135 FERC ¶ 61,029
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

ISO New England, Inc. and New England Power Pool Participants Committee	Docket Nos. ER10-787-000 EL10-50-000 EL10-57-000
New England Power Generators Association v. ISO New England Inc.	ER10-787-004 EL10-50-002 EL10-57-002
PSEG Energy Resources & Trade LLC, PSEG Power Connecticut LLC, NRG Power Marketing LLC, Connecticut Jet Power LLC, Devon Power LLC, Middletown Power LLC, Montville Power LLC, Norwalk Power LLC, and Somerset Power LLC v. ISO New England Inc.	

ORDER ON PAPER HEARING AND ORDER ON REHEARING

(Issued April 13, 2011)

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1. This order is the culmination of a paper hearing on certain proposed changes to the New England Forward Capacity Market (FCM) filed jointly by ISO New England Inc. (ISO-NE) and the New England Power Pool Participants Committee (NEPOOL) (collectively, the Filing Parties). In this order, the Commission rejects the Alternative Capacity Price Rule (APR) and the modeling of capacity zones and related mitigation aspects of the proposed changes that were the subject of the paper hearing, while finding, with one exception, that issues related to calculating the Cost of New Entry (CONE) are

moot; the Commission also finds that aspects of ISO-NE's July 1, 2010 proposal (July 1 Proposal) are just and reasonable, and approves them, subject to a compliance filing, as discussed below.

I. Background

A. FCM

2. Seven years ago, in response to a Commission order to include a locational component in New England's installed capacity market,[1] ISO-NE proposed to divide New England into multiple capacity regions, each with its own capacity requirement and monthly capacity auction (LICAP Proposal). As part of this design, the ISO proposed to establish a downward sloping demand curve to determine the amount of capacity that must be procured and the price to be paid for that capacity.

3. After more than two years of litigation, which included Congress requesting that the Commission carefully consider the objections of the New England states,[2] a full day of oral argument before the Commission, and settlement discussions involving 115 parties, the Commission approved a contested settlement agreement that replaced the LICAP Proposal with the FCM.[3]

4. The FCM departed from the LICAP Proposal in several significant respects. For example, rather than operate under a demand curve where the amount procured could be higher or lower than the ICR depending on supply conditions, the settlement instituted the Forward Capacity Auction (FCA) – an annual descending clock auction to procure an amount of capacity that was exactly equal to the ICR.[4] Providers whose capacity is taken in the FCA acquire Capacity Supply Obligations, which they must fulfill approximately

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[1] *Devon Power LLC*, 103 FERC ¶ 61,082, at P 37, *order on reh'g*, 104 FERC ¶ 61,123 (2003) (Devon Power).

[2] Energy Policy Act of 2005, Pub. L. No. 109-58, § 1236, 119 Stat. 961 (2005)

[3] *Devon Power LLC*, 115 FERC ¶ 61,340 (2006) (FCM Settlement Order), *order on reh'g*, 117 FERC ¶ 61,133 (2006), *aff'd in relevant part sub nom. Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008).

[4] In summarizing the settlement, the Commission acknowledged the consequence of this difference: "if the system has surplus capacity, not all capacity resources offered will be purchased." FCM Settlement Order, 115 FERC ¶ 61,340 at P 20.

three years later.[5] The settlement also established an APR mechanism to deter market participants from artificially lowering prices. The Commission explained that such a mechanism was necessary to address the same price suppression concerns raised in this proceeding.[6]

5. Thus far, ISO-NE has conducted four FCAs. The first two FCAs were conducted in 2008, the third in October 2009, and the fourth in August 2010. The fifth FCA is scheduled for June 2011.

B. Instant Proceeding

6. In December 2008, the Filing Parties submitted a filing that identified FCM issues that required further attention and proposed a stakeholder process to address them (FCM Phase II Filing). Subsequently, ISO-NE's Internal Market Monitor (IMM) issued its initial assessment of the FCM and provided recommendations for improvements (IMM Report).[7] These recommendations included addressing the reliability criteria used for determining capacity zones and evaluating de-list bids, modifying the APR, and changing the use of the CONE parameter in determining the starting price for each FCA.

7. Based on the FCM Phase II Filing and the IMM Report, the NEPOOL stakeholders created the Forward Capacity Market Working Group (FCM Working

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[5] The Commission accepted a portion of the market rules that implemented the FCM on April 16, 2007 (*ISO New England Inc*., 119 FERC ¶ 61,045, *order on reh'g*, 120 FERC ¶ 61,087 (2007)), and the remainder on June 5, 2007 (*ISO New England Inc*., 119 FERC ¶ 61,239 (2007), *reh'g denied*, 122 FERC ¶ 61,171 (2008)).

[6] *Id*. P 113 ("In the absence of the alternative price rule, the price in the FCA could be depressed below the price needed to elicit entry if enough new capacity is self-supplied (through contract or ownership) by load. That is because self- supplied new capacity may not have an incentive to submit bids that reflect their true cost of new entry. New resources that are under contract to load may have no interest in compensatory auction prices because their revenues have already been determined by contract. And when loads own new resources, they may have an interest in depressing the auction price, since doing so could reduce the prices they must pay for existing capacity procured in the auction.").

[7] ISO New England Inc. Market Monitoring Unit, *Internal Market Monitoring Unit Review of the Forward Capacity Market Auction Results and Design Elements* (June 5, 2009) ("Internal Market Monitor Report"), *available at* http://www.iso-ne.com/markets/mktmonmit/rpts/other/fcm_report_final.

Group), chaired by representatives from NEPOOL, the New England Conference of Public Utility Commissioners (NECPUC), and ISO-NE, to provide a stakeholder forum specifically constructed to consider FCM design changes. The FCM Working Group also considered recommended rule changes related to the APR, as required by section III.13.2.5.2.5(f) of the ISO-NE Transmission, Markets, and Services Tariff (Tariff), which required ISO-NE to evaluate whether the treatment of de-list bids rejected for reliability reasons should be modified.

1. The Joint Filing and Joint Complainants' and NEPGA's Complaints

8. As a result of this stakeholder process, on February 22, 2010, under section 205 of the Federal Power Act (FPA), the Filing Parties submitted significant revisions to the FCM market rules (Docket No. ER10-787-000) (the Joint Filing) addressing the concerns raised in the FCM Phase II Filing and the IMM Report. Though these proposed revisions passed with over 70 percent support in the Participants Committee, they passed with strenuous objection of the entire generation sector and much of the supply sector.[8] New England Power Generators Association (NEPGA) and PSEG Energy Resources & Trade LLC, *et al*. (Joint Complainants) filed complaints against ISO-NE under section 206 of the FPA in Docket Nos. EL10-50-000 and EL10-57-000, respectively, both of which addressed the substance of the proposed FCM market rules revisions and presented alternative proposals.[9]

2. The April 23 Order

9. On April 23, 2010, the Commission ruled on the Joint Filing.[10] The Commission found certain aspects of the filing to be just and reasonable, and accepted those

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[8] Joint Filing, Transmittal Letter at 35 ("[T]he Rule Changes were approved with support generally from those representing transmission, load serving entities, publicly-owned entities, alternative resources and end users, with opposition from the entire Generation Sector and further opposition or abstention in the Supplier Sector.").

[9] Both NEPGA and Joint Complainants stated that they filed their complaints primarily to ensure that their alternative proposals were considered at the same time the Commission considered the Joint Filing. *See NEPGA v. ISO-NE*, Complaint, Docket No. EL10-50-000, at 1; *PSEG Energy Resources & Trade LLC v. ISO-NE*, Docket No. EL10-57-000, at 2.

[10] *ISO New England Inc.*, 131 FERC ¶ 61,065 (2010) (April 23 Order), *order on reh'g and clarification*, 132 FERC ¶ 61,122 (2010) (August 12 Order).

provisions without suspension.[11] The Commission stated that its preliminary analysis indicated that the remainder of the filing had not been shown to be just and reasonable and that it may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. The Commission suspended these remaining Tariff provisions for a nominal period, made them effective on April 23, 2010, and set them for paper hearing. For purposes of the paper hearing, the Commission consolidated the complaints filed by NEPGA and Joint Complainants with these provisions of the Joint Filing, "so as to ensure that NEPGA and Joint Complainants are able to obtain full consideration of the arguments and alternative proposals they have raised in their complaints."[12]

10. The Joint Filing provisions about which the Commission expressed concern and set for paper hearing relate to three general issues, which will be discussed throughout the body of this order: the APR, the modeling of capacity zones and related mitigation, and the proper value of CONE. The Commission also found that the Joint Filing's proposal to extend the FCM price floor, which had been scheduled to expire after the first three FCAs, had not been shown to be just and reasonable. The Commission therefore accepted, suspended, and placed into effect the extension of the price floor but stated that "[w]e expect . . . that in the Commission's final order accepting an appropriate APR mechanism, we will terminate the price floor coincident with implementation of the new APR."[13] On rehearing, the Commission stated that any final determination relating to the expiration of the price floor would be made after a new APR and its interrelationship with the price floor had been considered and determined.[14]

C. <u>The Paper Hearing</u>

11. In the April 23 Order, the Commission provided parties just over sixty days to submit first briefs. The Filing Parties were to address questions posed by the Commission on each of the issues set for hearing, either supporting the Joint Filing or

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[11] April 23 Order, 131 FERC ¶ 61,065 at P 16.

[12] *Id*. P 17.

[13] *Id*.

[14] August 12 Order, 132 FERC ¶ 61,122 at P 41. As discussed below, we are approving in this order the retention of the price floor until specific tariff revisions to the current APR are approved by the Commission. As the Joint Filing proposes to retain the price floor only through the sixth FCA, this may require a further extension of the current price floor.

making new proposals.[15] As ISO-NE put it, "the Commission established a compact timeframe in which the ISO was challenged to develop and file a new design that addressed the issues the Commission found potentially unjust and unreasonable in the [Joint] Filing."[16] Any parties who wished to support the Filing Parties' proposed revisions were to submit briefs at that time as well. Parties with other positions on the issues set for hearing (such as the complainants in Docket Nos. EL10-50-000 and EL10-57-000) were to simultaneously submit briefs supporting their views. In the April 23 Order, the Commission also provided parties an additional sixty days in which to submit second briefs to respond to the arguments made in the first briefs.

12. The first briefs of most parties (including the complainants in Docket Nos. EL10-50-000 and EL10-57-000) largely addressed the Joint Filing proposals. However, ISO-NE's first brief disregarded the Joint Filing and instead contained an entirely new proposal on the paper hearing issues (July 1 Proposal). ISO-NE explained that, due to a lack of time, it could not completely vet the proposal with stakeholders, although it did present the conceptual framework of the July 1 Proposal to stakeholders at a meeting on June 15, 2010, and several subsequent meetings were planned. In light of ISO-NE's July 1 Proposal, the Commission provided parties the opportunity to file third briefs to respond to arguments made in second briefs.[17]

D. <u>The Instant Order</u>

1. <u>Context</u>

13. The backdrop against which we review these proposed changes is one of significant excess capacity. Every auction since the inception of the FCM has cleared at the price floor, and even at such levels, significantly more resources wish to provide capacity than is needed.[18] A substantial amount of new capacity has been constructed as a result of state-funded initiatives. Because such capacity resources receive revenue from outside the ISO-NE markets, they are able to offer into the FCM at below-market rates. In ISO-NE, such so called "out-of-market" (OOM) offers are currently permitted to clear

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[15] April 23 Order, 131 FERC ¶ 61,065 at P 21.

[16] ISO-NE Third Brief at 8-9.

[17] August 12 Order, 132 FERC ¶ 61,122 at P 60.

[18] For example, in the August 2010 FCA, when the price floor of $2.951/kW-month was reached, 5,374 MW of excess capacity, over 17 percent, remained in the auction. *ISO New England Inc.*, 133 FERC ¶ 61,230, at P 4 (2010).

the FCA and obtain Capacity Supply Obligations.[19] (In contrast, the PJM and NYISO capacity markets both employ offer-floors that are intended to preclude such offers.[20])

14. Allowing OOM capacity to clear creates a significant design issue for the FCM; all other things being equal, it suppresses the clearing price below competitive levels. Since the inception of the FCM, there has been an APR – a buyer market power mitigation mechanism – in place, but it has never triggered, and so OOM offers have never been mitigated despite the presence of a significant amount of OOM capacity.[21] In the April 23 Order, the Commission noted its concern that both the existing APR and the Joint Filing's APR proposal "fail to fully adjust for the effect of OOM investment on the capacity price."[22]

15. In sum, two major and interrelated issues are at play in this case: (1) whether the FCM design in New England will provide sufficient income to incent market entry when necessary without the assistance of supplemental revenue streams from outside ISO-NE markets and (2) the proper design of market power mitigation regimes to protect against both buyer and seller market power. It is perhaps because these issues are so fundamental to capacity market design that the stakeholder process had arrived at a seeming impasse when the Commission stepped in and established the paper hearing.

16. It is in these circumstances that we find that the Joint Filing's proposal on the issues set for hearing are in large part unjust and unreasonable and accept portions of ISO-NE's July 1 Proposal.

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[19] OOM designation does not imply bad intent; all the categorization means is that the resource is seeking to participate in the FCA at a price below its long-run average cost net of non-FCA market revenues.

[20] In NYISO, this price floor is subject to an exception that will be discussed in the body of this order.

[21] While seller market power typically involves the uneconomic withholding of capacity from the market in order to increase prices above competitive levels, buyer market power typically involves the converse: the uneconomic injection of capacity into the market in order to decrease prices below competitive levels. This buyer-side conduct can be profitable in circumstances directly analogous to withholding, since subsidized capacity offerings can significantly lower capacity prices.

[22] April 23 Order, 131 FERC ¶ 61,065 at P 85.

2. Buyer-Side Market Power Mitigation

17. As we explain further below, while we reject the APR proposal as formulated by ISO-NE in its July 1 Proposal, we find that the principles set forth by the ISO in that proposal form the basis for an effective buyer-side mitigation mechanism. We also agree with NEPGA's argument, made in its first brief, that asset-class-specific benchmark offer floors for new resource offers as in PJM would provide effective buyer-side mitigation.[23] Consequently, we will require ISO-NE to modify its proposal as discussed below.

18. The July 1 Proposal introduced the concept of the two-tiered pricing model, which incorporates benchmark pricing, into this proceeding. Under the July 1 proposal, anytime an OOM resource clears the auction, two clearing prices result. One price, based on parties' actual offers, is the Capacity Clearing Price. All new resources receive this price, whether they are OOM or new in-market resources. The second, higher price is the "Alternative" Capacity Price. The Alternative Capacity Price is arrived at by assuming all OOM offers had instead offered competitively through the use of benchmark pricing; it is the price existing resources receive. ISO-NE procures all capacity that bid at or below the Capacity Clearing Price (which amount equals the ICR). In addition, ISO-NE procures any additional existing capacity that bids below the Alternative Capacity Price, which results in the procurement of capacity in excess of ICR. If no OOM capacity clears the auction, the APR is not triggered and all resources receive the same price – the Capacity Clearing Price.

19. While we generally agree with the principles that underlie the two-tiered pricing model, we find that, in light of the design and history of the FCM, the APR proposal as formulated by ISO-NE in its July 1 Proposal fails to appropriately balance the competing interests at issue, in particular, the objective of limiting purchases to the ICR.[24]

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[23] NEPGA First Brief at 95.

[24] We recognize that the capacity market designs of NYISO and PJM employ sloped demand curves that allow for the procurement of capacity in excess of their respective capacity targets. But the sloped demand curves also allow for procuring less capacity than their respective capacity targets. These markets are designed such that the average amount of capacity procured over time is close to the capacity target, but the actual amount procured in any one period may be higher or lower than the target. Allowing the procurement in excess of the capacity target in some periods is reasonable in these markets to offset the potential for procuring less than the capacity target in other periods. By contrast, the New England market design contains no possibility of procuring less than its capacity target, and thus, there is no reason for requiring purchases in excess of the capacity target.

However, we find the feature of ISO-NE's July 1 Proposal that relies on these benchmark prices, coupled with limiting the amount of capacity purchased to the ICR, is just and reasonable, and, therefore, we will require ISO-NE to work with its stakeholders to develop an offer-floor mitigation construct akin to those in PJM and NYISO.

20. We also recognize in this order that states and state agencies may conclude that the procurement of new capacity, even at times when the market-clearing price indicates entry of new capacity is not needed, will further specific legitimate policy goals and, therefore, argue that certain resources that receive payments pursuant to state programs, which would otherwise trigger mitigation, should nonetheless be exempt from offering above a price floor. As discussed below, nothing in this order eliminates any rights entities may have under section 206 of the FPA to request a mitigation exemption.. Whether to grant an exemption will be based on each case's unique facts.

3. Historical OOM and Price Floor

21. We also accept in this order the Joint Filing proposal that OOM resources that cleared in the first three FCAs (so-called "historical OOM") should not trigger the APR. We do so even though the presence of historical OOM resources in the market has contributed to a large capacity surplus that is likely to last for many years. Our basis for this decision is that this investment has already been made. The purpose of the buyer-side mitigation is to prevent uneconomic entry; allowing historical OOM resources to trigger the APR would not prevent the entry of uneconomic historical OOM resources, because these resources have already entered the market.

22. Because historical OOM capacity will not be carried forward, we find it reasonable to extend the current price floor for a short additional period of time to address the entry of past OOM capacity, and we therefore preserve the Joint Filing's proposal to extend the price floor through the sixth FCA. Further, as we believe that the price floor should remain in place until revisions to the current APR are implemented, we note that ISO-NE may be required to make a subsequent filing to extend the price floor beyond the sixth FCA (depending on the timing of the stakeholder process triggered by our requirement to develop market rules to implement offer-floor mitigation). As noted in the "Timing" section below, we will require ISO-NE to outline a schedule for filing market rules in accordance with this order on paper hearing within 30 days of the issuance of this order.

