

125 FERC ¶ 61,102  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
Philip D. Moeller, and Jon Wellinghoff.

ISO New England Inc. and  
New England Power Pool

Docket No. ER08-1209-000

ORDER ACCEPTING FILING AND REQUIRING  
COMPLIANCE FILINGS

(Issued October 28, 2008)

	<u>Paragraph Numbers</u>
I. BACKGROUND .....	<u>2.</u>
A. Resources Needed for Reliability and Development of the Forward Capacity Market .....	<u>2.</u>
B. Results of the First Forward Capacity Auction .....	<u>4.</u>
C. The Current Filing .....	<u>5.</u>
1. Payment Provisions .....	<u>6.</u>
2. Provisions Relating to Retirement .....	<u>14.</u>
3. Provisions Relating to Pro Forma Cost of Service Agreement .....	<u>15.</u>
D. Protests, Comments and Answers .....	<u>16.</u>
II. PROCEDURAL AND THRESHOLD ISSUES .....	<u>17.</u>
A. Interventions and Motion to Strike .....	<u>17.</u>
B. Collateral Attack .....	<u>18.</u>
III. DISCUSSION.....	<u>21.</u>
A. The Filing Parties' Proposed Method of Compensating Generators Needed for Reliability is Just and Reasonable .....	<u>21.</u>
1. Going Forward Costs as Compensation for Resources De-listing for a Single Year.....	<u>22.</u>
2. Resource Adequacy vs. Security .....	<u>49.</u>
3. NRG's Counter-Proposal .....	<u>56.</u>
4. Payments to Norwalk Units for the First Forward Capacity Auction .....	<u>60.</u>
B. Arguments Raised by State and Municipal Entities .....	<u>70.</u>

1. Whether Payment to Resources Needed for Reliability Should Be Explicitly Based on Going-Forward Costs.....	<a href="#">70.</a>
2. ISO-NE Should Be Required to Pursue Alternatives to Rejecting De-List Bids in Order to Find the Least-Cost Solution.....	<a href="#">80.</a>
3. Timing of Notification to the Commission.....	<a href="#">82.</a>
C. Miscellaneous Issues .....	<a href="#">86.</a>
1. Proposed Revisions to Retirement Provisions.....	<a href="#">86.</a>
2. NSTAR Argument Concerning Elimination of Formal NEPOOL Reliability Review of Generator Retirements .....	<a href="#">98.</a>
3. Changes to the Pro Forma Cost of Service Agreement.....	<a href="#">105.</a>
4. The Process for Establishing Separate Capacity Zones .....	<a href="#">112.</a>
5. Effective Date of Tariff Sheets/Compliance Filing .....	<a href="#">115.</a>

1. In this order, the Commission accepts a filing by ISO New England Inc. (ISO-NE) and the New England Power Pool Participants Committee (NEPOOL, together Filing Parties) to provide compensation for units that are necessary for reliability. We also require compliance filings.

**I. Background**

**A. Resources Needed for Reliability and Development of the Forward Capacity Market**

2. Under ISO-NE's Forward Capacity Market (FCM), capacity providers bid into an auction (the Forward Capacity Auction) to supply capacity to the market, and, if they are chosen in the auction, are compensated by a clearing price set by the highest accepted offer.<sup>1</sup> Under the FCM construct, New England resources may submit bids specifying the price below which the resource is unwilling to supply capacity, referred to as a de-list bid. If the auction clears at a price below a resource's de-list bid (and the resource is not found to be needed for reliability), that resource will not be obligated to supply capacity during the applicable commitment period, which is approximately three years after each auction.

3. Historically in New England, inefficient resources that are unable to obtain sufficient revenue from providing capacity and energy and ancillary services, but that are needed for reliability, have entered into Reliability Must Run (RMR) Agreements. An RMR Agreement requires the resource to participate in the energy markets in return for compensation based on its cost of service, rather than market-based compensation.

---

<sup>1</sup> For more detail, see *ISO New England Inc.*, 119 FERC ¶ 61,045, at P 5-10 (Market Rules Order), *order on reh'g*, 120 FERC ¶ 61,087 (2007).

During the negotiations that led up to the settlement that resulted in the FCM, stakeholders recognized that the creation of a capacity market that valued capacity resources based, in part, on their location, would reduce the need for RMR agreements,<sup>2</sup> but that even in a locational market, there might be a need to retain some resources for reliability that would have to be compensated on an out-of-market basis. Consequently, the FCM settlement provided that ISO-NE may reject a de-list bid (i.e., prohibit that resource from de-listing) if it is needed for reliability and that the resource will be compensated at a just and reasonable rate.<sup>3</sup> In the instant filing, ISO-NE and NEPOOL propose a specific means for compensating resources whose de-list bids are rejected because they are needed for reliability.

### **B. Results of the First Forward Capacity Auction**

4. ISO-NE held its first auction in February 2008, to procure capacity for the 2010-2011 Capability Year. All resources submitting de-list bids were allowed to de-list, with the exception of two units in Connecticut. As required by the FCM Settlement, prior to conducting the auction ISO-NE initially determined that Connecticut, a historically constrained sub-area, would not be modeled in the auction as a separate capacity zone.<sup>4</sup> ISO-NE did not permit two Connecticut units, NRG Power Marketing's (NRG) Norwalk Harbor Unit 1 and Unit 2 (the Norwalk units) to de-list, on the basis that allowing either of the Norwalk Units to leave the market would have resulted in the inability of the Connecticut sub-area to meet the "Area Transmission Requirements" specified in ISO-NE's planning procedures.<sup>5</sup> In accordance with the FCM Settlement, the Commission approved the results of the first auction in June 2008.<sup>6</sup>

### **C. The Current Filing**

5. In the instant filing, ISO-NE and NEPOOL propose new rules for the treatment and compensation of resources whose de-list bids are rejected for reliability reasons along

---

<sup>2</sup> All RMR Agreements will terminate upon commencement of the first FCM commitment period – June 1, 2010.

<sup>3</sup> See section H of the FCM Settlement Agreement in Docket Nos. ER03-563-000 *et al.* (March 6, 2006).

<sup>4</sup> The Commission accepted this determination in *ISO New England Inc.*, 121 FERC ¶ 61,250 (2007), *order on reh'g*, 123 FERC ¶ 61,129 (2008).

<sup>5</sup> *ISO New England Inc.*, 123 FERC ¶ 61,290, at P 8 (First Auction Results Order) (2008).

<sup>6</sup> See First Auction Results Order, *supra*.

with revisions to sections I.3.9 and I.3.10 of the tariff to modify the reliability review processes provided for in the FCM.

### **1. Payment Provisions**

6. The Filing Parties' proposal for compensation of reliability resources in the FCM is based on the de-list bids submitted by resources that seek to leave the market in the Forward Capacity Auction. All de-list bids are subject to reliability review by ISO-NE to determine if allowing the resource to leave the market will result in a violation of NERC, NPCC, or ISO-NE reliability standards.

7. There are three types of de-list bids in the FCM rules that are relevant to this filing – static, dynamic, and permanent. All of the de-list bids are measured against the Cost of New Entry (CONE), which was set at \$7.50 per kilowatt month for the first auction held in February 2008 and will equal \$6.00 per kilowatt month for the second auction to be held in December 2008. Permanent and static de-list bids must be submitted approximately nine months before the auction, while dynamic de-list bids are submitted during the auction.

8. If a resource wishes to leave the capacity market for a single year above a threshold level of  $0.8 * CONE$ , the resource owner must submit a Static De-List Bid. Each of these Static De-List Bids is reviewed by the Market Monitor to determine whether the bid is consistent with the resource's going forward and opportunity costs. If the bid is approved by the Market Monitor, it would set the price if the unit submitting the bid is the unit that stops the descending clock auction.

9. If a resource wishes to leave the capacity market for a single year at a price below  $0.8 * CONE$  the resource owner must submit a Dynamic De-List Bid during the Forward Capacity Auction. Dynamic De-List Bids are not subject to review by the Market Monitor and would set the price if the unit submitting the bid is the unit that stops the descending clock auction.

10. If a resource wishes to permanently leave the capacity market but retain the option of otherwise operating the unit to provide other services or retiring, the resource owner must submit a Permanent De-List Bid. Permanent De-List Bids above the threshold value of  $1.25 * CONE$  are subject to Market Monitor review, allowing the unit to set the price below  $1.25 * CONE$  without Market Monitor review, but can only set the price above that level if the Market Monitor concludes that the bid is consistent with the unit's going forward and opportunity costs.

11. In addition, the instant proposal adds an additional non-price related means for a resource a new request to retire, introduced in the proposal as "the non-price retirement option," by which a resource can seek to retire, irrespective of the auction clearing price.

This option was developed by ISO-NE in response to stakeholder concerns that the de-list options above do not provide a non-price path for a unit that simply seeks to retire.

12. For all static de-list bids, and any permanent de-list bids above  $1.25 * CONE$ , the ISO-NE market monitor determines whether the bid is consistent with the resource's risk-adjusted going forward costs and opportunity costs. If the market monitor determines that the bid is not consistent with the resource's costs, it will restate the bid using the Commission-approved calculation for net risk-adjusted going forward costs<sup>7</sup> and opportunity costs. Because dynamic de-list bids are submitted during the auction (unlike static or permanent de-list bids, which are submitted in advance of the auction), they are not subject to market monitor review in advance of the auction; however, market participants are able to comment on dynamic de-list bids in response to ISO-NE's filing under section 205 of the Federal Power Act (FPA) of the results of the auction.

13. The Filing Parties' proposal compensates resources with de-list bids rejected for reliability reasons based on the type of de-list bid:<sup>8</sup>

- a) A resource whose cleared static or dynamic de-list bid (under which the resource seeks to de-list for one year only) is rejected for reliability reasons is compensated at its de-list bid. ISO-NE claims that compensation at an amount greater than the offered de-list bid exceeds the price at which a resource indicates it is willing to supply capacity and compensation, and an amount below the de-list bid would not cover the costs of keeping a unit in operation; therefore, the bid price results in just and reasonable compensation.
- b) A resource whose cleared permanent de-list bid is rejected for reliability reasons can choose to be compensated at (i) its de-list bid, or (ii) a Commission-approved cost of service rate. ISO-NE claims that Commission precedent allows cost of service treatment for units seeking to retire that are needed for reliability.
- c) If a resource with a non-price retirement request is needed for reliability, it can choose to proceed with its retirement or remain available. If the unit submitting a

---

<sup>7</sup> Section III.13.1.2.3.2.1.2 of Market Rule I defines going forward costs as "costs that might otherwise be avoided or not incurred if the resource were not subject to the obligations of a listed capacity resource during the Capacity Commitment Period (i.e., maintaining a constant condition of being ready to respond to commitment and dispatch orders)."

<sup>8</sup> Until one year prior to the capacity commitment period, ISO-NE can notify a resource that it is no longer needed for reliability and will not receive out-of-market payments.

non-price retirement request remains available for reliability it can choose to be compensated at (i) the normal auction clearing price (since it has not provided a de-list bid), or (ii) a Commission approved cost of service rate.<sup>9</sup> ISO-NE contends that limiting cost of service compensation to resources seeking to permanently de-list is consistent with Commission directives against toggling between market and out-of-market payments.

## **2. Provisions Relating to Retirement**

14. Additionally, the Filing Parties propose to revise tariff requirements currently set forth in sections I.3.9 and I.3.10 that require ISO-NE to determine that a resource's plan to retire or reduce capacity will not harm reliability before the resource may proceed. The proposal incorporates these requirements into the FCM rules, providing that all de-list bids are subject to a reliability review.<sup>10</sup> Because the auction is held approximately three years prior to its FCM commitment period, these reliability reviews will be conducted three years prior to the target period, rather than the current practice of sixty days prior.

