regard to the NERAM proposal.

14                  The first question was whether NERAM would  
15                  produce just and reasonable wholesale power prices, at  
16                  levels that encouraged needed generation additions, and we  
17                  can answer that quite affirmatively.

18                  NERAM will permit new entrants to compete with  
19                  existing generators, which has not been the case in the past  
20                  and has not -- would not be the case under ISO's proposal.  
21                  And that would achieve the least-cost, most efficient price.

22                  And particularly, we think, with the descending  
23                  clock auction mechanism that is being proposed, as well as  
24                  the three-year forward-looking auction, that we will get new  
25                  generation to commit to that time period, because they can

1 see exactly what the price is going to be.

2 They know what they're going to be paid, and then  
3 they will come in. The uncertainty has been reduced or  
4 almost eliminated.

5 Second, NERAM will permit load to purchase only  
6 the amount of capacity that's necessary for reliability, and  
7 will avoid what I described this morning as the volatility  
8 premium.

9 And that's extremely important, because it's not  
10 only the \$150 million per year that Mr. Daly just described,  
11 but it's the other components of the curve, the ISO demand  
12 curve, that are to the right of OC. All we have to procure  
13 is OC, and there's no payment for 115 percent of OC.

14 And so those cost savings will be substantial.  
15 And that will be a just and reasonable price, because we  
16 will produce reliable capacity at OC, and we will pay  
17 generators, the cost of new entry. That is, by definition,  
18 the just and reasonable rate.

19 Thirdly, NERAM will encourage needed generation  
20 by enabling new capacity to set the price. The new capacity  
21 will be able to come in and set the clearing price for the  
22 auction and, therefore, establish the just and reasonable  
23 rate.

24 Question No. 2: NERAM will provide adequate  
25 assurance that necessary electric generation capacity or

1 reliability will be provided. As Mr. Daly indicated, with  
2 LICAP, it is a hope and a prayer that we're going to pay  
3 them and they will come.

4 With NERAM, we have a commitment that three years  
5 hence, that capacity will be provided. If it's not  
6 provided, there will be penalties. So, we can be assured  
7 that the reliability that we've paid for, is actually going  
8 to be there at the price that we paid for it.

9 The NERAM auction will procure the necessary  
10 capacity for reliability, three years before the supply  
11 period. We'll know well in advance, that we're going to  
12 have adequate supply, and we'll be able to -- that three-  
13 year period, by the way gives us an opportunity to make  
14 adjustments.

15 Let's assume that there's a greater increase in  
16 load than we expected. There could be a supplemental  
17 auction in that three-year time period, to make sure that we  
18 catch up, and that we don't under-shoot OC by any  
19 significant amount.

20 That's the way we can make sure that we're going  
21 to hit OC.

22 NERAM will assure new entrants whenever there is  
23 a projected shortage. If you have a current over-supply, as  
24 is currently the case, then the price at the auction will be  
25 less than the cost of new entry, and you won't have new

1 entrants coming in, and, in fact, you may have some existing  
2 generators retire.

3 When there is a projected shortage, however, the  
4 new entrants will come into fill that gap.

5 The third question, and perhaps the most  
6 important, based on the questions that we've gotten this  
7 morning and this afternoon, relates to the cost. And, as Mr.  
8 Daly indicated, because this is a market-based, competition-  
9 based mechanism, it's difficult for us to project exactly  
10 what the costs would be. ISO had the advantage, with regard  
11 to LICAP, because it's just simply an administrative process  
12 and they can calculate very precisely, based on assumptions,  
13 what the costs are going to be. We can't do quite the same  
14 thing.

15 COMMISSIONER BROWNELL: Do you think you're going  
16 to come closer than a few statements, as you develop this  
17 proposal? It seems to me, rather difficult, particularly  
18 given the various numbers that were bandied about, and  
19 rejected by the Judge, that we need to be able to quantify  
20 this, just a tad more carefully.

21 MR. SPECK: Well, as Mr. Vince offered this  
22 morning, I think we could take advantage of ISO's expertise  
23 and their technical skills, and be able to come up with a  
24 much better estimate of what those costs are going to be.

25 COMMISSIONER BROWNELL: So you really haven't put

1 pen to paper, even back-of-envelope calculations of this?  
2 This is just what you assume?

3 MR. SPECK: Well, there have been some. I would  
4 characterize them as more than back-of-the envelope. There  
5 was testimony with regard to some of the elements of the  
6 cost, for instance, EBCC. We believe that the estimate that  
7 has been made of EBCC, is too high, and the testimony  
8 indicates that it's 20 to 30 percent too high.

9 COMMISSIONER BROWNELL: The testimony that you --  
10

11 MR. SPECK: The testimony that is in the record,  
12 actually sponsored by National Grid.

13 COMMISSIONER BROWNELL: Okay.

14 MR. SPECK: And we believe that a competitive  
15 market will drive that cost down to the lowest level.

16 SECRETARY SALAS: One minute warning.

17 MR. SPECK: And, therefore, we will save some  
18 money on the cost of new entrants, which is not taken into  
19 account in ISO's proposal, because they are just assuming  
20 what the EBCC is going to be, and that's the way they're  
21 setting their demand curve.

22 So we think that there are a lot of opportunities  
23 to refine those numbers. And we will get better numbers, I  
24 think, as we get cooperation from ISO and we get input from  
25 the generators and others.

1                   But that's a process that I think we have yet to  
2 go through.

3                   COMMISSIONER BROWNELL: Okay, thank you.

4                   MR. SPECK: And, most importantly, however, the  
5 NERAM costs will be less by eliminating ISO's volatility  
6 premium. And, as I indicated this morning, there are four  
7 different elements of that volatility premium, and we can  
8 eliminate all four of them by adopting an approach like  
9 NERAM.

10                  And it's simply because we will have much greater  
11 certainty, and, therefore, will be able to procure only the  
12 capacity that we need.

13                  SECRETARY SALAS: Time is up.

14                  MR. SPECK: Thank you.

15                  SECRETARY SALAS: Now, Mr. Getz, with seven  
16 minutes.

17                  MR. GETZ: Thank you. Good afternoon, Mr.  
18 Chairman and Commission. May it please the Commission, I'm  
19 Thomas Getz. I'm the Chairman of the New Hampshire Public  
20 Utilities Commission, and with me are Harvey Reiter from the  
21 law firm of Stinson, Morrison, and Hecker, and Dr. Thomas  
22 Austin, from the Maine Public Utilities Commission.

23                  We are appearing this afternoon on behalf of the  
24 Public Utility Commissions of Maine, Vermont, Rhode Island,  
25 and New Hampshire, to discuss our proposed alternative,

1       which we call NELRAM, the New England Locational Resource  
2       Adequacy Model.

3                   I would also note at this juncture, that the  
4       Maine Public Advocate has made a filing expressing its  
5       preference for NELRAM, and the New Hampshire Consumer  
6       Advocate has authorized me to indicate that she supports the  
7       locational feature of NELRAM.

8                   I will begin with some general remarks, then Mr.  
9       Reiter will provide an overview of NELRAM, focusing on the  
10      locationality features, and Dr. Austin will then offer some  
11      additional observations.

12                   I want to thank you for scheduling this oral  
13      argument and allowing us this opportunity to discuss NELRAM.  
14      My understanding is that oral argument has not been a common  
15      practice in recent years, and I believe the fact that you  
16      have adopted this measure, speaks to the seriousness of the  
17      issues and the deep level of your commitment to making the  
18      most fully-informed decision that you can.

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1           In responding directly to the Chairman's opening  
2 this morning, we agree completely that the status quo is not  
3 acceptable and we agree that an effective capacity market is  
4 critical to the future of system reliability in New England.  
5 As a result, we share the same goal. Where we have differed  
6 is the method of achieving that goal, which has two aspects.  
7 The first aspect is substantive and goes to the issue of  
8 whether the LICAP approach is the best basis on which to  
9 establish a capacity market or whether some other method  
10 such as the central procurement approach reflected in NERAM  
11 and NELRAM is superior. You have heard a great deal about  
12 that aspect, so I will not address the substance of the  
13 alternative approaches other than to observe that although  
14 there is an important distinction between NERAM and NELRAM  
15 there is far more that unites us and divides us on these  
16 issues.

17           The second aspect is procedural, and that is  
18 where I seek to direct your attention. As a state  
19 commissioner, I want to be confident that I have heard all  
20 the facts and considered all the arguments before I make a  
21 decision. And in this case, I do not think you have quite  
22 reached that position as of yet.

23           My personal belief is that the central  
24 procurement approach is superior to the LICAP approach.  
25 However, you have not had the opportunity to review a record

1 that compares and contrasts LICAP, NERAM, NELRAM and  
2 reliability options, which makes it difficult for you to  
3 definitively select among the best of the alternatives.

4 If I understand correctly, the purpose of this  
5 oral argument, you are looking for the foundation on which  
6 to make a decision whether to proceed with LICAP and the  
7 record as it stands or to reopen the record to consider  
8 whether there is a better way to create the capacity market  
9 that we all agree is so critical.

10 I hold the opinion that the judgment to focus  
11 exclusively on the LICAP approach was made prematurely and  
12 that you would have been better served with the testimony of  
13 Dr. Austin on the central resource adequacy model and  
14 testimony of Drs. Bidwell and Pecquin on reliability options  
15 had been part of the record and, thus, subject to  
16 examination and further development.

17 I've reached this conclusion based in part on  
18 what I consider to be the significant progress that has been  
19 made in recent months in refining the central resource  
20 adequacy model into the NELRAM alternative. As set out in  
21 the four states filing on September 13, we believe that  
22 NELRAM draws on the best elements of what has gone before  
23 it: namely, the National Economic Research Associates'  
24 original work in 2003 on the central resource adequacy model  
25 for PJM, New York and New England and ISO New England's work

1 on LICAP and PJM's work on its reliability pricing model, as  
2 well as the New England PUC's recent work on NERAM.

3 We are here today because we are deeply uneasy  
4 about the prospects of LICAP actually delivering what it  
5 promises and, even assuming for the sake of argument that it  
6 could deliver, we are concerned that customers as it now  
7 stands could be overpaying substantially for the end  
8 product. It seems clear, to us at any rate, that further  
9 examination of the capacity market issue in the context of  
10 other reasonable alternatives will contribute to a fully  
11 informed and, therefore, superior result.

12 COMMISSIONER KELLY: Mr. Getz, could I ask you  
13 why you don't think that a market mechanism would work?  
14 What is your concern with LICAP, why won't it work?

15 MR. GETZ: For the reasons that have been  
16 discussed here today. I think primarily we have a concern  
17 that there is no assurance that the generation will appear  
18 where and when it's needed and we believe that the resource  
19 adequacy model variance is a better way of attracting and  
20 being assured that that generation will be there. So in  
21 some respects, we believe there's flaws in LICAP as it's  
22 been executed, but we believe the central resource adequacy  
23 model as refined provides us better assurance.

24 COMMISSIONER KELLY: It's a concern that you have  
25 about how the market would work, right? I mean, has the

1 market -- the market has on the energy side provided for  
2 your needs relatively well. I mean, your state has  
3 deregulated, is that correct?

4 MR. GETZ: We are in kind of a hybrid, but  
5 essentially we have deregulated New Hampshire, though our  
6 largest utility still holds on to its generation assets.

7 SECRETARY SALAS: One minute.

8 COMMISSIONER KELLY: I guess I am struggling to  
9 see why, at the retail level, you have markets that are  
10 functioning but at the wholesale level you don't trust the  
11 market to work.

12 MR. GETZ: Well, I'm not so sure it's a matter of  
13 trusting the market to work, because what we will be doing  
14 if you accept NERAM is trusting that markets will result in  
15 the best auction prices and that that market will work  
16 better than an administratively-set demand curve. That  
17 brings me back to thinking about the great theories that we  
18 saw with PURPA and QWEPS and avoided costs that seemed very  
19 sound but then, in execution and in practice, ended up  
20 costing consumers a lot more money than really should have  
21 been necessary if an auction had been part of that process.

22 COMMISSIONER KELLY: How about your observation  
23 of the New York market under New York's LICAP plan, do you  
24 think that it's working?

25 MR. GETZ: I think I'm in the same position as

1 what I've heard earlier today. I think the jury is still  
2 out --

3 SECRETARY SALAS: Your time's up.

4 CHAIRMAN KELLIHER: We'll have to leave it at  
5 that.

6 SECRETARY SALAS: Next, Mr. Reiter, with 12  
7 minutes.

8 MR. REITER: Thank you. Good afternoon,  
9 Chairman, Commissioners. I wanted to emphasize just briefly  
10 a point that Mr. Strauss and Mr. Speck before me have made,  
11 and that is that the proposals that you've heard discussed  
12 and that you will hear discussed are not complete and that a  
13 process is necessary to supplement the record. There's been  
14 much ground work done, but there are details and Dr. Austin  
15 will be here to answer some specific questions about the  
16 details this afternoon.

17 I also want to express our appreciation to the  
18 ISO for its willingness to consider our requests in a  
19 supplemental process, if the Commission goes forward with  
20 one, to run simulations and studies necessary to flesh out  
21 the details. I understand that the ISO remains committed to  
22 the LICAP proposal and for that reason we're very  
23 appreciative that they're willing to extend this cooperation  
24 and to consider the alternatives that we'd like to develop.