4. Zonal Modeling and Supply-Side Market Power Mitigation

23. Next, we accept the July 1 Proposal to "model all zones all the time," which will increase the likelihood that FCM pricing will reflect local constraints, thereby reducing the need for ISO-NE to rely on out-of-market solutions to address reliability needs. Our acceptance of this proposal does not mean that price separation will result by default, however – zonal prices will only separate if constraints bind. Because this zonal

modeling regime increases the likelihood that smaller zones will separate during an auction, it also increases the opportunity for sellers to exert market power. Therefore, we also accept the July 1 Proposal's corresponding revised mitigation proposal.

24. The mitigation regime we accept entails a revised threshold for IMM review of de-list bids that will result in the IMM reviewing requests by sellers to exit the market beginning at a relatively lower price. We find this revised $1.00/kW-month threshold to be reasonable as it represents a level below which market power is likely not a concern while still allowing resources to offer de-list bids above this threshold (with justification). As detailed below, we also accept the July 1 Proposal's revisions to the calculation of acceptable static and permanent de-list bids to take into account the fact that capacity resources typically participate in energy and ancillary services markets in addition to the FCM, and therefore these de-list bids should reflect that fact.

5. CONE

25. Finally, we find below that the issue of the proper value of the CONE parameter has been mooted by our acceptance of ISO-NE's various proposals to eliminate or replace the current uses of the CONE parameter. As a result, CONE will essentially be written out of the FCM market rules.[25]

II. Procedural Issues

26. Many parties have addressed the legal status of both the Joint Filing and the July 1 Proposal. ISO-NE states that, while some parties argued that its role in the paper hearing should have simply been to file additional support for the Joint Filing, ISO-NE believes that it already had provided the Joint Filing's full supporting rationale and that, based on ISO-NE's reading of the April 23 Order, the Commission did not intend such a narrow role for ISO-NE, which, at any rate, would not have served the region well. Instead, ISO-NE states that it performed considerable further analysis to address the paper hearing issues.

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[25] However, as noted below, because we are accepting the Joint Filing's proposal to extend the price floor through the sixth FCA (and potentially longer depending on the timing of the offer-floor mitigation stakeholder process), we are requiring ISO-NE to retain the CONE parameter only with reference to the appropriate price floor. The market rules developed based upon this order should reflect the elimination of this last function of CONE upon the implementation of revised APR rules.

1. Comments and Responses

27. Many parties assert that the Commission's role under section 205 is only to determine whether a rate proposed by a utility, here the Joint Filing, is just and reasonable and is not to determine whether the Joint Filing is more or less reasonable than alternatives. Therefore, these parties argue, because the Joint Filing is properly filed under section 205 of the FPA, the Commission may not consider proposed alternatives without first finding that the Joint Filing will not produce just and reasonable results.

28. Other parties point out that ISO-NE itself has stated that all auctions, including the fourth auction that was conducted according to the Joint Filing rules, have produced just and reasonable results. Some state that the proponents of any alternative must therefore demonstrate materially changed conditions in order to show that the existing FCM rules, rules which were found by the Commission to be just and reasonable, are now instead unjust and unreasonable. Load parties emphasize that the FCM functions well, securing reliability, procuring capacity, and eliminating the region's reliance on reliability-must-run (RMR) agreements. These parties contend that there is no basis in the record to find that the existing FCM rules, as modified by the Joint Filing, are unjust and unreasonable. Other parties disagree, arguing that the FCM has missed almost all its design objectives, rendering the resulting rates unjust and unreasonable. For example, NEPGA asserts that the unrestrained exercise of buyer market power threatens to destroy the FCM.[26]

29. For various reasons, many parties continue to argue (consistent with their original comments on the Joint Filing) that the Commission should consider the Joint Filing's FCM revisions as a package. Some support this position because the Joint Filing was the result of a lengthy and careful process of discussion and compromise, with input from state regulators, the IMM, ISO-NE, and the NEPOOL stakeholders. Some argue that if the Commission were to pick and choose provisions from the Joint Filing, it would hamper future stakeholder efforts. Others emphasize that the complexity of the FCM dictates that provisions cannot be selected piecemeal from the Joint Filing, or, as ISO-NE argues, from its July 1 Proposal.

30. On the other hand, Boston Gen asserts that the Commission is not required to consider either the Joint Filing or the July 1 Proposal as an integral package and notes that the Commission has already rejected this argument as to the Joint Filing. NEPGA observes that, on rehearing, the Commission stated that it cannot "defenestrate" its duty to ensure just and reasonable rates under any circumstances, even when, as NEPGA puts it, "a super-majority of likeminded stakeholders have agreed to a one-sided package

[26] NEPGA First Brief at 19.

wholly in their favor."[27] Boston Gen states that, if the Filing Parties or ISO-NE fail to carry their burden for any particular proposed change, the Commission may either reject the proposal outright or direct the Filing Parties or ISO-NE to modify that aspect of the proposal with an alternative the Commission determines is just and reasonable.

31. Some parties argue that, if the Commission believes that further FCM rule development is necessary, the Joint Filing should be returned to the stakeholders. These parties suggest that the Commission can set a time-limited stakeholder process, and/or instruct ISO-NE to make a new section 205 filing addressing the matters set for paper hearing. Some conclude that a paper hearing, where "new proposals are developed and modified on the fly," is not the appropriate venue for deciding the future of the FCM.[28] On the other hand, generator parties believe that a return to the stakeholder process would only cause unreasonable delay, arguing that stakeholders have had multiple rounds to try to resolve the issues currently before the Commission and have failed. NEPGA urges the Commission to eliminate any decisional role for stakeholders in any process going forward, arguing that ISO-NE should consult with stakeholders only to develop Tariff language in response to the Commission's order on the paper hearing.[29]

32. Turning now to the comments discussing the legal status of ISO-NE's July 1 Proposal, NEPOOL asserts that for the Commission to consider the July 1 Proposal pursuant to section 205, the July 1 Proposal's revisions must have first been presented to NEPOOL Participants for consideration and vote under the terms of the NEPOOL Participants Agreement, which the July 1 Proposal was not.[30] On the other hand, Boston Gen asserts that the July 1 Proposal is an amendment to the Joint Filing and argues that the Commission must evaluate under section 205 both (1) the provisions in the July 1 Proposal that supersede equivalent provisions in the Joint Filing and (2) the remaining (non-superseded) provisions of the Joint Filing that were set for hearing.[31] In further support for its argument that the July 1 Proposal should be evaluated under section 205, Boston Gen notes that the April 23 Order specifically directed the Filing Parties to

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[27] NEPGA Second Brief at 87 (citing August 12 Order, 132 FERC ¶ 61,122 at P 22-24).

[28] Public Systems Second Brief at 8.

[29] NEPGA Second Brief at 90-92.

[30] NEPOOL First Brief at 3 (citing NEPOOL Participants Agreement §§ 11.1.2 to 11.1.4).

[31] Boston Gen Second Brief at 11-12.

"submit briefs addressing our questions, either supporting their prior proposal, or making new proposals."[32]

33. Many parties argue that ISO-NE's July 1 Proposal is procedurally improper and violates the FPA, the Commission's regulations, and/or the ISO-NE Tariff, Transmission Operating Agreement (TOA), or the Participants Agreement. HQUS argues that the July 1 Proposal is in essence a section 205 filing and maintains that ISO-NE was therefore required to provide prior notice and a description of the filing to stakeholders, which it failed to do.[33] HQUS also argues that as a section 205 filing, the July 1 Proposal must contain sufficient detail to give notice as to its effects, which it does not. Others note that the Tariff, Participants Agreement, and/or the FPA mandate not only notice, but also a stakeholder process and a meaningful opportunity to vet the proposal. Joint Filing Supporters (JFS) argues that the July 1 Proposal violates section 205's rate change requirements that limit the frequency with which a utility may propose rate changes.[34]

34. Parties also argue that ISO-NE's July 1 Proposal is not ready for any Commission consideration, calling it vague, inchoate, insufficiently specific, and "an unsupported concept that is not even close to being capable of implementation."[35] Some parties assert that the July 1 Proposal is so lacking in detail that the Commission may not and cannot determine its justness and reasonableness. These parties assert that ISO-NE has offered no evidence to support the July 1 Proposal; no analysis as to its cost impact or likely effects; has not shown how the July 1 Proposal will mesh with existing rules; does not itself contain market rules; and leaves major questions unanswered, including questions explicitly posed by the April 23 Order.

35. On the other hand, NEPGA argues that the Commission "has substantial record evidence" to find that aspects of the existing rules prior to the Joint Filing, and the Joint Filing, are unjust and unreasonable, as well as substantial record evidence to find that the equivalent provisions of the July 1 Proposal are just and reasonable.[36] NEPGA notes that, while ISO-NE has not provided testimony in support of its APR proposal in its July 1 Proposal, NEPGA has, in the form of extensive expert testimony fully supporting the

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[32] *Id.* at 11.

[33] HQUS Second Brief at 20-26.

[34] JFS Second Brief at 19.

[35] *Id.* at 18.

[36] NEPGA Second Brief at 86-88.

economic soundness of the APR proposal. For its part, ISO-NE states that it developed its July 1 Proposal in response to the Commission's determination *not* to entrust the further development of the capacity market design to the stakeholder process, instead establishing a compact timeframe in which the ISO was challenged to develop and file a new design that addressed the issues the Commission found potentially unjust and unreasonable in the Joint Filing. ISO-NE asserts that a very detailed Commission order placing a compliance obligation on ISO-NE that minimizes the opportunity for re-argument during the rule drafting process will help achieve the Commission's goal of swiftly putting into place changes to the market rules that will remedy the flaws in the FCM.[37]

2. Commission Determination

36. Given the complexity of the procedural issues presented by this case, it is helpful for us to refer back to our specific findings, and our specific directives to the parties, contained in the April 23 Order. It is that order that provides the framework in which we analyze the parties' comments and positions. In pertinent part, in the April 23 Order, the Commission stated (at P 15):

> We find certain aspects of the [Joint Filing] to be just and reasonable, as set forth in P 16 below, and we accept those provisions without suspension. Our preliminary analysis indicates that the remainder of the Rules Changes Filing has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. In consideration of the fact that ISO-NE must conduct its next FCA in August 2010, and of the uncertainty that would result from not having replacement tariff provisions in place to govern that auction, we will accept those remaining proposed tariff provisions for filing, suspend them for a nominal period, and make them effective April 23, 2010.

37. Thus, in the April 23 Order, the Commission, pursuant to its section 205 authority, accepted without suspension a portion of the Joint Filing, effective as of April 23, 2010. We also found that other aspects of the Joint Filing had not been shown to be just and reasonable but, for the reasons set forth above, accepted those provisions effective as of the date of that order, suspended them, and also set them for paper hearing.[38] With

[37] ISO-NE Third Brief at 8-9.

[38] April 23 Order, 131 FERC ¶ 61,065 at P 15.

respect to the suspended provisions of the Joint Filing, the Commission stated (at note 11): "To provide parties sufficient certainty regarding the August 2010 auction, we intend to make any changes to the FCM tariff provisions prospective only and thus do not intend to order refunds."

38. In the April 23 Order, the Commission addressed the paper hearing procedures. With respect to the suspended aspects of the Joint Filing, the Commission specifically allowed (at P 21) the Filing Parties (who had submitted the Joint Filing) to make new proposals in lieu of supporting their first proposal.

39. Our task in the instant order is to first address the suspended aspects of the Joint Filing that were set for paper hearing.

40. We disagree with parties who argue that we must consider the Joint Filing or the July 1 Proposal solely as a complete package. Parties variously argue that we must do so: because the Joint Filing is the result of the stakeholder process; because in disassembling the Joint Filing's package of concessions we may hamper future stakeholder processes; because our role is to determine whether the rate resulting from the Joint Filing is just and reasonable, not to pass judgment on its component parts; and because the FCM is so complex that individual components cannot be cherry-picked from different proposals.

41. First, given that in the April 23 Order, the Commission divided the Joint Proposal into those provisions that we accepted without suspension and those that we suspended and set for paper hearing, it is clear that we never regarded the Joint Filing as an inseparable "take it or leave it" package. In our August 12 Order, the Commission addressed a party's rehearing request that the Commission consider the Joint Filing as a single package and expressly rejected it.[39] In the August 12 Order, the Commission also responded to similar arguments by noting that, "while stakeholder consensus is an important factor to be considered in reviewing the justness and reasonableness of a rate design, stakeholder support alone cannot ultimately prove that a rate design is just and reasonable."[40] We are cognizant of the fact that many parties made compromises during the stakeholder process, and we encourage parties to continue to do so. However, stakeholder proceedings cannot function as a substitute for Commission review. Finally, while it is certainly true that the FCM is complex and that any rule change must be

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[39] August 12 Order, 132 FERC ¶ 61,122 at P 23 ("Joint Filing Supporters are in error in asserting that the Commission was required to either accept or reject the February 22 filing in its entirety or set the entire package of proposed changes for paper hearing.").

[40] *Id.* P 22. The Commission also noted that the Joint Filing is a rate filing, not a black box settlement proposal, and that the Commission is therefore obligated to address whether each of the Joint Filing's provisions are just and reasonable. *Id.* P 23.

considered in the context of the whole, it does not follow that each rule change we accept must have been filed as part of a single proposal. Our consideration of any rule change will include consideration of its interaction with other FCM rules or rule changes.

42. We next turn our attention to ISO-NE's July 1 Proposal. Parties offer a multitude of opinions as to the nature of this filing, ranging from Boston Gen's assertion that the July 1 Proposal is, in fact, an amendment to the Joint Filing that must be evaluated under section 205, to HQUS' assertion that the July 1 Proposal is procedurally improper and violates both the FPA and the TOA, to NEPOOL's assertion that the July 1 filing is a section 206 filing entitled to no more weight than the filing of any other party.

43. We first note that, in accordance with the Participants Agreement, absent exigent circumstances, ISO-NE cannot make a proposal to change market design under section 205 without first taking that proposal through the NEPOOL Participants Committee.[41] The July 1 Proposal was not taken through the Participants Committee; consequently, it cannot be treated as a section 205 submission. While the July 1 Proposal was not expressly presented to us under section 206, we agree with NEPOOL that it is effectively a proposal under section 206 to replace rates found unjust and unreasonable, and thus we will accord it no more weight than the filing of any intervenor to the proceeding. We believe that this approach best balances the rights of all parties to the proceeding and best adheres to the express terms of the Participants Agreement with respect to the prerequisites that ISO-NE must follow before submitting a section 205 filing with the Commission. Further, our actions in this order to find certain portions of the FCM construct unjust and unreasonable, and to put a just and reasonable replacement into place, are also taken pursuant to complaints filed under section 206 by NEPGA and Joint Complainants, who have asserted that both the Joint Filing and additional pre-existing aspects of the FCM construct are unjust and unreasonable.

44. We do not believe that the fact that prior FCAs, including the fourth, may have resulted in just and reasonable outcomes precludes ISO-NE or any other party from arguing, or the Commission from finding, that some specific provisions of the existing FCM rules or of the Joint Filing are unjust and unreasonable. First, taken to its logical conclusion, parties' arguments in this regard would mean that no section 206 challenge to any market design rates on file could succeed and that any such rate on file, once approved, is just and reasonable in perpetuity unless and until the utility itself files a proposed change under section 205. Second, a claim that previous FCAs may have resulted in just and reasonable outcomes has no relevance to the Commission's express finding in the April 23 Order that some aspects of the Joint Filing may produce unjust and unreasonable results for future FCAs. Thus, we disagree with JFS and Mass DPU

[41] NEPOOL Participants Agreement § 11.1.

that ISO-NE must demonstrate materially changed conditions in order to challenge the Joint Filing.

45. Because we will treat the July 1 Proposal as a proposal under section 206 to replace rates found unjust and unreasonable, the arguments that the filing is procedurally improper because parties did not receive the notice associated with section 205 applications and the filing was not first vetted by stakeholders are misplaced – these requirements apply only to section 205 filings. (In any event, we find that all affected parties had actual notice of and adequate opportunity to protest and comment on the July 1 Proposal.) We similarly reject JFS' argument that the July 1 Proposal violates section 205's rate change filing requirements. First, this is not a case of a utility presenting a "moving target," and second, the Commission in the April 23 Order explicitly extended to parties an offer to present new proposals, which ISO-NE did in its July 1 Proposal.[42]

46. We also disagree with parties who argue that a paper hearing is not the appropriate venue to argue the merits of proposed FCM rules. First, these parties are seeking untimely rehearing of the April 23 Order that established these paper hearings. Second, as the Commission noted in the April 23 Order (at n.15), we have full discretion to determine the most appropriate procedures to apply, and no party has demonstrated our employment of a paper hearing has significantly prejudiced it or unreasonably delayed the resolution of this proceeding.

47. Parties express concern regarding the lack of detail in the July 1 Proposal. We do not believe, however, that specifics are so lacking that the proposal is a "conceptual" one that is so vague that we cannot determine its justness and reasonableness. We agree with ISO-NE's assessment that it is well settled that "an agency has the right to exercise its administrative discretion in deciding how to proceed to develop needed evidence."[43] We furthermore agree that, in reaching a decision in this paper hearing, we need only demonstrate that we have "made a reasoned decision based upon substantial evidence in the record."[44] We have before us thousands of pages of argument supporting and opposing the July 1 Proposal, and we can determine the adequacy of the July 1 Proposal's level of detail and support on this record on a provision-by-provision basis, as discussed

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[42] April 23 Order, 131 FERC ¶ 61,065 at P 21.

[43] ISO-NE Third Brief at 10 (citing *Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519, 544-46 (1978)).

[44] *Id.* (citing *Pac. Gas & Elec. Co. v. FERC*, 373 F.3d 1315, 1319 (D.C. Cir. 2004), and quoting *N. States Power Co. v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994).

below. In addition, we note that ISO-NE and NEPOOL will still be required to file tariff provisions reflecting our decisions here which the Commission will subsequently review.