## **3. Provisions Relating to *Pro Forma* Cost of Service Agreement**

15. Lastly, the Filing Parties' proposal revises the *pro forma* Cost of Service Agreement to (i) reflect modifications found in all currently effective cost of service Agreements; (ii) conform the Agreement to the FCM rules; and (iii) more clearly state resources' obligations.

---

<sup>9</sup> A resource that submits a non-price retirement request that remains available for reliability and must make a capital expenditure to remain available because it is needed for reliability can make a separate filing under section 205 to recover those costs. This capital expenditure filing may be made in advance of the resource's filing to receive cost-of-service treatment. This option is not available for resources whose permanent de-list bids are rejected because those resources can continue to operate in the energy markets and external capacity markets to recover such costs.

<sup>10</sup> The proposal also incorporates language clarifying that the existing rules in sections I.3.9 and I.3.10 will govern resources without future capacity obligations until the commencement of the first commitment period.

#### **D. Protests, Comments and Answers**

16. Notice of the filing was published in the *Federal Register*, with motions to intervene, notices of intervention, comments and protests due by July 22, 2008.<sup>11</sup> Timely motions for intervention were filed by Dynegy Power Marketing, BG Energy Merchants, *et al.*, Exelon Corporation, Northeast Utilities Service Company, and the Mirant Companies. Timely motions to intervene and notices of intervention, and protests or comments, were filed by NRG Companies and the FirstLight Companies, (NRG/FirstLight), NSTAR Electric Company (NSTAR), the New England Power Generators Association (New England Generators), the PSEG Power Companies (PSEG), the Connecticut Department of Public Utility Control (Connecticut Commission), the Massachusetts Municipal Wholesale Electric Company (Massachusetts Municipals), the Connecticut Municipal Electric Energy Cooperative (Connecticut Municipals), Dominion Resource Services (Dominion), the New England Conference of Public Utility Commissioners (New England Commissions), the Attorney General of the State of Connecticut (Connecticut Attorney General), the Connecticut Consumers Counsel, the PPL Companies (PPL) and the Massachusetts Department of Public Utilities (Massachusetts Commission). FPL Energy moved to intervene out of time. ISO-NE filed an answer to the protests and comments, as did Massachusetts Municipals, NEPOOL, NRG/FirstLight, and the Connecticut Commission. ISO-NE filed a motion to strike portions of the Connecticut Commission's answer. NEPOOL also filed the decision of the NEPOOL Review Board with regard to NRG's appeal of NEPOOL's acceptance of the proposed compensation mechanism. Mirant, New England Generators, NRG/FirstLight, and NSTAR filed answers to the answers of the other parties, and ISO-NE filed an answer to New England Generators' answer.

#### **II. Procedural And Threshold Issues**

##### **A. Interventions and Motion to Strike**

17. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214 (2008)), the notices of intervention and the timely-filed unopposed motions to intervene serve to make the entities filing them parties to this proceeding. We will grant FPL Energy's motion to intervene out-of-time given its interest in this proceeding, the early stage of the proceeding, and the absence of any undue prejudice or delay. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2008), prohibits an answer to a protest or an answer unless otherwise

---

<sup>11</sup> 73 Fed. Reg. 41056 (2008). The Commission subsequently extended the comment date to August 1, 2008.

ordered by the decisional authority. We will accept the answers filed by all parties, because they have provided information that assisted us in our decision-making process.

**B. Collateral Attack**

18. In its August 29 answer to the protests, ISO-NE urges the Commission to reject several of the challenges to this filing on the basis that those challenges are collateral attacks on prior Commission rulings. ISO-NE argues that the Commission has already ruled on the following issues: the use of going forward costs to analyze de-list bids to prevent market power, the lack of "extra" compensation to generators providing security, and the reliability review of bilateral contracts and de-list bids based on NERC, NPCC, and ISO-NE criteria.<sup>12</sup> The Connecticut Commission similarly argues that the protesting generators seek here to belatedly protest the Commission-approved static de-list bid formula, raising arguments that the Commission has previously addressed.<sup>13</sup> ISO-NE contends that the protesting generators cannot seek to amend Commission-approved FCM rules in a section 205 filing, and that the compromises achieved under the FCM Settlement should not be undone in this proceeding, which is limited to compensation for rejected de-list bids.

19. We agree, as will be discussed below with regard to the specific issues raised, that some of these arguments constitute collateral attacks on earlier Commission rulings,<sup>14</sup> which we are not altering here.

---

<sup>12</sup> ISO-NE August 29 answer at 9-11.

<sup>13</sup> Connecticut Commission August 29 answer at 15, stating that the Commission approved the de-list provisions that the generators find objectionable in *Devon Power LLC*, 115 FERC ¶ 61,340 (2006), in which the Commission approved the FCM Settlement, and *ISO New England Inc.*, 119 FERC ¶ 61,054 (2007), in which the Commission approved the FCM Market Rules.

<sup>14</sup> See, e.g., *Midwest Indep. Transmission Sys. Operator, Inc.*, 123 FERC ¶ 61,297, at P 74 (2008); *State of California, ex rel. Bill Lockyer v. British Columbia Power Exchange Corporation*, 99 FERC ¶ 61,247, at 62,061-62 (2002) (arguments dismissed as "an impermissible collateral attack" on the basis that they were "advanced and addressed in prior Commission orders").

20. Nonetheless, assuming *arguendo* that the challenges are not collateral attacks, we also find that the filing by ISO-NE and NEPOOL is just and reasonable, for the reasons that follow.<sup>15</sup>

### **III. Discussion**

#### **A. The Filing Parties' Proposed Method of Compensating Generators Needed for Reliability is Just and Reasonable**

21. As explained below, we find the Filing Parties' proposal to be just and reasonable. Specifically, we find compensation for rejected one-year de-list bids at the level of the offered de-list bid to be just and reasonable. Similarly, we find that only allowing the option of cost-of-service compensation for rejected permanent or non-price retirement request bids is also just and reasonable. We also disagree with the presented arguments that generators with rejected one-year de-list bids should receive compensation in excess of their de-list bids. Last, consistent with our direction in the First Auction Results Order,<sup>16</sup> we will encourage New England stakeholders to revisit the mechanism for establishing capacity zones under limited circumstances (as presented in Connecticut for the first auction) as soon as practicable.

#### **1. Going Forward Costs as Compensation for Resources De-listing for a Single Year**

##### **a. Positions of the Parties**

22. The instant filing was protested largely by the generation sector, which asserts that the proposal is unjust, unreasonable, and confiscatory. The generator protests focused mainly on the proposed compensation for resources with static or dynamic de-list bids (i.e., one year de-list bids) that are rejected for reliability. The generators argue that despite the fact that some units are needed for system security rather than for resource

---

<sup>15</sup> However, the Commission denies ISO-NE's motion to strike. We will take under advisement ISO-NE's view that portions of the Connecticut Commission's answer addressing the use of the Transmission Security Analysis to evaluate de-list bids go beyond the appropriate scope of our evaluation of the instant filing. However, we will not pre-judge the appropriateness of that material by striking it without giving it full consideration.

<sup>16</sup> First Auction Results Order at P 82.

adequacy,<sup>17</sup> these units are not allowed to receive a scarcity price that reflects their relatively higher value to the system (compared to resources that only satisfy the one in ten year Loss of Load Expectation resource adequacy standard). Instead, generators note that for a rejected one-year de-list bid, they are offered a choice between compensation under the market monitor-reviewed existing net risk adjusted going forward costs formula (for static de-list bids up to  $1.25 * CONE$ ) or under a dynamic de-list bid (below  $0.8 * CONE$ ). The protesters contend that this "going-forward cost" compensation does not reflect the bids that would be offered in a competitive long-run market like FCM where the obligation is three years forward, and fails to compensate resources for the locational value of the capacity that they provide.

23. The generator protesters criticize the instant proposal for relying on models of economic theory based on assumptions of perfect competition, so as to justify compensating these resources based on short-run marginal costs. For example, NRG states that this compensation construct does not give old, inefficient units like its Norwalk units (which had the only rejected de-list bids in the first auction) a reasonable opportunity to recover their long-run costs. NRG further argues that the first auction demonstrates that units with rejected de-list bids will typically be those with high operating costs and low capacity factors, like the Norwalk units. NRG maintains that rationally, the owner of units like Norwalk, that must recover its long-run costs and that cannot expect to earn additional revenues in the energy or ancillary service markets, would not bid its short-run marginal costs: rather, it would bid the higher of (a) its long run average costs or (b) just below the expected bid of the lowest cost new entrant. NRG points out that this is not possible under the risk adjusted going forward costs formula, which does not allow for the inclusion of risk-adjusted costs or capital costs.

24. The generators contend that unless a resource is willing to make a permanent de-list bid, terminating the resource's eligibility for capacity payments, the "mitigated" bid level makes no provisions for recovery of costs greater than a one-year avoided cost. They state that because ISO-NE has no provision in place to replace a unit with a rejected de-list bid in a reconfiguration auction, a resource could be required to provide capacity indefinitely while only receiving a one-year avoidable cost payment each year. Further, the generators note that the range of costs that are avoidable increase as the period of time considered increases.

---

<sup>17</sup> Under the FCM construct, the Forward Capacity Auction procures sufficient capacity to meet the Installed Capacity Requirement for the given Capacity Commitment Period. The Installed Capacity Requirement is a resource adequacy standard that reflects the amount of resources needed to meet the reliability requirements defined for the New England Control Area of disconnecting non-interruptible customers, a loss of load expectation no more than once every ten years. By contrast, resources needed for system security usually refer to local system needs (for example, voltage control and support).

25. The generators also contest ISO-NE's reliance on the Commission's recent order accepting NYISO's proposal to strengthen market power mitigation for the New York In-City Installed Capacity Market, in which the Commission endorsed the use of going-forward marginal costs as the basis for bids,<sup>18</sup> as support for the proposition that rates in a competitive market based on going forward costs are just and reasonable. The generators argue that this comparison is inapposite since the NYISO In-City Installed Capacity Market is a short-term spot market that is not relevant to a long-term, forward market like FCM. Second, the generators contend that in the NYISO In-City Order, the Commission was approving the use of short-run marginal cost-based offers to calculate mitigation reference prices to be used in a single clearing price auction – not as a form of as-bid compensation. Last, the generators contend that the cases cited by the Commission in the NYISO In-City Order do not demonstrate that it is just and reasonable to base competitive offer prices on marginal costs. Instead, the generators contend, these cases only stand for the idea that it is just and reasonable to set prices using a single market-clearing price auction, which is designed to encourage the submission of bids at marginal costs.

26. Moreover, NRG contends that under the instant proposal, ISO-NE is given the option to call on any existing resource it determines is needed for local system security, as existing generators are compelled to either participate in the FCM as a price-taker or submit a de-list bid which ISO-NE can reject even though the capacity is not needed to fulfill the resource adequacy standard. NRG argues that the value of this option exceeds the short-run marginal costs of the resource whose de-list bid has been rejected – it is equal to the lower of the cost of replacing the reliability benefit of the resource to the system or the expected cost to the transmission system if the resource was not available to maintain system security.