25 I did want to talk briefly, just touch on a

1 couple of questions that Commissioner Kelly had raised. One  
2 of these was -- and I guess I'll really be paraphrasing. If  
3 we try C-RAM, and I hate that acronym, but if we tried it  
4 and we didn't reach agreement, why try? I guess I have two  
5 answers to that. One is for the reasons that Mr. Daly has  
6 discussed and that Chairman Getz has discussed. We've  
7 reached common ground on an awful lot of what would go into  
8 NERAM or NELRAM. And there's a part that divides us, the  
9 locational component. And we may be able to bridge that gap  
10 with settlement talks.

11 But the second answer I would give is that the  
12 alternative is to ignore the possibility that LICAP won't  
13 work and to deny an opportunity to develop the record on  
14 alternatives that might. And that may be difficult. We've  
15 attempted, through the proposal that Mr. Strauss has  
16 outlined, to devise a method by which we could supplement  
17 the record and the Commission could make an informed  
18 decision on alternatives.

19 I mentioned this morning our position and the  
20 testimony we'd submitted that expressed grave doubts about  
21 whether a LICAP mechanism would work. Now Mr. Estes, I  
22 think, had said earlier today that well the Capacity  
23 Suppliers had responded -- the record wasn't devoid of any  
24 response to Mr. Fedders' testimony. What their witness, Mr.  
25 Boland, actually said was if you adopted the mechanism, the

1 LICAP mechanism that the ISO had proposed -- this was in  
2 Exhibit CS-51 at page 10 -- that the structure as proposed  
3 by ISO New England cannot be financed; that's the concern we  
4 share. Now they proposed what they say would be fixes to  
5 that, but those are fixes that the ISO opposes strongly.

6 So we have, at least in part, some agreement with  
7 the generators that -- again, as their witness said, Mr.  
8 Boland -- that as currently contemplated, there's more cycle  
9 risk within LICAP's structure than investors would be  
10 willing to bear. So if you adopt the ISO proposal as the  
11 Judge has proposed it, the generators have some problem with  
12 this, too. That's why we think alternatives need to be  
13 explored.

14 Now if you'll bear with me, I would like to get  
15 into the locational component but I did want to reiterate  
16 just briefly a couple of things about what NELRAM and NERAM  
17 have in common. One is that we're talking about a market-  
18 based compensation for a defined product in both  
19 alternatives. I think, as I stated this morning, we don't  
20 think LICAP is a market mechanism, it's an administratively-  
21 determined demand curve.

22 And the conversation I had earlier today with Mr.  
23 Jaffe -- and I think it was a point that Chairman Getz just  
24 made -- when we talked about how to deal with developing a  
25 price for cogeneration: back when PURPA was first passed, a

1 number of states developed an alternative, they said we'll  
2 try to figure out what the avoided cost is for generation  
3 and they chose some pretty expensive generation and wound up  
4 committing to contracts that were greatly in excess of what  
5 were produced later through the auction method.

6 So we think the auction method is really more of  
7 a market-based mechanism than an administratively-determined  
8 demand curve. We're not opposed to markets. I think we  
9 agree with the Commission that markets, unaided by the  
10 Commission with a regulatory mechanism, won't work so we try  
11 to replicate as best we can what a market would produce. We  
12 think that the NELRAM and NERAM proposals better do that  
13 than LICAP. Neither of them are really pure market  
14 mechanisms.

15 I think another feature that NELRAM and NERAM  
16 have in common is that they'll facilitate competition  
17 between new and existing generation because of the long-term  
18 commitment built in to the mechanisms. And we also agree --  
19 as do the proponents of NERAM -- that there ought to be a  
20 locational forward reserves market and that that will help  
21 the capacity problem in New England.

22 Now that said why do we think we need a --

23 COMMISSIONER KELLY: Mr. Reiter, how about the  
24 RMR problem, how do you anticipate it working to solve the  
25 RMR problem?

1                   MR. REITER: Well, here I'm going to have the  
2 luxury of punting to Dr. Austin, who I think can provide you  
3 better answers than a lawyer can on some of this. If you  
4 want, I can punt right now or maybe we can come back to  
5 that.

6                   COMMISSIONER KELLY: Are you going to talk about  
7 that --

8                   MR. AUSTIN: I'd rather talk about it on Harvey's  
9 time, if that's okay.

10                  CHAIRMAN KELLIHER: You can talk on Mr. Reiter's  
11 time if you like or address it on your own time.

12                  MR. AUSTIN: Harvey, what do you want to do?

13                  MR. REITER: Be my guest.

14                  MR. AUSTIN: Any of these mechanisms if they're  
15 well structured and reduce the RMR costs -- probably none of  
16 them will really eliminate the RMR costs because there are  
17 always going to be particular odd situations where RMR will  
18 exist. At the same time, the current problem with RMRs --  
19 and I think one of the reasons they're expanding so much --  
20 is highlighted actually in the recent filing by the  
21 Connecticut AG, among others. If RMRs are cost plus then it  
22 puts generators in the point of getting the greater of cost  
23 or market and as long as you stay in that situation you're  
24 going to have a big RMR problem. It doesn't really matter  
25 too much what you do with LICAP. LICAP can't fix that one;

1 you have to deal with that one directly.

2 MR. REITER: If I could return to some of the  
3 reasons why we think there needs to be a NELRAM alternative  
4 to LICAP -- and I'll get to location in just a moment. But  
5 again this is in part something that we have in common with  
6 the NERAM proposal.

7 One is I think this does result in a mechanism in  
8 which future payments result in capacity being available,  
9 with the hope that it will become available. It also  
10 addresses the concern with long-term commitments that new  
11 generation has and investors in new generation have about  
12 whether there will actually be a mechanism in place down the  
13 line that results in compensation.

14 The ISO itself described the regulatory risk  
15 inherent in LICAP as the Achilles heel of its proposal, and  
16 we agree and we think that NELRAM addresses this by  
17 providing long-term commitments to generators that puts new  
18 generation and existing generation on equal footing.

19 And last, and this is a point that Mr. Speck  
20 made: the volatility that you see in installed capability  
21 levels historically -- and that the ISO itself predicts will  
22 occur under LICAP -- is something that we think is fixed by  
23 a mechanism like NERAM or NELRAM, because we're soliciting  
24 bids for specific amounts of capacity that will come online.

25 COMMISSIONER BROWNELL: I don't see Maine and

1 Connecticut's name next to the locational NERAM proposal.  
2 Is that -- are we mixing the -- you have one proposal for  
3 the general capacity market. You're proposing a more  
4 locational variety -- you're talking about the states, but I  
5 don't see all the states on the same page.

6 MR. REITER: No, no, no. I should be very clear  
7 on this.

8 COMMISSIONER BROWNELL: Please do.

9 MR. REITER: The states that I'm speaking for  
10 this afternoon are the states of Vermont, Rhode Island,  
11 Maine and New Hampshire.

12 COMMISSIONER BROWNELL: So NECPUC itself does  
13 not agree.

14 MR. REITER: There is no NECPUC position on  
15 location.

16 COMMISSIONER BROWNELL: Okay. Thank you.

17 COMMISSIONER KELLY: Could you also address the  
18 difference between NELRAM and NERAM on the favoring  
19 transmission over generation? As I understand, there's some  
20 concern that without a locational aspect, given how New  
21 England allocates the cost of transmission, that NERAM would  
22 unduly favor transmission.

23 MR. REITER: I think that's a fair statement of  
24 the four states concern about NERAM, that because it lacks a  
25 locational component and it doesn't address something -- a

1 concern that we share with the ISO and with the Commission  
2 in its earlier statements and with PJM that a capacity  
3 adequacy mechanism should assure that capacity is built  
4 where it is needed most and that it has to take into account  
5 not only that capacity may be less expensive to install in  
6 some subregions but that when you add the cost of  
7 transmission you have to take that into the equation in  
8 deciding what is the most economical and efficient  
9 alternative to solve resource adequacy concerns.

10 We're in agreement with the authors of the C-RAM  
11 report -- the four states -- that the C-RAM report that  
12 preceded the development of NELRAM and NERAM that a single  
13 bidder mechanism can accommodate a locational component  
14 within a region as large as New England, it's sizable, and  
15 containing significant sized subregions. We think that it  
16 can accommodate a locational component.

17 And we also believe, as I think I've just  
18 mentioned, that locational prices for capacity are critical  
19 to send the correct economic signals.

20 COMMISSIONER KELLY: When you say that it's big  
21 enough to handle the locational component, do you mean that  
22 there will be enough competition among generators within the  
23 various locations?

24 MR. REITER: Generally, but I think we recognize  
25 -- and I think Dr. Austin will address some of this -- that

1 there are actual problems of market power exercise. And  
2 those have to be accommodated within the framework.

3 I see that I've covered most of the points I  
4 wanted to, and I will turn the rest of my time over to Dr.  
5 Austin, if that's acceptable.

6 SECRETARY SALAS: Very well.

7 MR. AUSTIN: Just starting with that last  
8 question, if you go to a locational market is there an  
9 increased potential for market power concerns in specific  
10 locations, and the answer is that's certainly a possibility  
11 and the smaller the location, the bigger concern it's likely  
12 to be. Our position is not that we can tell you absolutely  
13 that there would never be a market power problem in NEMA or  
14 Southwest Connecticut or Connecticut but, rather, that we  
15 should begin with the attempt to solve this through markets  
16 and then if it turns out that in a particular situation in a  
17 particular year there's a market power problem in this  
18 place, then you deal with it at the time.

19 The other thing I guess I'd point out is that PJM  
20 in its recent RPM filing is proposing going to I'm going to  
21 say 23 separate zones -- it's approximately that number  
22 anyway -- which is going to include some pretty small zones.  
23 And again they have recognized the problem, have begun  
24 discussing ways of dealing with it, and I think that's the  
25 way we at least would suggest you approach it going forward.

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Having said that, it's always difficult to go last because you never know what everybody in front of you will say. In this case, Mr. Daly in particular stole most of my thunder and said about three-quarters of the things I was about to say.

One of the very interesting things, if you look at the hallmarks or the bullet-point lists of what NERAM and NELRAM are -- and they are virtually identical, with one exception. And that was the result of quite a bit of work among Mr. Daly and me and a wide variety of other folks, both within NECPUC and particularly representatives of the utilities, trying to come to closure -- we didn't get there all the way, but we got a long way.

I guess the other thing I wanted to repeat is something Chairman Getz said, which is we fully recognize that we need a solution. You can't rely on a market solution in the sense of just an energy market solution, because it just won't work. We need to come up with some other answer.

And one of the places that goes is an observation Mr. Estes made that I just want to address briefly. His characterization -- and I don't want to go too far with this, John -- was that the big difference --

MR. ESTES: You can go too far if you want.

1 (Laughter.)

2 MR. AUSTIN: The big difference between NERAM,  
3 NELRAM on one side and LICAP on the other is LICAP starts  
4 sooner and, by implication, the generators would just as  
5 soon have a little money sooner, thank you very much, which  
6 I fully understand.

7 COMMISSIONER BROWNELL: So you don't agree with  
8 the -- what was filed by the New England ISO in their  
9 September 13th brief and earlier that states the problem is,  
10 in fact, urgent. You don't agree with that urgency, 2006  
11 maybe in Connecticut, 2008 on a system-wide basis, that's  
12 not so --

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1                   MR. AUSTIN: I think there are two issues here.  
2                   One is how fast will the capacity for the reliability  
3                   problem come, and how quickly and how seriously? I mean, do  
4                   we have a big problem next year or a small problem next  
5                   year, that grows over time?

6                   The issue I was trying to address with Mr. Estes,  
7                   though, is the question of so what payments might happen  
8                   between now and the first year that NERAM might come on,  
9                   which is, for the sake of discussion, 2009, 2010?

10                  And I think we recognize that that's a legitimate  
11                  issue and one we need to discuss and go forward with.  
12                  Having said that, we don't have any specific proposal,  
13                  because that's not the way one negotiates.

14                  But that's --

15                  COMMISSIONER BROWNELL: After two and a half  
16                  years, I would think somebody would have figured out a way  
17                  to negotiate, but that's okay.

18                  MR. AUSTIN: But the negotiation bears entirely  
19                  on the litigation, as any negotiation would.

20                  COMMISSIONER BROWNELL: Okay. I look at the  
21                  numbers and I have that sense of urgency.

22                  MR. AUSTIN: Okay.

23                  COMMISSIONER BROWNELL: There is no  
24                  deliverability component in anything I see. Is that because  
25                  of the transmission constraints in New England? They just

1 can't support that, or you don't think that's viable or  
2 important?

3 MR. AUSTIN: There certainly is no component  
4 which requires deliverability absolutely. Our thought is  
5 that there's a transmission expansion process which would  
6 look at the need for new transmission, and create or not  
7 create deliverability, based upon the costs and benefits of  
8 new transmission and new generation at the time.