48. In conclusion, in this order we will review the Joint Filing under FPA section 205. And, as discussed below, we find certain aspects of the Joint Filing to be unjust and unreasonable. We will next review alternative proposals, including the July 1 Proposal, under FPA section 206. We note that parties to this proceeding received notice of and an opportunity to respond to all the proposals before us. Parties were first put on notice that the Commission had difficulties with certain aspects of the Joint Filing upon issuance of the April 23 Order. Parties then had several opportunities to provide further support for the Joint Filing or to propose alternative solutions. After ISO-NE filed its July 1 Proposal with the Commission, all parties were given two subsequent opportunities, on September 1, 2010 and September 29, 2010, to provide non page-limited briefs to the Commission regarding ISO-NE's July 1, or any other, proposal. As discussed above, we will confer upon ISO-NE's July 1 Proposal no more (and no less) weight than we will confer upon any other alternative proposal provided to us during the paper hearing. Throughout the remainder of this document, we carefully consider the thousands of pages that constitute the paper hearing record and weigh all the arguments supporting and opposing all of the proposals before us and reach what we believe to be reasoned decisions based on substantial record evidence.

III. Joint Filing

49. As discussed above, in the April 23 Order, the Commission found that the Filing Parties had not demonstrated that certain aspects of the Joint Filing were just and reasonable. In order to allow parties to provide additional argument, the Commission set certain issues for paper hearing: (1) issues related to the APR; (2) the modeling of capacity zones and related mitigation; and (3) whether the value of CONE should be reset. After considering the additional argument both for and against these aspects of the Joint Filing, we find that the Joint Filing is unjust and unreasonable as to these issues, with the exception of its proposed treatment of historical OOM,[45] which we find to be just and reasonable. We discuss each issue in turn below.

A. Alternative Price Rule

50. APR is a market power mitigation rule intended to discourage buyers who have the incentive and ability to suppress market clearing prices below a competitive level

[45] "Historical OOM" for purposes of this order is capacity that was found to be OOM in the first three FCAs.

from doing so.[46] Generally speaking, the APR functions by first identifying OOM capacity, that is, new resources that offer into the FCM at a price deemed by the IMM to be below their long-run average costs. Specifically, under the current Tariff, OOM capacity is capacity whose offer price, in the opinion of the IMM, is below the resource's long run average costs net of expected non-capacity market revenues.[47] Depending on circumstances that will be described below, the presence of OOM resources in an auction may or may not trigger APR mitigation under the Joint Filing's proposed rules.

51. In the April 23 Order, the Commission found that the Joint Filing's APR revisions improved upon the then-existing APR in most or all respects.[48] However, the Commission noted that certain concerns raised by commenters warranted further investigation and therefore set three APR-related issues for hearing: (1) the appropriate APR triggering conditions, if any; (2) the treatment of OOM resources that create capacity surpluses for multiple years; and (3) the appropriate price adjustment under APR. We will first discuss (1) and (3) together, and then discuss (2).

1. Triggering Conditions and Price Adjustment

52. Under the preexisting and Joint Filing rules, the fact that resources deemed to be OOM are taken in an auction is not enough by itself to "trigger" APR – that is, the presence of OOM capacity is not enough to prompt price mitigation. The Joint Filing proposes three different APRs, each triggered under a mutually exclusive set of conditions such that only one of the APR mechanisms can be triggered per capacity zone per FCA. "APR-1" is a revised version of the preexisting APR and triggers only when new capacity is needed and new OOM capacity fully satisfies the need.[49] "APR-2"

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[46] April 23 Order, 131 FERC ¶ 61,065 at P 69.

[47] *See* ISO-NE Tariff § III.13.1.1.2.6. The IMM reviews, in advance of the FCA, the offer prices of all new resources that wish to submit offers below 0.75 * CONE. If the IMM determines that the offer of such a resource is not consistent with its long-run average costs net of expected non-capacity market revenues, that resource is considered OOM capacity.

[48] April 23 Order, 131 FERC ¶ 61,065 at P 72.

[49] Specifically, APR-1 is triggered when (1) the ICR exceeds existing capacity after deducting permanent de-list bids that clear in the auction and permanent de-list bids and non-price retirement requests rejected for reliability; (2) there is adequate supply offered into the FCA to meet the ICR; and (3) the amount of OOM capacity exceeds the need for new capacity.

addresses the situation in which a sufficiently large amount of OOM capacity from previous FCAs may eliminate the need for new capacity, thus depressing the price in a subsequent FCA.[50] If either of these APRs is triggered, the market clearing price is adjusted upward to the lower of: (1) a penny below the lowest price offered by a new in-market resource or (2) CONE, which is the same re-pricing mechanism that was used under the preexisting rules. "APR-3" is designed to mitigate the price-suppressing effects of de-list bids that are rejected for reliability rather than to mitigate buyer-side market power.[51] APR-3 employs a re-pricing mechanism in which the ISO determines the FCA price that would have resulted if de-list bids had not been rejected for reliability.[52]

a. <u>Comments and Responses</u>

53. Allowing that the Joint Filing revisions still enable OOM capacity to enter the market without triggering the APR, supporting parties argue that these triggers strike a just and reasonable balance between the need to prevent the "artificial" suppression of capacity prices and the need to preserve legitimate opportunities for bilateral contracts and self-supply. JFS emphasizes that these limited triggering conditions are necessary in the context of the Joint Filing's broad definition of OOM. JFS asserts that these limited

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[50] Specifically, APR-2 is triggered when (1) no new capacity is needed; (2) there is adequate supply offered into the FCA to meet the ICR; and (3) at the Capacity Clearing Price, the amount of new capacity required plus the amount of permanent de-list bids clearing in the FCA plus the amount of carried forward excess capacity is greater than zero.

[51] Rejected de-list bids have a price-suppressing effect because such resources are retained at essentially a zero price. APR-3 is triggered specifically when (1) new capacity is not needed; (2) new capacity would not be needed after considering carried forward excess capacity; (3) the price has been depressed because a de-list bid that would otherwise be expected to set the price is rejected for reliability reasons; and (4) the pre-adjusted Capacity Clearing Price from a re-run of the FCA without rejecting the de-list bids is less than 0.6 * CONE. Carried forward excess capacity is OOM capacity from a prior FCA that carries forward (carried forward excess OOM capacity), along with other excess capacity that carries forward due to the rationing rules.

[52] Specifically, if the price is less than 0.6 * CONE, a demand curve is developed where each price-quantity pair on the curve results in the same total costs as the price-quantity pair that would have resulted if the rejected de-list bids had not been rejected. The APR-3 price is set at the intersection of the aggregate supply curve and this adjusted demand curve.

triggers serve to ensure that the APR does not replace market forces with prices that are frequently set administratively.[53] These supporting parties (including JFS) urge the Commission to accept the Joint Filing's APR price adjustments as part of a comprehensive package.

54. Most parties opposed to the Joint Filing's triggering conditions argue that the conditions still exclude circumstances where OOM capacity can depress prices. For example, Potomac Economics, the external market monitor (EMM) for ISO-NE, states that these triggers exclude situations where new capacity is not needed or where the amount of OOM is less than the amount of new capacity needed. The EMM argues that in both instances OOM capacity impacts the price but the APR will not be triggered.[54] NEPGA argues that OOM capacity can always suppress price and provides a similar example to that provided by the EMM demonstrating circumstances where the Joint Filing APR will not be triggered. NEPGA argues that the mutually exclusive triggering conditions for APR-1 and APR-2, based on whether OOM is new or existing, are not necessary and that using 0.6 * CONE as an upper threshold on the pre-adjusted price in the triggering conditions of APR-3 serves no purpose.[55]

55. Maine PUC states that it did not protest the Joint Filing because ISO-NE had agreed to revisit issues surrounding the APR and OOM through the stakeholder process.[56]

56. Generator parties and the EMM are also opposed to the APR re-pricing scheme under the Joint Filing because (as with the preexisting APR) it fails to adjust the market clearing price to the price that would have prevailed but for OOM entry. Therefore, these parties contend that the Joint Filing APR neither corrects for the adverse effects of OOM entry, nor does it remove the incentive to offer uneconomic capacity into the FCM.[57]

57. Many commenters (including the EMM) oppose APR-3, and the inclusion in APR-1 of certain rejected de-list bids, on that grounds that treating rejected de-list bids as

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[53] JFS First Brief at 20-26.

[54] EMM First Brief at 4.

[55] NEPGA First Brief, Ex. 1 at 12, 40, 53 (Shanker Testimony).

[56] Maine PUC Second Brief at 2-3

[57] Consistent with their positions in the proceeding that led to the April 23 Order, the generator parties maintain that these flaws have resulted in state-led exercises in buyer market power where new state-subsidized capacity is required to offer into the FCA below its actual costs, displacing lower-cost existing resources.

OOM is inappropriate. These parties assert that because APR-3 ignores constraints, it fails to address the underlying reliability need that caused the bids to be rejected.

b. Commission Determination

58. We first note that, through four FCAs, the APR has never been triggered, despite the entrance of significant amounts of OOM capacity.[58] In proposing the Joint Filing APR changes, ISO-NE and NEPOOL acknowledged that the proposal "does not resolve all the major issues regarding the FCM design."[59] They stated that "future stakeholder processes will continue to consider how to improve the FCM and, among other issues, consider further refining the definition of OOM resources, when the APR should be triggered, and how the price should be set under the APR."[60]

59. In the April 23 Order, the Commission agreed that APR design issues remained. The Commission noted that "OOM resources can affect prices even when no new capacity is needed, by displacing what would otherwise be the marginal, price-setting existing resource."[61] The Commission therefore found that the Joint Filing's APR triggering conditions "may overlook situations in which an OOM resource may be used as an instrument of buyer market power."[62] The Commission also found that the re-pricing mechanisms under APR-1 and APR-2 "fail to fully adjust for the effect of OOM investment on the capacity price."[63] The Commission directed parties to address in their briefs whether additional changes were necessary concerning APR price adjustment, stating that "[m]echanisms that fail to address OOM capacity surpluses do not provide the long term price signals that support efficient private investment."[64]

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[58] We recognize that the specific quantity of OOM capacity that has entered the FCAs to date is a disputed fact in this proceeding (as discussed elsewhere in this order), but no party challenges the fact that a considerable quantity of OOM capacity has entered the FCM.

[59] Joint Filing at 3.

[60] *Id.* at 10.

[61] April 23 Order, 131 FERC ¶ 61,065 at P 70.

[62] *Id.* P 76.

[63] *Id.* P 85.

[64] *Id.* P 87.

60. Parties arguing in favor of the Joint Filing's APR revisions have allayed neither our concerns that the Joint Filing's triggering conditions are too narrow, nor our concerns that its price adjustments fail to fully mitigate the suppressing effects of OOM capacity on the FCA price. In fact, parties supporting the Joint Filing's APR have failed to adequately demonstrate that that rule meets the standards set forth in the April 23 Order.[65] Further, ISO-NE itself no longer supports the APR mechanism from the Joint Filing, stating, for example, that the proper way to correct for the effect of OOM resources is to establish the Alternative Capacity Price[66] at a level that would have prevailed if the OOM resources had submitted competitive offers into the FCA.[67]

61. Because the concerns the Commission expressed in the April 23 Order have not been addressed to our satisfaction, we find the Joint Filing's APR as to triggering conditions and pricing adjustment unjust and unreasonable. Specifically, none of the Joint Filing supporters provide a compelling response to our concern that the Joint Filing's triggering conditions are too narrow because they disregard that OOM resources can affect prices even when no new capacity is needed. While expressing concerns over administrative pricing under ISO-NE's proposed alternative in its July 1 Proposal (as discussed elsewhere in this order), the load parties fail to offer an economic rationale for why the APR should not be triggered whenever OOM capacity accepts a Capacity Supply Obligation. As noted by the parties to this proceeding, the Commission has stated previously that "all uneconomic entry has the effect of depressing prices below the competitive level and that this is the key element that mitigation of uneconomic entry should address."[68] In the circumstances before us, we find the triggering conditions of the Joint Filing's APR to be unjust and unreasonable.

62. Furthermore, we generally agree with ISO-NE that the proper way to correct for the effect of OOM capacity is to establish an APR price at the level that would have prevailed if OOM resources had submitted competitive offers. The re-pricing mechanism under APR-1 and APR-2 does not establish such a price. Those in favor of the Joint Filing's re-pricing mechanism do not provide any support for failing to employ a full price correction to address uneconomic offers. Instead, these parties raise general concerns over administrative pricing if the related APR triggering conditions are

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[65] *Id.* P 69-87.

[66] ISO-NE introduces this term in its first brief and states that it is an administratively-set price that would have resulted absent the entry of OOM resources.

[67] ISO-NE First Brief at 11.

[68] *N.Y. Indep. Sys. Operator, Inc.*, 124 FERC ¶ 61,301, at P 29 (2008) (*NYISO I*).

revised.[69] In the absence of such support, we find the Joint Filing's APR pricing provisions to be unjust and unreasonable.

63. As to APR-3 (and as to the inclusion in APR-1 of specific rejected de-list bids), we agree with commenters who argue that it is not appropriate to attempt to use the APR to correct for the potentially price-suppressing effect of rejected de-list bids. When triggered, APR-3 would re-price an entire zone,[70] on the basis that a single bid needs to be rejected for reliability. In many instances, rejected de-list bids are the result of undefined constraints, and we find such a situation best handled by improved zone modeling (an issue addressed in more detail below).

2. OOM Resources that Create Surpluses for Multiple Years

64. As discussed above, APR-2 triggers when OOM resources that cleared in a previous FCA create a sufficient capacity surplus to fully displace new in-market capacity in a given FCA. As noted in the April 23 Order, the Joint Filing places two limitations on this consideration of OOM which has or will create surpluses for multiple years: (1) no OOM resource clearing in any of the first three FCAs (so-called "historical OOM") will be considered and (2) no OOM resource that first clears after the third FCA will be considered to be OOM in more than six subsequent FCAs (for a total of seven years).

a. Historical OOM

65. In the April 23 Order, the Commission noted that parties had raised important arguments both for and against the Joint Filing's treatment of historical OOM and also its choice of seven years as the total duration of APR mitigation.[71] The Commission requested that the parties submit further argument on these issues.

i. Commission Determination

66. After considering the additional arguments regarding the Joint Filing's proposal not to consider prospective mitigation of historical OOM (i.e., not to carry forward the mitigation of this historical OOM), we are convinced that this specific aspect of the Joint Filing is just and reasonable. We therefore are accepting the Joint Filing as to its

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[69] JFS First Brief at 34-35.

[70] In the absence of zonal modeling, this re-pricing could set the price for the entire New England market.

[71] April 23 Order, 131 FERC ¶ 61,065 at P 82, 84.

treatment of historical OOM, inclusive of its proposed extension of the price floor.[72] We will provide our detailed discussion of parties' argument on historical OOM and our response on APR in the paper hearing section, in which we discuss ISO-NE's revised APR proposal (which retains this aspect of the Joint Filing).

b. Duration of APR Mitigation

i. Comments and Responses

67. NEPGA and Boston Gen argue that OOM capacity should be mitigated until it becomes in-market. NEPGA argues that the Joint Filing's proposal to deem OOM capacity as "in-market" after a fixed number of auctions is arbitrary, likely to be either over- or under-inclusive, and invites opportunities to game the market rules.[73]

68. On the other hand, JFS and other load parties argue that the Joint Filing's fixed, six-year OOM carry-forward period provides certainty, permits market participants and state regulators to estimate the impact of a particular bilateral contract or subsidy, and precludes the triggering of an administrative price that could be perpetuated for decades when there is little or no load growth.

ii. Commission Determination

69. We find the Joint Filing proposal to limit the number of years in which OOM can be carried forward from previous auctions to six to be unjust and unreasonable. No party has demonstrated that six years (seven auctions) is the appropriate limit for capacity that inappropriately suppresses prices to be carried forward in subsequent FCAs. The Filing Parties contend that the seven auction limit was derived from the time that it would take for the total quantity of OOM resources from the first three FCAs (defined as historical OOM in this order) to be exceeded by projected load growth in New England. However, this market rule is intended to address situations in addition to the existing historical OOM. We find that the price-suppressing effects of a new OOM resource could extend beyond the seventh auction after the FCA in which the OOM resource enters, depending on load growth and other new in-market generation that enters the market over that time period. As generator parties note, this defined OOM period (while providing "certainty" as noted by the load parties) invites opportunities for gaming

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[72] As noted previously, because we are requiring that the price floor remain until revisions to the current APR are implemented, this may require ISO-NE to make a subsequent filing to extend the price floor beyond the sixth FCA.

[73] NEPGA First Brief, Ex. 2 at 24-25 (Stoddard Testimony).

whereby OOM capacity procurements are timed such that OOM capacity can regularly become in-market capacity based solely on the passage of time, and we therefore find this provision unjust and unreasonable.

B. Modeling of Capacity Zones

70. The Joint Filing proposes to use the existing energy market load zones as the basis for the modeling of capacity zones and proposes to consider additional de-list bids – with the exception of dynamic de-list bids[74] and static de-list bids[75] from pivotal suppliers –to trigger zone formation.

71. In the April 23 Order, the Commission found that the proposal to consider certain additional de-list bids in the modeling of capacity zones improved upon the existing rules.[76] However, relying on New England precedent citing the need for locational capacity and the fact that rejected de-list bids trigger out-of-market pricing, the Commission stated that always modeling zones should be the ultimate goal. Nevertheless, the Commission stated that the Filing Parties and others had raised concerns with respect to doing so and therefore set for hearing the following issues: (1) whether zones should always be modeled; (2) whether all de-list bids should be considered in the modeling of zones; (3) whether a pivotal supplier test is necessary; and (4) whether revisions to current mitigation rules would be necessary in order to model all

[74] A dynamic de-list bid is a bid to de-list an existing qualified capacity resource during the FCA. By definition, such bids are not reviewed by the IMM and the threshold (currently 0.8 * CONE) represents the maximum allowable value for this bid type.

[75] A static de-list bids is a bid to de-list an existing qualified capacity resource. However, by definition, static de-list bids (those above 0.8 * CONE) must be reviewed by the IMM prior to the FCA to ensure that the bid is consistent with the resource's net risk adjusted going forward and opportunity costs.