27. Further, since generators with rejected permanent or non-price retirement request bids are given the choice of either receiving their de-list bid or pursuing a cost of service agreement (while rejected one year de-list bids only receive their de-list bid), the protesters contend that the current compensation mechanism is discriminatory, in violation of section 205. The protesters note that under the instant proposal, generators providing the same security service will receive different compensation based solely on the arbitrary basis of their retirement decision. The protesters argue that this may result in higher costs to consumers because a resource that has no likely opportunity to recover

---

<sup>18</sup> *New York Indep. Transmission Sys. Operator, Inc.*, 122 FERC ¶ 61,211, at P 36 (2008) (NYISO In-City Order)("[r]egarding KeySpan's argument that a competitive offer price should be based on average costs, not marginal costs, the Commission disagrees. The Commission has consistently found that it is just and reasonable to base competitive offer prices on marginal costs").

its long-run average costs in the market may be effectively forced to exit the FCM on a permanent basis.

28. Several protesters also argue that a market rule that requires suppliers to bid and receive compensation based upon their short run marginal costs in a long-run market like FCM is not only economically unrealistic, but also sends the wrong price signals to incent new transmission or capacity solutions. The protesters argue that the instant proposal subsidizes the failure to plan the transmission system to prevent problems with reliability. For example, NRG/FirstLight notes that compensating units needed for reliability at only their short-run marginal costs undercuts the appropriate long-run price signal – long-run average costs – that NRG/ FirstLight believes is necessary to provide adequate incentives for transmission solutions, new generating capacity, or demand response measures to address the reliability problem, and that this compensation method will result in less supply.

29. ISO-NE's proposal allows cost-of-service rate treatment only for those resources whose cleared permanent de-list bids or non-priced retirement requests are rejected for reliability. Under ISO-NE's proposal, cost-of-service rate treatment would not be allowed for resources whose cleared single-year de-list bids are rejected for reliability reasons. ISO-NE explains that, consistent with Commission policy,<sup>19</sup> its proposal is designed so that resources are not given the opportunity to toggle between the higher of cost-of-service or market rates. ISO-NE states that resources that submit such a de-list bid or request have determined that there is insufficient value in participating in the capacity market in the future and the resource has higher avoidable costs than the compensation it expects to receive through capacity payments. ISO-NE's proposal restricts cost-of-service rate treatment to resources that may no longer participate in the FCM and thus have no opportunity to toggle.

30. The protesting generators challenge ISO-NE's stated concern that generators needed for reliability may "toggle" between the higher of the market or cost of service compensation. The generators contend that the toggling issue is a red herring, since (1) the practical possibility of toggling is remote in a forward market like the FCM, as forecasting capacity prices three to four years in advance is difficult as best; (2) ISO-NE "over-interprets" Commission precedent as an absolute bar to any possibility of toggling; and (3) even if the possibility of toggling in the FCM were real and the Commission disfavored toggling, it still would not justify the "draconian" measures proposed in the FCM Revision.

---

<sup>19</sup> See *Bridgeport Energy, LLC*, 118 FERC ¶ 61,243, at P 66 (2007) (*Bridgeport Energy II*); *Bridgeport Energy, LLC*, 113 FERC ¶ 61,311 (2005) (*Bridgeport Energy I*); First Auction Results Order at P 54.

31. The Connecticut Commission asserts that the instant proposal resolves the Commission's concerns that resources not be permitted to toggle between cost-of-service and market rates. Addressing the Commission's rejection of a 30-day termination notice period in the *Bridgeport Energy* cases, the Connecticut Commission states that whether the termination notice period is 30 days or 3 years, if left unchecked, resources could still use the rules to elect cost-of-service or market-based compensation. Moreover, answering claims that it will be too difficult to predict future conditions to choose between cost-of-service or market-based rates, the Connecticut Commission claims that making such predictions is not a difficult task. ISO-NE similarly claims that generators have every incentive to toggle their resources if they are able to recognize that they are needed for reliability and are able to act on their decision to seek an administrative reliability payment.

32. Reiterating that the FCM is a physical market for capacity, ISO-NE contends that the instant filing is a significant step towards a decrease in out of market arrangements and urges the Commission to "stay the course" on this market design. The Connecticut Commission also notes that the Commission has accepted the use of going-forward costs not only in New England but also in PJM and NYISO.<sup>20</sup>

33. ISO-NE states that the arguments against going forward cost compensation offered by the protesting generators lack economic support. ISO-NE contends that existing resources in a competitive market will bid short run marginal costs, and will only bid at their long-run average costs when they are able to exercise market power. Further, ISO-NE claims that the Commission has already ruled that compensation through the FCM based on going forward costs is just and reasonable: in the order approving the FCM market rules, the Commission directed the market monitor to review de-list bids above certain price thresholds in order to "determine an accurate and appropriate bid level for an existing generation capacity resource consistent with its net risk-adjusted going forward and opportunity costs."<sup>21</sup> ISO-NE states that the Commission found that this would allow the existing generator the chance to submit a revised de-list bid consistent with the market monitor's determination and "would prevent any possibility of confiscatory ratemaking."<sup>22</sup> Thus, ISO-NE contends, the Commission has previously rejected the generator argument that going forward costs compensation is confiscatory.

---

<sup>20</sup> The Connecticut Commission cites *PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,065, at P 17 (2008) and *New York Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,211, at P 21 (2008).

<sup>21</sup> Market Rules Order at P 120.

<sup>22</sup> *Id.*

34. In addition, ISO-NE notes that when a dynamic de-list bid is rejected, it is only holding the generator to the obligation to which the generator agreed: to provide capacity at its marginal cost. Further, ISO-NE notes that the formula for net risk adjusted going forward costs from section III.13.1.2.3.2.1.2 of Market Rule 1 (which provides for recovery of costs that could be avoided by de-listing for one year) was previously accepted by the Commission and is unchanged by the instant proposal. ISO-NE points to the fact that a generator chooses which type of de-list bid it makes, and a resource will only choose a one-year de-list option if it feels that revenues from participating in the FCM will exceed its avoidable costs over a multi-year period. ISO-NE observes that the issue to consider in compensating these resources with one year de-list bids is not whether they genuinely have additional costs, but whether these costs will be incurred because of the rejection of the de-list bid.

**b. Commission Determination**

35. The Commission has stated, with regard to compensation in the New England capacity market, that a just and reasonable market design ensures that resources are provided the *opportunity* to recover their costs, not a guarantee that they will recover those costs.<sup>23</sup> The protests of the instant proposal are mainly focused on just and reasonable compensation for rejected one-year de-list bids (either static or dynamic). As discussed below, we agree with ISO-NE and NEPOOL that the proposed compensation for both rejected one-year de-list bids and permanent de-list bids is just and reasonable.

36. The protesters argue that because these resources with rejected one year de-list bids provide value to the system that is in excess of the value provided by resources that merely satisfy the resource adequacy standard, they should receive compensation that reflects that relatively greater value. The protesters maintain that the unique value provided by these resources is not sufficiently recognized under either the FCM mechanism, which procures capacity based solely on the resource adequacy standard, or a compensation mechanism founded on going forward costs.

37. We first note that, as referenced above, protesters as to this issue are making an impermissible collateral attack on a prior Commission order. In its order accepting the FCM Settlement, the Commission expressly endorsed the idea that an existing generator's bid into the FCM should be based on the net risk-adjusted going forward costs for its unit. We first noted that "[t]he FCM . . . is designed to allow new capacity to set the clearing price,"<sup>24</sup> not current capacity; thus, price signals could be sent and received

---

<sup>23</sup> *Bridgeport Energy I* at P 29.

<sup>24</sup> *Devon Power, LLC*, 115 FERC ¶ 61,340, at P 27 (2006).

based on the bids submitted by new entrants. We subsequently noted, with regard to bids that would be reviewed by ISO-NE's Market Monitor, that the purpose of that review would be to ensure that bids approximated an existing resource's net risk-adjusted going-forward and opportunity costs:

[T]he Market Monitor will review bids priced above or below specified price thresholds, which are tied to percentages of CONE. For example, the Market Monitor will review and decide whether to accept into the auction a capacity resource that submits any type of de-list bid (*i.e.*, enabling it to exit the market temporarily or shut down permanently) that is higher than 0.8 times CONE. In such instances, should the Market Monitor determine that the bid is consistent with the resource's net risk-adjusted going-forward and opportunity costs, the bid is incorporated into the auction.<sup>25</sup>

We further noted, with regard to new capacity or imports, that "the Market Monitor will review any new capacity or imported capacity bid below 0.75 times CONE, to determine whether the bids are consistent with the long run average costs of that new capacity resource or the opportunity cost (or another reasonable economic measure) for the import,"<sup>26</sup> thus making clear that while other economic measures might be used for new capacity or imports, the only measure available for existing capacity was a resource's net risk-adjusted going-forward and opportunity costs.

38. Additionally, in approving the FCM market rules,<sup>27</sup> the Commission ruled on static and permanent de-list bids that exceed the established price thresholds: although ISO-NE proposed simply to limit such resources to revised de-list bids at a maximum of  $0.8 * \text{CONE}$ , the Commission directed the market monitor to revise these de-list bids to an appropriate bid level consistent with the resource's net risk-adjusted going forward and opportunity costs, precisely so as to prevent confiscatory ratemaking. We note that the instant proposal does not seek to modify the net risk-adjusted going forward formula used to review these de-list bids under FCM,<sup>28</sup> and that formula only provides for recovery of costs that could be avoided by de-listing from the FCM for a single year. As such, the

---

<sup>25</sup> *Id.* at P 28.

<sup>26</sup> *Id.*

<sup>27</sup> Market Rules Order at P 117, 120.

<sup>28</sup> Section III.13.1.2.3.2.1.2 of Market Rule 1.

Commission has affirmed that FCM capacity payments based upon going forward costs are just and reasonable.

39. Importantly, ISO-NE's proposed compensation for rejected de-list bids is the same price that the resource would receive if the clearing price was equal to the resource's de-list bid (and thus, the resource would remain in the capacity market and receive the clearing price). Since paying the resource its de-list bid would be just and reasonable under these conditions, given that the resource itself signaled that that price would be acceptable, we see no reason why paying the resource a higher (for example, cost-of-service) price would be reasonable when the market clearing price is below its de-list bid. The resource would be providing the same services and incurring the same costs whether the delist bid was rejected for economic or reliability reasons.<sup>29</sup>

40. The de-list bid of any resource that lacks market power typically reflects its going forward costs for the commitment year.<sup>30</sup> Any resource that lacks market power would want to bid its going forward costs because (i) bidding higher would not increase the clearing price, (ii) the resource could make at least some profit whenever the clearing price was even slightly higher than its going forward costs, and thus, (iii) bidding higher would risk the possibility that the resource would be rejected as a capacity resource when the resource could have made a profit by being accepted (because the capacity price was higher than its going forward costs but lower than its bid). Resources that wish to bid above  $.8 * CONE$  can do so, but only if the market monitor concludes, in advance of the auction, that the higher bid accurately reflects the resource's going forward costs. Thus, when a resource is paid its going forward costs, the resource is no worse off by providing capacity than if it were allowed to de-list.

---

<sup>29</sup> A resource whose de-list bid is mitigated may not willingly provide capacity at its de-list bid. If the mitigated bid accurately reflects its going forward costs, the resource would prefer to de-list at a higher price in order to raise the market price by exercising market power. However, if the mitigated bid accurately reflects the resource's going forward costs, the mitigated bid reflects the minimum price at which the resource could profitably provide capacity without exercising market power. Additionally, this question does not arise here since for the first FCA, none of the de-list bids rejected for reliability reasons were mitigated.

<sup>30</sup> In this context, going forward costs are the costs that would be incurred only if the resource takes on the obligations of a New England capacity resource (and hence, costs that would be avoided if the resource does not become a capacity resource). Going forward costs include opportunity costs.