9 COMMISSIONER KELLY: I had a follow-on question  
10 from the one that you answered before on Mr. Reiter's time.

11 If we were to eliminate RMR contracts under the  
12 LICAP proposal, that would take care of -- you stated, I  
13 believe, in answer to the question, that we'd have an RMR  
14 problem in New England, if we adopted LICAP, because, in  
15 fact, the RMR contract price may be above the LICAP price.

16 MR. AUSTIN: Just to be clear, I think there are  
17 two reasons you'd have the problem: One is, as long as the  
18 RMR contracts are allowed with a choice of market or cost,  
19 the higher of market or cost, you're going to have a  
20 problem, regardless of what you do with the capacity market.

21 The other thing I'd say is that I think LICAP and  
22 any of the other schemes, no matter how well done, will  
23 still require some, hopefully fairly small, level of RMR  
24 contracts.

25 COMMISSIONER KELLY: That's the point that I

1 wanted to make, that as I understand it, we would eliminate  
2 almost all RMR contracts, at least under LICAP.

3 SECRETARY SALAS: One minute.

4 COMMISSIONER KELLY: Would you eliminate them  
5 under NELRAM?

6 MR. AUSTIN: You'd love to, but I'm not sure you  
7 ever can. I mean, where you have situations where you have  
8 RMR contracts driven by very local concerns, you know, one  
9 particular transmission line or one particular piece of the  
10 transmission system inside Boston, for example, I can  
11 imagine you might have situations where that was just the  
12 only choice left or the only really logical choice.

13 Let me get back to just one other point. There  
14 was a long discussion earlier on demand curves and what data  
15 you use to pick the standard deviation and related issues.  
16 And I just wanted to point out that I think that issue --  
17 I'm out of time -- that issue is --

18 SECRETARY SALAS: I'm sorry, Mr. Austin. You  
19 reserved six minutes for rebuttal. Did you want to change  
20 that?

21 MR. AUSTIN: Just drop it down to five, and let  
22 me take one more minute here.

23 SECRETARY SALAS: Sure.

24 (Laughter.)

25 SECRETARY SALAS: I'll start now.

1 (Laughter.)

2 MR. AUSTIN: Where you have a monthly curve and  
3 you're predicting how generators will respond, three, five,  
4 seven years out, you've got a lot of uncertainty as to what  
5 that response will be. And that's what causes the need for  
6 the so-called standard deviation and the over-buy of five  
7 percent.

8 If you go to a mechanism where you're contracting  
9 three to five years out, and you have contractual terms that  
10 allow for both termination fees, if somebody back out, and  
11 the ability to reconfiguration auctions to backstop anyone  
12 who backs out, you just eliminate the need for that whole  
13 aspect of the debate, that whole aspect of the standard  
14 deviation.

15 I think that's a good thing. Thanks.

16 COMMISSIONER KELLY: Do you think that under  
17 either plan, that either plan, LICAP or NELRAM or NERAM,  
18 would favor one type of generation over another?

19 SECRETARY SALAS: That's time.

20 COMMISSIONER KELLY: I'm sorry, I thought we were  
21 on rebuttal. Sorry.

22 CHAIRMAN KELLIHER: Do you want to use up some  
23 amount of your rebuttal time to answer the questions?

24 MR. AUSTIN: Just very quickly --

25 CHAIRMAN KELLIHER: That's a yes, then.

1 (Laughter.)

2 MR. AUSTIN: That's yes, and I think there is  
3 some difference associated with the locational aspects, what  
4 kinds of outcomes that favors, but I don't see that as being  
5 a huge issue between them.

6 SECRETARY SALAS: That's four and a half left,  
7 okay?

8 (Pause.)

9 SECRETARY SALAS: I just need a second to reset  
10 my --

11 (Discussion off the record.)

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1                   CHAIRMAN KELLIHER: Let's resume. Madam  
2 Secretary, let's proceed.

3                   SECRETARY SALAS: For the next session, Capacity  
4 Suppliers with 37 minutes.

5                   MR. ESTES: Thank you.

6                   Mr. Chairman, Commissioners:

7                   I want to make a couple of brief points. Some of  
8 them are following on from the morning and some things we  
9 have heard, and then I am going to launch into our view of  
10 the world of alternatives, the differences between what  
11 we've heard and what we haven't heard and LICAP, and answer  
12 your questions in light of both.

13                   I first want to--and it's not because I want to  
14 say 'don't listen to anything about these alternatives,  
15 period, they're too late; or anything like that, because  
16 we're going to talk about what we think makes sense--but I  
17 want to clear up the record about how these alternatives did  
18 or didn't arise. Because I think that it is just important  
19 that we be accurate about this.

20                   First of all I get the impression that Load  
21 somehow thinks the Judge somehow did something wrong by  
22 excluding their testimony. She did exactly what your Orders  
23 told her to do. And I don't know what they expected her to  
24 do -- reverse you, I think.

25                   And the second thing I wanted to say is that we

1 heard mention of the CRAM Report. It is actually dated on  
2 the front "February 2003." That's a typo. I have concluded  
3 after looking at all the documents surrounding this, this  
4 came out in early 2004, February 2004.

5 This document was around, and it culminated a  
6 year's worth of stakeholder processes and all three ISOs  
7 and, you know, joint ones with all three all together. The  
8 stakeholder process here paralleled the stakeholder process  
9 for LICAP.

10 It is interesting to note that no one when the  
11 protested the ISO's filing mentioned CRAM--that odd name--at  
12 all. This supposed alternative, though it was in the  
13 frontal lobe of everyone's brain, wasn't offered up at all.

14 In fact, if you look at the world of alternatives  
15 presented to you when you set this case for hearing--and  
16 you're now being criticized for not somehow having some big  
17 hearing where five things were considered--there was only  
18 one real other alternative. It was about 137 pages of  
19 pleadings, and it said: Do a Downward Sloping Demand Curve.  
20 That's the right way to go. But--and this will sound really  
21 familiar--make it non-locational. And while you're at it,  
22 rely on operating reserves to come in as your locational  
23 component.

24 That was the only alternative presented to you.  
25 It obviously didn't do what you had asked. We were supposed

1 to develop a locational component. So you said: This  
2 curve. Litigate the parameters. And the Judge did just  
3 that. She actually went I think to every possible extent  
4 she could to give Load a chance to make their case. That's  
5 why our record has all this evidence which I thought about  
6 trying to fight because I thought, you know, you'd said that  
7 it's Just and Reasonable to have a Downward Sloping Demand  
8 Curve, that we shouldn't do LICAP; that this is not Just and  
9 Reasonable, the wrong way to go; that's why we can compare  
10 the cost of doing nothing to the cost of doing LICAP.

11 So we litigated the universe that was presented  
12 to you, and that is what the Judge decided. I believe I'm  
13 right about this, but if I'm not I assume someone on Load  
14 will correct me. I don't think in their rehearings of that  
15 Hearing Order, the June 2nd Order, they said 'do CRAM,'  
16 either.

17 I think what happened was they started writing  
18 testimony, and they decided we have some ideas. So we heard  
19 about Connecticut's Reliability Option, and we had a few  
20 pages from Dr. Austin--probably less detailed than you have  
21 now in your NELRAM proposal. We got that stricken--properly  
22 so.

23 Now I tell this story not to suggest that these  
24 folks are too late and we have to cut off the discussion and  
25 you shouldn't listen to a word they have to say; but just so

1 we understand how we got here:

2 The case was tried based on the opportunities and  
3 the alternatives presented. And that was the right call  
4 based on circumstances that arose. Now you have been asked  
5 to look at alternatives, and I believe that under the  
6 circumstances the right thing for you to do is to give  
7 reasoned consideration to the arguments presented to you.  
8 That is always your duty.

9 And I think, frankly, this argument is what that  
10 is all about. You have had pleadings, a paper hearing of  
11 sorts, and you've had oral argument. And I would submit to  
12 you that that actually discharges your obligation to give  
13 reasoned consideration, if you write an Order explaining  
14 what, you know, what our view of the world is anyway, you  
15 have a clear road to an affirmable, sustainable outcome.

16 Now let me tell you what I think that is. And I  
17 am really quite surprised no one on Load side said anything  
18 about it because I thought I called it out earlier this  
19 morning. Under these circumstances, the right thing for you  
20 to do is put the LICAP Curve in place and tell the Load  
21 parties that if they come up with a proposal, it might be  
22 that that proposal ultimately could be implemented; there  
23 can be a filing made; and maybe there can be a complement to  
24 LICAP, a forward complement put in place in what is  
25 probably, as I will explain in a moment, the 2011 or 2012

1 time frame. It's really not going to get here before that.  
2 I'll explain it in great detail.

3 And that ends up looking, as I think I said, like  
4 an awful lot like what PJM did. PJM has the Downward  
5 Sloping Demand Curve. Their filing talks at great length  
6 about why you need that. It is totally absent from the  
7 proposal we have here. It is both a measure needed now to  
8 provide the transition that you heard mentioned, and a  
9 necessary component to NERAM or NELRAM or Reliability  
10 Options, or whatever we have down the road.

11 And I'll explain why in more detail in a little  
12 while.

13 Now let me--oh, and by the way, I think I  
14 mentioned this this morning, but for emphasis--that is  
15 pretty much exactly what you said in the New York ISO  
16 Orders, which were affirmed by the D.C. Circuit. People  
17 came in and said: We want CRAM. And you said: The  
18 Downward Sloping Demand Curve can accommodate that. There's  
19 no inconsistency here.

20 You know, Chairman Kelliher, it really goes to  
21 exactly the same point you raised when you asked Load: Well  
22 why can't you just contract long? You have that tool  
23 available to you.

24 There's a bilateral market in place now taking  
25 place with much of the volume in the current ICAP market.

1 The ICAP market is like the real-time energy market. You  
2 balance the last bit. And LICAP will be the same way. All  
3 we are talking about with these proposals, I respectfully  
4 suggest, is an organized forward market. People can do it  
5 themselves, but if Load wants to have some auction process  
6 that's a tool--if the details can be done right, and there  
7 are a lot of challenges here; that's I think why CRAM didn't  
8 find its way into this proceeding; there are a lot of  
9 challenges--but if they can be met and a sustainable market  
10 structure can be developed, it could be laid in place. You  
11 know, the auction could be held in maybe 2008, or whatever,  
12 and you actually can have the best of both worlds.

13 Now let me talk about timing. And I've got a re-  
14 do of my timeline here. And it's got a lot more detail, and  
15 that detail is courtesy of the process discussion we had  
16 earlier. It basically confirms what I think several of you  
17 said. Which is, that there is an awful lot to get done here  
18 according to this time frame, and I submit to you these  
19 assumptions are not only heroic, they really are absurd. It  
20 is just impossible.

21 Now you see these little yellowish-green bars at  
22 the bottom [indicating a chart]? That's what we did with  
23 LICAP. We had a stakeholder process of over a year, and  
24 then we had a hearing process of over a year. And you see  
25 depicted here this little orange box and little green box?

1 That's in rough proportion the time period that Load  
2 suggests they'll use to finish the process here.

3 I am going to zip by the stakeholder process  
4 because this case isn't going to settle, unfortunately, in  
5 that time frame. What we are told is we might have only  
6 two or three proposals at that point because right now, mind  
7 you, we have three and we're told there may be others. So  
8 maybe we'll have specific proposals.

9 Then we have a trial in like three or four months  
10 this spring. Okay, that means direct testimony.  
11 Intervenors testimony. Staff. Rebuttal. Post-trial--a  
12 trial, with cross-examination. Post-trial briefs.  
13 Discovery in there somewhere. That is at least eight months  
14 if not a year.

15 We are told you are going to issue a decision  
16 without the benefit of the Judge sifting through the  
17 evidence at all in something like a month or two because  
18 you're supposed to do this in the summer. And we finish the  
19 hearing in the Spring.

20 I don't, with all due respect, think that is  
21 really realistic. But it's not getting any better for Load  
22 because then the ISO has maybe the toughest job of all. They  
23 have the rest of the summer, God Bless them, to come up with  
24 the specific implementation rules and the software.

25 I think you will hear them say that is just not

1       happening. It can't. Oh, and by the way, the rules have to  
2       be filed with the Commission. That is a 60-day item.  
3       Protests. You have to approve them. And LICAP will be  
4       implemented in October 1 and we'll have an auction on  
5       January 2007. There are four or five reasons why that is  
6       not going to happen.

7                 Now let me point out a couple of things, though  
8       that weren't apparent, or at least one thing that wasn't  
9       apparent from the discussion here.

10                We are talking about a forward auction for the  
11       time period starting in, well, 2010--we'll be just really  
12       charitable--covering perhaps a multi-year period. Well  
13       before we have our auction, we have to do something that New  
14       England finds extremely hard: Estimate OC, or IC, or  
15       whatever you want to call it. How much are you going to  
16       buy?

17                We have to do it starting three years in  
18       advance--it's hard enough to do it one year in advance; you  
19       know that--covering a multi-year period. And that's got to  
20       happen before we have our auction. So presumably we are  
21       doing it alongside all of these other things as if we don't  
22       all have too much to do already.

23                Really what's going to happen is, all of this has  
24       got to stretch out. There's no other way around it. And I  
25       submit to you I think Mr. Vince had it exactly right. You

1 know, for this to happen before the end of 2007, if not  
2 2008, is awfully unrealistic.