[76] As noted in the April 23 Order, under the preexisting and Joint Filing rules, capacity zones are established only when the existing internal resources for an import-constrained zone cannot satisfy the resource adequacy requirement before a given auction (though this definition is extended to the "higher of" the resource adequacy requirement or the transmission security criteria under our acceptance of related rules in the April 23 Order). Of note, dynamic de-list bids and static de-list bids from pivotal suppliers are not able to trigger the formation of a zone.

zones.[77] After considering parties' additional arguments, we find the zonal modeling proposal from the Joint Filing to be unjust and unreasonable.

a. <u>Comments and Responses</u>

72. Load parties, who support the Joint Filing's zonal modeling proposal, are generally opposed to always modeling zones on the grounds that doing so carries a heightened risk of the exercise of supplier market power due to the smaller resulting zones. JFS states that the Joint Filing represents a just and reasonable approach that balances the two competing needs: (1) to model zones whenever practical to set appropriate locational rates and (2) to prevent existing generators from creating a separate zone through the exercise of market power. In their view, the revisions included in the Joint Filing will virtually eliminate the need for ISO-NE to reject de-list bids for reliability reasons.[78] Other parties argue that modeling all zones all the time is unnecessary and will undermine the development of transmission infrastructure. On the other hand, generator parties, who favor always modeling zones, note that pre-auction tests for establishing separate import-constrained capacity zones have not been met in any FCA to date, despite the need to reject de-list bids in these same auctions. Therefore, these parties assert that the modeling and mitigation rules accepted in the Joint Filing will still prevent locational pricing. Further, they contend that market power concerns ought to be addressed by strengthening market power mitigation measures rather than by compromising market design by not always modeling the zones.

73. Parties supportive of the Joint Filing point out that allowing certain de-list bids to trigger formation of a zone during an FCA will result in zones being modeled more frequently. These parties support the Joint Filing's proposal to exclude dynamic de-list bids from consideration in the modeling of zones, however, asserting that allowing these bids to set the price in a capacity zone would allow suppliers the potential to exercise market power by withholding capacity from the market up to a price of 0.8 * CONE (the current dynamic de-list bid threshold). These parties contend that this threshold can be higher than the suppliers' marginal cost of selling capacity. On the other hand, Joint Complainants asserts that a dynamic de-list bid must be allowed to set the price in order

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[77] April 23 Order, 131 FERC ¶ 61,065 at P 18.

[78] Specifically, JFS and Mass DPU note that the Joint Filing's proposal to use the higher of the Transmission Security Analysis (TSA) and Local Resource Adequacy Requirement (LRA) in determining the LSR for a zone will result in fewer rejected de-list bids, since ISO-NE will use the same criteria to model zones as well as to assess the reliability need for resources that seek to de-list.

to achieve an economically rational and sustainable outcome, arguing that such de-list bids, at less than 0.8 * CONE, by definition pose minimal risk of market power abuse.

74. Parties in favor of the Joint Filing's proposed use of a pivotal supplier test in order to allow only non-pivotal static de-list bids to be considered in determining zones assert that not doing so could permit the exercise of market power by a pivotal supplier. On the other hand, NEPGA argues that applying a pivotal supplier test to static de-list bids would amount to over-mitigation, since static de-list bids are already subject to IMM review by definition.

75. Many parties contend that modeling all zones all the time will require revisions to the current mitigation rules. For example, the IMM, the EMM, and ISO-NE argue that it would not be appropriate to allow the dynamic de-list bid threshold to remain at 0.8 * CONE if dynamic de-list bids are allowed to trigger zone formation due to market power concerns.

b. Commission Determination

76. Upon consideration of the additional arguments presented in the paper hearing, we find the Joint Filing zonal modeling proposal to be unjust and unreasonable. The Joint Filing revisions continue to determine the modeled capacity zones based on a subset of de-list bids submitted before the auction, thereby administratively preventing the creation of additional zones during the auction. The EMM observes that the Joint Filing's proposed triggering criteria for capacity zone formation appears to be premised on a concern for potential market power abuse (specifically, the concern that a dynamic de-list bid threshold of 0.8 * CONE in combination with relatively smaller zones would allow for the exercise of supplier market power if such de-list bids could set the zonal clearing price). As a result, the EMM recommends and we agree, that it is preferable to improve the mitigation measures, rather than to mitigate market power by not always modeling zones. In light of the fact that ISO-NE has rejected de-list bids in several of the auctions held to date without triggering a specific zone, we find that using larger zones as a form of market power mitigation is not a just and reasonable approach.

77. In ignoring constraints that arise during an auction and by not permitting all de-list bids to set zonal prices, the Joint Filing creates a situation where zonal capacity prices will not reflect proper long-term locational price signals. Under the Joint Filing's zonal revisions, ISO-NE continues to address reliability through out-of-market actions (by rejecting de-list bids) rather than in-market means (modeling all zones and allowing for a different zonal price where the constraint is located). Contrary to the claims of some, we believe that with proper constraint definition and market power mitigation, an expansion of zonal modeling will increase, not decrease, market efficiency. We furthermore remind parties that simply modeling a zone does not mean that prices will separate during the auction.

78. Last, because we find unjust and unreasonable the Joint Filing's proposal to model zones only in advance of the auction under specific circumstances, the issue of whether the accompanying pivotal supplier test is necessary has been mooted.

C. Value of CONE

79. The Joint Filing proposed (and the April 23 Order explicitly accepted) certain revisions to the methodology for updating CONE in the FCM construct.[79] Although the Commission stated that the CONE value itself was not part of the Joint Filing, the April 23 Order directed parties to address the issue of the proper value of CONE, as this value is "intrinsically tied to the OOM determinations that are part of the APR Issue."[80]

80. In the paper hearing, generator parties reiterate their arguments that the value of CONE under the preexisting and Joint Filing rules grossly understates the actual cost of constructing a new peaking plant. Load parties reiterate their prior arguments that the current CONE value properly reflects clearing price trends and dispute the idea that CONE should be based on the costs to construct a peaking unit.

a. Commission Determination

81. As the Commission noted in the April 23 Order, the value of CONE is most significant for its role in the determination of mitigation review thresholds. In light of this fact, and because in this order we find unjust and unreasonable both the Joint Filing's APR proposal (outside of its proposed treatment of historical OOM) and the Joint Filing's zonal modeling proposal, a ruling on the proper value of CONE under the Joint Filing is unnecessary. We therefore find the issue of the value of CONE under the Joint Filing to be moot, and we decline to address it further. We will, however, discuss the value of CONE below, in the context of other proposals that address the paper hearing issues.

IV. Paper Hearing

82. Briefs or comments filed in the paper hearing are listed in Appendix A.

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[79] April 23 Order, 131 FERC ¶ 61,065 at P 150-152.

[80] *Id.* P 151.

A. Procedural Issues

83. On August 30, 2010, NRG filed an answer to Mirant's Emergency Request for Clarification filed on August 20, 2010. On November 16, 2010, HQUS filed a Motion for Leave to File Limited Response and Limited Response to ISO-NE's third brief.

84. Rule 213(a)(2) of the Commission's Rule of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2010), prohibits an answer to a protest, comments, or answer unless otherwise ordered by the decisional authority. We accept the answer filed by HQUS because it has provided information that assisted us in our decision-making process. We will reject NRG's answer to Mirant's emergency request for relief, on the basis that both Mirant's request and NRG's answer have now become moot (see P 367 below).

85. Because we have found the Joint Filing Proposal to be unjust and unreasonable as it concerns the issues set for paper hearing (outside of its proposed treatment of historical OOM), we will now consider the alternative proposals under section 206. Though we will accord the ISO-NE July 1 Proposal no more weight than we accord proposals submitted by any other party to this proceeding, for readability's sake, we structure the remainder of this document around the July 1 Proposal. This is appropriate given that the July 1 Proposal is the only complete alternative proposal before us and that the bulk of the parties' briefings respond to the July 1 Proposal.

B. APR/Buyer-Side Mitigation

86. As noted previously, the April 23 Order set the following APR issues for paper hearing: the triggering conditions, if any, for the APR, the treatment of OOM resources that create capacity surpluses for multiple years, and the appropriate price adjustment under the APR.

1. July 1 Proposal

Triggering Conditions

87. Addressing the Commission's concerns over the APR that were noted in the April 23 Order, ISO-NE states that the revised APR mechanism fully compensates for the effects of OOM investment in each auction and sends appropriate price signals to both new and existing resources. Stating that the revised APR proposal only affects the price paid to existing resources when there are OOM resources that lower the FCA clearing price, ISO-NE notes that the revised APR is a single mechanism (rather than a three-part

APR as proposed in the Joint Filing) that applies whenever new or carried-forward OOM capacity clears in the FCA.[81]

Carried-Forward OOM Capacity

88. ISO-NE states that the effect of new OOM resources is not limited to the FCA in which these resources enter. As such, the revised APR proposal will add the quantity of new OOM capacity clearing in an FCA to a running total of past OOM capacity that will be carried forward, with the total decreased each year by load growth and resource retirements.[82] Carried-forward OOM capacity will trigger the APR and the resource will be re-priced to a benchmark value in order to create the adjusted aggregate supply curve.

APR Price Adjustment

89. ISO-NE states that the proper way to correct for the effect of OOM resources is not to set a price that would have resulted absent the entry of OOM resources but instead to establish the Alternative Capacity Price at a level that would have prevailed if the OOM resources had submitted competitive offers into the FCA; the Alternative Capacity Price is the price at which resources are just sufficient to meet the ICR when OOM resources are re-priced at their competitive offer prices.

90. ISO-NE states that existing resources should receive the Alternative Capacity Price because these resources formulated their entry prices without being able to account for the price suppression that might come from OOM resources. Further, ISO-NE states that paying the Alternative Capacity Price to existing resources will insulate investors from the risk that OOM resources will inappropriately depress clearing prices.

91. By contrast, ISO-NE contends that the Alternative Capacity Price is not an appropriate price signal for new resources. ISO-NE argues that it is not necessary to

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[81] New OOM resources are defined as capacity that remains in the FCA below specified benchmark prices that will be determined by the IMM, unless cost justification for such capacity has been submitted to and approved by the IMM prior to the FCA. ISO-NE notes that these benchmarks will be developed by the IMM, will be specific to each resource type, and will be fully known to participants ahead of the FCA.

[82] ISO-NE states that the reductions in carried-forward OOM would be applied first to the oldest OOM resources participating in the instant FCA. If the full capacity of OOM resources is not accounted for by load growth or retirement in a given year, ISO-NE states that the megawatts from each OOM resource in that year would be reduced *pro rata*.

provide the Alternative Capacity Price to new resources since these resources typically have not yet committed to entry and would generate additional excess capacity that would be carried in this and future FCAs. ISO-NE contends that the appropriate price signal for new resources is the relatively lower Capacity Clearing Price – the price from the FCA with OOM resources as offered and not re-priced. ISO-NE contends that the Capacity Clearing Price sends appropriate signals to new investors about the need for new capacity.

92. Under the revised APR mechanism, all resources that clear in the FCA receive a Capacity Supply Obligation, with new resources receiving capacity payments for a fixed timeframe of five consecutive Capacity Commitment Periods at the price from the first FCA in which the resource clears. ISO-NE states that new resources receive this price for a fixed period to provide these resources with an incentive to offer based on the cost of entry rather than based on the possibility of obtaining the higher Alternative Capacity Price in subsequent FCAs.

93. Under the revised APR mechanism, existing resources that did not clear in the FCA but that offered in an FCA at or below the Alternative Capacity Price also receive a Capacity Supply Obligation, since these are the resources that were displaced by the OOM resources. As a result, ISO-NE notes that this higher Alternative Capacity Price does not send an accurate signal about the need for new capacity.

94. ISO-NE states that if all resources were paid the higher Alternative Capacity Price, too much new capacity would be installed creating significant inefficiency. By contrast, ISO-NE argues that the two-tiered pricing model addresses the oversupply problem that is introduced when paying the Alternative Capacity Price to existing resources by sending a price signal to new capacity that reflects the actual quantity in the market. ISO-NE states that the two-tiered approach is not harmful to new resources since (by definition) the Capacity Clearing Price is the price that new resources clearing in the FCA indicated that they were willing to accept.

95. Thus, ISO-NE contends that its July 1 Proposal on APR represents the best balancing of three high-level design elements that are fundamentally in tension: (1) allowing new capacity submitting OOM offers to clear in the FCA and to provide capacity; (2) ensuring that the market for existing resources is not distorted by the presence of that OOM capacity; and (3) ensuring that total purchases do not exceed the ICR. ISO-NE argues that, if OOM capacity is allowed to clear in the FCA, the only way to insulate existing resources from the price effects of that OOM capacity is to impose additional costs on load by procuring capacity in excess of the ICR. Similarly, ISO-NE maintains that if the Commission imposes a requirement that the FCA procure no capacity in excess of the ICR, existing resources will be disadvantaged by the clearing of any OOM capacity.

96. ISO-NE maintains that the first element – allowing OOM capacity to clear in the FCA and to provide capacity – has been an element of the FCM design since its inception and has been generally supported by stakeholders, the states, ISO-NE, and the Commission. ISO-NE contends that if such resources are going to be built to meet state policy objectives, it would be inefficient to exclude them from the FCA, which would result in the procurement of alternate, essentially redundant sources of capacity. ISO-NE states that the second element – ensuring that the market for existing resources is not distorted by the presence of OOM capacity – is strongly supported by some generator parties and is the basis for the current APR in the FCM design. Further, ISO-NE notes that the Commission expressed its concern in the April 23 Order that the currently effective APR "fail[s] to fully adjust for the effect of OOM investment on the capacity price." Last, ISO-NE states that the third element – that total purchases not exceed the ICR – has been an integral part of the FCM since its initial design and this requirement is extremely important to many load parties and the states.

97. ISO-NE argues that the July 1 Proposal is the best approach, as it allows new OOM resources to clear while fully insulating existing resources from the price effects of this OOM capacity. ISO-NE states that its two-tiered pricing mechanism effectively accomplishes both of these goals while excess procurement above ICR is minimized by providing a price signal to potential new entrants that reflects the actual capacity supply situation in the region.

Imports

98. ISO-NE states that its proposal treats imports similarly to resources within New England; new imports that require a significant investment (similar to the level required for existing resources to become new under the current market rules) to provide capacity to New England would be treated as a new resource and would be eligible for the Alternative Capacity Price after the expiration of the initial five-year commitment. Otherwise, the imports would receive the Capacity Clearing Price, since this price reflects the actual supply-demand situation in the region.

Sunsetting of the Alternative Capacity Price for Existing Resources

99. ISO-NE states that under the July 1 Proposal, after the 20th FCA in which a resource participates, that resource will no longer be eligible to receive capacity payments based on the Alternative Capacity Price. Instead, beginning with the 21st FCA in which a resource participates, the resource will receive capacity payments based on the Capacity Clearing Price in each FCA. ISO-NE notes that the basis for this provision is that the rationale for providing the higher Alternative Capacity Price becomes less compelling over time – after 20 years, the incremental expected revenue has little impact on the expected price at which a new entrant would offer. Further, as a resource faces a retirement/de-list decision, ISO-NE contends that such a decision is better informed by

the Capacity Clearing Price which reflects the supply-demand balance in the market, providing a more appropriate price signal. Of note, ISO-NE proposes that this sunsetting not be applied retroactively, such that for all currently existing resources, the fourth FCA (conducted in August, 2010) will be the first year of the 20-year count. The basis for this proposal is that it balances the goal of holding existing resources harmless from the price effects of OOM resources and the goal of sending the best possible long-term price signals.

Treatment of Historical OOM

100. Consistent with its Joint Filing, ISO-NE's revised APR mechanism in its July 1 Proposal does not carry forward any OOM capacity from the first three FCAs. ISO-NE states that carrying forward this historical capacity would be inappropriate since it would constitute retroactive application of new rules, creating significant market uncertainty.[83] Also, ISO-NE cites prior Commission guidance in a NYISO case where the Commission noted that mitigation should be directed at avoiding inefficient entry but should not apply to historical OOM capacity since the associated costs of this OOM capacity could no longer be avoided.[84]

OOM Capacity Determination

101. Under the revised APR mechanism, ISO-NE proposes to modify the IMM's review process to determine whether offers from new resources are OOM capacity. Rather than continuing to review offers from resources submitted at prices below 0.75 * CONE in order to assess whether the offer is OOM, the IMM will now calculate benchmark offers for different types of resources to reflect what a resource would seek from the capacity market, accounting for revenues from other wholesale markets and other generally available sources. New resources that remain in the auction when the price drops below 0.8 * the relevant benchmark will be designated as OOM absent the receipt of cost data support from the project sponsor before the auction. ISO-NE states that the methodology for calculating the benchmark offers would be developed by the IMM, which will present its methodology and results to stakeholders.

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[83] ISO-NE contends that if these rules were in place during the first three FCAs, "resources that did not properly support their offers below 0.75 [*] CONE may have been motivated to provide additional data to support their offers and thereby may have not been considered OOM in the first instance." Joint Filing, Transmittal Letter at 16 n.80 (citing Ethier Test. at 19).

[84] Joint Filing, Transmittal Letter at 23 (citing *N.Y. Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,211, at P 100-101, 118-119 (2008)).

102. ISO-NE states that the use of resource-type specific benchmarks provides two benefits over the use of CONE. First, ISO-NE contends that the use of a single CONE value for all resource types is inefficient and results in the review of far more offers than is necessary; different resource types have different project costs and benefits. Second, because the revised APR mechanism requires offers that have been designated as OOM to be replaced with adjusted competitive offers, the resource-specific benchmark offers calculated by the IMM will provide the basis for these adjusted offers, streamlining the qualification and review process for OOM resources. By contrast, ISO-NE contends that CONE, which bears no relationship to the specific characteristics of each resource type, would not serve this purpose as well. ISO-NE states that, under the revised APR mechanism, CONE plays no role in the OOM determination, addressing a concern raised by the Commission in the April 23 Order.

103. ISO-NE states that the revised APR proposal will affect which new resource offers are reviewed but will not alter the standard of review applied to these offers or the definition of OOM itself. ISO-NE explains that for offers that are reviewed, the IMM shall determine whether the offer submitted is consistent with the long run average costs of the resource net of expected net revenues other than capacity revenues. Addressing the Commission's concerns from the April 23 Order that APR mitigation not restrict capacity introduced to satisfy legitimate public policy goals or bilateral contracting, ISO-NE states that the IMM observes that the determination of intent behind a specific offer is by definition subjective and unnecessary. According to ISO-NE, the IMM states that all OOM resources have the ability to depress the Capacity Clearing Price below competitive levels, and therefore all OOM resources should be included in the calculation of the Alternative Capacity Price.