41. We disagree that a higher level of compensation is required for resources wanting to temporarily de-list because they are compelled to participate in the New England capacity markets; nor do we agree that sound economic principles require compensation equal to long-run average costs in every year. First, it is not accurate to state that resources are compelled to remain in the market against their will. Under ISO-NE's proposal, any resource that wishes to retire can do so by submitting a non-price retirement request, and the resource is allowed to retire even if ISO-NE concludes that it is needed for reliability. In addition, a resource that wishes to remain operational but is willing to permanently – rather than temporarily – exit from the New England capacity market can submit a de-list bid as high as  $1.25 * \text{CONE}$  without market monitor review. Such a resource may not be allowed to exit from the New England capacity market if it is needed for reliability. But if it is needed for reliability, the resource would be paid the higher of its cost-of-service or a de-list bid that could be as high as 25 percent above CONE. This compensation would equal or exceed that proposed by protesters for resources with rejected one year de-list bids.

42. Thus, we disagree with those generators who assert that ISO-NE is compelling them to provide service at confiscatory prices. Rather, under the proposed rules, a generator may control its own economic situation by making a choice as to the type of de-list bid it offers, based on its perception of the potential for future FCM revenues. The protesters object to the compensation proposed for resources who submit single-year de-list bids, because they wish to preserve the opportunity to offer capacity into the FCM in future years, and would like to receive the higher of the market or full cost-of-service compensation (or some equivalent compensation in excess of their going forward costs) in each year. However, if generators wish to participate in the FCM on a long-term basis, the FCM market rules give them an opportunity over time to recover not only going forward costs, but also additional fixed costs and a profit.

43. The purpose of the New England FCM is to attract and retain sufficient capacity to maintain ISO-NE's Installed Capacity Requirement, and to do so, FCM capacity prices will need to average out over time to the cost of new entry. But while the average price over time can be expected to match the cost of new entry, the prices in individual years will vary with market conditions above and below that average level. In that light, we do not agree that a resource should be guaranteed recovery of its full cost-of-service in each year, when the resource has the opportunity to earn more in some years. As we stated in *Bridgeport*, "we find no basis for a generator operating under market-based rates authority to claim that for it to remain available in a competitive market, it must receive energy revenues equivalent to a full cost-of-service."<sup>31</sup>

---

<sup>31</sup> *Bridgeport Energy I* at P 29.

44. In any single year, compensation below the cost of new entry would not, by itself, drive away future investment. As long as the prices in other years are higher and the average price approximates the cost of new entry, New England can still attract investment. A resource whose temporary de-list bid is rejected for reliability reasons will have the opportunity to receive these higher prices in future years, and protesters are therefore wrong to assert that paying a temporary de-list resource its de-list bid in one year would prevent the resource from ever recovering any fixed costs. To the contrary, since the resource wants to preserve its opportunity to supply capacity in future years, it will have an opportunity to receive prices above its going forward costs in future years.

45. We find the Filing Parties' proposal, which addresses the Commission's concerns about toggling, to be just and reasonable. As noted above, in *Bridgeport Energy*, the Commission held that if generators are guaranteed to receive the higher of market-based or cost-based rates, competitive markets will never develop and/or generators will be guaranteed to earn higher profits than they would under the traditional regulated model.<sup>32</sup> Further, in the order accepting the first auction results filing, the Commission stated that "we would expect that any proposed revisions to the current compensation mechanism for reliability units will limit or eliminate concerns over generators earning the 'higher of' a market or cost-based rate."<sup>33</sup> Thus, it is clear that our prior concerns over toggling were equally applicable to the FCM construct.

46. We agree with ISO-NE that it is not reasonable to allow a resource that will remain in the capacity market in future years to toggle between cost-based and market-based compensation since a resource that could receive market prices when they exceed its costs and cost-based prices in the other years would be virtually guaranteed to earn revenues above costs over time. Providing a resource with a cost-based backstop would also blunt incentives for the resource to minimize its costs. As the current retirement provisions of sections I.3.9 and I.3.10 allow for retirement with notice (despite the forward capacity obligation that a cleared resource has accepted under FCM), we agree with the Filing Parties that these retirement provisions should instead be tied to the FCM construct. Moreover, addressing the protesters' arguments concerning the loss of the current retirement provisions, we note that it would be unjust and unreasonable for load to have a set (and transparent) forward price obligation from the auction that cleared capacity resources (with equal obligations) could abrogate based on the auction clearing price.

---

<sup>32</sup> *Bridgeport Energy II* at P 66.

<sup>33</sup> First Auction Results Order at P 54.

47. Consistent with the Commission's directives, the instant proposal addresses toggling concerns by allowing cost-of-service payments only for capacity that seeks to leave the capacity market permanently yet is needed for reliability—resources with permanent de-list bids or non-price retirement requests. Under the proposal, resources whose permanent de-list bids or non-price retirement requests are rejected for local reliability concerns will have the option of receiving cost-based payments, but once the reliability concern is resolved, any cost-based payments will terminate and that resource will be unable to participate in any future auctions, eliminating the ability for the resource to receive market-based capacity payments. This, in coordination with a security review of bilateral transfers of capacity, prevents gaming by holding these units needed for reliability to their committed capacity obligation.

48. We also dismiss New England Generators' and PSEG's arguments that toggling concerns are unfounded because resources would have to predict costs and market revenues three to four years in the future to successfully toggle. The protests of the current proposal by the generation sector highlight the toggling problem. For example, due to the overall excess of capacity, the first auction cleared at the price floor of \$4.50 per kW-month. At this relatively low price, there is an incentive for the generators to seek increased compensation outside of the market. In this case, that pursuit has taken the form of requests for cost-of-service agreements for those units that are needed for reliability under the assertion that they provide a unique product relative to other cleared resources. We note that contrary to the assertions of the generation sector, with the current overall surplus of capacity, the conclusion that the FCM will clear at a relatively low price (when compared with cost-of-service compensation) does not require any complex analysis. Under the current FCM rules, a resource needed for reliability will receive the higher of its de-list bid or the market clearing price. By seeking to establish a cost-of-service backstop for units whose de-list bids are rejected, the generators are seeking to change this equation from the higher of its de-list bid or the market clearing price to the higher of the market clearing price or a resource's cost-of-service.<sup>34</sup>

---

<sup>34</sup> Moreover, as ISO-NE points out:

Permitting a resource to make the choice between cost of service or market-based rates places all of the risk of the forward market on load. . . . Forward markets can actually facilitate toggling by allowing a resource to trigger its decision on the realized price, not on a price expectation.

## 2. Resource Adequacy vs. Security

### a. Positions of the Parties

49. The protesters state that the instant proposal relies on an out-of-market construct – assigning these resources their de-list bid offer – to pay for their reliability service, since ISO-NE has no market in place to value security. The protesters argue that resource adequacy and security are different products, since adequacy involves procuring sufficient capacity to meet forecasted load for a Regional Transmission Organization (RTO) footprint over a long-term planning horizon, namely, to satisfy the one day in ten year loss of load probability. The generators contend that security, by comparison, involves the retention of resources within particular small areas that are needed to maintain reliability throughout the system on a day-to-day or hour-to-hour horizon. The generators argue that the critical difference between the two products is that under the adequacy standard, all capacity is interchangeable, providing the same reliability benefit, whereas only certain resources (or resources in certain locations) can ensure security.

50. The FCM construct is designed to satisfy the resource adequacy standard, by procuring adequate resources to meet the Installed Capacity Requirement. The protesters contend that the instant proposal is flawed in that it seeks to compensate generators for providing security while purporting to compensate them for providing resource adequacy. As a result, the protesters argue, the scarcity value provided by these resources is confiscated: they assert that there is no justification for assuming that the compensation for a unit's bid requirements for one purpose in a particular market should be the same when the unit serves a different purpose. Further, the protesters argue that the fact that any de-list bids are rejected for reliability demonstrates that this is an incomplete market, since, according to this argument, if a market for security was designed properly, free entry and exit would occur. They contend that by not procuring adequate resources for security, the resulting capacity price for zones with rejected de-list bids is too low by default.

51. In response to this argument, ISO-NE contends that a resource purchased by load on a forward basis is not simply used for adequacy services. Instead, ISO-NE notes that the resource is bound to follow all ISO-NE rules, including the requirement to provide security, and there are no market rules or operating procedures that limit ISO-NE's ability to dispatch resources for only adequacy reasons. ISO-NE further contends that defining a security product as outside the scope of the FCM would represent a blatant exercise of market power. As resources needed for security have market power by definition, ISO-NE argues that its Market Rules must mitigate this power.

52. In addition, ISO-NE states that with existing markets for nodal energy, locational capacity, locational forward reserves, reactive power, and regulation, plus uplift payments for resources called out of merit, there is no basis for creating another market to

price security as a separate product, especially when the number of potential providers is so small that the market would not generate a competitive price. Further, ISO-NE contends that the potential price discipline provided by a new resource would allow the existing pivotal resource to unjustly and unreasonably withhold capacity up to the price of new entry. Finally, ISO-NE observes that the generators previously raised this precise point in an earlier Commission order regarding the FCM rules, where it was dismissed.<sup>35</sup>

**b. Commission Determination**

53. Since the Commission has previously approved the use of a going-forward cost mechanism to compensate resources under the FCM, and we have reaffirmed its use here, the remaining argument for higher compensation is that the generators with rejected de-list bids provide a capacity product (namely, security) that is uniquely valuable, as demonstrated by the fact that ISO-NE will not allow them to de-list. This argument is based on the premise that these resources provide value in excess of the value provided by other generators who only satisfy ISO-NE's resource adequacy obligation.

54. We note that the Commission has addressed this point in a prior order on the FCM rules. In the context of ISO-NE's proposed review of bilateral transfers of capacity obligations, NRG previously asserted that to the extent any review of a transfer among qualified suppliers within the same zone is rejected, this demonstrates that the services provided by the suppliers are not the same, and thus the resource whose transfer was rejected should be paid additional compensation through the FCM. The Commission disagreed with NRG's position, finding that "if generators are asked to provide additional services including VAR support or regulation, they will be compensated for those services through the appropriate ISO tariff or markets, not through the FCM."<sup>36</sup> Thus, the Commission has previously determined that location is not an adequate basis for allowing these units to receive additional compensation for providing a separate security service (and, as ISO-NE points out in its answer, the generators' argument here is a collateral attack on that decision).

55. The protesting generators argue that our prior finding is distinct from a specific finding that the instant proposal, which proposes to pay resources whose de-list bids are rejected for reliability their de-list bids, is just and reasonable. We disagree. While both the resource adequacy and security functions are necessary, it is not clear that the FCM should compensate resources with rejected de-list bids differently, especially when we have previously noted that specific markets exist for compensating these security functions. The protesting generators have not established that ISO-NE is conscripting the

---

<sup>35</sup> *ISO New England Inc.*, 119 FERC ¶ 61,239, at P 37 (2007).

<sup>36</sup> *Id.*

value of the generators with rejected de-list bids. As ISO-NE states in its answer, under FCM, load is paying each resource to operate as needed to maintain reliability throughout the system: if resources in the capacity market were only used for adequacy purposes as argued by the generators, the system would be inoperable.