3 Now that doesn't mean don't pursue this  
4 alternative. That just means we have to be clear-eyed about  
5 when it will come in with new capacity. And I'll note, by  
6 the way, we're told we're using a three- or three-and-a-  
7 half-year planning period, it's called, before the capacity  
8 comes on line. PJM proposed four.

9 Now there are some variables here that are really  
10 pretty important. And the one thing we wouldn't want to do  
11 is shrink the planning period just to fit it artificially on  
12 this timeline. Because the longer your planning period, the  
13 more transmission can bid; the more different types of  
14 generation can bid. So that is an important variable.

15 I think what really has happened here is that  
16 Load has tried to compress its schedule -- it's painfully  
17 obvious they've tried to do that -- because they realize  
18 that if their parachuting in with new resources, you know,  
19 at the end of or after this darker red bar, it is just that  
20 much more not credible. But that's really the inescapable  
21 conclusion.

22 We are talking about something that comes in in  
23 2011, if everything works pretty well. Now we already have  
24 the problem you've discussed, which is we've got a problem  
25 as early as 2008. And this "alternative" is not really an

1 alternative at all not only because it's a supplement, not a  
2 substitute for LICAP; it's not really an alternative because  
3 it does not solve your problem, at least not for the first  
4 several years.

5 That is why you need to put LICAP in place now  
6 and let this process wind its course in an intelligent way.

7 COMMISSIONER BROWNELL: Mr. Estes, I just have to  
8 ask one question because I want to be sure we clear this up  
9 before we go further.

10 MR. ESTES: Yes.

11 COMMISSIONER BROWNELL: There were a lot of  
12 statements made about market power, generators controlling  
13 sites and not building because they were enjoying scarcity  
14 rents.

15 Could you just speak to that, because I want to  
16 clear that up one way or the other before we go too much  
17 farther.

18 MR. ESTES: I am very glad you asked that  
19 question. And since I represent a number of the generators  
20 in NEMA, I felt personally addressed by it.

21 A couple of things:

22 It is very interesting to me that generators  
23 apparently have this power. I wonder why they didn't use it  
24 in 1999, 2000, 2001, or 2002 to block new entry when we were  
25 on our way to a period of over-supply? They didn't. And

1 they would have had the same incentive if they actually  
2 tried to do things, had the incentive and had the ability.

3 The second is that you have market-based rate  
4 rules, regulations and cases about all of these things. And  
5 if someone really could block competitors from coming into  
6 the market, presumably that would be an issue that would be  
7 raised in those cases and dealt with appropriately.

8 You have generally presumed for very good reason  
9 that the market in new generation is workably competitive  
10 and existing incumbents can't block entry. There is no  
11 empirical evidence whatsoever that that has ever occurred.  
12 And I am here to--I'm sorry.

13 COMMISSIONER BROWNELL: And so no one has ever  
14 suggested in either Connecticut or Massachusetts that  
15 perhaps one of those sites could be used for new generation?

16 MR. ESTES: You know, Commissioner Brownell, I'm  
17 at a little bit of a loss to answer your question except to  
18 say I've never seen any specific allegation of this ever  
19 happening in this case. And no one has ever said, oh,  
20 here's a complaint I filed over here explaining how, you  
21 know, one of your clients, or one of someone else's clients,  
22 or Mr. Cornell's company did the same thing.

23 This I think is a--is sort of a specter, a shadow  
24 that's been launched up here in order to give some strength  
25 to the argument--and it does need strength because it's very

1 weak--some strength to the argument that prices will climb  
2 up to the max here and just stay there and never go  
3 anywhere.

4 CHAIRMAN KELLIHER: Mr. Estes, part of the  
5 argument was the assertion that the generators own all of  
6 the possible sites for new generation facilities, and that  
7 they will hoard them and not make them available.

8 That's you know, a factual statement. Is that  
9 factually true? When N-STAR sold its generation, did it  
10 sell all the real estate where it might have developed  
11 future generation?

12 MR. ESTES: I guess I would be very surprised if  
13 there were no sites available. When the ISO had John Reed  
14 talk about, you know, the cost of siting and everything like  
15 that, I mean he did find there were places to build in the  
16 load pockets.

17 I am not aware that my clients or anyone else's  
18 clients own all of the possible industrial sites where you  
19 can put things. And I might add that, that, you know, there  
20 are more than two suppliers in NEMA, and there are more than  
21 two suppliers in Connecticut. So there are various  
22 possibilities. There are factories and other things.

23 But if someone would point to a specific  
24 occasion, a specific situation where there was some, you  
25 know, abusive tactic like this, I would know how to

1 respond. But I think your procedures are more than equipped  
2 to deal with this. I think it is simply supposition that's  
3 been thrown out there to try and jack up the costs that they  
4 can claim.

5 Because if you get to the high end of the scale:  
6 Well, oh, my gosh, this is hugely expensive. Now, you know,  
7 your instinct rightly tells you that this is commerce.  
8 Someone will build for that. I actually heard someone say  
9 if the prices gets high enough, people will build.

10 But I find it hard to believe that there is no  
11 site anywhere in these load pockets. And NEMA is actually a  
12 particular non-problem, as I understand it, since they keep  
13 claiming they are about to become unconstrained. So we can  
14 build in rest-of-pool and deal with them at least for awhile  
15 until the load pocket is binding again.

16 You know, while we're on the subject, this is all  
17 part of the "Will LICAP Work?" I had this later, but let me  
18 go ahead and deal with it now.

19 This argument that LICAP--no one will build to  
20 LICAP because there's too much uncertainty, but they'll  
21 build to this other model--proves way too much. The  
22 argument is--and we heard it--that you need a long-term  
23 contract according to Mr. Fedder, Bill.

24 Well, there's no long-term contract in NERAM or  
25 NELRAM. We don't even know what period the contract lasts

1 for, but it is one, two, three, they say maybe four or five  
2 years. So there's a lot of merchant risk on the back end  
3 that somebody is going to have to take.

4 I will go into more detail about the cost  
5 implications of all that, but, you know, the real way to  
6 solve this, if it were a problem, is to contract long for a  
7 10- or 15-year period. And that is not what they're talking  
8 about.

9 Let's talk about these market designs for a  
10 minute. They've never been used anywhere. LICAP has, but  
11 these have never been used anywhere. They are as NELRAM  
12 said, conceptual proposals. And there are some hard issues,  
13 some real challenges.

14 COMMISSIONER KELLY: Mr. Estes, I have a  
15 question.

16 MR. ESTES: Sure.

17 COMMISSIONER KELLY: Your suggestion that LICAP  
18 could be adopted short-term with the possibility of adding  
19 an auction market later--

20 MR. ESTES: Yes?

21 COMMISSIONER KELLY: --will that dampen the  
22 desire of generators to come in now and build if they know  
23 there's going to be an auction market later?

24 Or, if they are uncertain about what the  
25 situation is going to be later?

1           In other words, we are hoping that there is going  
2           to be a signal that there is a revenue stream out there and  
3           that generators will build in response to that. But if we  
4           hold out a specter of change, what is that going to do?

5           MR. ESTES: I've given a lot of thought to that,  
6           Commissioner Kelly, and I think it shouldn't be a problem as  
7           long as you make clear that you would expect in the first  
8           instance a curve to remain in place under these proposals.

9           Of course you are not going to be issuing an  
10          Order on NERAM or NELRAM confirming that this is the  
11          situation probably for awhile, under my scenario. The issue  
12          under NERAM or NELRAM is, if you built now as a LICAP  
13          resource and you got it right, you understood the Curve,  
14          you didn't, you know, you didn't tank prices yourself; you  
15          came in and everything was going fine, that tells you that  
16          you are needed by the system or else you wouldn't have a  
17          healthy LICAP price.

18          Now if the auction market is designed properly,  
19          and you are a new resource and you've entered, you know, in  
20          an intelligent fashion, there is not much of a practical  
21          chance that suddenly in the auction market you're going to  
22          be completely unnecessary.

23          Now--

24          COMMISSIONER KELLY: Would you bid into the  
25          auction market?

1                   MR. ESTES: Sure. Sure. And the key, though,  
2 ends up being that if you don't have a Curve underneath  
3 NERAM or NELRAM, there is an awfully lot of price volatility  
4 risk.

5                   We heard from Mr. Speck that he thought it  
6 removed volatility, and he was talking about quantity  
7 changes, although that is a little bit of an over-argument,  
8 too. What can happen under NERAM or NELRAM without a curve  
9 underneath it like for example PJM proposed, is you can end  
10 up with the same sort of binary outcomes you had in the  
11 vertical demand curve world where you buy exactly what you  
12 need. Somebody comes in. All of a sudden the price goes  
13 down to everybody's Going Forward costs and the new entrant,  
14 you know, when his contract ends up, is stranded. And  
15 there's not anything to show him a gradual, you know, price  
16 support underneath that.

17                   Now I happen to believe LICAP itself works. And  
18 so, you know, we've supported that. And I think it is fine  
19 to say: Do LICAP. But I also think it is not going to  
20 erase the build signal if you say there may ultimately be a  
21 long-term market on top of that. Because people are going  
22 to build according to LICAP when they're needed, and the  
23 chances of them suddenly being uneconomic in a properly  
24 designed forward market I think is not very likely.

25                   We've heard a lot of discussion about whether

1 these markets should be locational or not. That is  
2 obviously a hard question. And it is going to have to be  
3 resolved. But working beneath this dispute is something we  
4 heard a little bit about.

5 According to NERAM, we have to get the Forward  
6 Locational Operating Reserves Market running at the same  
7 time. That is, itself, a bit of a challenge. You know, it  
8 doesn't exist yet, either. There's not a market like that  
9 in operation, as I understand it, either. ISO New England  
10 was working hard on that. But that is another challenge  
11 we're now asking to do I guess three things at once, you  
12 know, where they have to make those two things land at the  
13 same time, which further threatens I think your completion  
14 date, at least if we're doing NERAM the way it has been  
15 described.

16 And I should not, as I understand it the Forward  
17 Locational Operating Reserve Market is a small market. It  
18 is like 1200 to 1500 megawatts. So that is not something  
19 that is going to pay anything to the bulk of suppliers in  
20 New England. It is really quite a niche market.

21 You know, how that would play into a pool-wide  
22 capacity market with no locational features is something  
23 that would take some development.

24 Now I mentioned the planning period as kind of,  
25 you know, an issue that needs some thought. Maybe even more

1 complex to figure out right is what is the commitment  
2 period? What period are you buying for?

3 We heard from NELRAM it is one to five years,  
4 which is a pretty big swing. The CRAM Report says three, by  
5 the way. PJM is doing yearly auctions, as I understand it.  
6 We heard from NERAM one to three years as determined by the  
7 stakeholders but, you know, this ends up being a big issue.  
8 If it's on the short end, you know you're not really giving  
9 new entrants any more security of revenue than you are with  
10 LICAP. Because in LICAP you can pretty much see that, you  
11 know, if the LICAP market is done right you can tell what  
12 the price is going to be in the next year.

13 That is really pretty much what they're talking  
14 about. It is only when you get into long commitment periods  
15 that you get a little more, although not complete, security,  
16 just a little more, and that has its own problems because  
17 the debate that colored this issue when the NERA report was  
18 done was that that transferred too much ownership risk to  
19 supply--I mean to load. So they didn't really like that.  
20 So there's a real push on each side on that issue, and that  
21 is not an easy one to decide.

22 Now I thought I might hear an answer to my next  
23 tough issue, and I'm not really sure I did. Who is the  
24 buyer?

25 Each proposal talks about a central buyer. Is it

1 ISO New England? Do they take title? Do we have a contract  
2 with them? Do we sue each other if there's an issue? Are  
3 they the credit? Is there some state entity like  
4 California's DWR that's set up except we need six of them,  
5 and they all need to pass legislation at the same time so  
6 they can all enter into contracts?

7 You know, who is doing this? That, as I  
8 understand it, was one of the tough issues that stalled  
9 CRAM. And I don't know if you even realize this, but CRAM  
10 as I understand it, is really kind of stalled right now.  
11 You get status reports in the New York ISO docket about it,  
12 and the last one said that, well, we're working on an  
13 individual capacity market plans.

14 But it seems to have kind of stalled. And this  
15 is a tough issue. I already talked about do we have a  
16 demand curve. We didn't hear anything about that. You do,  
17 by the way. One service a demand curve could perform is  
18 we're contracting way into the future. We're going to be  
19 wrong on our assumptions, obviously. Load growth is going  
20 to be different than prophesied. Someone is going to  
21 retire, or a plant is going to blow up, or something. You  
22 know, life will intervene. And there will be something to  
23 correct.

24 And so some of the models talk about a  
25 reconfiguration auction or some form of a more spot auction

1 to fill in those problems. That is an issue that the demand  
2 curve could help solve, but would have to be addressed under  
3 these proposals.

4 Demand Response. This is actually another real  
5 tough one. I know the Commission thinks encouraging demand  
6 response is really important. In LICAP it is easy to do.  
7 Monthly auctions. Demand response knows it can be there.  
8 You know, it's got whatever arrangement it has. It just  
9 goes and bids.