Rejected De-List Bids

104. Unlike the Joint Filing proposal, ISO-NE states that the revised APR proposal does not include rejected de-list bids in the APR as OOM capacity. ISO-NE states that this change is made possible with the introduction of smaller capacity zones as part of its July 1 Proposal since these smaller zones will more likely reflect the transmission constraints that currently lead to de-list bids being rejected for reliability.

a. Comments and Responses

i. Supporting Comments and Responses

105. The EMM contends that the July 1 Proposal addresses the three concerns it raised upon reviewing the Joint Filing: (1) it is applied in *all* instances when OOM entry occurs or is carried forward; (2) it abandons the previous pricing structure of setting the FCA price at the lower of CONE or the lowest-offered non-cleared new resource; and (3) de-list bids rejected for reliability will no longer be treated as OOM capacity. The EMM states that the mechanism that the IMM employs to review owner-supplied costs will be

an important detail since it is conceivable that an economically rational participant may offer a short-run commitment below its long-run costs. As such, the EMM recommends that ISO-NE establish a threshold within which a participant may offer relative to its verified costs.

106. NEPGA states that ISO-NE's July 1 Proposal is the most "elegant" solution to reconcile the divergent requirements of the instant proceeding. First, NEPGA notes that the revised APR is properly triggered whenever OOM capacity is included in the auction. NEPGA argues that there is no alternative to this triggering condition unless the Commission wishes to allow OOM capacity to be used to manipulate capacity price. Second, NEPGA states that when the APR is triggered, two parallel auctions establish two prices – in the FCA auction, only seller-side mitigation is applied, while when the APR price is set, OOM offers are also subject to buyer-side mitigation. Thus, NEPGA states that under this methodology, all supplier prices are prevented from being uneconomically high and all OOM prices are prevented from being uneconomically low. Further, NEPGA states that as long as OOM capacity is allowed to clear in the FCM (unlike in NYISO and PJM Interconnection, L.L.C. (PJM)), these dual clearing prices cannot be avoided. NEPGA states that failing to protect existing in-market resources from artificial price suppression would "heavily discourage" any further competitive entry into the capacity market, while paying OOM resources the lower FCA price diminishes their incentives to distort capacity markets.

107. The Mass DPU states that ISO-NE's July 1 Proposal properly allows OOM capacity to clear the market and receive a capacity payment. As a result, the Mass DPU notes that this allows load to self-supply for environmental, resource adequacy, or other public policy goals and be supported by revenues from the FCM.

ii. Opposition to July 1 Proposal

General Issues With Two-Tiered Pricing

108. Numerous state and load parties contend that ISO-NE's revised APR proposal is unjust and unreasonable and support the detailed briefs and supporting testimony offered by JFS. In addition to arguing that no party (including ISO-NE) has met its section 206 burden of showing that the original Joint Filing was not just and reasonable, JFS also contends that ISO-NE's proposed two-tiered APR mechanism is not just and reasonable. In support of this position, the JFS makes several arguments: (1) the proposed triggering conditions are overly broad; (2) the proposal to use benchmark pricing is unjust and unreasonable; (3) the proposal would create an administrative (rather than market-based) mechanism to set prices; (4) the procurement of more capacity than needed to meet the ICR is unjust and unreasonable; and (5) paying existing capacity the APR price for

twenty years while paying new capacity the lower clearing price for five years is unjust and unreasonable.[85]

Triggering Conditions

109. First, JFS states that the APR triggering conditions under ISO-NE's revised APR proposal are unjustly and unreasonably broad. JFS contends that, in contrast to Commission guidance from the April 23 Order, the revised APR proposal fails to differentiate between OOM that is offered in the FCA to influence the market-clearing price anti-competitively and other OOM resources that are offered in the FCA for legitimate reasons. Instead, JFS notes that ISO-NE inappropriately categorizes every new resource that would remain in the auction at rates below those needed to cover its estimated net long-run average costs as OOM that must be mitigated. JFS argues that retention of the current "overly broad" definition of OOM along with this revised triggering mechanism will result in the APR being invoked routinely, even for legitimate state programs seeking to encourage public policy objectives.

110. JFS argues that the Commission has previously approved rules exempting from mitigation certain types of OOM investments that are not intended to be used as market power tools. For example, JFS notes that the Commission agreed that it may be appropriate to exempt from minimum offer price requirements those new resources that "further specific legitimate [state] policy goals, such as renewable portfolio standards."[86] JFS further argues that the Commission's acknowledgement that a state's jurisdiction provides it with the ability to favor particular generation technologies[87] allows states (by analogy) to provide direct payments to preferred technologies without finding these resources to be OOM. The Maine PUC contends that ISO-NE's revised APR proposal specifically rejects any bright-line test to assess capacity that should trigger APR mitigation since the IMM believes that intent is subjective. As a result, it argues that

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[85] JFS states that to the extent that NEPGA and Boston Gen adopt ISO-NE's revised APR proposal, their proposals are unjust and unreasonable for the same reasons.

[86] JFS Second Brief at 26 (citing *NYISO I*, 124 FERC ¶ 61,301 at P 38).

[87] *Id.* at 27 (citing *S. Cal. Edison Co.*, 70 FERC ¶ 61,215, at 61,676 (1995), *order on reconsideration*, 71 FERC ¶ 61,269, at 62,080 (1995); *see Consol. Edison Co. of N.Y. v. Pub. Serv. Comm'n of State of N.Y.*, 472 N.E.2d 981 (N.Y. Ct. App. 1984), *appeal dismissed*, 470 U.S. 1075 (1985) (state cannot set a purchase price for Qualified Facility power above the purchasing utility's avoided cost); *Midwest Power Sys., Inc.*, 78 FERC ¶ 61,067, at 61,246-48 (1997) (same); *Cal. Pub. Utils. Comm'n*, 132 FERC ¶ 61,047, at P 64-66 (2010) (same)).

renewable capacity procured by a state to fulfill its Renewable Portfolio Standard (RPS) will likely trigger APR every year.

111. JFS argues that with its revised triggering conditions, ISO-NE's two-tiered APR proposal "overreaches." Specifically, JFS contends that there may be a justifiable reason why a supplier might offer a new resource into the FCA at a low price, including to ensure that a nearly completed unit will receive a capacity payment. Further, JFS argues that the July 1 Proposal would unjustly and unreasonably treat as OOM all resources that receive any revenue from the New England states or capacity buyers and would substitute the IMM's determination of a "benchmark" price. JFS notes that this refusal to examine the "intent" behind an OOM offer will result in the APR triggering every year, despite evidence from the first three FCAs that resources will participate in the FCM at clearing prices that include OOM capacity.

112. Last, JFS argues that the revised triggering conditions present two incentives for offering a relatively small amount of new capacity at a low price in order to trigger the APR. First, JFS argues that by triggering the APR with a new capacity offer designated as OOM, suppliers' other existing portfolio of resources will receive the higher Alternative Capacity Price instead of the new Capacity Clearing Price. Thus, JFS states that such a supplier would offer its new capacity not on the basis of its costs but on the basis of how it can affect the APR price for the suppliers' existing resources. Second, JFS argues that a supplier with a portfolio of existing resources will be able to discourage new capacity resources from independent suppliers by offering its new capacity at a low price in the FCA so that other new capacity offers do not clear.

113. NEPGA states that any argument that suggests a revised APR will interfere with a state's right to advance a particular policy is a "red herring." Instead, NEPGA notes that the only effect of any APR is on the price of capacity, and the price of capacity is a matter undisputedly within the Commission's exclusive jurisdiction.[88] Further, NEPGA argues that because the IMM only looks at subsidies that are not widely available across New England when considering whether an offer is OOM, the New England region and/or the Federal Government would still be able to subsidize preferred types of capacity resources without running any risk of triggering any APR or other OOM mitigation. In addition, NEPGA contends that arguments that seek to retain the "balance" established in the FCM Settlement Agreement[89] (where APR revisions would be balanced by changes in load's favor elsewhere in the FCM) are "nonsensical."

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[88] NEPGA Second Brief at 22. In support, NEPGA cites *Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009) (CT DPUC).

[89] The parties' settlement leading to the implementation of the FCM was accepted in FCM Settlement Order, 115 FERC ¶ 61,340.

NEPGA states that the historical APR was "too full of loopholes to work" and, therefore, a restoration of balance first requires an effective APR.

114. NEPGA states that any proposed APR exemptions for state-supported resources have no basis in law or economics. In support, NEPGA argues that the states are not neutral arbiters but instead represent interests on the buyer side of the capacity market and NEPGA contends that it is "unaware of the Commission ever having granted such an extraordinary privilege to an interested party."[90] On a legal basis, NEPGA argues that this exemption is analogous to the states' argument in an earlier proceeding that the FPA grants them the authority to set an FCM parameter affecting capacity prices – ICR. NEPGA states that this prior argument was "resoundingly rejected."[91] NEPGA argues that the states do not have the authority to override Commission decisions setting wholesale capacity prices since wholesale capacity prices are "undisputedly" within the Commission's exclusive jurisdiction. Rather, NEPGA contends that in the New England capacity markets, state or load-sponsored actions to seek short-term gains pose the greatest threats to competitive markets since in the long-run, investors will be discouraged from investing. NEPGA witness Kalt further contends that it is not a defense to point out that states exercise market power on behalf of buyers rather than sellers since seller market power equally distorts the relationship between prices and costs.

115. ISO-NE states that JFS witness Wilson's argument that the APR should only be applied to resources that are being used to inappropriately suppress prices demonstrates a misunderstanding of the objective of the APR. ISO-NE states that the objective of the APR is to establish the price that would have prevailed if the OOM resources had submitted offers based on their full cost of entry and not based on OOM revenues that other resources do not receive. ISO-NE states that the objective of the APR is not as Wilson contends, i.e., to remedy a situation where there is an exercise of buyer market power. ISO-NE argues that the intent issue is irrelevant since prices are suppressed regardless of the intent behind the offer. ISO-NE notes that while the states can subsidize anything they like, that fact is not relevant to the Commission's statutory responsibility to keep wholesale markets reliable with just and reasonable rates. Further, ISO-NE notes

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[90] NEPGA Second Brief at 21.

[91] NEPGA cites *ISO New England Inc.*, 111 FERC ¶ 61,185, *order on reh'g and clarification*, 112 FERC ¶ 61,254 (2005), *petition for review granted*, CT DPUC, 484 F.3d 558 (D.C. Cir. 2007), *order on remand*, *ISO New England Inc.*, 122 FERC ¶ 61,144, *reh'g denied*, 123 FERC ¶ 61,036 (2008), *petition for review denied*, CT DPUC, 569 F.3d 477 (D.C. Cir. 2009).

that neither the Commission nor ISO-NE is able to arbitrate between a legitimate and an illegitimate program.

116. The IMM states that the inclusion of the word "inappropriately" in the description from the April 23 Order[92] of potential bright-line tests to distinguish OOM capacity that should trigger mitigation, from capacity that should not trigger mitigation, raises the issue of whether some price suppression is appropriate. The IMM states that as a result of this language, some parties (like JFS) have advocated that in order to determine that an offer is OOM, the IMM must find that the offer was submitted with the *intention* of suppressing price. Addressing this position, the IMM argues that the Commission should not alter the current definition of an OOM offer to include an element of intent since intent is not directly observable and without plain documentation of intent, it becomes a matter of subjective interpretation.

117. NEPGA and Boston Gen agree with the IMM, arguing that the Commission should reject proposals to exempt OOM offers from mitigation absent evidence of intent to suppress prices. In support, NEPGA argues the following: (1) the Commission recently rejected such a requirement in a NYISO capacity market case;[93] (2) the intent requirement would be extremely burdensome to implement on a case-by-case basis; (3) it is unnecessary as in many cases the sponsors of OOM resources have publicly professed their desire to artificially suppress capacity prices; and (4) to the extent that the sponsors of OOM resources truly do not intend to artificially suppress prices, they should have no objection to the appropriate correction of such price suppression effects. Further, Boston Gen notes that the buyer-side mitigation rules in PJM and NYISO use bright-line tests, which define uneconomic entry in terms of offers that are below some minimum fraction of actual or assumed costs. Boston Gen contends that the advantage of such quantitative measures is that they allow for objective application and Commission review.

118. NEPGA states that the Commission's findings in *NYISO I*[94] disprove the idea that an intent test could ever be a "simple bright-line test" as portrayed by the load parties.[95] NEPGA witness Kalt contends that all OOM resources artificially suppress prices regardless of intent and should thus be mitigated. However, Kalt argues that states should be free to pursue whatever social benefits they desire but should not benefit from

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[92] April 23 Order, 131 FERC ¶ 61,065 at P 77.

[93] *NYISO I*, 124 FERC ¶ 61,301.

[94] *Id.*

[95] NEPGA cites *NYISO I*, 124 FERC ¶ 61,301 at P 28.

non-social benefits, i.e., having incumbent capacity sellers pay for these investments via monopsonistic price suppression in capacity markets. Kalt contends that these latter "benefits" are not net social benefits but simply transfers from one private interest (capacity sellers) to another (capacity buyers). Addressing whether a bright-line test should be implemented to assess intent, the Mass DPU states that such a test "would be very difficult to implement and to enforce" and the approach "would invite gaming and litigation."

119. Addressing NEPGA's critique of state policies that subsidize certain resources during a time of excess supply, JFS contends that building a temporary oversupply is not "wasteful" but properly places greater net social value on resources that further public policy goals. Further, JFS states that any premium that may be paid for renewable resources represents the social value that these resources provide above the revenues available from ISO-NE's electricity markets. In addition, JFS states that promoting demand response, even paying more for demand response resources in order to avoid buying capacity, makes sense in the context of a public policy initiative to reduce dependence on fossil fuels.

Benchmark Pricing

120. Addressing benchmark pricing, JFS contends that the two-tiered pricing proposal relies on a benchmark pricing proposal that has no "defensible" objectivity standard. JFS argues that this flaw is magnified due to the fact that the IMM's benchmark bids will replace OOM offers not only in the first FCA in which the OOM resource clears but in every subsequent FCA in which that OOM resource is carried forward. JFS contends that not only does this allow for a potentially incorrect initial offer, but it also fails to recognize that, after entry a resource's entry costs are sunk, it would rationally offer as a price-taker at its going-forward costs. Thus, JFS states that ISO-NE's approach would materially distort the APR Price in those subsequent FCAs because it will reflect an offer as if the OOM resource were a new resource every year in which it is carried forward.

121. JFS argues that such a proposal will have an additional negative and perverse impact since existing obsolete and polluting units will receive no price signal to retire – they will continue to receive the higher APR price so long as the OOM capacity carries forward. The Maine PUC states that, ironically, higher capacity payments due to the presence of state-subsidized OOM capacity under the two-tiered pricing mechanism will go to the resources that these state programs seek to displace. JFS contends that ISO-NE has not provided an adequate basis for its proposed increased administrative role in OOM determinations. The Mass DPU contends that the benchmark methodology would benefit by stakeholder review as there are many questions to consider and requests that the Commission require such a review.

122. Last, JFS argues that ISO-NE's proposal would not produce an administrative price that reflects "the best approximation of the price that would have prevailed but for

the presence of the OOM resources in the FCA." Rather, JFS states that new resources that did not clear in the FCA will not receive a Capacity Supply Obligation and will not become a capacity resource even if they submit offers below the APR price. As such, JFS states that these resources will be unavailable as existing resources in existing FCAs, inflating the APR price in all subsequent auctions.

123. NEPGA questions the load parties' "newfound skepticism" concerning the IMM's ability to accurately estimate costs since it is the IMM who estimates costs for the purpose of seller-side mitigation.

124. BG Entities states that it supports ISO-NE's proposed use of resource-specific benchmark pricing to assess whether capacity is OOM. However, because BG Entities alleges that the methodology for determining the benchmarks will be a critical input to the Capacity Clearing Price, it constitutes a "practice affecting rates" that must be filed with the Commission under section 205.[96] BG Entities alleges that that filing should identify the technologies that will serve as reference technologies for the key cost elements and assumptions, how they will be determined, and the procedures by which they will be updated.

125. Addressing the criticisms of benchmark pricing, ISO-NE states that it does not maintain that benchmark pricing is an ideal approach. Instead, ISO-NE contends that it is part of the market design that is required to solve the pricing problem that is introduced by permitting OOM capacity to clear in the FCA and provide capacity. ISO-NE agrees with JFS witness Wilson that it cannot exactly reproduce the "but for" price in the absence of OOM resources. However, ISO-NE states that that fact does not provide a basis for failing to implement its revised APR. Further, ISO-NE highlights the irony in Wilson's contending that it is futile for the IMM to attempt to determine what capacity prices would have been in the absence of OOM, yet having no discomfort when it comes to the IMM making similarly complex assumptions and determinations in its examination and mitigation of supplier market power. ISO-NE, as well as the IMM, state that the methodology for calculating the benchmark offers will be developed by the IMM in consultation with stakeholders, and the resulting values will be reviewed in the stakeholder process and included in the Tariff through a filing with the Commission, providing appropriate transparency.

126. In response to arguments alleging that resource-specific benchmarks are not representative of competitive prices, the IMM states that it agrees with ISO-NE that the use of these benchmarks is a "second-best approach" that is necessary if OOM offers submitted by new resources are permitted to clear in the FCA. Addressing the general

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[96] BG Entities cites CT DPUC, 569 F.3d 477 (D.C. Cir. 2009).

use of resource-specific benchmark costs to identify and address market power issues, the IMM notes that the Commission previously has approved their use in forward capacity markets.[97] Further, the IMM argues that the Commission's orders on PJM's Reliability Pricing Model (RPM) are clear that PJM's market monitor has the authority to replace non-compliant offers with mitigated bids based on the benchmark offers and that these mitigated bids could establish the marginal unit. The IMM argues that ISO-NE's July 1 Proposal using benchmarks is consistent with this precedent.