### **3. NRG's Counter-Proposal**

#### **a. Positions of the Parties**

56. NRG, supported by the other generators, proposes a "market" alternative to the compensation mechanism offered in the instant proposal. Under NRG's proposal, if a de-list bid is rejected for reliability, ISO-NE and the affected Transmission Owners would first seek a feasible transmission solution to resolve the security violation. If a transmission solution cannot be identified, Local Reconfiguration Auctions would be held in conjunction with the first annual reconfiguration auction to solicit new offers for capacity to address the capacity need. A resource whose bid was rejected in the auction would be required to offer its capacity in the Local Reconfiguration Auction. If the market monitor determines that the resource is not pivotal, the resource would receive the clearing price of the highest bid of the resource(s) that addresses the security need. If the market monitor finds the resource to be pivotal, then the Local Reconfiguration Auction clearing price would not exceed the higher of 110 percent of CONE or its rejected de-list bid. NRG contends that, consistent with the Commission's preference for market-based solutions, its proposal is designed to attract cost-effective alternative solutions to the reliability need and, failing that, to produce a market price that more accurately reflects the locational value of the system security being provided.

57. ISO-NE and the Connecticut Commission both contend that NRG's proposed alternative facilitates the exercise of market power in the guise of pricing security. ISO-NE argues that the need for a scarcity price in the proposed Local Reconfiguration Auction is undercut by the fact that there is no shortage of capacity in the area to justify scarcity pricing. Thus, ISO-NE argues that there is no justification for a system that allows a pivotal supplier to extract a payment above going forward costs. The Connecticut Commission states that the only guaranteed level of competition in the proposed Local Reconfiguration Auction would be the rejected de-list bidder, since any potential new entrant would receive the Local Reconfiguration Auction price for one year. Thus, the Connecticut Commission finds that the NRG proposal will likely revert to a purely administrative price, since the resource with the rejected de-list bid will be found pivotal. This would result in a "market price" represented by the higher of 1.1 \* CONE or the rejected de-list bid. As such, the Connecticut Commission finds the NRG proposal to serve an "illegitimate" purpose of establishing administrative rates for reliability units in excess of the competitive level.

58. The Connecticut Commission also argues that the Commission should apply the usual section 205 standard of review whereby alternatives to the proposal are only considered if the proposed changes are unjust and unreasonable. The Connecticut Commission notes that instead NRG seeks a "jump ball" standard that would allow for the Commission to pick the best among all proposed alternatives.

**b. Commission Determination**

59. As an initial matter, because the Commission is finding that ISO-NE's and NEPOOL's proposal is just and reasonable, we need not address the merits of the NRG proposal, especially in the context of a section 205 proceeding initiated by ISO-NE. However, it is clear that in most cases, the reliability concern that prompted rejection of the de-list bid will be relatively local in nature, limiting the likelihood of finding alternative suppliers through the proposed Local Reconfiguration Auction. Instead, the proposal would provide the generators with rejected de-list bids the ability to exercise their market power in a subsequent auction (after they know they are needed for reliability) to increase their compensation to a minimum price floor of  $1.1 * CONE$ . Since the Commission has previously found (as reiterated herein) that de-list bids based upon going forward costs represent just and reasonable compensation, we find no basis for adopting NRG's proposal to adopt an administrative reliability payment. While NRG contends that the only incentive provided under the instant proposal is for retirement, it has offered no support for this allegation.<sup>37</sup>

**4. Payments to Norwalk Units for the First Forward Capacity Auction**

**a. Positions of the Parties**

60. NRG states that if the Commission does not approve its alternative proposal, then it should allow NRG an option to change the status of Norwalk Units 1 and 2 to "Rejected Permanent De-List" for purposes of the first Capacity Commitment Period so they can then receive the full cost-of-service compensation which ISO-NE proposes to pay to generators who permanently de-list. NRG also contends that the Commission should give any other resources that did not submit Permanent De-List Bids for the second auction the option to do so within thirty days of the Commission's order.

---

<sup>37</sup> ISO-NE's Informational Filing in support of the second Forward Capacity Auction states that 169 new projects, providing 7,298 MW, have sought to enter the capacity market.

61. In support, NRG states that at the time it submitted its bids in the first auction, it was unaware of the specific reliability criteria that would be used to reject its Static and Dynamic De-List Bids in the first auction. Instead, NRG contends that it assumed that the compensation that the Commission would determine to be just and reasonable for such rejected bids would continue to reflect long-standing Commission precedent - that resources needed for reliability would be eligible for cost-of-service rates. NRG states that as a result of the delay in submitting ISO-NE and NEPOOL's Proposal until after the first auction was complete and the deadline for submitting Permanent De-List Bids in the second auction had passed, there was no transparent rate structure from which NRG and other market participants could evaluate whether to submit Permanent, Static, or Dynamic De-List Bids.

62. NRG argues that it did not submit its Dynamic De-List Bids of \$5.99 kW-month because it believed that amount was just and reasonable compensation.<sup>38</sup> Instead, NRG notes that it submitted the maximum possible Dynamic De-List bids (i.e., below 80 percent of CONE or \$6.00/kW-month) for Norwalk Units 1 and 2 because it was the simplest way to delist the units, and because, based on publicly available information about supply and demand, it was clear that the first auction would clear well below Norwalk's Dynamic De-List Bid. NRG maintains that the results of the first auction would not have been any different had Norwalk submitted a Permanent De-List Bid in the first auction, and Norwalk gains no competitive advantage by being allowed to permanently de-list after the auction. NRG argues that allowing Norwalk an option to permanently de-list and be paid its full cost-of-service for reliability service will instead send a price signal to build transmission facilities or new capacity that can replace Norwalk.

63. NRG also addresses the NEPOOL Review Board's decision to deny NRG's appeal, which sought to reject the adoption of the Filing Parties' proposal in favor of its proposal.<sup>39</sup> NRG states that the Review Board decision does not provide a reasoned basis

---

<sup>38</sup> NRG states that it has sought clarification from the Commission that the limits imposed on De-List Bids for market mitigation purposes would not constitute just and reasonable compensation if those De-List Bids were rejected. *ISO New England Inc.*, 119 FERC ¶ 61,045, at P 77 (2007).

<sup>39</sup> NRG notes that the Review Board rejected its appeal based on the following: (1) the FCM Market and its provisions for compensation in these cases are intended by the Commission to provide just and reasonable compensation and there is no basis to believe that the Commission intended that cost-of-service level compensation is required under these circumstances; (2) NRG should have submitted a Static De-List Bid reflecting its view of just and reasonable compensation and then appealed to the Commission if the Market Monitor rejected that bid; (3) NRG chose to submit a De-List  
(continued...)

for accepting the Filing Parties' proposal or for rejecting the NRG proposal. NRG contends that the Review Board did not focus on the merits of the Filing Parties' proposal, but on whether it resulted in unfair or discriminatory treatment of NRG and other capacity providers with respect to rejected De-List Bids. NRG notes that although it found ISO-NE's revisions to Market Rule 1 to be reasonable, the Review Board recognized that, at the time of the first auction, the Filing Parties' proposal had not been adopted. As a result, NRG states that the Review Board recommended a one-time review of the appropriate compensation for NRG's subject units in this case as well as the compensation for other units that may have been similarly affected.

64. Addressing the merits of the Review Board's general denial of its proposal, NRG contends that, contrary to the position offered by the Review Board, the fact that NRG chose to submit Dynamic De-List Bids for Norwalk Units 1 and 2 at just below the 80 percent of CONE level simply has no bearing on whether that amount is compensatory. In support, NRG contends that the Commission has yet to address whether the limits on Static or Dynamic De-List Bids would also be limits on compensation if those De-List Bids were rejected. In addition, NRG states that the Review Board's suggestion that inframarginal revenues obtained by Norwalk during the year, in addition to its de-list offer capacity payments, provides the opportunity to realize compensatory rates "defies reality."<sup>40</sup> NRG notes that Norwalk runs almost exclusively for reliability, and almost routinely as the marginal resource, providing very little inframarginal revenues. Finally, NRG finds the Review Board's deference to the ISO-NE and NEPOOL Participants Committee stakeholder process to be wholly misplaced since that stakeholder process did not produce a consensus as to the appropriate compensation for rejected Static and Dynamic De-List Bids.

65. Addressing the Review Board's contention that NRG should have submitted a Static De-List Bid reflecting its view of just and reasonable compensation and then appealed to the Commission if the Market Monitor rejected that bid, NRG responds that the Commission had just rejected, in its Market Rules Order, NRG's protests that it ought to be allowed to submit Static De-List Bids at about 80 percent of CONE. Thus, NRG contends that submitting an impermissible Static De-List Bid, followed by an appeal of the Market Monitor's likely rejection would have been a pointless gesture that the Commission would have likely been deemed a collateral attack. Finally, NRG contends

---

Bid just below the 0.8 CONE level which avoided Market Monitor review of its offer; and (4) NRG will keep any inframarginal revenues obtained during the year it is required to provide capacity services in addition to its de-list offer capacity payments, providing the opportunity to realize compensatory rates.

<sup>40</sup> NRG protest at 55.

that the rejection of its proposal based on the Commission's guidance that generators not toggle between the market and regulated rates is a *non sequitur*, as NRG is not advocating cost-of-service compensation, except as a last resort. Instead, NRG notes that it seeks the use of Local Reconfiguration Auctions to determine a market-based price that appropriately compensates resources with rejected De-List Bids for the locational value of the reliability service they provide.

66. Regarding NRG's alternative requests to receive cost-of-service compensation for the Norwalk units (through the use of a retroactive permanent de-list bid), ISO-NE contends that NRG has not demonstrated that the harm it may suffer justifies the proposed remedy, especially when NRG willingly submitted a dynamic de-list bid at \$5.99/kW-month (as opposed to a higher static de-list bid) for the Norwalk units. The Connecticut Commission states that the Commission should reject NRG's proposal, since cost-of-service compensation would subvert the FCM design which sought to lessen the need for RMR agreements.<sup>41</sup> The Connecticut Commission also contends that ISO-NE and NEPOOL have provided no procedure for reviewing the compensation for the Norwalk units in the first Commitment Period. While the Connecticut Commission agrees that the Norwalk units should not be retained for reliability, it also notes that NRG should accept the results of the agreed-upon schedule which required ISO-NE to make a filing by July 1, 2008 to address compensation for units needed for reliability. As such, the Connecticut Commission contends that the Commission should not modify the schedule for the second auction to allow resources the ability to modify their de-list bids for the second Commitment Period.

**b. Commission Determination**

67. NRG acknowledges that it chose to offer a dynamic bid just below the bid cap, to "access the just and reasonable compensation rate promised by the FCM Settlement," knowing that there was a "substantial surplus of capacity in the market" and that there was "widespread anticipation that the clearing price would be at or near the floor price of \$4.50 per kW-month."<sup>42</sup> Thus, knowing that the capacity price would be near the floor price for the first auction, NRG chose to offer a de-list bid just below  $0.8 * CONE$  (well above the floor price), in order to maximize its return absent market monitor review. Several parties state that Norwalk could have offered a relatively higher static de-list bid (greater than  $0.8 * CONE$ ), and if that de-list bid was rejected by the market monitor, NRG could appeal to this Commission to substantiate its bid. In response, NRG states

---

<sup>41</sup> The Connecticut Commission cites *Devon Power LLC*, 107 FERC ¶ 61,240, at P 7 (2004); *see also Devon Power LLC*, 115 FERC ¶ 61,340 at P 166 (2006).