10 So it's relatively easy for LICAP to accommodate  
11 demand response. These forward models make it a lot harder  
12 because--and they admit it on their face--the longer  
13 commitment period is something demand response doesn't  
14 really have an easy time doing, particularly if you get into  
15 multi-year chunks of time.

16 That is why we heard discussion of some sort of  
17 set-aside. Well, we'll just give a certain tranche of what  
18 we need of demand response and we'll have them bid for it  
19 and we'll hope it shows up.

20 You don't have to go to those same lengths with  
21 LICAP. I raise this--again to clarify it--not to say that  
22 these forward approaches are completely unworkable, but just  
23 that there are a number of challenges to deal with.

24 And the final one, we didn't actually hear that  
25 much about, but maybe a little bit, is mitigation measures.

1 Now PJM in their filing has extensive and complex measures  
2 to mitigate supposed market power in the capacity markets.  
3 We have a bit of a different view here. We have, as I  
4 understand it, NERAM saying we probably won't need any  
5 because new entry will discipline everything. And NELRAM is  
6 saying we want to talk to the ISO and figure out what we  
7 need here.

8 That is another thorny issue. It would have to  
9 be worked through somewhere in our timeline here as part of  
10 the development process, the hearing process, or something.  
11 I mean maybe we don't take this one to hearing if we do what  
12 I'm talking about, but that is the last sort of challenge I  
13 wanted to lay out.

14 There are a number of things that have to be  
15 addressed. And to say they're going to happen in the year  
16 2006 is, I think, just beyond what can rationally be  
17 assumed.

18 Now let's talk for a moment about comparing the  
19 two. We heard the claim that NERAM and NELRAM are both  
20 cheaper in a couple of ways. One is the \$150 million  
21 number. Again, it is kind of interesting. That assumes  
22 that the market costs \$3 billion a year. And since we are  
23 told we're going to hit the OC target right on every year--  
24 actually what that means is you are paying around about \$3  
25 billion minus maybe a few savings every year. It doesn't

1 fluctuate as much as LICAP does.

2           So that just underscores the price tag sort of  
3 component that, you know, any real solution to these things  
4 ends up being expensive. But let's talk about the deducts  
5 that they claim will exist.

6           They say that we won't need this cushion. That  
7 is another really tough design challenge. I think the truth  
8 is there will have to be some. And if you look at the CRAM  
9 proposal actually you find some discussion of these issues  
10 particularly in smaller markets. I assume New England  
11 itself is a rather small market. We have subzones that are  
12 that much smaller.

13           You know, if you have load growth of a certain  
14 size, 50 megawatts in a load pocket or what have you, you  
15 can't just continue to add 50 megawatts every year in your  
16 auction. I mean because what you'll end up with is a whole  
17 raft of peakers with high heat rates. And you might need  
18 more peakers, but eventually that's not the right move.  
19 Eventually you need something bigger.

20           And because of that fact, and because load growth  
21 ebbs and flows and resource additions are lumpy, you never  
22 get this trued up exactly. Now unless you are willing to  
23 shoot at OC and just miss it whenever something goes not  
24 according to plan, you need to over-shoot a bit. And, you  
25 know, it is perhaps a fair question, though we don't know

1 the answer, to say if one person is looking at procurement  
2 and saying I want you and I don't want you, that you might  
3 have less variation if you did this. We really don't know  
4 exactly how much. And it's really hard for me to imagine  
5 it's going to be less variation than vertically integrated  
6 utilities have seen. And they've seen, you know, a three or  
7 four percentage points of variation.

8 So, you know, the idea that we can just totally  
9 eliminate a phenomenon that has existed in the utility  
10 industry for decades seems an awfully tall order.

11 We also heard that there will be a saving of, is  
12 it, \$2.7 billion? Yes. Because load might pay two times  
13 EBCC at the max price under LICAP and that won't happen  
14 under their alternatives.

15 Actually, first of all you heard me talk about  
16 the notion that assuming you just sit at the cap and nobody  
17 ever builds is a fallacy, but there actually isn't any cap  
18 in their proposal. If people decide their proposal is  
19 really expensive and raises a lot of risk and bid in because  
20 it's expensive--you know, high prices--you know, that's just  
21 what happens. I guess you could say you'd mitigate, but  
22 there's no a priori reason to think that there will be  
23 savings on that front.

24 And I might add in defense of LICAP, we did have  
25 a trial about what EBCC is, and I would like to think that

1 is worth something, but this is an administratively  
2 determined number. And so quite intelligently the market  
3 design has an approach built in to adjust it over time.

4 Now in conclusion, we have nascent proposals in  
5 front of us. Perhaps they might lead somewhere. I am not  
6 asking you to tell load they can't go try and develop these  
7 things. I don't think you should assume they'll arrive at  
8 the finish line. And I think you have to assume you need to  
9 do something that deals with the problem you have  
10 approaching quickly.

11 And unless we are prepared to have nothing but  
12 RMR contracts and other out-of-market solutions--and you  
13 quite properly asked us to try a LICAP design that tried to  
14 minimize RMR agreements--you really can't avoid putting  
15 something significant in place.

16 We have that something significant. We spent  
17 over a year litigating it. It got tested in the crucible of  
18 trial. And it is pretty much the same thing that exists in  
19 New York and, you know, that certainly doesn't seem to be  
20 melting down.

21 And so actually this is not the experimental  
22 device; it's the one that is ready to go. If the  
23 experimental device ends up working, you know, we see about  
24 adding it down the road.

25 With that, I had said I would reserve five

1 minutes for my colleagues which they were going to split.  
2 If there are no further questions, I will hand the mike to  
3 them.

4 MR. CORNELL: Thank you, Commissioners. Just a  
5 few points to underscore some of the things Mr. Estes said.

6 COMMISSIONER KELLY: Steve, before you begin,  
7 you, or John, or Michael. How long has New York's LICAP  
8 been in place?

9 MR. ESTES: It was approved in 2003. It was put  
10 in place in either late 2003 or early 2004.

11 COMMISSIONER KELLY: Has anything been built?

12 MR. CORNELL: Yes.

13 MR. ESTES: Yes. Quite a bit of capacity.

14 MR. CORNELL: New York City, primarily under  
15 contracts that have been created in response to RFPs that  
16 ConEd and I believe NYPA have issued, and there continues to  
17 be commercial activity in terms of looking for more  
18 development.

19 In fact, if you look at the market forecasting  
20 services like SERA and ICF, you will see that the capacity  
21 prices for Zone J are projected, New York City, are  
22 projected to go down significantly due to the commercial  
23 entry to new capacity and the kind of lumps that Mr. Estes  
24 was just talking about.

25 So I mean there's some corroboration from the

1 market place itself that entry is taking place and is  
2 expected.

3 COMMISSIONER KELLY: And is that a zone--

4 COMMISSIONER BROWNELL: If you look at the State  
5 of the Markets Report, 12,000-plus megawatts in 2004,  
6 probably too early to attribute to that; 5,000-plus 2005 to  
7 2007.

8 COMMISSIONER KELLY: And New York has its own  
9 zone?

10 MR. CORNELL: New York City has its own zone, and  
11 Long Island has its own zone, much like the constrained  
12 areas in New England would.

13 COMMISSIONER KELLY: And how about in the rest of  
14 New York?

15 MR. CORNELL: The rest of New York has less  
16 activity because it has prices that reflect the over-supply  
17 that's currently there. But again, if you look at the  
18 commercially available price projections, forward prices for  
19 capacity are predicted to go up as reserve margins shrink in  
20 Upstate New York. And again one would expect commercial  
21 activity in response to that.

22 And I can tell you that our company is actively  
23 exploring and preparing to repower and develop not only in  
24 that market but in other markets like Connecticut where we  
25 anticipate prices will be high and where we anticipate being

1 able to get contracts from load-serving entities that will  
2 help us finance at a low cost. And in fact that is one of  
3 the very good things about the Connecticut law I mentioned  
4 this morning, is that as you suggested, Mr. Chairman, the  
5 states can take actions on their own that will facilitate  
6 and help provide the contracting opportunities that really  
7 need the price signals alongside them in the wholesale spot  
8 markets to make development happen.

9 We are prepared to do that. We are seeking to do  
10 that. And I think it is just a misunderstanding of the  
11 competitive power business to think that companies would not  
12 want to repower aging facilities with newer, more efficient,  
13 more economical and longer life facilities whenever we get  
14 the chance to do that. So that is the first thing I wanted  
15 to say in fact, that we are actively looking for those  
16 opportunities.

17 We completely agree with the Chairman's  
18 observation that states can, and Connecticut has, taken  
19 steps, take steps to facilitate the longer term contracting  
20 that will help in combination with price signals from the  
21 LICAP markets, make new investment happen.

22 And I will--

23 MR. WENTWORTH: Go ahead.

24 MR. CORNELL: Another point I think is really  
25 important here, the CRAM process did go on a long time. I

1 was involved with it. People in my group at our company  
2 were involved in it. And my sense is that it was beaten up  
3 pretty good and understood pretty good, and essentially ISO  
4 staff's and participants felt it would be better both in PJM  
5 and in New England to go down the LICAP market than to go  
6 down the CRAM market.

7 Now I think there are attractive characteristics  
8 to the forward procurement concept, and I think we can see  
9 the best hybrid approach in the--

10 SECRETARY SALAS: One minute warning.

11 MR. CORNELL: --in the RPM proposal where you  
12 have both the demand curve and a forward procurement  
13 characteristics, or opportunity. I would note that we are  
14 kind of on both side of that here. The ISO has got a demand  
15 curve and no forward procurement, and these folks are  
16 thinking about forward procurement and no demand curve.

17 It seems to me the best solution, as Mr. Estes  
18 suggested, both in terms of the time and perhaps in terms of  
19 the ultimate policy, is to combine the two and have  
20 something that might look very much like the RPM proposal in  
21 the end.

22 And finally, I would just observe that if this  
23 market works as Mr. Speck suggested it would, it seems that  
24 the highest the price could ever be would be the long-term  
25 cost of marginal cost of entry in some years, but in other

1 years it would be lower at the going-forward cost.

2 That means the expected value, if it really  
3 worked like that, the expected values investors would look  
4 at would be less than what it is going to cost them to  
5 invest in that market. If that is true, I just don't think  
6 it will work.

7 SECRETARY SALAS: Time. Now on behalf of ISO New  
8 England, Mr. Hepper, with 38 minutes.

9 MR. HEPPER: Thank you.

10 Thank you very much. Thank you, Commissioners,  
11 for this opportunity. I think I will ask for a ten-minute  
12 warning, if you would give me one, but given the fact that  
13 Mr. Estes has I think read my braille notes--

14 (Laughter.)

15 MR. HEPPER: --I think I can beat that.

16 MR. ESTES: Well I wish I could.

17 MR. HEPPER: Before I begin my argument, the ISO  
18 would like to thank the proponents of the alternatives for  
19 working hard to try and get solutions to the capacity  
20 problems facing New England. The ISO in the last year has  
21 been very difficult--and I have had the pleasure of being  
22 there for that whole year only--because we have been at odds  
23 regarding capacity market design with the regulatory and  
24 political infrastructure of much of the region.

25

1                   After the discussion we've heard today, I'd like  
2                   to point out three positive developments as a result of the  
3                   processes that we've all gone through with regard to  
4                   capacity markets. One, there appears to be a recognition by  
5                   everybody that there is a capacity issue in New England.  
6                   Two, there's a recognition that capacity has to get paid.  
7                   And three, the majority of the states recognize the value of  
8                   capacity differs depending on location. These are changes  
9                   from where we've been in the past and these are all very  
10                  helpful changes as we move forward and try and solve the  
11                  problem.

12                  We also like to particularly thank the Load  
13                  parties for all the support of the locational forward  
14                  reserves market. We hope that that market actually can  
15                  finish its development, get voted on at NEPOOL and be  
16                  presented to this Commission with somewhat less controversy  
17                  than LICAP has had over the last year. Unfortunately, as  
18                  I'll explain later, implementation of that locational  
19                  forward reserves market does not in any way obviate the need  
20                  for a locational capacity market.

21                  I don't think there's any need to talk about the  
22                  history of how we've gotten here. I think everybody has  
23                  done that many, many, many times.

24                  (Laughter.)

25                  I'd like to stop very briefly and just mention

1 the reliability options model, which I don't believe Mr.  
2 Speck even mentioned today, as one of the two alternatives  
3 Connecticut supports. If we do go forward with the  
4 stakeholder process, that's certainly something that could  
5 be explored. But we really don't have many comments on it  
6 today. None of the parties seem to have gone forward with  
7 that process.

8 While there are sharp differences between NERAM  
9 and NELRAM which I think their proponents have tried to  
10 minimize today, they share a fairly common framework, and I  
11 think I'd like to turn next and really talk about that in a  
12 couple of sentences. And the first one I'd like to talk  
13 about is cost both with, I would say, the big C and the  
14 little C.

15 Cost with a big C, we've heard the \$15 billion  
16 number thrown out and things like that. And we heard Mr.  
17 Daly say the \$2.7 billion number that Mr. Estes referred to.  
18 I've actually read most of the C-RAM report and what the C-  
19 RAM report says is that if you do things forward you'll  
20 typically clear at the price of new entry. That means that,  
21 as Mr. Estes pointed out, we won't have much variability but  
22 we'll pay that cost.