127. Addressing the argument that the use of 80 percent of the benchmark value to determine whether an offer is OOM has no rational justification, the IMM states that the purpose of the 80 percent figure is to allow for some estimation error and to allow a resource with some flexibility to offer based on its own business plan, cost structure, and technology.

128. As noted earlier, the IMM states that the use of resource-type specific benchmarks provides significant benefits over the current use of CONE since the use of a single CONE value for all resource types for the purpose of determining whether a resource is OOM is inefficient because different resource types have different project cost, revenue and risk profiles. Further, the IMM states that the development of benchmark offers in advance of the FCA will allow resource owners to know ahead of time whether a resource will be considered in or out of market at a given FCA price, increasing transparency and reducing the overall administrative burden.

129. The IMM responds to arguments that benchmark estimates would be subject to substantial error and may not appropriately deal with demand resources. In response, the IMM states that it recognizes that demand resources are more varied than generation technology and it is more probable that there will be various demand resource benchmark values grouped along several defining dimensions. As a result, the IMM states that it will develop estimates of competitive offers for demand resource types (both passive and active) by end user (industrial, commercial, and residential) by end use (e.g. heating, cooling, lighting, process controls), and by load reduction strategy. The IMM states that for both generation and demand resources, the project details, expected future cash flows, and financing terms and conditions will be inputs into a capital budgeting model to determine the break-even contribution required from the capacity market to yield a net

[97] In support, the IMM cites *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331, at P 34 (regarding buyer market power) and P 33 (regarding seller market power) (2006).

present value of zero for the project, with the benchmark offer set to equal the year one capacity price derived from the model.[98]

130. Addressing a related point, the IMM states that under the existing rules, the minimum in-market offer price is calculated as the year-one value from a set of levelized break-even capacity prices for the project based on total project costs and revenues over the life of the project. Thus, the current methodology incorporates all costs in determining long-run average net levelized costs, rather than including only those costs that can be categorized as incremental costs at the time the decision is made to enter the capacity market. The IMM states that the assumption underlying the use of total project costs as opposed to incremental costs was that: (i) most project costs would be incurred in the 40 months between the FCA and the start of the Capacity Commitment Period; and (ii) receiving sufficient payment in the capacity market was necessary for a project to go forward.

131. By contrast, the IMM notes that witness Wilson testified on behalf of JFS that the appropriate costs to use in making a decision on whether to complete a project are the incremental costs to complete the project and that a competitive offer should therefore not be based on the total project costs. The IMM states that based on the Wilson testimony and the proposed change from reviewing all projects individually to a benchmark offer approach, the total project costs standards should be modified. As a result, the IMM states that benchmark offers should be based on the incremental cash flows to a project – i.e., the cash flows that can be avoided if the resource does not take on a Capacity Supply Obligation.[99]

132. In support of Wilson's approach, the IMM states that the relevant cash flows are those that can be avoided if the resource does not take on a Capacity Supply Obligation. Clarifying an example offered by NEPGA witness Shanker concerning an "existing" generating resource that has been built and is in operation but that has not previously

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[98] The IMM states that these revenues will include all revenues that are tradeable and or available broadly to any investor in a given resource type

[99] For example, the IMM notes that the benchmark offers for combined cycles and gas turbines should be calculated based on all costs except site acquisition and pre-development costs. By comparison, the IMM states that given the short lead times of most demand resources, all demand resource costs will be considered incremental for purposes of calculating benchmark offers. The IMM does not plan to calculate benchmark offers for large base-load facilities since long-lead time plants will have incurred most of their costs (and therefore they are sunk) before the decision to participate in a particular FCA is made.

participated in the FCM, the IMM states that in that circumstance, the IMM would evaluate whether the offer is OOM based on the benchmark offer for a resource of the same type, not on its going forward costs.

133. NEPGA argues two points concerning the economic cost of a resource. First, it argues against JFS' position that the OOM benchmark price should be determined solely on the basis of going-forward cost after discounting all state subsidies. NEPGA contends that this would "eviscerate" the APR. In support, NEPGA states that such a rule would permit states to escape OOM mitigation since no resource would ever be found to be OOM. Second, NEPGA contends that the appropriate benchmark for OOM revenue should be full economic cost, rather than merely the lower going-forward cost. Shanker agrees with Wilson that an existing resource may offer at its net going forward costs but states that Wilson's proposal ignores the ultimate issue that the facility was uneconomic when it was built in the first place. Shanker contends that once a new unit is built, its going-forward costs provide no useful information about whether a new resource should be classified as OOM. Instead, Shanker argues that the correct measurement of costs in the context of entry decision-making is the long-run levelized average cost of new entry. Shanker states that one cannot ignore the implications of uneconomic entry by noting that, after it occurs, an associated bid that is low is "rational" since at that point, "the harm is already done."

Administrative Mechanism versus Competitive Market

134. Citing to the FCM Settlement Order, JFS argues that the "primary purpose" of the APR is not to correct FCA prices for the presence of OOM resources as ISO-NE claims, but to remove the incentive for load to self-supply their own capacity for the purpose of depressing capacity prices.[100] JFS contends that because ISO-NE's proposed triggering provisions make no effort to limit the APR's application to those resources that intend to suppress FCA prices, ISO-NE's proposal will unjustly and unreasonably transform the APR from its original intent. JFS contends that providing the IMM with the discretion to adjust OOM offers contradicts Commission precedent preventing IMM discretion in making such decisions.[101]

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[100] FCM Settlement Order, 115 FERC ¶ at 61,340 at P 109.

[101] In support, JFS cites to its first brief at 37 & n.120 (citing 18 C.F.R. § 35.34(k)(6) (2009) (providing for "objective monitoring of [the] markets [an RTO] operates and administers")); *Marketing Monitoring Units in Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,267, at P 5 (2005) (declaring that "ISO/RTOs may administer compliance with tariff provisions only if they are expressly set forth in the tariff" and "involve objectively identifiable behavior"); *PJM*

(continued…)

135. In addition, JFS states that the IMM will have great difficulty providing a reliable estimate of a resource type's long-run levelized cost and its forecasted wholesale market revenues since such an analysis relies on myriad assumptions that are highly subjective. JFS contends that this analysis is made more difficult by demand response resources, that are each unique by definition, requiring many "tailored" benchmarks. EMCOS contends that the proposed use of benchmark pricing "undermines any prospect of market pricing for capacity."[102]

Purchases of Capacity in Excess of the ICR

136. JFS contends that ISO-NE's proposal would overturn a "bedrock" principle of the FCM whereby ISO-NE would purchase only the amount of the ICR during the auction. JFS argues that under ISO-NE's proposal, due to the likely presence of OOM each year, there will likely be "in-between" resources that will cause the collective Capacity Supply Obligation of resources in a zone to exceed the ICR or Local Sourcing Requirement (LSR), whichever applies. JFS states that the "excess capacity" that will be purchased above the ICR or LSR could be substantial, with no material benefit for capacity purchasers. JFS states that this outcome provides market participants with an incentive to manipulate their offers in order to trigger the APR, resulting in capacity payments to more megawatts of existing resources than needed for reliability. JFS states that ISO-NE should prorate the capacity that would receive the Alternative Capacity Price such that load (consistent with the first four auctions) pays no more than the amount of existing capacity required to meet the ICR multiplied by the Alternative Capacity Price. The Mass DPU argues that ISO-NE should consider mechanisms that would avoid the purchase of more capacity than necessary to meet the ICR, including that the "in-between" resources would not be allowed to clear or that the ICR methodology could be revised to take this additional capacity into account.

137. ISO-NE notes that load fails to acknowledge the tradeoffs associated with the positions that they advocate. Specifically, ISO-NE states that if OOM capacity is allowed to clear in the FCA, then one of two consequences must follow: either load is

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Interconnection, L.L.C., 119 FERC ¶ 61,318, at P 180 (2007) (finding that "[b]ecause this discretion [with regard to the Minimum Offer Price Rule (PJM's equivalent of the APR), mitigation rules, and data submission] would allow the Market Monitor to use its sole judgment to determine inputs that can ultimately set the market clearing price, we reaffirm our determination that such discretion is not appropriate" and "[i]nstead of relying on the Market Monitor's discretion, objective criteria should be developed for use in such instances so that predictable results will emerge.").

[102] EMCOS Second Brief at 10.

harmed by exposure to costs associated with purchases above ICR, or existing resources are harmed by depressed clearing prices and in some cases by not clearing at all due to the presence of the OOM capacity. ISO-NE states that since it is clear that load wishes for OOM capacity to clear in the FCA, then the remaining choice is whether to: (i) hold existing resources harmless for the presence of the OOM capacity by procuring capacity in excess of ICR or (ii) hold load harmless by procuring no capacity in excess of ICR, lowering the clearing price paid to existing resources and displacing some existing resources entirely. ISO-NE states that it is implicit in load's arguments (which seek to both allow OOM capacity to clear and limit the total capacity purchased to ICR) that existing resources should be required to bear the costs of allowing OOM capacity to clear in the FCM. ISO-NE counters that load has offered no justification for such an outcome, and ISO-NE believes that it would be the wrong design decision because it would undermine the effectiveness of the FCM.

138. ISO-NE argues that there are several reasons why the associated costs should be allocated to load if OOM capacity is to be permitted to clear in the FCA. First, ISO-NE states that load is "directly responsible" for the presence of OOM capacity, and therefore it is appropriate for load to bear the costs associated with having OOM capacity in the FCM, as this may provide some incentive to minimize its use. Second, ISO-NE states that sound market design requires holding existing resources harmless for the presence of OOM capacity in the FCM since they formulated their entry prices without being able to foresee the price suppressing effect of OOM capacity. ISO-NE notes that this is consistent with Commission guidance from the April 23 Order where the Commission stated its concern that the existing APR failed to fully adjust for the effect of OOM capacity on the clearing price. In addition, ISO-NE states that, as detailed previously, the two-tiered pricing element of its July 1 Proposal would provide the correct incentives to minimize the amount of capacity in excess of ICR that is procured. Last, ISO-NE argues that any purchases in excess of the ICR result in increased reliability.

139. ISO-NE argues that, for the same reasons that the costs of allowing OOM capacity to participate in the FCA should be allocated to load, the load parties' call to continue pro-rationing should also be rejected. ISO-NE states that pro-rationing imposes on existing resources the costs of allowing OOM resources to clear in the capacity market and undermines investment incentives by reducing prices below competitive levels.[103]

[103] By reducing the payment to each resource so that load is able to purchase all resources needed to meet ICR as well as any excess quantity above the ICR for the same total cost it would have paid had it paid the full clearing price just to resources needed to meet the ICR.

140. Addressing JFS witness Wilson's argument that the revised APR rule creates incentives for manipulation, ISO-NE and the IMM contend that Wilson's examples are not realistic and mistakenly assume that the manipulator knows (or can estimate with a high degree of certainty) the supply curve in the FCA and the supply curve that sets the Alternative Capacity Price. ISO-NE states that such an assumption is false due to the substantial amount of information that would be required to construct these curves accurately, including the offers of new resources, dynamic de-list bids, and the amount of new OOM capacity (which will not be known until after the FCA), in addition to the flawed assumption that bidders from prior FCAs will continue their previous bidding behavior and that the manipulator is the only bidder that has all of this information.[104]

141. Last, the IMM recommends reviewing the current practice of disclosing each qualified resource (including megawatts and its resource type) in the current informational filing that precedes the auction.

Undue Discrimination

142. JFS and the Mass DPU argue that the two-tiered capacity payment system would discriminatorily pay existing generation higher capacity payments than new generation without any justification. JFS notes to the extent that there should be differing capacity payments for new and existing resources, prices should be higher for new capacity rather than existing capacity, since a potential resource, unlike an existing resource, has few sunk costs. JFS argues that ISO-NE's proposal would inappropriately pay new resources less than existing resources, even if new capacity investment is needed for reliability. JFS maintains that this scenario will occur annually since the APR price will likely trigger each year under ISO-NE's revised triggering conditions.

143. National Grid contends that paying the "lower" Capacity Clearing Price (rather than the Alternative Capacity Price) to new resources under state legislative mandate or to resources that have a cost of entry equal to zero would be "improper" and would not address surplus capacity clearing in the FCA. National Grid argues that "reduced pricing" for these two groups would not influence entry and is, therefore, unduly discriminatory by default. National Grid argues that Commission precedent prohibits this

[104] ISO-NE and the IMM also state that Wilson makes a flawed assumption when posturing that a manipulator might develop a higher-cost new resource rather than a more efficient new resource on the basis of a slight increase in the profit for that one FCA for that one year, reducing profits in the energy market and future FCAs. ISO-NE argues that such logic ignores the fact that many of the resources in the FCA are long-lived assets and their bidding is not limited to the profits of the FCA in any given year.

discriminatory treatment of similar resources.[105] As a modification to ISO-NE's two-tiered proposal, National Grid proposes that if a new resource is (1) either being built under state mandate or regulatory order or is a resource with a true cost of entry of zero and (2) the resource commits to offer its capacity into the FCM as a price-taker, then that resource should be eligible for the Alternative Capacity Price. National Grid states that under its proposal, price adjustments for existing resources will remain unchanged.

144. Addressing ISO-NE's proposal to limit compensation for new resources to the lower FCA clearing price for a five-year period, JFS contends that this would eliminate an important feature of the FCM that allows new resources to choose whether to receive the FCA clearing price in their first year of selection for only one year or up to five years. JFS states that ISO-NE's proposal may reduce competition by discouraging new resources' participation when they anticipate a low FCA clearing price that would lock them into that price for five years. Further, JFS argues that ISO-NE's rationale for making this change – to prevent resources from seeking to enter based on the probability of receiving the higher Alternative Capacity Price – is unreasonable, and the five year duration is arbitrary.

145. By comparison, JFS argues that existing resources will be "overcompensated" under the two-tiered pricing mechanism, creating inefficiency. JFS argues that it is "equally true" that existing resources that clear at the lower clearing price have indicated that this is a price that they are willing to accept. As such, JFS contends that any higher price, i.e., the APR price, will overcompensate those resources. Further, JFS contends that contrary to ISO-NE's justification for this treatment, existing generation resources only need to receive their going-forward costs (at the lower FCM clearing price) to remain a capacity resource. JFS alleges that paying these existing resources "above-market" prices will only produce excess capacity.

146. JFS states that it is also unjust and unreasonable to give all existing resources the APR price for 20 years after they first participated in the FCA. In support, JFS argues that if the Commission were to approve these changes, only capacity resources with commercial operating dates beginning in 2014-2015 (only after these resources could argue that a reliance interest exists) should be eligible for the APR price. The Mass DPU argues that ISO-NE has not provided sufficient rationale for 20 years rather than another period, nor for when the 20 years would start.

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[105] In support, National Grid references *Cal. Indep. Sys. Operator Corp.*, 112 FERC ¶ 61,013, at P 73 (2005).

147. NEPGA witness Stoddard contends that the 20-year sunset provision[106] is unjust and unreasonable, arguing that there should be no sunset provision and the APR price should remain the default price in the market. In support, Stoddard argues that ISO-NE implicitly acknowledges that the Capacity Clearing Price represents "special case" pricing. As a result, Stoddard argues that it is inefficient to drive older yet viable resources out of the market, only to replace them with expensive new resources. Further, Stoddard warns of a future "time bomb" when the 20-year mark approaches and all of the resources that clear in the first FCA will be sunsetted out of the APR 20 years downstream. Stoddard warns that these resources may represent a substantial amount of the existing resources in the auction, and, therefore, load will be able to profitably suppress the capacity prices without being exposed to the Alternative Capacity Price for these resources.

148. ISO-NE addresses National Grid's argument that the proposed two-tiered pricing structure inappropriately "reduces" payments to new resources that may be fulfilling important state policies, i.e. for whom the entry decision has already been made and for whom price signals, therefore, are irrelevant. In response, ISO-NE contends that National Grid demonstrates a "fundamental misunderstanding of the APR" when it states that, to avoid being discriminatory and inefficient, the two-tiered pricing mechanism must reduce payments only where necessary, since the proposed APR does not in any case reduce payments. Rather, ISO-NE notes that the APR will increase prices when OOM clears to reflect the price that would have prevailed if OOM entry had bid competitively. Thus, ISO-NE contends that National Grid must demonstrate that there is something to be gained, from a design perspective, by increasing payments to this subset of new resources who will contribute to further unnecessary oversupply and that are already committed to entry.

149. Addressing undue discrimination arguments raised by load parties, ISO-NE contends that new resources are not similarly situated to existing resources since existing resources have sunk investment costs that cannot be reversed. Further, ISO-NE argues that the Commission should resist simplistic charges of discriminatory pricing and focus instead on whether the design will achieve efficient outcomes given the constraints that are imposed. ISO-NE notes that any new investment should occur under the expectation of receiving a capacity price that accurately reflects the actual capacity situation in New England – the unadjusted Capacity Clearing Price. ISO-NE states that National Grid's proposal has no merit and appears to be an effort to obtain the higher price for new

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[106] The sunset provision provides that existing resources will be eligible to receive the Alternative Capacity Price for 20 years starting with the first commitment year in which the resource cleared the FCA.

resources that National Grid has already committed to acquire under contract or may prospectively procure.

150. Addressing Stoddard's argument that the sunset provision should not trigger and the Alternative Capacity Price should remain the default price in the market, ISO-NE states that fundamental in the ISO's July 1 Proposal is the assumption that decisions at the margin should face the appropriate price signals at the margin. Thus, ISO-NE argues that with respect to a new unit not yet committed or an older unit that may be facing a retirement or mothball decision, the appropriate price signal at the margin is the Capacity Clearing Price, not the Alternative Capacity Price. ISO-NE argues that Stoddard's argument that it is inefficient to drive existing resources out of the market by replacing them with expensive new resources fails to recognize that new resources (for the first five years) and existing resources that first cleared in an FCA over 20 years ago will both face the same price, the Capacity Clearing Price. ISO-NE also responds to Stoddard's 20-year "time bomb" argument by noting that the intent of this mechanism is to ensure that the market produces a just and reasonable result and does not discriminate against existing capacity – it is not in place solely to reduce the incentive to lower market prices through uneconomic entry. Further, ISO-NE contends that the proposal properly balances market objectives, and Stoddard has no quantitative analysis to support his allegation.