<sup>42</sup> NRG August 29 answer at 6.

that the Commission-approved net risk adjusted going forward costs formula employed by the market monitor does not capture Norwalk's "true going forward costs" including a return of and on capital.<sup>43</sup>

68. We reject NRG's request to be able to offer revised Permanent De-list Bids for the Norwalk units for the first and second auctions. NRG's contention that the Commission previously rejected NRG's request to submit Static De-list Bids "at about" 80 percent of CONE is unclear since (1) at  $0.799 * \text{CONE}$ , NRG's offered dynamic de-list bid is effectively at 80 percent of CONE and under the instant proposal will represent NRG's payments; (2) at  $\$5.99/\text{kW-month}$ , NRG's Norwalk units will earn a just and reasonable rate in excess of the rest of the New England market and (3) in the Market Rules Order, the Commission actually agreed with NRG's position that static de-list bids found to be in excess of actual going forward costs should not be mitigated to  $.8 * \text{CONE}$  (as proposed by ISO-NE) but should be revised to reflect actual going forward costs under the net risk adjusted going forward costs formula.<sup>44</sup> We do not agree, however, that NRG should receive unique compensation that includes a return of and on capital, when it has already offered its capacity at the maximum possible dynamic bid. NRG has failed to establish that Commission acceptance of a dynamic bid that NRG chose to provide is unjust and unreasonable.

69. Further, we note that NRG's contention that it assumed that just and reasonable compensation for units with rejected de-list bids (i.e., units needed for reliability) would continue to be eligible for cost-of-service rates is disingenuous. As NRG is aware, in the context of numerous RMR proceedings in New England, the Commission has noted its approval of cost-of-service RMR agreements only as a "last resort." Further, in advance of the instant proposal, the Commission even stated that "we would expect that any proposed revisions to the current compensation mechanism for resources retained for reliability will limit or eliminate concerns over generators earning the higher of a market or cost-based rate."<sup>45</sup> Thus, NRG was well aware that the status quo would likely not be one of the options for compensation under the instant proposal. Rather, now that the first

---

<sup>43</sup> *Id.* at 9.

<sup>44</sup> Market Rules Order at P 120 ("The Commission will also require ISO-NE to amend the proposed FCM rules to allow existing generating capacity resources whose Permanent De-List, Static De-List, Export, or Administrative Export bids are determined to be inconsistent with their net risk-adjusted going forward and opportunity costs, as determined by the Market Monitor, be allowed to submit revised de-list bids consistent with the price level determined by the Market Monitor").

<sup>45</sup> First Auction Results Order at P 54 (2008).

auction has determined that the Norwalk units are needed for reliability for the first auction, NRG seeks to use that knowledge to "toggle" into a cost-of-service rate, and we will reject that attempt.

**B. Arguments Raised by State and Municipal Entities**

**1. Whether Payment to Resources Needed for Reliability Should Be Explicitly Based on Going-Forward Costs**

**a. Positions of the Parties**

70. Static de-list bids, which must be approved by the market monitor before the auction, establish acceptable going forward costs based on compliance with the net risk-adjusted going forward formula from the tariff. By contrast, because dynamic de-list bids are not known prior to the auction, they cannot be included in the pre-auction filing to the Commission, but are included in ISO-NE's post-auction section 205 results filing that is submitted to the Commission.

71. Massachusetts Municipals and the Connecticut Attorney General argue that all units receiving one-year reliability compensation should be paid going forward costs. They point out that static and dynamic de-list bids simply represent the price below which the generator at issue would prefer to exit the market for a one-year period, and do not, *per se*, justify the payment of amounts greater than a unit's going forward costs. Massachusetts Municipals and the Connecticut Attorney General acknowledge the fact that ISO-NE will include dynamic de-list bids for resources retained for reliability reasons in the filing it makes regarding the results of the auction, which is submitted to the Commission pursuant to section 205 and "provides for Commission review and gives all parties the opportunity to comment on the rate."<sup>46</sup> However, Massachusetts Municipals and the Connecticut Attorney General are concerned that the potential exists that generators will claim a right to be paid at the level of rejected dynamic de-list bids even if those bids exceed the relevant unit's going forward costs. To avoid this problem, Massachusetts Municipals and the Connecticut Attorney General urge the Commission to either (a) require ISO and NEPOOL to modify section III.13.2.5.2.5.1(a)(1) to provide that rejected dynamic de-list bids will be paid the generator's going forward costs, as determined by the Commission, or (b) clarify that the Commission will apply a going forward cost standard when reviewing the compensation to be paid for rejected dynamic de-list bids under the "just and reasonable" standard of section 205.

72. Massachusetts Municipals and the Connecticut Attorney General further argue that, to enable the Commission to review the justness and reasonableness of

---

<sup>46</sup> Transmittal letter at 18, cited in Massachusetts Municipals protest at 15.

compensation to units that submitted dynamic de-list bids, it must require ISO-NE to provide data substantiating the generator's claimed going forward costs, even if ISO-NE must obtain that data from the generator after the auction is conducted or to make arrangements with the generator to submit the data contemporaneously with the ISO's filing. Massachusetts Municipals and the Connecticut Attorney General urge the Commission to adopt a standing protective order governing the use of confidential cost data submitted by the ISO or a generator in support of a pre- or post-auction filing setting forth compensation for rejected delist bids, and to maintain on ISO-NE's website a list of reviewing representatives who have signed the non-disclosure certificate associated with that protective order, in the case that a generator seeks to protect commercially sensitive data. Massachusetts Municipals and the Connecticut Attorney General also state that ISO-NE and/or the relevant generator should be required to serve reviewing representatives on that list with the non-public version of any relevant filing containing such information. Connecticut Municipals also asks the Commission to clarify that dynamic de-list bids must be based on a resource's going-forward costs. These protesters would like the Commission to establish a formal process for reviewing dynamic de-list bids, ensuring that acceptable de-list bids should be based strictly on a resource's approved going forward costs (consistent with the treatment of static de-list bids). These would also like to apply this screen to Norwalk's rejected de-list bids from the first auction, which were offered just below the  $.8 * \text{CONE}$  threshold.

73. In addition, the Connecticut Commission, the New England Commissions and Connecticut Consumers Counsel state that the Commission will not be able to review, or intervenors challenge, the dynamic de-list bids submitted for the first auction, since ISO-NE filed those first auction results on March 3, 2008 and the Commission approved them on June 20, 2008. These parties therefore ask the Commission to require that this rule be amended, so as to enable the Commission to review the compensation provided to the two Norwalk units, which submitted dynamic de-list bids that were rejected because those units were required for reliability. These parties assert that the bids filed by those units were "unlikely . . . [to] represent each unit's net risk-adjusted going-forward costs and opportunity costs,"<sup>47</sup> and without a procedure to review those bids, the Commission will have no basis on which to determine that compensation to those units is just and reasonable.

74. More generally, Massachusetts Municipals and the Connecticut Attorney General ask the Commission to confirm that ISO-NE's reliability determinations will be subject to Commission review under section 205 as the factual predicate justifying the payment of out-of-market compensation.

---

<sup>47</sup> Connecticut Commission protest at 15.

75. ISO-NE states that although the FCM rules do not explicitly require dynamic de-list bids to be based on a resource's going forward costs, going forward costs represent an "appropriate starting point" for the Commission's review. ISO-NE also states that, for purposes of the first auction, it assumed that the level of the dynamic de-list bid filed by a resource would reflect its going forward costs, because a resource must assume, when it submits a bid, that the market may clear at that level and they will receive their bid. It also states, however, that it has "recommended that for future auctions, the Commission provide an opportunity for justification of dynamic de-list bids."<sup>48</sup>

**b. Commission Determination**

76. First, with regard to the confirmation sought by Massachusetts Municipals and the Connecticut Attorney General, we note that, as previously determined,<sup>49</sup> the Commission's review under section 205 of the FPA includes a review of the evidence supporting the fact that a facility is needed for reliability.

77. While the Commission would expect dynamic de-list bids to generally reflect going forward costs, we disagree with the state parties that the Commission should require ISO-NE to file generator-specific going forward cost data with the Commission under a standing protective order. While parties are always free to challenge the compensation associated with the auction (as established under the FCM Settlement), we think that a dynamic de-list bid establishes a reasonable default level of compensation for units needed for reliability. A dynamic de-list bid must be at least 20 percent below CONE, and is only entered into the auction in an auction round where the clearing price is at or below that level. Over the long run, the average price for capacity should reflect CONE, in order to attract new entry needed for reliability. The costs of an existing unit would ordinarily be below the entry cost of a new unit, and we conclude that a default level for existing resources that is at least 20 percent below the cost of a new entrant (and at least 20 percent below the likely average price of capacity over time) is reasonable.

78. Moreover, we conclude that it is acceptable to establish a default level of compensation at a reasonable level, because of the administrative convenience that it provides: generators submitting de-list bids below this level do not need to provide cost support and the market monitor need not expend the resources to review the bids. In addition, some going forward costs (especially opportunity costs) may be difficult to quantify, so allowing a default bid level would avoid the burden of attempting to quantify these costs.

---

<sup>48</sup> ISO-NE August 29 answer at 63.

<sup>49</sup> *Bridgeport Energy I* at P 8.

79. Additionally, the protesters' position is inconsistent with the basis for accepting prices when de-list bids are not rejected for reliability reasons. If a de-list bid below the threshold level of  $.8 * CONE$  is not rejected for reliability reasons, that de-list bid would not be reviewed by the market monitor, and it could potentially set the market clearing price for all generators in the market. But if the bid is rejected for reliability reasons, it would be reviewed by the market monitor to establish compensation for only that resource (and no other resource in the market). If it is just and reasonable to allow a de-list bid below the threshold level to establish the market price for all capacity without market monitor review, then a lower bid (based on market monitor review) should not be required to establish the compensation of only the single resource needed for reliability, as this practice would be unduly discriminatory. We will, therefore, reject these protesters' request to reject the Filing Parties' proposal in this regard.

**2. ISO-NE Should Be Required to Pursue Alternatives to Rejecting De-List Bids in Order to Find the Least-Cost Solution**

80. Massachusetts Municipals and the Connecticut Attorney General further ask the Commission to ensure that, when ISO-NE seeks to offer out-of-market compensation to a generator needed for reliability, it must also demonstrate that that is the least-cost solution to the particular reliability problem. Massachusetts Municipals states:

Upon review of NEPOOL's decision to support the instant filing, the NEPOOL Review Board was "troubled that in this era of deregulation and free markets that NEPOOL and the ISO-NE still have to use a power market solution to solve what is clearly a transmission engineering problem." The Board further cautioned that "there may be engineering solutions that can provide reliable voltage and stability control at a significantly lower cost than maintaining the operation of older, inefficient and costly to operate generating units."<sup>50</sup>

81. While the instant proposal does not require the specific least-cost demonstration that Massachusetts Municipals and the Connecticut Attorney General seek, we note that the FCM construct has significantly reduced the need for reliability agreements in New England. We encourage ISO-NE to continue to employ the Regional System Plan process to identify potential reliability issues and corresponding solutions where possible.

---

<sup>50</sup> Massachusetts Municipals protest at 21, citing NEPOOL Board of Review Decision Denying Appeal with Recommendations, July 16, 2008, at 9 (filed by NEPOOL in this docket on July 17, 2008).

### **3. Timing of Notification to the Commission**

#### **a. Positions of the Parties**

82. The proposed rules provide that when ISO-NE rejects a Non-Price Retirement Request for reliability reasons, the resource may seek to recover the costs of capital improvements that will permit the unit to remain in operation, and to do so, the generator must file an application with the Commission under section 205. That generator may also make a separate filing to recover costs of a capital expenditure necessary for the resource to continue to remain available to provide capacity. The proposed rules also require a resource seeking such treatment to notify the affected state utility commissions, ISO-NE, and the NEPOOL Participants Committee, at least 120 days prior to the generating resource making the capital expenditure.