23 The \$2.7 billion that Mr. Daly used I suspect is  
24 his version of staying above EBCC and never going below.  
25 But there's an offset to that. If you look at when this

1 case began and some of the cost projections we put in for  
2 even the 2005-2006 power year/2006-2007 power year, we'd be  
3 below that cost of new entry, so there would be savings in  
4 those kinds of years. That's what fluctuations do.

5 COMMISSIONER KELLY: Mr. Hepper, can I ask you a  
6 question about the demand curve and whether or not at some  
7 point it should be vertical? At some point where -- and I  
8 can't quite recall if it's where C target has been reached  
9 or -- there's some point on the curve there where there's  
10 been an argument made that it could go vertical?

11 MR. HEPPER: I'm not sure I know what argument  
12 you're referring to, Commissioner.

13 COMMISSIONER KELLY: The curve slopes and  
14 continues with the slope. The slope changes but then the  
15 curve slopes?

16 MR. HEPPER: Right. There's two slopes.

17 COMMISSIONER KELLY: There's two slopes.

18 MR. HEPPER: Okay.

19 COMMISSIONER KELLY: Okay.

20 MR. HEPPER: Right.

21 COMMISSIONER KELLY: So when the slope changes,  
22 does it make any sense for that slope to be vertical or drop  
23 to zero?

24 MR. HEPPER: Drop to zero.

25 COMMISSIONER KELLY: Drop to zero.

1                   MR. HEPPER:  If you drop it to zero at that  
2 point, you're going to have to make sure you're always  
3 paying a higher price.  The purpose of the curve overall is  
4 to create basically the economic opportunity to getting the  
5 cost of new entry over a long period, and it's sort of  
6 trying to recall back to my days of calculus the area under  
7 the curve.  If you get rid of -- I think what you're saying  
8 is get rid of the right-hand side, the more gentle slope --

9                   COMMISSIONER KELLY:  Yes.

10                  MR. HEPPER:  You've got to push the balloon  
11 somewhere else.  You've got to have somehow that area under  
12 the curve being enough that the generator has the  
13 opportunity to get the cost of new entry over the long term.  
14 So while I guess it's theoretically possible, I'm not sure  
15 from all the testimony that's in the record that it's a  
16 sensible solution to do it that way because you're really  
17 just going to force people to pay -- you're going to have  
18 more of a volatility problem of going from the high number  
19 to zero at some specific point.

20                  COMMISSIONER KELLY:  That's another way of  
21 telling me there's no free lunch?

22                                 (Laughter.)

23                  MR. HEPPER:  I would never put it that way, but  
24 since you did --

25                                 (Laughter.)

1 MR. AFONSO: This turns out to be a steak dinner.

2 MR. HEPPER: The next point, and I just want to  
3 reiterate Mr. Estes' point here, and that's on the setting -  
4 - and New England has a great habit of changing words.  
5 During the case it was "objective capability," now it's  
6 "installed capacity" but they're both the same thing. We  
7 just changed the label when we became an RTO. That is a  
8 very, very controversial process.

9 The Commission got a slight taste of it this year  
10 when people thought there might be some money riding on it.  
11 For basically five months, we had quite a heated debate here  
12 on paper as to what it should be and a heated debate in  
13 NEPOOL. Under any forward procurement model, we're going to  
14 be doing it 3-6 years in advance and trying to know what the  
15 whole transmission system is going to look like at that same  
16 time. That is no easy task.

17 Now I'd like to stop and turn to two different  
18 questions that have been raised, and one is the timing  
19 question, and that's come up in a number of different  
20 contexts and this time I think Mr. Estes has been sitting in  
21 the ISO staff meetings. He's got it fairly close to right.

22 The ISO can't do locational forward reserves,  
23 NERAM, NELRAM and all of that at the same time. We expect  
24 that even if we could follow the schedule that Mr. Strauss  
25 laid out to you, it would be late 2007 realistically by the

1 time we could have an auction under a forward procurement  
2 model. We'd have to go through, solve the difficult issues  
3 Mr. Estes talked about -- I'll talk about a few of them --  
4 get the Commission to issue an order on that, have rules,  
5 write software, all of that takes time. Mr. Daly sort of  
6 said well they've had a lot of time, they've been working on  
7 that. This is a completely different model. It's different  
8 than PJM has proposed. So there's a lot of time that would  
9 be taken there.

10 Now the other issue that I want to stop on here  
11 is the RMR contracts.

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1                   There have been a number of questions from all  
2 three of you today, dealing with whether there are RMR  
3 contracts. And I think there is actually very significant  
4 agreement between the ISO and the load, in terms of RMR  
5 contracts.

6                   We all want them to go away, to the greatest  
7 extent possible. There really has been, I think,  
8 unintentionally through a number of circumstances, an  
9 opportunity for generators to look at getting the higher of  
10 cost or market.

11                   The reason for that, though, is that we don't  
12 have a capacity market. And once that capacity market is in  
13 place, the test for how you get an RMR contract, and what  
14 the terms of that contract are, need to be much more strict  
15 than they are today.

16                   I suspect we'll be back here again, taking  
17 somewhat different sides and different roles, discussing  
18 that issue, but they need to go away to the greatest extent  
19 possible. There's no way to say we know they will all go  
20 away. I think everybody pointed out that you could get an  
21 odd transmission situation, but I think that's the reality  
22 of the situation.

23                   Now, we've heard a lot that there is an insurance  
24 here under forward procurement, that doesn't exist under  
25 LICAP. How does this work?

1                   Well, there's a contractual commitment, whether  
2                   it's a tariff or whatever it is, where the counterparty  
3                   takes on a contractual obligation to pay a set amount for  
4                   capacity, three years in the future.

5                   This contract, it's a financial obligation with  
6                   penalties. If the contract is broken by the supplier, the  
7                   supplier pays money.

8                   If finishing a plant or maintaining an existing  
9                   plant becomes uneconomic, that contract will be broken.  
10                  They will pay the penalties, but they will abandon the  
11                  project.

12                  There are huge credit issues around this. We  
13                  have to deal with all of those. Under LICAP, we're not  
14                  dealing with that kind of a situation.

15                  Penalties won't get us a power plant; they'll get  
16                  us money. Under LICAP, only real plants get paid for real  
17                  demand response. There isn't a promise and a financial  
18                  consequence for breaking that promise.

19                  Instead, there's a real payment for real power  
20                  plants, if and when they are available, and when they  
21                  provide reliability.

22                  The contract does not provide significantly more  
23                  certainty, as Mr. Estes pointed out, than LICAP does. It's  
24                  a one- to three-year commitment, three years out, for a 20-  
25                  year power plant.

1           The NERAM and NELRAM proposals at some points  
2 talk about a longer commitment period. They say maybe three  
3 to five years, maybe longer for new entry.

4           Load talks about these benefits of a long-term  
5 contract, but they ignore the risks. What if the contract  
6 become uneconomic? Customers are stuck with the stranded  
7 costs.

8           That's my understanding of why we got out of the  
9 whole forward planning model and wanted to put the risks  
10 back on the markets. If we get longer commitments, we start  
11 looking more at things.

12           And we heard Commissioner Getz talk about PURPA.  
13 We can get back to PURPA, or, more recently, California  
14 situations, with contracts that range from five to ten  
15 years, that people ended up rather unhappy about, very  
16 shortly after they were signed.

17           Now we've heard a lot of opposition to LICAP,  
18 because its price can go twice as high as EBCC, and this  
19 will create a huge incentive for generators to raise  
20 barriers to entry.

21           In any market, incumbents will try and prevent  
22 new entry. The real question is whether their ability to  
23 succeed, is any different under the forward procurement or  
24 LICAP.

25           The answer to that is no. As I think everybody

1 has pointed out this morning, the Commission -- all during  
2 the day -- the Commission has a number of powers and a  
3 number of new powers to deal with those situations.

4 But under either model, they control the same  
5 sites, they have the same ability to raise objections to new  
6 power plants, and they have the same desires to prevent  
7 competition. I don't say that in a good way or a bad way;  
8 it's just a fact.

9 If they prevent new entry, they'll drive up price  
10 in either situation. If a new entrant is afraid that he  
11 can't build under a full procurement model, he's going to  
12 have the same concerns as he does under LICAP.

13 Under LICAP, the demand curve will determine how  
14 much that price can rise, if, in fact, there is some kind of  
15 inappropriate market power. Under full procurement, there  
16 really is no mechanism yet, but they recognize they need  
17 one.

18 That's going to be very, very difficult to  
19 determine what to do. NERAM and NELRAM advocates imply that  
20 under LICAP, new entry doesn't compete with existing  
21 resources. This, again, isn't a true statement.

22 New entrants will respond to LICAP markets and  
23 build capacity in response to price signals, and they will  
24 do that the same way they do under any market. They will  
25 look forward and see what prices look like.

1                   Now, the next one is that there's an allegation  
2                   in both the proposals that forward procurement -- that --  
3                   let me start that over -- that LICAP stops bilateral  
4                   contracting and forward procurement doesn't.

5                   This is based on basically a false notion that  
6                   because generators know the next month's price, they'll only  
7                   contract to sell capacity at that price. That may be true  
8                   for the next month, but what generators will not know, is  
9                   what the price would be for the next three, five, or ten  
10                  years, and if load wishes to have a long-term contract, it  
11                  is very viable, and I'm sure the generators will be as  
12                  interested in entering into that contract as load might be.

13                  Now, if I could talk a minute about demand  
14                  response, Mr. Estes focused on this point, as well. Demand  
15                  can participate currently in LICAP.

16                  We expect to see demand response, immediately  
17                  after LICAP is implemented. Demand that wishes to  
18                  participate in a capacity market, can do so by joining the  
19                  ISO demand response program. Under these programs, those  
20                  that reduce demand, receive the same payments as generators  
21                  do.

22                  Demand can also reduce its LICAP obligation by  
23                  reducing its load at the time of the system peak.

24                  COMMISSIONER KELLY: Would you repeat that,  
25                  please?

1                   MR. HEPPER: Demand can basically reduce LICAP by  
2 reducing its load at the time of the system peak. It's not  
3 necessarily the easiest thing to predict, I will admit, but  
4 we had a few very hot days this summer. There were two of  
5 them that I recall, where we saw demand of probably more  
6 than a thousand megawatts higher than we'd ever seen it  
7 before.

8                   If demand had responded on those days, if the  
9 price signals were there, I suspect people could have done a  
10 pretty good job at predicting when those peaks would have  
11 been.

12                   Now, I want to get back to cost, and, I think,  
13 this time with the small-c. The big-C, I think, we've all  
14 recognized there's probably not much difference in cost.  
15 And I want to stop on a point Mr. Speck made earlier, that  
16 there is evidence in the record that the ISO may have  
17 overestimated EBCC by ten to 30 percent.

18                   We don't believe we did, the Judge doesn't  
19 believe we did, but if we did, let's stop and talk for a  
20 moment about what happens under LICAP. Actually, what's  
21 going to happen is that a whole lot of people are going to  
22 come into the market very quickly.

23                   They're going to say, we can make money; the  
24 ISO's demand curve is too high. That's going to get more  
25 supply than we need, and move you down along that demand

1 curve, fairly rapidly, so that you'll get a little more  
2 reliability. It will, actually, in total, cost less, if it  
3 happens.

4 I had to at least have one chart today, and I'd  
5 like to put it up there at this point, if I could, just  
6 because everybody seems to like charts.

7 It's actually two quotes from the NERAM and the  
8 NELRAM proposals, that say how they will work. NERAM will  
9 permit the amount of installed capacity to be optimized to  
10 the precise load needed to meet the generally-accepted NERC  
11 standard.

12 Now, I want to emphasize those couple of words  
13 there, "optimized" and "precise." The NELRAM proponents  
14 basically say almost the same thing.

15 Now, it's not a matter of simply targeting and  
16 paying for this precise amount. No regime, regulation, or  
17 markets, can provide certainty about what will happen, three  
18 to six years in the future.

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1                   We've heard quite a bit this morning -- this  
2 morning and this afternoon about historical data and its  
3 validity or its irrelevance. But history explains to us why  
4 we need to actually acquire a bit more capacity than we need  
5 on average to meet the one-day-in-10-year reliability  
6 standard. Load growth isn't perfectly predictable. Some  
7 plants will not be completed on time or they'll be completed  
8 early. Some plants will retire early due to unexpected  
9 problems. A nuclear plant, as we've seen in the past, could  
10 go out, come back after two years or never come back.  
11 Generation is lumpy.

12                   All of those are problems we're going to face  
13 under any market. So the Load's hope of promising that  
14 LICAP will be \$150 million more expensive than forward  
15 procurement is a hope, but I don't believe it can come true.

16                   Now they've talked about using supplemental  
17 auctions to try and reduce this fluctuation. That may work  
18 somewhat. You may predict too much. You can't un-buy what  
19 you've already bought. It's those kinds of fluctuations  
20 that are inherent in any situation. We can't do everything  
21 perfectly.

22                   Forward procurement supporters claim the markets  
23 will be perfect. We'll perfectly predict the amount of  
24 capacity needed four years out. We'll tell the market that.  
25 We'll plan it perfectly. And the markets will hit both the

1 precise amount and the precise timing right on the nose. I  
2 think that's unlikely.