Carry-Forward Period for OOM Resources

151. The Mass DPU notes that, because the July 1 Proposal would carry forward OOM resources into future FCAs until offset by load growth and retirements, doing so could result in OOM resources being carried forward for "tens of years." By contrast, the Mass DPU notes that in the Joint Filing, the Filing Parties agreed on a six-year carry-forward period. The Mass DPU states that while it agrees that some carry-forward period is reasonable, there should be a limit to the carry-forward provision. JFS argues that ISO-NE's proposal is flawed since it would continue to use the IMM's estimated benchmark value to set the APR Price until this carry-forward capacity has been absorbed through load growth or retirement, despite the fact that the OOM resource itself would only receive the lower new capacity price for five years and only after that point be treated as any other existing resource.

2. Alternative Proposals

JFS Proposal

152. As noted previously, JFS states that it supports the Joint Filing as a unified package of modifications to the FCM. However, JFS states that if the Commission finds that the Joint Filing's revised APR provisions are nonetheless unjust and unreasonable and chooses to expand their applicability, it must do so in such a way that there remains a properly limited role for the APR. Reiterating the intent argument, JFS contends that the APR should not trigger when OOM does not have a price-suppression purpose. JFS

states that in order to make this distinction, the Commission should require a bright-line test to differentiate between offers from resources that seek to distort the FCA clearing price and should be mitigated and offers from resources that are either owned by those with no incentive to suppress prices or are implementing legitimate state policy initiatives and should not be mitigated.

153. JFS proposes three criteria for determining when resources with offers below a specified threshold should be mitigated and should trigger the APR: (1) to prevent manipulation, no resource's offers should be mitigated if the resource is not owned by or contracted to a net capacity buyer or an agency of a state government; (2) unless the IMM finds evidence of an intention to suppress the FCA clearing price, it should presume that resources procured or subsidized pursuant to a state program specifically authorizing or requiring the program were intended to further legitimate state policies and should not be mitigated; or (3) if the offering price in the FCA is at or above the resource's net going-forward or opportunity costs associated with accepting a Capacity Supply Obligation after crediting any revenues received pursuant to a state program specifically authorizing or requiring the program that were intended to further legitimate state policies, it should not be mitigated. JFS contends that if a resource satisfies *any* of these three tests, regardless of whether it has been found to be OOM, it should not be mitigated.

154. JFS similarly argues that if the Commission determines that parts of the Joint Filing Proposal's APR price adjustment mechanism are unjust or unreasonable, it should reject any alternative proposal that is not based on competitive offers in the FCA. As such, JFS argues that it would be unjust and unreasonable to set the APR price using an estimated "benchmark" price for each type of resource since such an estimate would be "subject to substantial error." Moreover, JFS contends that the IMM could not reliably estimate the "idiosyncratic costs" for demand response resources, which will vary tremendously. Finally, JFS contends that any mechanism that relies on the IMM's judgment to determine compliance with a benchmark cost would be inconsistent with the Commission-specified role for the market monitor, which does not permit the market monitor to exercise such discretion.

<u>EMCOS Proposal</u>

155. EMCOS states that to the extent that the Commission determines it should simplify the "complicated" three-rule APR regime established by ISO-NE in its Joint Filing, EMCOS would offer two elements for a replacement APR. First, EMCOS states that the Commission should assess the facts, including the relevant geographic market, the level of buyer-side market concentration, and other factors for any conclusion that a resource has the ability and the incentive to suppress market clearing prices. Second, as discussed elsewhere in this order, EMCOS contends that no mitigation (in the form of an APR) should be applied to any self-supplied FCA resource.

a. Commission Determination

156. The generator parties generally support ISO-NE's revised two-tiered pricing proposal, while noting that it mistakenly fails to consider the effects of historical OOM capacity on future FCM pricing. By contrast, the load parties generally argue that no significant revisions are necessary to any aspect of the FCM as it stands today, yet if any changes are to be made, they should be the changes that were proposed in the Joint Filing which were vetted through the stakeholder process. ISO-NE states that this proceeding largely focuses on the issue of market power because "each side believes that it is fully justified in exercising market power to affect prices, but loudly decries the ability of the opposing side to exercise such market power."[107] In the context of the APR discussion, the market power issue focuses on the allegations by the generator parties that load parties have employed their buyer-market power (due to an ineffective APR rule) to suppress FCM prices in the auctions held to date and that this current surplus and any future OOM capacity will result in lower capacity prices for many years going forward. Our discussion here will only address potential revisions to the current APR rule to address OOM capacity on a prospective basis. The issue of how to treat historical OOM capacity is addressed later in the paper hearing section of this order.

157. As discussed earlier in this order, we find that the APR revisions from the Joint Filing are not just and reasonable. Therefore, pursuant to our obligation under section 206 of the FPA, the Commission must determine and put into place a just and reasonable alternative.[108] In exercising this obligation, we begin with ISO-NE's July 1 Proposal, as we find that the principles that underlie this approach, in particular, its use of benchmark pricing, form the basis for a just and reasonable buyer-side mitigation mechanism.

158. Entities with buyer-side market power can artificially lower the capacity price, sometimes substantially, by subsidizing new investment that is then offered into the market at prices below its full entry costs. The result is that new resources enter the market even though the market clearing price is lower than their true cost of entry. The

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[107] ISO-NE Third Brief at 3.

[108] *See* section 206(a), 16 USCS § 824e(a): "Whenever the Commission . . . shall find that any rate, charge, or classification . . . for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract . . . and shall fix the same by order."

cost of the subsidized new resource is higher than the market price, which on first impression would seem to be financially harmful to buyers. But buyers as a whole may benefit from the subsidized resource because the lower market price may reduce the total bill for acquiring existing capacity, and this bill reduction may outweigh the net cost of the new resource.

159. ISO-NE's July 1 Proposal would remove the financial incentive to exercise buyer market power because it would raise the price paid for existing capacity back to the level that would have occurred if the new OOM capacity had offered into the auction at a competitive price reflecting its cost of entry, that is, at its benchmark price. Under the July 1 proposal, anytime an OOM resource clears the auction, two clearing prices result. All new resources, whether OOM or in-market, that offer below the Capacity Clearing Price would receive the Capacity Clearing Price, which is based on parties' actual offers. On the other hand, ISO-NE also procures all existing resources that bid below the comparatively higher Alternative Capacity Price (and pays these resources the Alternative Capacity Price), which is arrived at through the use of benchmark pricing. This mechanism would reduce or remove the incentive for buyer-side entities to subsidize uneconomic entry. However, since ISO-NE procures all existing capacity that bid below the Alternative Capacity Price as well as all capacity that bids below the Capacity Clearing Price, the mechanism results in ISO-NE procuring capacity in excess of ICR.

160. As JFS points out, requiring customers to purchase more than the ICR when the APR triggers risks causing a material increase in customers' capacity charges. These excess purchases are not needed under the FCM market design to meet New England's reliability objectives.[109] In balancing the cost of procuring additional capacity above the ICR on ratepayers against buyer-side market power, we agree with load parties that it is not just and reasonable or consistent with the design of the FCM to require ISO-NE to purchase additional capacity above the ICR.[110]

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[109] JFS offers the following example. If the ICR is 32,000 MW, and the APR Price at $4/kW-month requires procurement of 10 percent excess capacity, customers will be required to pay $153.6 million in excess capacity charges.

[110] We recognize that the capacity market designs of NYISO and PJM employ sloped demand curves that allow for the procurement of capacity in excess of their respective capacity targets. These markets are designed such that the average amount of capacity procured over time is close to the capacity target, but the actual amount procured in any one period may be higher or lower than the target. NYISO and PJM employ different mechanisms to prevent buyer market power, including a minimum offer price rule.

161. The ISO states that it has designed its July 1 Proposal so as to balance three competing objectives: (1) allowing new OOM capacity to clear and obtain a capacity supply obligation; (2) preventing new OOM capacity from distorting the market for existing capacity; and (3) ensuring that total purchases do not exceed the ICR.[111]

162. The ISO's July 1 Proposal attempts to accomplish the first and second objectives by allowing new OOM capacity to clear while simultaneously raising the price paid for existing capacity to the price that would have prevailed if the OOM capacity had offered into the auction at a price approximating its full cost of entry. In order to make this balance work, the July 1 Proposal requires customers to purchase more capacity than is necessary to satisfy the ICR.[112] The ISO frames this feature of its proposal as a necessary consequence of clearing OOM and protecting the market.

163. However, ISO-NE has not offered a persuasive reason why, in the particular context of the design, purpose, and history of New England's FCM it is just and reasonable to require customers to incur unnecessary costs in order to purchase more capacity than the FCM was established to procure and that is needed for reliability.

164. While the capacity market designs of NYISO and PJM employ sloped demand curves that allow for the procurement of capacity in excess of their respective capacity targets, these sloped demand curves also allow for procuring less capacity than their respective capacity targets. These markets are designed such that the average amount of capacity procured over time is close to the capacity target, but the actual amount procured in any one period may be higher or lower than the target.[113] Allowing the procurement in excess of the capacity target in some periods is reasonable in these markets to offset the potential for procuring less than the capacity target in other periods. By contrast, the New England market design contains no possibility of procuring less than its capacity target. We agree with JFS that limiting purchases to the ICR is a "bedrock" principle of the FCM model. Thus, in light of the design and history of the FCM, we find the tradeoff

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[111] *See* above at P 95.

[112] Under the July 1 Proposal, customers would purchase all new capacity offered below the Capacity Clearing Price and all existing capacity offered below the Alternative Capacity Price. As a result, the total amount of capacity purchased would exceed the ICR.

[113] *PJM Interconnection, L.L.C.*, 129 FERC ¶ 61,090, at P 71 (2009).

proposed by ISO-NE, that is, requiring purchases in excess of the capacity target in order to permit all OOM to clear, to be unjust and unreasonable.[114]

165. While we reject ISO-NE's July 1 Proposal, we find that the fundamental component upon which it relies, benchmark pricing, forms the basis for a just and reasonable buyer-side mitigation measure. Benchmark prices, which would be developed by the IMM and specific to each resource type under ISO-NE's proposal, represent competitive offers. We find that, with some modification, the competitive offer requirement of benchmark pricing can be preserved without incurring the negative consequences of purchasing above the ICR. As NEPGA argues in its first brief, an asset-class-specific benchmark for new resource offers similar to the minimum offer price rule in PJM would provide effective buyer-side mitigation, and would do so without incurring the negative consequences of purchasing above the ICR. Under its July 1 Proposal, ISO-NE proposes to establish benchmark pricing in order to calculate the "but for the presence of OOM" clearing price. We will therefore require ISO-NE to work with its stakeholders to develop a mitigation regime that relies on these benchmarks but does not procure more capacity than ICR, that is, to develop an offer-floor mitigation construct akin to those in PJM and NYISO.

166. On balance, we find that applying offer-floor mitigation to the ISO-NE capacity market with values based on the proposed benchmarks from the July 1 Proposal would render the FCM just and reasonable. First, if the offer floor is set at a level that approximates the net cost of entry of a new resource, offer-floor mitigation would deter the exercise of buyer-side market power and the resulting suppression of capacity market prices associated with uneconomic entry. By preventing new resources from offering at prices that are significantly below their true net cost of entry, new resources would not be able to lower the price of capacity significantly below competitive levels.[115] As a result, there would be no financial reward for subsidizing new resources for the purpose of exercising buyer-side market power.

167. But unlike ISO-NE's two-tiered pricing proposal, offer-floor mitigation would not require a capacity purchase in excess of the ICR when OOM capacity seeks to enter the

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[114] JFS Second Brief at 40.

[115] As discussed below, we will require stakeholders to determine how far below the net cost of entry new resources should be able to bid without triggering mitigation. We will not prejudge at this point whether a threshold below 100 percent of net cost of entry appropriately balances the desire to allow legitimate market forces to bid down the capacity price relative to the desire to prevent buyer market power from artificially suppressing prices.

capacity market. Offer-floor mitigation would essentially eliminate one of the "rounds" of the auction proposed by ISO-NE to be employed in the two-tiered pricing proposal. Specifically, offer-floor mitigation would eliminate the auction round that permitted new resources to clear at offers below their entry costs. Instead, under offer-floor mitigation, the supply offers of all new resources (except those that are exempted from mitigation) would reflect their entry costs. The auction would select the lowest-cost set of resources needed to meet the ICR, and no more. Thus, unlike the two-tiered pricing proposal, offer-floor mitigation would spare customers the cost of procuring capacity in excess of the ICR – excess capacity that is not needed to meet ISO-NE's reliability objectives.

168. Under such a regime, not only will the FCM procure just the ICR and no more, but resources initially classified as "OOM" will not necessarily be precluded from clearing, because a resource seeking to offer below its benchmark will have the opportunity to justify its costs with the IMM. If justified, such a resource will be permitted to bid its actual costs. Furthermore, as we state elsewhere/below, nothing in this order shall be construed to limit the ability of any party to come before the Commission to argue that it should be exempt from the minimum offer price.

169. Accordingly, we will require ISO-NE to address offer-floor mitigation through the stakeholder process. As noted in the "Timing" section below, we will require ISO-NE to include the expected timeframe for this stakeholder process in its schedule for filing market rules in accordance with this order on paper hearing within 30 days of the issuance of this order. Specifically, this stakeholder process should develop tariff revisions to implement buyer-side mitigation in the FCM that would impose offer floors on new resources offering into the FCM auctions. The filing should include a description of all of the details needed to implement the mitigation method, as well as support for the proposed specifics. Among other things, the filing should include proposals to address the following issues. First, consistent with ISO-NE's proposal to implement benchmark pricing under the July 1 Proposal, the filing should include a set of proposed estimates of the applicable costs of new entry for various categories of new resources, a process for revising these estimates over time, and a proposal establishing offer floors for various categories of resources based on these cost estimates (e.g., whether the offer floor threshold should equal 80 percent of the applicable cost of entry versus some other level). The second issue is the process for individual resources to request a different, resource-specific, offer floor based on resource-specific data. The third issue is how long a resource should be subject to an offer floor and/or what conditions should be met before removing the offer floor for the resource. In supporting the proposal regarding this third issue, ISO-NE should explain how its proposal addresses the concern that the effect of new OOM resources on market prices can extend beyond the FCA in which these resources first seek to enter. We are not precluding the retention of certain aspects of the July 1 Proposal that address these highlighted requirements, and the market rules filing may also include other features that ISO-NE can demonstrate are reasonable.

State Policy

170. The Commission acknowledges the rights of states to pursue policy interests within their jurisdiction. Our concern, however, is where pursuit of these policy interests allows uneconomic entry of OOM capacity into the capacity market that is subject to our jurisdiction, with the effect of suppressing capacity prices in those markets. We note that our primary concern stems not from the state policies themselves, but from the accompanying price constructs that result in offers into the capacity market from these resources that are not reflective of their actual costs. We agree with arguments contending that OOM capacity suppresses prices regardless of intent[116] and that the Commission has exclusive jurisdiction on assessing whether wholesale rates are just and reasonable.[117] In fact, the Commission has previously found that uneconomic entry can produce unjust and unreasonable prices by artificially depressing capacity prices, and therefore, the deterrence of uneconomic entry falls within the Commission's jurisdiction.[118] It is these unjust and unreasonable outcomes in a Commission-jurisdiction market that is the focus of our actions here.

171. We recognize that states and state agencies may conclude that the procurement of new capacity, even at times when the market-clearing price indicates entry of new capacity is not needed, will further specific legitimate policy goals and, therefore, argue that certain resources that receive payments pursuant to state programs, which would otherwise trigger the offer floor price, should nonetheless be exempt. Whether to grant an exemption is based on each case's unique facts. Parties have not provided sufficient specificity to allow us to approve an appropriately narrow exemption and we cannot establish an exemption in a vacuum or without facts supporting a specific exemption. Of course, nothing in this order eliminates any rights entities may have under section 206 of

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[116] *See, e.g.*, Mass DPU Second Brief at 19 (noting that, because it is "undisputed" that OOM resources participating in the FCA will typically lower the Capacity Clearing Price and displace otherwise in-market resources, the resulting question is "whether resources that are constructed to accommodate public policy goals should be allowed to suppress the clearing price"); JFS First Brief at 28-29 (asserting that the Commission should focus on intent when assessing OOM capacity through the adoption of a bright-line test).

[117] NEPGA Second Brief at 22 (*citing Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009) (CT DPUC)).

[118] *NYISO I*, 124 FERC ¶ 61,301, *order on reh'g*, 131 FERC ¶ 61,170 (2010), *rehearing pending*.

the FPA to request a mitigation exemption. At that time, we will evaluate the merits of a proposed exemption.

Benchmark Pricing/Offer Floor Price

172. As noted previously, among other issues, the load parties argue that ISO-NE's proposal to employ benchmark pricing as part of its two-tiered pricing proposal is flawed, contending that the ISO does not submit any "defensible"[119] criteria to identify an objective benchmark bid. Further, in contrast to ISO-NE's proposal to replace the bids for that resource in every FCA where the resource is carried-forward, the load parties aver that even if the IMM applies the correct replacement offer for a resource in the first FCA in which the resource offers, such an offer "will have no bearing" on the bids for that resource in future FCAs. Instead, the load parties argue that once operational, the resource's entry costs are sunk and it will only need to cover its going-forward costs. By contrast, the generator parties are generally supportive of benchmark pricing but (as addressed elsewhere in this order) raise a concern whether the IMM's current OOM evaluations for demand resources are comparable with those for generators. While we are not accepting ISO-NE's two-tiered pricing proposal, we note that offer floor price mitigation raises essentially the same concerns as benchmark pricing since both involve the determination of a resource's true competitive price. As such, we will address the general objections to benchmark pricing raised in the paper hearing.[120]

173. As noted in the IMM's September 29, 2010 brief, this Commission has previously approved the use of benchmark pricing in the context of PJM's capacity market to address buyer and seller market power, providing PJM's IMM with the ability to mitigate non-competitive bids.[121] In fact, ISO-NE states that it might develop the benchmark offers "in conjunction with Monitoring Analytics, PJM's Independent Market Monitor," since these values will be recalculated soon for PJM's RPM, which employs an offer price floor.[122] In any case, the IMM has committed to developing the benchmarking methodology "in consultation with stakeholders" and to include the resulting values in a

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[119] JFS Second Brief at 33.