83. The Connecticut Commission, the New England Commissions, Connecticut Consumers Counsel and Massachusetts Commission assert that this timing provision may strip state commissions of the ability to review such capital expenditures, because by the time a resource notifies affected state commissions, its expenditure may already have been approved by the Commission. These parties therefore urge the revision of this timeline so that resources seeking recovery of capital expenditures must give notice to state commissions at least 60 days prior to any section 205 filing or 120 days prior to making the capital expenditure, whichever is earlier.

84. In response, ISO-NE states that this recommendation ignores the fact that persons challenging the capital expenditure will have the opportunity to make their case before the Commission, so that no expenditure will escape scrutiny. Further, ISO-NE argues that the state parties do not allege that the provision is unjust and unreasonable, nor have they made that demonstration. As such, ISO-NE argues that no modification is necessary.

#### **b. Commission Determination**

85. As ISO-NE states, when a party makes an application with the Commission under section 205 to recover the costs of capital improvements, all interested parties may intervene and make their case before the Commission as to whether granting that application is warranted. Thus, the interests of state commissions are protected.

### **C. Miscellaneous Issues**

#### **1. Proposed Revisions to Retirement Provisions**

##### **a. Positions of the Parties**

86. ISO-NE's current retirement provisions require resource owners to notify ISO-NE of their intent to retire at least 60 days prior to retirement. Presently, if ISO-NE determines through a reliability review that the retirement will adversely affect the transmission system, the resource owners and ISO-NE must then take steps to address the concerns; however, the resource will ultimately have the ability to retire should those efforts not resolve the concerns.<sup>51</sup> ISO-NE states that sections I.3.9 and I.3.10 contain resource retirement provisions that may conflict with certain FCM rules when a resource wishes to opt out of the capacity market or retire. As such, ISO-NE's proposal eliminates the resource retirement provisions in sections I.3.9 and I.3.10, incorporates interim measures to govern retirements during the transitional period, and conforms the provisions that address resource retirements to the FCM rules.

87. ISO-NE's proposal will allow generators to retire from the FCM only if they have a cleared permanent de-list bid, or have submitted a non-price retirement request. Further, resources that have a cleared permanent de-list bid may only retire if the resource is not found to be needed for local reliability. The proposal adopts interim measures for resource retirements and deactivations during the transition period to the first capacity commitment period.<sup>52</sup>

---

<sup>51</sup> Currently, sections I.3.9 and I.3.10 permit a unit to shut down with 60 days notice if it is not needed for reliability, or with 180 days notice if it is needed for reliability and a mutually acceptable agreement can not be reached to allow for continued operation.

<sup>52</sup> The interim measures provide that (1) resources may be deactivated for any period between the proposed effective date of the rule changes and one day prior to the first commitment period, provided that the deactivation is not deemed to have adverse effects on the transmission system; (2) a resource with a cleared permanent de-list bid or non-price retirement request may deactivate or retire at any time under the current provisions if it has no capacity obligations between June 1, 2010 and the start of the commitment period for which it has a cleared permanent de-list bid or non-price retirement request; (3) a resource as described in (2) above that seeks retirement prior to the first capacity commitment period and is determined to be needed for reliability may seek cost of service compensation through June 1, 2010; and (4) a resource as described in (2) above whose retirement is determined to have adverse effects on the transmission system may seek to retire under the current rules.

88. The protesting generators argue that in contrast with the current retirement provisions under sections I.3.9 and I.3.10 which allow for retirement upon 60 day (if not needed for reliability) or 180 day (if needed for reliability) notice, the resulting four year lead time necessary to retire is unjust and unreasonable and strikes against the voluntary notion of ISO-NE markets. The protesters contend that this establishes a disincentive for new entry, especially at compensation equal to going-forward costs.

89. The protesters also note that the Commission has rejected efforts in the past to require a resource to "continue to operate for an indeterminate period" for reliability reasons. Instead, the protesters assert that there is a multitude of ways to deal with toggling, such as addressing the transmission system limitations that create the local reliability violations. The generators also maintain that because any potential bilateral transactions are reviewed under the stricter security standard<sup>53</sup> (as opposed to the resource adequacy standard), they are unable to retire before the relevant commitment period. They contend that this security review conflicts with the intent of the FCM design and with the FCM settlement itself, imposing an unjust and unreasonable limitation on a resource's ability to exit the market. They note that it is very likely that a resource that is needed for reliability will fail such a review and will have no choice but to continue to provide capacity.

90. Addressing the claim that ISO-NE's review of bilateral transactions unreasonably limits the ability of generators with rejected de-list bids to cover their obligation, ISO-NE notes that the Commission has already addressed this point in the orders approving the FCM rules. ISO-NE states that the Commission rejected this exact argument, previously made by NRG, when, noting that NRG was a signatory to the FCM settlement, it stated that "we disagree with NRG's claim that ISO-NE review of proposed bilateral transfers of capacity obligations contradicts the FCM Settlement."<sup>54</sup> Instead, ISO-NE notes that the Commission observed that "this reliability review prevents gaming by holding these units needed for reliability to their committed capacity obligation."<sup>55</sup> As such, ISO-NE contends that the generator's arguments in this regard should be rejected.

91. ISO-NE also states that (a) the FCM is a physical market and the notion that resources should have an unfettered right to exit the market is inconsistent with the basic construct of FCM, and (b) ISO-NE plans its system on the basis that resources that are committed four years in advance will be available. It further notes that resources may

---

<sup>53</sup> ISO-NE Tariff § 13.5.1.1.3(a).

<sup>54</sup> *ISO New England Inc.*, 119 FERC ¶ 61,239, at P 35 (2007).

<sup>55</sup> *Id.* at P 38.

cover their capacity obligation in the bilateral markets or reconfiguration auction, provided that the replacement resources address the reliability need. ISO-NE notes that its proposal introduces the Non-Price Retirement option which allows resources to choose to retire, regardless of any reliability impact.

92. ISO-NE contends that by contrast, the protesting generators would like to alter the fundamental nature of the approved FCM rules such that load is obligated to guarantee payment to generators on a forward basis while generators have no obligation to provide capacity and could exit the market at any time upon 60 days' notice. Thus, ISO-NE argues that the generators seek to convert the physical FCM into a financial market in which reliability is not addressed, noting that the revised retirement provisions prevent generators from circumventing the FCM reliability review process.

93. New England Generators note that while the Commission has clarified that the FCM is a forward market for physical resources, that fact should not vitiate the right of capacity resources to transfer their obligations as outlined in the FCM settlement. New England Generators contend that ISO-NE erroneously seeks to redefine the product sold in the FCM from a physically-backed fungible capacity product into a series of unit-specific contracts for reliability. New England Generators argue that this position is at odds with the FCM Settlement which found that "the product is a megawatt of deliverable capacity with a future supply commitment in a Power Year three years in advance."<sup>56</sup> New England Generators note that the FCM repeatedly provides options for trading this fungible capacity product under specified circumstances to maintain market liquidity. In contrast to the other ISOs/RTOs, New England Generators argue, ISO-NE's interpretation of the product substantially increases the price of the product purchased without paying for it.<sup>57</sup> New England Generators also dispute that the Commission accepted ISO-NE's interpretation when it ruled that ISO-NE had the power to review bilateral transactions. New England Generators state that this decision did not invalidate the fact that capacity resources have the right to cover their positions.

94. ISO-NE contends that no part of the instant proposal reduces the ability of a resource to trade an FCM obligation. Addressing New England Generators' argument concerning fungibility, ISO-NE notes that while electricity is indeed a commodity, that

---

<sup>56</sup> New England Generators answer at 4 citing the FCM Settlement Explanatory Statement at 22.

<sup>57</sup> New England Generators note that despite having a physical capacity market, PJM does not conduct a reliability review on each transfer of the capacity supply obligation.

fact does not necessarily equate to fungibility, especially when the FCM only seeks to procure just enough capacity to meet the projected ICR.

**b. Commission Determination**

95. We accept ISO-NE's proposal to eliminate the current notice provisions regarding retirement of resources. We agree with ISO-NE that a resource that has sold its capacity into the FCM should be required to honor its capacity commitments. New England loads rely on the commitments made by such resources, and these resources receive just and reasonable compensation for their capacity commitments. No resource should be allowed to escape their capacity commitments by retiring under the current notice provisions (or any other notice provisions). We disagree with protestors that the proposal unreasonably conflicts with the voluntary nature of ISO-NE markets. As discussed earlier, any resource is able to retire once it has satisfied its then existing capacity obligations – even if the resource is currently needed for reliability – by submitting a non-price retirement request. Also, in response to the comments of New England Generators, we agree with ISO-NE that the instant proposal does not reduce the ability of a resource to trade an FCM obligation.

96. Further, as noted by ISO-NE, the Commission has already addressed the protestors' contentions that including a reliability review of a bilateral capacity transfer severely limits resources' ability to exit the market and is at odds with the FCM settlement. In accepting the FCM rules, the Commission stated that "we disagree with NRG's claim that the proposed relevant market rules, which allow for ISO-NE review of proposed bilateral transfers of capacity obligations and reject any that endanger reliability, contradict the FCM Settlement."<sup>58</sup> We note that it is because resources are not fully substitutable that the Commission is properly concerned about the use of market power to toggle between the higher of the market and cost of service compensation.

97. Finally, New England Generators contend that PJM, NYISO, California ISO, or Midwest ISO do not limit the ability for resources to engage in bilateral transfers based on a reliability review. The Commission has consistently recognized that regional differences may be recognized in its analysis of the just and reasonableness of transmission organization proposals,<sup>59</sup> and the fact that other RTOs have enacted (or

---

<sup>58</sup> *ISO New England, Inc.*, 119 FERC 61,239, at P 9 (2007).

<sup>59</sup> See *Midwest ISO*, 116 FERC ¶ 61,292, at P 53 (2006); *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, 71 Fed. Reg. 43,564 ( August 1, 2006), FERC Stats. & Regs. ¶ 31,226, at P 100 (2006); *Southwest Power Pool, Inc.*, 110 FERC ¶ 61,031, at P 22-23 (2005); *Midwest Independent Transmission System Operator, Inc.*, 102 FERC ¶ 61,196, at P 43 (2003).

failed to enact) a particular market rule is not dispositive of the justness and reasonableness of ISO-NE's market rule.

**2. NSTAR Argument Concerning Elimination of Formal NEPOOL Reliability Review of Generator Retirements**

**a. Positions of the Parties**

98. ISO-NE and NEPOOL propose to eliminate tariff language regarding NEPOOL reliability review of proposed plans for a reduction in capacity and retirement from sections I.3.9 and I.3.10 of the tariff. Currently section I.3.9 of the tariff provides for the reliability review of proposed plans submitted to ISO-NE. Under this section, ISO-NE must review proposed plans for changes to supply-side resources, demand-side resources and transmission projects for potential adverse reliability effects. Section I.3.10 provides that projects found to have an adverse effect on the system may not proceed unless the participant takes certain actions that ISO-NE determines to be necessary to avoid any adverse effect. Section I.3.10 also provides that, if the project involves the retirement of a resource, then further procedural steps by ISO-NE and the resource are required to resolve any adverse effect and ultimately retire the facility. The provisions proposed here include a reliability and retirement review conducted by ISO-NE under the FCM.