3 Now there's another cost problem inherent in a  
4 lot of the forward procurement proposals, and that goes back  
5 to the contractual notion that we had before: they'll make  
6 people do it because they'll put a big stick of a penalty  
7 out there and say if you don't do what you promised, you'll  
8 pay. That's called a risk premium. Generators will all put  
9 it in their bids and it will raise the price of new entry.  
10 There's a chance that they might not make it, and that  
11 penalty will raise the cost of new entry. That doesn't  
12 happen in LICAP. It's only because LICAP pays on an on-  
13 going basis.

14 I want to use a very simple analogy here. I've  
15 used it before and I think it bears use here. And it's sort  
16 of this notion that because LICAP is only monthly it won't  
17 work. And I've come to liken it to apartment rentals. And  
18 people who have apartments rent them on a month-to-month  
19 basis; when the landlords see rent going up, they build more  
20 apartments. But there's no promise out there that says  
21 because you paid this month's rent you promise to be there  
22 in five years. That's just not the way markets work. And I  
23 think that's really the simplest way I think of in terms of  
24 LICAP to say you're really paying the current rent for the  
25 generator, and that's why the market will work as you see

1 prices change.

2           The next point I'd like to turn to is what people  
3 have tried to convey today as just a small difference  
4 between NELRAM and NERAM, the issue of whether a capacity  
5 market should be locational or regional. It's a fundamental  
6 issue to the debate that we think the Commission, no matter  
7 what they do going forward, can decide now. Even if there's  
8 a decision for more process, we believe the locational issue  
9 should be decided as soon as possible, and we believe it  
10 should be decided in favor of a market being locational.

11           Locational price signals drive efficient  
12 decisionmaking. If generators are sent a price signals, the  
13 generation, wherever it is located, is equally valuable,  
14 they'll respond accordingly. They'll build where it's  
15 cheapest and easiest to build. And all we have to do is  
16 look at the history of New England over the last six or  
17 seven years. Too much generation has been built in Maine  
18 and rest-of-pool relative to the constrained areas. It's  
19 because the price signals weren't right.

20           The second point is location has already worked  
21 and retaining this price signal will make it keep on  
22 working. For several years, everybody has recognized that  
23 there was a need for major transmission upgrades in  
24 Connecticut and Boston, but for much of that time there was  
25 no price signal and no real fear of a price signal that said

1 build that transmission.

2 As this Commission began down the road of  
3 locational capacity markets -- and I would note that today  
4 is the third anniversary of the SMD order on September 20th  
5 of 2002 that really began some of these discussions --  
6 things have happened. And I think Commissioner Brownell has  
7 noted this a couple times and I think a great thanks to her  
8 for the time she spent in Connecticut.

9 But in Boston we've seen major upgrades planned,  
10 sited, and, indeed, they're nearing completion. In  
11 Connecticut, phase one of the massive two-phase project has  
12 been sited and construction has actually now been begun.  
13 Phase two has received siting approval and there's detailed  
14 work going on for the beginning of construction of that  
15 project. Much of that has taken place since this Commission  
16 started down the road of locational pricing for capacity.

17 In addition, Connecticut has actually done even  
18 more work. We've seen -- and this shows up in the R-CET  
19 summary that we've provided to you -- that Connecticut has  
20 done some infrastructure improvements over the last year  
21 that relaxed some of the capacity constraints into  
22 Connecticut. That helps. These are the compelling reasons  
23 to continue down the path of a locational market. The price  
24 signal must be maintained to ensure the resources -- whether  
25 they're generation, transmission, or demand -- are priced

1 properly to get the right result.

2 As I said, there's actually good news. And we've  
3 talked about this a little bit or talked around it today.  
4 But as we look forward -- and it goes to Chairman Kelliher's  
5 question this morning -- we're actually seeing as we look at  
6 price projections in the future, and they're just that,  
7 they're projections, but we're seeing price separation going  
8 away significantly over the next few years. But that's  
9 based on the view that these transmission projects will be  
10 completed. If we don't keep that locational signal going,  
11 the next time there's a shortage in an area, we'll be back  
12 in the same situation.

13 Now I'd like to turn to the NERAM proposal for a  
14 moment. The NERAM supporters contend that their proposal  
15 will meet the region's needs by doing basically two things:  
16 they'll have a regional capacity market and a locational  
17 forward reserves market. And though locational forward  
18 reserves are a critical component of the ISO's wholesale  
19 market plan, it isn't a substitute for locational capacity.

20 Under locational forward reserves, the ISO will  
21 be sending a price signal for about 2000 megawatts of  
22 extremely flexible fast-start resources, particularly in  
23 load pockets. Capacity on the other hand is a 30,000  
24 megawatt market. Sending the proper price signal for the  
25 2000 megawatts of specific resources is a critical step in

1 efficient markets, but it won't eliminate or reduce the need  
2 for proper price signals for the region's capacity markets.  
3 I liken this one to trying to cure a cannon wound with a  
4 Band-Aid. We're really saying let's use that 2000 megawatt  
5 market and it will solve all the problems. It simply can't  
6 do it.

7 Now there are a number of very difficult issues  
8 that have to be resolved if we go down the path of forward  
9 procurement. Mr. Estes has talked about a number of them,  
10 so I'll shorten up. I think the first one is the demand  
11 curve, do we have one or don't we? PJM is the only market  
12 that has really gone down the forward procurement path, and  
13 they're proposing to do it with the demand curve. We're not  
14 taking a position at this point on whether it's needed or  
15 not, but it's something that should be very carefully  
16 considered.

17 Related to this, and we've discussed it quite a  
18 bit, is market power. How do we deal with market power?  
19 LICAP actually does it through a very simple and  
20 straightforward mechanism that has not received much support  
21 from the generators but the Load, both today and in their  
22 briefs, have given a lot of support: actually count all  
23 existing capacity --

24 SECRETARY SALAS: Ten minutes, Mr. Hepper.

25 MR. HEPPER: Thank you.

1                   -- net of imports and exports. We're looking at  
2 a long-term market here. That's the best way to set the  
3 price. But under forward procurement, we're going to have  
4 to look at that very carefully.

5                   Mr. Estes discussed, so I won't reiterate it  
6 here, both the planning period and the commitment period  
7 will be absolutely critical. The auction design will be  
8 absolutely critical. None of those have been done yet.

9                   I want to come back to credit for a moment and  
10 talk about it because we're really looking, if we look at a  
11 three-year planning period and a three-year procurement  
12 period and the cost of new entry is what's going to be the  
13 price that clears the market. We're talking about somewhere  
14 between \$2.5 and \$3 billion a year. So that means we'll  
15 have \$9 billion on the high-end, \$7.5 billion on the low end  
16 of commitments.

17                   What's the credit that's standing behind that  
18 that's going to ensure generators that they'll get paid? I  
19 can assure you, after talking to our CFO, we don't have that  
20 much credit. It's a long stretch. I'm not sure whether all  
21 the transmission owners in New England who basically sit  
22 behind our tariff have enough credit for that. But those  
23 are the kind of issues, as I understand it -- having not  
24 been part of C-RAM at the beginning: that was one of the  
25 most difficult issues that people tried to deal with.

1                   The other side of that is equally true, the  
2 financial assurances that we want from the generators to be  
3 there. I've mentioned that before; it's another difficult  
4 issue. Qualification of bidders, milestones, all of those  
5 will be incredibly difficult and we'll have to deal with  
6 them as we go forward.

7                   As I've noted throughout this discussion, the ISO  
8 is ready to participate in discussions regarding the  
9 potential alternatives. What we mean by that, I think, has  
10 been interpreted differently by different people. What the  
11 ISO can't do is take ownership of any of the alternatives  
12 for the policy decisions that need to be made with those  
13 alternatives. Those really need to be taken on by those who  
14 believe that those proposals are better and workable. We  
15 can provide technical support, we can do analytical work --  
16 we certainly have some expertise. But as Mr. Estes pointed  
17 out and as we see in the filings, we know there's three,  
18 maybe there are more. We don't have enough resources if  
19 everyone in the room says I've got my idea, could you please  
20 help. That's not what the ISO is structured to do.

21                   So where do we go from here? I think that's  
22 probably the hardest question of the day. The forward  
23 procurement proponents freely admit that their proposals are  
24 conceptual and need significant further development. That's  
25 a difficult process. The ISO feels first this Commission

1 should resolve the locational issue no matter what we do.  
2 This is only one of the tough issues.

3 As a result, we look at it and say -- basically  
4 as Mr. Estes did -- LICAP should go forward. We say this  
5 for several reasons. First, it's a good market design that  
6 we strongly believe will work. It's gone through rigorous  
7 testing and it's been improved through a highly-litigated  
8 stakeholder process. Second, time is of the essence.

9 New England needs a good functioning capacity  
10 market in the very near future. With supply running short  
11 in the 2008-2010 timeframe, we can't wait until 2010 or 2011  
12 to start sending a price signal that's appropriate.

13 Third -- and I noted this earlier -- we're  
14 relying on this mixed regime of markets and RMR contracts  
15 and that doesn't work effectively.

16 All this being said, however, we understand the  
17 state's concerns regarding LICAP and their goal of  
18 developing and implementing an effective forward procurement  
19 model for New England. As many parties have discussed  
20 throughout the day, this could be accomplished as an  
21 alternative or a supplement to LICAP. I suspect Load will  
22 not support that, but we believe it's the best way to go  
23 forward.

24 The ISO's view is that there should really be a  
25 three-step process. One is we can use a couple of months

1 for the proponents of the alternatives to try and develop  
2 them further to see where they go. In the next few months  
3 there could be a stakeholder process to determine whether  
4 consensus proposals could be accomplished by all the New  
5 England stakeholders. If we do need a hearing as a third  
6 step, it would have to be very short -- and we agree with  
7 Mr. Estes, it would be very difficult to do in the  
8 timeframes that have been laid out.

9 We believe LICAP should be put in. If  
10 alternatives want to be developed, they can be. We'll work  
11 on them. But we simply can't wait and we don't see LICAP as  
12 something that is in any way worse and, in fact, we think  
13 better than what we have seen thus far. So it's incumbent  
14 on the Commission to really look at an order by early- to  
15 mid-winter of this year to get a capacity market in place by  
16 October 1st. Otherwise, we're looking at a longer timeframe  
17 and a continued mixed solution to what we're trying to deal  
18 with here, which is the upcoming capacity problem in New  
19 England.

20 COMMISSIONER KELLY: Mr. Hepper, if the  
21 Commission were to do that and in that order allowed for the  
22 possibility that a forward procurement program would be  
23 added or possibly could replace it, what impact would that  
24 uncertainty have on the effectiveness of LICAP?

25 MR. HEPPER: I think Mr. Estes actually gave a

1 very similar answer to the one I would give to that  
2 question, which is as long as the order makes it clear that  
3 this is not going to be the possibility of taking everything  
4 away -- that would kill the market. But if it was to say  
5 forward procurement can replace it, we've heard I think  
6 fairly general agreement that it's going to be the cost of  
7 new entry that we're going to be looking at going forward as  
8 the sort of price-setting point in these markets. If the  
9 order makes it clear to investors that they're not going to  
10 get their legs cut out from under them, our suspicion is the  
11 same as what Mr. Estes has said: it can work.

12 COMMISSIONER KELLY: Thank you.

13 MR. HEPPER: Thank you.

14 COMMISSIONER BROWNELL: This morning someone  
15 mentioned -- or earlier today someone mentioned that the New  
16 England ISO proposal had changed over time. Were those  
17 changes because the New England ISO changed their mind or  
18 they were responding to issues that were raised by  
19 stakeholders during the process?

20 MR. HEPPER: It was because there were issues  
21 raised by stakeholders during the process. I think  
22 litigation is an effective means of making people really  
23 look very carefully. We did that. We saw -- and there were  
24 two changes made during the hearing process, starting with  
25 August 31st, and it was pointed out this morning, but I'll

1 go back to them.

2 The two changes were we started with what was  
3 called the critical hours availability metric and doing it  
4 all after the fact. The generators pointed out that that  
5 didn't work for a number of reasons. We listened, we sat  
6 down, we worked through trying to resolve those issues and  
7 develop the shortage hours proposal that was put into the  
8 case. They didn't like it much better, but it dealt with  
9 most of the concerns that we believe they raised that were  
10 legitimate concerns.

11 The second one was how to deal with market power.  
12 Reading the June 2nd order in terms of what rights  
13 generators should have, we weren't certain as to how much  
14 liberty and flexibility we had in terms of dealing with  
15 generators' decisions to participate or not. But as the  
16 litigation continued, Staff I think, more than anyone,  
17 really pushed on the question of whether we had a concern  
18 about market power. And the more the market design folks  
19 looked at it, the more they said yes --

20 SECRETARY SALAS: One minute warning.

21 MR. HEPPER: Thank you.

22 They said yes, we do, and so that was the other  
23 change. But they were both driven by valid concerns that  
24 were raised during the litigation process.

25 I'm finished.

1 SECRETARY SALAS: You have one second.

2 COMMISSIONER BROWNELL: I'll waste it.

3 (Laughter.)

4 MR. ESTES: I'll take it.

5 SECRETARY SALAS: Today's winner.

6 CHAIRMAN KELLIHER: Do you want to give your time  
7 to Mr. Estes?

8 MR. HEPPEL: I would be happy to. I have nothing  
9 further to add.

10 MR. ESTES: 40 seconds.

11 SECRETARY SALAS: Let me first note for the  
12 record Mr. Speck had reserved three minutes for rebuttal.

13 CHAIRMAN KELLIHER: Oh that's right, yes, yes.

14 SECRETARY SALAS: And Mr. Austin has 4-1/2  
15 minutes, so how do you want to proceed?

16 MR. ESTES: Let's finish out his --

17 CHAIRMAN KELLIHER: Why not use your 40 seconds  
18 or whatever.

19 SECRETARY SALAS: Sure. Go ahead.

20 MR. ESTES: A feature to keep in mind that  
21 reduces risk and therefore costs with LICAP is that it  
22 offers suppliers the opportunity to significantly hedge  
23 weather risk and, by the same token, the ISO says -- and  
24 there's a reason -- loses any incentive for anyone to  
25 withhold in the real-time energy markets. And it doesn't

1       this because it uses actual price streams to calculate what  
2       the deduct's gonna be for the contribution you get from the  
3       energy market rents.

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1 Under this proposal, you don't know, you're  
2 guessing, in the three- to six-timeframe out, what it will  
3 be. There's a huge risk there.

4 If you're wrong and you predict too much or too  
5 little, you can really lose money. That raises the ante on  
6 risk and raises costs, potentially, and that's another  
7 comparative point you should have in mind.

8 SECRETARY SALAS: That's time. Mr. Speck, for  
9 the NERAM proposal.

10 MR. SPECK: I just have one point and then I'll  
11 turn it over to --

12 CHAIRMAN KELLIHER: Is your microphone on, Mr.  
13 Speck?

14 MR. SPECK: Thank you. I have one quick point,  
15 and then I'll turn it over to Mr. Daly. I'm pleased to see  
16 that both Mr. Estes and Mr. Hepper agree that the NERAM  
17 proposal still needs further development. We concur on that  
18 completely.

19 It's not had the opportunity for a gestation  
20 period, similar to what Mr. Hepper just described with  
21 regards to ISO's proposal. Although Connecticut protested,  
22 originally, that other alternatives should be considered, we  
23 asked for rehearing when the Commission denied that request.

24 We then submitted testimony on an alternative, 70  
25 pages that were stricken from the record, and we made it an

1 offer of proof, but we've never had the opportunity to  
2 present that proposal or any other alternative proposal, and  
3 we would like the opportunity to do that.

4 That's what we've asked for, and that will  
5 produce a full and complete record for the Commission. Mr.  
6 Daly?

7 MR. DALY: Thank you. I have just a couple of  
8 points to reiterate. We really believe that regionwide  
9 market is the appropriate market for New England capacity,  
10 and we've noted that it has been that before.

11 This is at the risk of repeating myself, but we  
12 have put in place, and I would point out that we really put  
13 a regional arrangement in place, so that we could have a  
14 regional market. And that mechanism is in place today to  
15 ensure that we put in place, the generation that's needed,  
16 and that's the mechanism that's delivering the -- I'm sorry,  
17 the transmission that's needed, and that is the mechanism  
18 that is delivering that transmission to us.

19 So, we think the mechanism --

20 CHAIRMAN KELLIHER: Excuse me, Mr. Daly, but is  
21 your proposal based on the assumption that all the planned  
22 transmission projects are built, exactly on time, without a  
23 hitch? Is that a premise of your proposal?

24 MR. DALY: Yes, we assume that those major  
25 transmission projects will be built, as, indeed, as most

1 people expect.

2 CHAIRMAN KELLIHER: But exactly as planned,  
3 without delay?

4 MR. DALY: By and large, as planned, without  
5 delay.

6 The other aspect is that it was said that the  
7 NERAM proposal is not locational. We would need to  
8 reiterate that it is locational.

9 SECRETARY SALAS: One minute left.

10 MR. DALY: And that it has a locational forward  
11 reserves market. It's been pointed out that that market is  
12 relatively small.

13 Well, actually, the solution is not small,  
14 compared with the task that it is being put to. It is quite  
15 an important market in the areas in which it would be  
16 implemented.

17 So we think --

18 CHAIRMAN KELLIHER: Can I ask you one question  
19 back on that same point? Do you -- your proposal, though,  
20 doesn't envision a deliverability requirement on an ongoing  
21 basis. You assume that you will eradicate the immediate  
22 transmission congestion, and that no more transmission  
23 congestion will arise in the future? How would that be  
24 assessed?

25 MR. DALY: Well, that's correct. Within the

1 transmission that's been proposed, and the generation that  
2 we currently have, combined with -- with those in place,  
3 then, price separation is not really prevalent.

4 CHAIRMAN KELLIHER: But you're not proposing a  
5 deliverability requirement?

6 MR. DALY: We're not proposing a deliverability  
7 requirement, that is correct.

8 CHAIRMAN KELLIHER: That's why I don't quite  
9 understand how we can be assured that there will be no  
10 future transmission congestion in New England.

11 SECRETARY SALAS: Time, Mr. Chairman.

12 CHAIRMAN KELLIHER: Sorry.

13 (Laughter.)

14 MR. DALY: I have an answer, I have an answer.

15 (Laughter.)

16 SECRETARY SALAS: And now Mr. Austin, with four  
17 and a half minutes.

18 MR. REITER: If you don't mind, I'll start.

19 SECRETARY SALAS: I'll do four, okay, but you  
20 know that you have four and a half, but I'll give you the 30  
21 seconds.

22 MR. REITER: Let me address first, a point that  
23 Mr. Hepper made, distinguishing LICAP from the NELRAM  
24 proposal. He says that while we have a procurement model,  
25 there's no guarantee that capacity will actually be built,

1 but, instead, what we'll wind up with is financial  
2 penalties.

3 And, by contrast, he says, under LICAP, there  
4 will be actual payment for capacity. That's true, but I  
5 think, incomplete, significantly incomplete, because it  
6 doesn't guarantee, LICAP doesn't guarantee that the capacity  
7 will actually come online.

8 There is payment for capacity, but it may turn  
9 out to be, and, in fact, our big concern is that it may turn  
10 out to be payment for a small amount of capacity, and that  
11 no capacity will be added.

12 What will happen is, the payment under LICAP will  
13 go up, not because there's been any performance, but  
14 precisely for the opposite reason, so I don't think that's a  
15 reason to support LICAP.

16 Now, Mr. Estes has said that -- and I think  
17 they're erecting a strawman -- that objections were that the  
18 Judge made a mistake in excluding evidence of alternatives.  
19 I think it was -- to be candid, we think it was the  
20 Commission's mistake, and that's what we've said in our  
21 brief on exceptions.

22 And I think the mistake the Judge made was in  
23 admitting testimony on the workability of LICAP, the  
24 testimony that Mr. Fedder provided, and the failure to  
25 discuss either Mr. Fedder's testimony or the testimony of

1 Mr. Bowen, who agreed that it wouldn't work, at least the  
2 LICAP proposal, as devised by the ISO.

3 If the Commission agrees with us, and, I think,  
4 legally, the Commission is obliged to address that concern  
5 on exceptions, if it agrees with us and it concludes that  
6 LICAP isn't workable, then it needs to look at alternatives,  
7 and that means that it will need to look at alternatives,  
8 even if it's difficult and the process is going to be tough.

9 We're prepared to submit -- to devote the time  
10 and resources to development of a record, and we hope the  
11 Commission will consider that.

12 Let me say also that --

13 CHAIRMAN KELLIHER: I'm sorry, Mr. Reiter, but  
14 just on the question of alternatives and whether the  
15 Commission has considered alternatives, did Connecticut file  
16 a rehearing request for the June 2nd Order, that presented  
17 alternatives?

18 MR. REITER: I'm not sure who did, but there were  
19 several parties who --

20 CHAIRMAN KELLIHER: Connecticut?

21 MR. REITER: I don't know.

22 PARTICIPANT: Connecticut did.

23 CHAIRMAN KELLIHER: Connecticut did?

24 PARTICIPANT: Yes.

25 CHAIRMAN KELLIHER: Are you speaking -- I'm

1       losing track of your affiliation.  You're not speaking on  
2       behalf of --

3                   MR. REITER:  NEHPUC.

4                   CHAIRMAN KELLIHER:  NEHPUC didn't file a hearing  
5       request that presented alternatives?

6                   MR. REITER:  NEHPUC did protest, and I think this  
7       was something that Mr. Estes was wrong about.  They did  
8       protest.

9                   CHAIRMAN KELLIHER:  I just want to point out that  
10      the parties did have an opportunity to present alternatives  
11      in rehearing requests, and I guess there was a grand total  
12      of one party that did so?

13                  MR. REITER:  I think the answer I would give to  
14      that, Mr. Chairman, is the one that we provided on brief,  
15      and that is that when you're presented with a proceeding in  
16      which you have to decide the reasonableness of the proposal,  
17      the ordinary process is that you get a chance to examine  
18      alternatives, and --

19                  SECRETARY SALAS:  One and a half minutes.

20                  MR. REITER:  -- the defects in the record would  
21      be cured, we hope, by allowing consideration of  
22      alternatives.

23                  I do want to make one brief point, that the  
24      suggestion by both the ISO and the Capacity Suppliers, that  
25      LICAP can work as an interim measure, we think that doesn't

1 really make sense. LICAP, the whole premise is that it  
2 provides some long-term assurance of stability, if you will,  
3 that a payment stream will be available to generators.

4 All that LICAP, implemented on a interim basis,  
5 will do, is provide a payment stream to existing generators.  
6 It won't incentivize new generation, and, I would add, with  
7 respect to the problem that may occur in 2008 under a worst-  
8 case scenario, LICAP won't produce generation in 2008,  
9 either, even if it's implemented in 2006.

10 There is going to be a lag, as with any proposal,  
11 before it kicks in, even if it works exactly as expected.  
12 It will simply provide a revenue stream to existing  
13 generators.

14 I'm sorry, I think I've used up the time. We  
15 have 30 seconds?

16 MR. AUSTIN: I'm sorry, I thought Harvey used my  
17 time.

18 SECRETARY SALAS: It's 15 now.

19 (Laughter.)

20 MR. AUSTIN: Very quickly, as to the timing  
21 issue, it deserves a little more thought and little more  
22 careful review to see what difficulties you may or may not  
23 run into, if you go forward with some sort of a NERAM/NELRAM  
24 proposal.

25 SECRETARY SALAS: That's time, Mr. Chairman.

1                   CHAIRMAN KELLIHER: I want to sum up and make a  
2 few comments here at the end.

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1           I do want to first of all thank everyone for  
2 their participation today. We've had a thorough ventilation  
3 of the issues and it's been an interesting day. And through  
4 the course of the day, a lot of valuable information has  
5 been added to the record in this proceeding, and my  
6 colleagues and I appreciate all of your help in trying to  
7 identify what you think is the best approach for the region.

8           There does seem to be consensus around a  
9 threshold issue that there is a problem under the status quo  
10 that needs to be addressed. I believe every presenter,  
11 other than one, agreed that the Commission has to take some  
12 kind of action. Unfortunately, beyond that, there doesn't  
13 seem to be a great deal of consensus and the Commission does  
14 have a difficult decision in front of us.

15           And at this point, we will consider the record --  
16 the information and the arguments we've heard today and  
17 decide how to proceed. If we decide that we need to receive  
18 further information as a follow-up to today's proceeding,  
19 we'll issue a notice describing what should be filed and  
20 when. And in the meantime, I want to urge the parties to  
21 meet and attempt to settle this matter. We've had some  
22 interesting discussion of that today. You certainly can  
23 request the services of a settlement judge or the dispute  
24 resolution service.

25           One aspect of the procedural option that was

1 presented today involved assigning a FERC settlement judge  
2 to hold settlement discussions in the Boston area. And  
3 we're willing to provide those resources if the parties  
4 desire it and if there is a legitimate prospect of  
5 settlement; on that latter point, there may be a question.

6 Now any settlement discussions would have to take  
7 place on an expedited basis, of course, given the discussion  
8 we've had over the past hour. And the fact that the  
9 alternatives presented are largely conceptual in nature  
10 presents a challenge to any kind of settlement discussions.

11 But as the parties decide whether or not it's in  
12 their interest to pursue settlement in good faith, I want to  
13 remind you of the old gypsy curse that may you be involved  
14 in a lawsuit in which you're convinced you're right.

15 (Laughter.)

16 CHAIRMAN KELLIHER: And some of you may be -- I  
17 don't want to curse people at the end of a meeting, I know  
18 it's kind of bad form.

19 (Laughter.)

20 CHAIRMAN KELLIHER: But at least open your minds  
21 to the possibility that some people on the other side of the  
22 table actually have merit in their position as well.

23 Anyway, we will digest -- we will sit down and  
24 deliberate and try to decide what the next course of action  
25 is. But it's been a good day and I've enjoyed it. This

1 meeting is adjourned.

2 (Whereupon, at 4:25 p.m., the conference was  
3 adjourned.)

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