99. NSTAR seeks to retain the formal Reliability Committee stakeholder review traditionally associated with generator requests for temporary capacity reductions and permanent facility retirement. NSTAR states that ISO-NE's proposal to employ the reliability review process under the FCM does not capture the transparent basis upon which generator reduction and retirement applications should be reviewed, and that ISO-NE would be the exclusive judge of whether a unit may permanently retire. NSTAR contends that the present stakeholder consultation is important in order to guard against the potential use of the section I.3.9 process by any individual generating resource owner to exercise market power. NSTAR contends that under ISO-NE and NEPOOL's proposal, there will no longer be an open forum, outside of a Commission proceeding, if ISO-NE and a Transmission Owner disagree as to whether a resource should or should not be allowed to retire. Thus, NSTAR states that the language in section I.3.9 that obligates ISO-NE to consult with Market Participants in reliability determinations should be reinstated unless a better substitute has been approved.

100. In response to NSTAR's protest, NEPOOL states that its support for ISO-NE's proposal was conditioned on ISO-NE's agreement and commitment to consult in a "meaningful manner" with the Participants in making its determination under the FCM Market Rules regarding de-list bids reflecting requests to temporarily deactivate or permanently retire. NEPOOL notes that it anticipates that such consultation will occur in the context of the Reliability Committee process, but states that the details of the consultation have not been fully discussed or worked out. As such, NEPOOL offers that

it would support Commission clarification and direction in its order regarding these amendments to section I.3.9 and I.3.10 in order to ensure that ISO-NE considers stakeholder input.

101. ISO-NE contends that NSTAR's arguments that the proposed revisions would reduce system reliability and transparency are incorrect, and constitute an attack on the design of the FCM. ISO-NE notes that under its proposal, with regard to resources submitting Static and Permanent De-list bids, all affected transmission owners are consulted regarding reliability needs for those resources prior to the auction, and in the case of Dynamic De-List bids, all Transmission Owners have representatives on site at ISO-NE to review the reliability need with ISO-NE. In addition, ISO-NE states that it has committed to share the results of its reliability reviews with the NEPOOL Reliability Committee and to work with the Participants to develop any necessary changes to the Participants' Agreement. ISO-NE also notes that provisions regarding the reliability review of retirements or reductions in capacity will be removed from section I.3.9, but the reliability review under this section will be retained for new or material additions to generating or demand resources, and for changes to transmission facilities. ISO-NE also states that it will retain language in section I.3.9 that prevents a participant from proceeding with a plan that ISO-NE determines will have a significant adverse effect.

102. NSTAR argues that ISO-NE is misinterpreting the issue, which is the elimination of an open forum in which Transmission Owners can agree or disagree with a reliability or retirement decision. It contends that the undefined stakeholder process proposed by the ISO is not an acceptable equivalent, and that it sees no benefit from the removal of stakeholder process, which should be reinstated unless and/or until a better substitute has been approved.

**b. Commission Determination**

103. The Commission supports continued stakeholder review of reliability determinations as they relate to resource capacity reductions or retirements. We note that ISO-NE has affirmed that the current reliability review process will be retained for new or material additions to generating or demand resources, and for changes to transmission facilities. While ISO-NE has offered its commitment to discuss capacity reductions and retirements with the Reliability Committee in some form, it is clear that with the revision of section I.3.9, this review will be materially changed from the current process for capacity reductions or retirements.

104. Due to the procedural timeframes and rules associated with the FCM, it may be necessary for ISO-NE to revise section I.3.9 in regards to the current stakeholder reliability review process. We recognize that, as ISO-NE states, several years will elapse between the acceptance of a resource's choice to de-list or retire and the date on which that de-listing or retirement takes place. However, we find that ISO-NE has not

demonstrated that the solution it proposes here – elimination of reliability review by the NEPOOL Reliability Committee – is justified. We agree with NSTAR that ISO-NE's commitment to "consult" with transmission owners and other NEPOOL members during its review of reliability determinations in an as-yet-undetermined manner is insufficient to ensure the retention of both procedural transparency and the opportunity for NEPOOL member participation currently afforded by the existing Reliability Committee review. We will therefore require ISO-NE, within 180 days of the date of this order, to refile its revisions to sections I.3.9, I.3.10 and new I.3.11, as necessary, to set forth the procedure for consulting with NEPOOL members through the Reliability Committee or otherwise regarding resource capacity reductions or retirements.

### **3. Changes to the *Pro Forma* Cost of Service Agreement**

#### **a. Positions of the Parties**

105. ISO-NE's *pro forma* Cost-of-Service Reliability Agreement is used to provide just and reasonable compensation when an eligible resource elects cost-of-service treatment. ISO-NE and NEPOOL state that they propose to replace the current Cost of Service Agreement found in the Market Rules<sup>60</sup> because (1) it does not reflect the modifications found in all of the currently approved Cost of Service Agreements; (2) the proposed Cost of Service Agreement incorporates modifications to conform the Cost of Service Agreement to the FCM Rules; and (3) the Filing Parties have modified the Cost of Service Agreement to more clearly state resource obligations.

106. ISO-NE and NEPOOL note that the proposed Cost of Service Agreement retains basic concepts such as obligations to supply capacity, and payments based on a Commission-accepted annual fixed cost revenue requirement along with compensation for variable costs. They state that the proposed Cost of Service Agreement also incorporates the changes necessary to reflect the requirements of the FCM Rules.

107. Dominion asks the Commission to clarify that acceptance of the *pro forma* Cost of Service Agreement does not preclude the negotiation of alternative Reliability Agreement arrangements in unique circumstances. Dominion points to the settlement between ISO-NE and Dominion Energy Salem Harbor, accepted by the Commission, which diverged from the typical RMR agreement to address the recovery of full direct costs of equipment necessary for environmental compliance to prevent retirement of the Salem Harbor Units. Similarly, PSEG requests that the Commission specify that the proposed Cost of Service Agreements be considered the "basic structure," but that any counterparties to the agreement in the future will have the ability to propose alternative terms as necessary.

---

<sup>60</sup> Section III of Market Rule 1, Appendix A, Exhibit 4.

108. PSEG also seeks modification of section 4.4.2 of the proposed Cost of Service Agreement which addresses Availability Credit (the allocation of funds collected from other generators who fail to perform during Shortage Events). As PSEG notes, Availability Credits become available to resources that perform when others do not. PSEG states that section 4.4.2 of the proposed Cost of Service Agreement caps the benefit of such Availability Credits at the Annual Fixed Revenue Requirement established for the resource under the maximum earnings provision of Schedule 3, Part 1. Thus, PSEG contends that although the Cost of Service Agreements include opportunities for units needed for reliability to earn less than their Annual Fixed Revenue Requirement (including for being unavailable during a Shortage Event), this section distorts the fairness of such an arrangement and results in only downside risk for resources operating for the benefit of system reliability. They argue that this section should be modified to restore this balance.

109. In its answer, ISO-NE maintains that the Cost of Service Agreement is designed to create a consistent document that is used when resources seek to leave the market permanently but are needed for reliability. Therefore, ISO-NE argues that significant changes should only be made pursuant to section 206.

**b. Commission Determination**

110. The Commission finds the proposed *pro forma* Cost of Service Agreement to be just and reasonable. Dominion and PSEG seek Commission clarification that the proposed Cost of Service Agreement only represents a "working version" that can be revised as necessary. We note that consistent with Article 11.11 of the *pro forma* Cost of Service Agreement, any application for changes to the formula for calculating Stipulated Variable Costs shall only be made under section 206. In addition, consistent with current RMR contracts in place in New England, the Commission will review the reliability need and the annual fixed revenue requirement for proposed reliability agreements under section 205.

111. We will not require modification of the Availability Credits under section 4.4.2 of the proposed Cost of Service Agreement as requested by PSEG. As we stated in an order addressing an RMR agreement for the Norwalk units, "the purpose of an RMR agreement is not to encourage efficient operation of a particular facility. Rather, as stated previously, the Commission views RMR agreements as tools of last resort."<sup>61</sup> Further, in contrast to resources whose FCM compensation is based on a going forward cost basis, resources under Cost of Service Agreements will earn a return of and on their investment. As such, no further incentives should be required to make such resources economically

---

<sup>61</sup> *Norwalk Power, LLC*, 120 FERC ¶ 61,048, at P 42 (2007).

viable, especially since these resources are under no obligation to pursue a Cost of Service Agreement.

#### **4. The Process for Establishing Separate Capacity Zones**

112. Protesters argue that the existence of rejected de-list bids is *prima facie* evidence that the auction did not adequately identify a complete set of capacity zones where transmission constraints bind. We agree with ISO-NE that the current method for establishing zones has already been accepted by the Commission. We also note that this issue is outside the scope of this section 205 filing, which involves only the compensation for resources needed for reliability that want to de-list.<sup>62</sup>

113. In his affidavit in this docket, Dr. Ethier states that ISO-NE has already committed to address the issue of capacity zones in the stakeholder process.<sup>63</sup> New England Generators argues that this stakeholder process, which will likely not solve localized security problems, should nonetheless be conducted expeditiously, in time to be implemented before the fourth auction. ISO-NE responds that the stakeholder process mentioned by Dr. Ethier arises out of the auction results filing in Docket No. ER08- 633-000 and is not part of the instant proceeding. ISO-NE states that the stakeholder process is limited in scope to examining and reconciling the use of the Transmission Security Analysis and the Local Sourcing Requirement when determining zones prior to an auction and determining how much capacity to procure within each zone to meet system reliability requirements. By contrast, ISO-NE states that it has already conducted a comprehensive stakeholder process with regard to the compensation for resources that have a de-list bid rejected for reliability reasons. ISO-NE notes that New England Generators' members presented the alternatives supported by New England Generators and others in this proceeding during the stakeholder process and those alternatives were rejected

114. Generators in other FCM proceedings have urged the Commission to revise the method for establishing zones. In each case, the Commission has declined to require

---

<sup>62</sup> ISO-NE filed a Motion to Strike certain comments contained in the Motion to Answer and Answer of the Connecticut Department of Public Utility Control to Suppliers' Protests of Filing Parties' Compensation Filing filed by the CT DPUC on August 29, 2008. ISO-NE contends that CT DPUC's answer includes arguments challenging ISO-NE's Commission-approved use of the Transmission Security Analysis from another docket (ER08-633).

<sup>63</sup> See generally, affidavit of Dr. Robert Ethier, attachment to ISO-NE's August 29 answer.

such revisions, but has encouraged the parties to address concerns related to determining capacity zones as soon as practicable. We reiterate here our position that the New England stakeholders should address the capacity zone issue as soon as practicable. Further, to clarify, we do not equate the need to reject de-list bids as evidence that the capacity zones for a given auction were inadequate. Rather, the stakeholder process should focus on situations similar to the one that occurred in Connecticut for the first auction, where the security requirement for a relatively large area could have been met by any resources in that area.

**5. Effective Date of Tariff Sheets/Compliance Filing**

115. We note, *sua sponte*, that the effective dates on the tariff sheets submitted to us by ISO-NE and NEPOOL together with this filing are not all consistent. We will require ISO-NE, within 10 days of the date of this filing, to make a ministerial re-filing of all of the tariff sheets, showing an effective date of October 29, 2008, for each of these tariff sheets. We accept these tariff sheets, effective October 29, 2008.

The Commission orders:

(A) The filing is accepted, effective October 29, 2008.

(B) We hereby require ISO-NE to refile sections I.3.9, I.3.10 and new I.3.11, as necessary, to set forth the procedure for consulting with NEPOOL members through the Reliability Committee or otherwise regarding resource capacity reductions or retirements within 180 days of the date of this order.

(C) We hereby require ISO-NE to make a ministerial re-filing of each of these tariff sheets, within 10 days of the date of this order, to provide an effective date of October 29, 2008 for each tariff sheet.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.