[120] Because we are not approving ISO-NE's two-tiered pricing proposal, we will not address benchmarking comments that are specific to ISO-NE's July 1 Proposal, including concerns over the manipulation of two-tiered pricing, the sunsetting of the Alternative Capacity Price, etc.

[121] *See PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331.

[122] ISO-NE First Brief at 30.

Tariff filing with the Commission.[123] In addition, the IMM states that it will post and periodically update these values on ISO-NE's website.[124] While we are requiring the implementation of offer-floor mitigation rather than benchmarking, we find that these analogous commitments should be implemented and should address the transparency concerns raised by those parties that argue that this process remains largely undefined.[125]

174. Addressing the concerns raised by the load parties about the IMM's ability to calculate a proper benchmark price (or an offer-floor price as required by this order) due to "myriad assumptions that are highly subjective,"[126] we first reiterate that this methodology will be developed in consultation with stakeholders as noted above. As such, we find these concerns to be premature at this point. Further, we note that the IMM presently reviews offers from "new" resources below 0.75 * CONE for buyer market power and various de-list bids of existing resources above their respective thresholds to assess seller market power. Included in that review process is the ability for the IMM to reset non-competitive seller offers, subject to Commission review. In making its argument that this proposed benchmarking mechanism will be "crude" and "error-prone,"[127] JFS fails to distinguish the IMM's role under the proposed benchmarking proposal from the IMM's current responsibilities in this regard..

175. The IMM also proposes a revised benchmarking methodology to address incremental cash flows. Under this methodology, benchmark offers would be calculated for different types of resources, based on the incremental cash flows to the benchmark project as of the date of the auction. The incremental cash flows are those that would be avoided if the benchmark resource does not take on a Capacity Supply Obligation. As we understand the IMM's proposal,[128] incremental cash flows would be calculated assuming

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[123] IMM Third Brief at 29.

[124] ISO-NE First Brief at 30.

[125] To ensure that the floor-price values are calculated using appropriate resource assumptions and characteristics, when ISO-NE files to include these values in its Tariff, it should explain the methodology for calculating the offers for each category and subcategory of resources.

[126] JFS Second Brief at 38.

[127] *Id.* at 39.

[128] *See* IMM September 29, 2010 Brief at 33. Here, in response to the comments of NEPGA witness Shanker, the IMM clarifies that it would evaluate the offer of a new generating resource that is fully built and operational before it offers into the FCA for the

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that construction of each benchmark resource would be completed shortly before the beginning of the commitment period. As a result, benchmark resources with lead times less than three years would be assumed not to begin construction until after the conclusion of the applicable FCA. Thus, the benchmark offer (and floor price) for most types of resources would reflect most, if not all, of the resource's construction costs. The exception would be for any project with a very long lead time (e.g., baseload nuclear and coal steam plants), where most construction costs would necessarily be incurred before the first FCA into which the resource is offered and thus, would not be considered to be incremental costs. Thus, for long-lead-time resources, the IMM proposes a benchmark price of zero, which we assume the IMM would argue should become the floor price for these resources per our requirement in this order to develop price-floor mitigation.

176. We agree with the IMM that a competitive offer in a single-clearing-price auction would reflect the incremental costs of the supplier. Thus, we agree that for purposes of evaluating whether a resource is OOM, it is reasonable to evaluate the resource's offer by comparing it with a floor price that reflects the incremental costs of the same type of resource. However, we also agree with Shanker that it would be unreasonable, in determining the OOM status of a newly constructed resource that has not previously cleared an FCA, to use a floor price that reflects only going-forward costs that exclude fixed costs. That is because such a procedure would allow the resource owner to circumvent the mitigation rules by delaying for only a brief period the resource's participation in the FCA until the construction of the resource is completed. We are largely satisfied by the IMM's response to Shanker's concern that the APR rule could be circumvented by completing construction of a new resource before offering it into the FCA. As long as the new resource is not a long-lead-time resource, its offer would be compared to a floor price that reflects most, if not all, of its construction costs. Thus, completing construction of such a new resource before offering it into the FCA would not allow the supplier to circumvent mitigation.

177. However, we are concerned that in the absence of other mitigation measures, the IMM's proposal to establish a zero benchmark price for long-lead-time resources could

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first time based on the benchmark for a resource of the same type, not on the actual going forward costs of the actual resource. In his September 1, 2010 brief, the IMM states that the benchmark offers for most resources (other than large baseload resources with long lead times) would be calculated under the assumption that most if not all project cash flows would be incremental. Thus, even if an actual new resource (other than a baseload resource) delayed offering into the FCA until after construction was completed, the resource's offer would be compared with a benchmark offer calculated assuming that most or all construction costs have not been incurred prior to the auction.

permit the exercise of buyer-side market power. As noted earlier, a long-lead-time resource must necessarily begin construction several years before the first FCA into which it would offer capacity. A competitive offer would typically reflect the supplier's incremental cost, and the incremental cost of long-lead-time resources is comparatively low by the time that its owner first offers the resource into the FCA. Thus, a competitive supplier would typically offer long-lead-time capacity at a low price, reflective of its low incremental costs. But we would expect that a competitive supplier would typically decide to begin construction only if it expected that, at the time that its operations begin, it would receive revenues (including capacity market revenues) that approximate its total costs. However, a buyer-side entity could exercise market power by beginning construction of long-lead-time resources when the entity expected that – at the time when operations begin – market revenues would be significantly below its average total costs. Such entry would be uneconomic. But under the IMM's proposal, the resource would be allowed to offer into the capacity market at a zero price, thereby artificially depressing capacity market prices.

178. We will require ISO-NE to revisit this issue in the stakeholder process and to include a timeframe for addressing our concern in the timeline required later in this order. We note that one potential approach for addressing this issue would be to require the floor price used to determine whether a long-lead-time resource is OOM to be its full, levelized average annual cost of entry, net of expected energy and ancillary service revenues, unless the resource's owner receives an exemption (potentially from the IMM). Under this scenario, the IMM would need to determine whether the expected market revenues that the resource would receive in its first year of operation would reasonably approximate the resource's full, levelized average annual cost of entry net of expected energy and ancillary service revenues. Consistent with ISO-NE's current review of offers below 0.75 * CONE, the decision of the IMM whether to grant the exemption would be reviewable by the Commission. Under such circumstances, if the resource received an exemption, its floor price would be zero. We conclude that this (and other analogous proposals) could discourage uneconomic entry of long-lead-time resources by ensuring that long-lead-time resources will be assigned a zero floor price only when they can expect, prior to construction, that their capacity would be economic when operations begin. The Commission has accepted a similar exemption mechanism for the NYISO capacity market, whereby an entity, wishing to offer capacity into the capacity market in the New York City capacity zone, can be exempted from buyer-side mitigation only if the NYISO determines prior to construction that the resource is expected to be economic at the time that it begins operation.[129]

[129] *See* NYISO Services Tariff, Attachment H, § 23.4.5.7.2.

179. JFS witness Wilson argues that, after the first year in the capacity market, a resource would only need to recover its going-forward costs, and therefore ISO-NE's proposed benchmark prices/floor prices (which for most resources reflect most or all of the resource's long-run levelized costs, net of wholesale revenues) are an improper measure of such offers. But while we agree that a competitive supplier would offer into the capacity market after it is constructed at its going-forward costs, such a supplier would also avoid constructing a resource during periods of substantial surplus when market revenues would fail to cover the full costs of the resource. Wilson's comments fail to reflect this latter point. We disagree with Wilson's suggestion to establish benchmark/floor prices that reflect only going-forward costs, to the extent that this suggestion would apply to resources that failed to clear in a previous capacity auction. Wilson's suggestion would allow the provisions of the APR, including any carry-forward provisions, to be circumvented and, thus, would permit buyer-side entities to exercise market power through uneconomic entry. Wilson's suggestion, if applied to a resource that failed to clear in previous auctions, would allow an uneconomic entrant – one whose construction is completed during a period of surplus when market revenues are below the resource's full entry costs – to clear the auction and artificially lower the capacity price by waiting only a single year after the construction is completed. As detailed previously, we agree with ISO-NE that some form of carry-forward provision is reasonable and necessary, in order to correct a deficiency in the existing APR mechanism. That deficiency allows buyer-side entities to avoid triggering the APR mechanism by continually investing in sufficient uneconomic capacity so as to maintain a continual capacity surplus.

3. Treatment of Imports

a. July 1 Proposal

180. ISO-NE states that its revised APR proposal treats imports similarly to resources within New England – new imports that require a significant investment (similar to the level required for existing resources to become new under the current market rules) to provide capacity to New England would be treated as new resources and would be eligible for the Alternative Capacity Price after the expiration of the initial five-year price commitment. Otherwise, imports receive the Capacity Clearing Price, since this price reflects the actual supply-demand situation in the region.

b. Comments and Responses

181. HQUS and BEMI argue that ISO-NE's proposal would deny the Alternative Capacity Price to existing external suppliers despite the fact that they are eligible to

participate in the FCA and contribute significantly to the New England market.[130] HQUS contends that such treatment is inconsistent with the requirement under the FCM Settlement Agreement[131] that external capacity contracts be treated comparably with internal resources, and it also puts HQUS at a distinct disadvantage in the competitive marketplace. Further, HQUS argues that ISO-NE's proposal to pay imported capacity a lower price than is available to in-area capacity, even when both suppliers are providing the same service, contradicts the most basic tenets of open and non-discriminatory access guaranteed under the FPA and the Commission's open access policies, especially since importers are subject to the same market-distorting effects of OOM resources. HQUS contends that ISO-NE's s proposal is vague, unduly discriminatory, and contrary to the FPA and Commission policy. In addition, HQUS states that, in order to prove that the proposed discrimination is not undue discrimination, ISO-NE has the burden of demonstrating that its disparate treatment of importers is based upon a factual distinction deemed appropriate by the Commission.[132] HQUS and BEMI argue that ISO-NE has failed to make this demonstration, noting that ISO-NE provides no witness testimony to attempt to justify treating competitive imported capacity differently than all other existing capacity.

182. HQUS argues that the "significant investment" criteria applied to new resources may be one indicator to assess whether an FCM participant is engaging in arbitrage. However, HQUS contends that if this is the only factor considered by ISO-NE in determining whether an import should be eligible for the Alternative Capacity Price, then it has the potential to discriminate against external resources whose long-term participation in the FCM provides benefits to reliability and market efficiency. Further, HQUS and BEMI contend that the "significant investment" criteria will not address the

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[130] HQUS notes that under the Revised FCM Proposal, existing, in-area resources receive the Alternative Capacity Price for years 1-20 of their capacity sales while existing imports are only ever eligible to receive the Capacity Clearing Price. New, in-area capacity resources will receive the Capacity Clearing Price for years 1-5 and the Alternative Capacity Price for years 6-20. HQUS notes that new import capacity may receive the Alternative Capacity Price only if the supplier is able to demonstrate that it has made a new and significant investment to provide capacity in New England.

[131] *See* Settlement Agreement § 11, pt. VI; FCM Settlement Order, 115 FERC ¶ 61,340 at P 140.

[132] *Midwest Indep. Transmission Sys. Operator, Inc.*, 112 FERC ¶ 61,169, at P 40 n.32 (2005) ("[T]he utility has the burden of satisfying FERC that such differences exist between the classes as to justify the separate rates.") (quoting *Ala. Elec. Co-op., Inc. v. FERC*, 684 F.2d 20, 29 (D.C. Cir. 1982)).

purported problem since the location of a resource physically within the ISO-NE control area does not ensure that the resource contributes to the reliability and market efficiency of New England. Rather, HQUS and BEMI argue that capacity suppliers located both within and outside of the ISO-NE control area may choose where to sell their capacity (existing resources only have a one year capacity obligation), and they may import or export their capacity accordingly.

183. Therefore, HQUS states that, in addition to considering whether an importer has made a "significant investment" in providing capacity in the New England market, ISO-NE should assess the commitment of the importer – i.e., whether the importer is committed to providing capacity to New England on a long-term basis (like HQUS) or simply attempting to leverage positions in multiple markets on a short-term basis. HQUS states that these criteria could include commitments to build transmission lines to deliver capacity to New England, a commitment to build and maintain generation capacity to supply New England markets, a demonstration of a history of capacity sales to the region, or a long-term bilateral contract with a load-serving entity in the ISO-NE region. HQUS states that these commitments would provide ISO-NE with a method to identify and appropriately compensate those capacity sellers that are providing significant long-term benefits to the New England market.

184. ISO-NE argues that the price imports receive should not be based on whether or not they are similar to other classes of resources. Instead, ISO-NE argues that the price should be based on setting the right incentives and sending the right price signals to those external resources. ISO-NE states that providing the Alternative Capacity Price to imports only when the import has made a significant investment to support the delivery of imported capacity is necessary to prevent OOM resources from undermining the long-term investment signals sent by the FCM. ISO-NE notes that the capacity price in New England is not the primary incentive for the development of resources in external control areas, and there is no reason to expect New England's capacity prices to significantly influence investment in adjacent control areas for several reasons: (1) practical experience shows that developers seek to develop projects inside the control areas to which they want to provide power; (2) import limits add significant risks for importers of capacity; and (3) the administrative and transactions costs associated with being subject to the dispatch and planning requirements of one control area (external to New England), while also being subject to the capacity requirements in New England, are clearly greater.

185. ISO-NE states that if investments are not being made based on the New England capacity price, then the Alternative Capacity Price should not be paid to that resource type. ISO-NE argues that importers that are deciding whether to commit their resources to the New England market or their home market on a year-by-year basis should make that decision based on the Capacity Clearing Price, which is based on the actual balance of supply and demand in New England. By comparison, ISO-NE contends that imports that commit to a significant investment in response to the capacity price in New England

(not on a year to year basis) receive a proper price signal from the Alternative Capacity Price. ISO-NE argues that there is no market design rationale for using the higher Alternative Capacity Price to incent the development of additional resources outside of New England since the capacity price does not generally drive such investments, and paying it would be a waste of consumers' money.

186. Last, ISO-NE refutes HQUS's argument that the new vs. existing framework central to the APR should apply equally to imports. In support, ISO-NE notes that the distinction between new and existing resources is difficult to apply to imported capacity since it raises a fundamental question as to how an importing resource should be defined – as the physical generator providing the capacity or the commitment or contract to provide capacity to New England from external sources. ISO-NE states that it has struggled with related issues such as whether the "long-term" contract can be readily terminated, and what recourse exists if an existing import, backed by a long-term contract, fails to participate in an FCA. ISO-NE disagrees with the arguments of HQUS and BEMI that their historical imports provide a basis for receiving the Alternative Capacity Price; ISO-NE contends that such imports may simply indicate relative pricing and do not indicate whether investments have been made. By contrast, ISO-NE does indicate that it would support development of rules that allow capacity imports utilizing historical investments to be eligible for the Alternative Capacity Price on a case-by-case basis.

187. In response to BEMI's concern about how ISO-NE proposes to treat "in-between" imported resources (i.e., imports whose offer prices are above the Capacity Clearing Price but below the Alternative Capacity Price), ISO-NE clarifies that in-between imports would not clear in the capacity auction nor receive a capacity obligation, except for imports that make significant investments to provide capacity to New England.[133]

188. In a follow-up limited response, HQUS states that it supports ISO-NE's proposal to develop rules that allow capacity imports utilizing historical investments to be eligible for the Alternative Capacity Price on a case-by-case basis. HQUS states that the Commission should hold ISO-NE to this commitment.

c. Commission Determination

189. In light of our decision to reject ISO-NE's two-tiered pricing proposal, the debate about which of the two prices (i.e., the Alternative Capacity Price or the Capacity Clearing Price) would be paid to imports is moot. Under the offer-floor mitigation mechanism that we are requiring in this order, the same price will apply to all resources

[133] ISO-NE Third Brief at 42.

in a given zone and in a given auction. Thus, all resources in a given zone, including imports, that are accepted in a given auction would receive the same clearing price.

190. However, we must address the issue of how imports are to be treated with respect to the offer floors that we are requiring. In particular, we must address which (if any) imports are to be subject to the offer floor. In this regard, we agree with ISO-NE that it is generally difficult to determine what resource or set of resources is supporting an import and whether the supporting resource or set of resources is new, existing, or should only be considered in terms of the import contract. Accordingly, in crafting its July 1 Proposal, ISO-NE proposed that the offer prices of imports would not be compared to a benchmark price, and thus, imports would not trigger APR mitigation, no matter how low the offer price. In this respect, then, ISO-NE proposed to treat imports like existing internal capacity; offer prices of existing internal capacity similarly would not be compared to a benchmark price and would not trigger APR mitigation. This feature of ISO-NE's July 1 proposal was not protested.

191. In light of the difficulty in determining the resource or resources that support imports, we conclude that it is reasonable to treat most imports like existing internal resources for mitigation purposes. Thus, we think that it is reasonable not to require an offer floor for most imports. The exception would be for imports where a specific new external resource is identified as the sole support for the import, and where a significant investment (such as the construction of a new transmission line to import power from an adjacent control area) is made to provide capacity to New England. We think that these latter resources are clearly new resources that are devoted to the New England market over the long term, and should therefore be treated like new internal resources for mitigation purposes. Thus, we conclude that such an import, supported by a clearly identified new external resource, should be subject to an offer floor associated with a benchmark price related to the external resource's technology type. We direct ISO-NE to include tariff language to implement this provision in its filing to comply with this order.

4. Treatment of Historical OOM

a. July 1 Proposal

192. Consistent with its Joint Filing,[134] ISO-NE's revised APR mechanism does not carry forward any OOM capacity from the first three FCAs – historical OOM capacity will not be mitigated going forward. In the Joint Filing, ISO-NE and NEPOOL argued

[134] In its joint February 22, 2010 filing, ISO-NE (along with NEPOOL) sought an extension of the price floor for three FCAs to address the fact that OOM Capacity from the first three FCAs will not be included as OOM in the revised APR provisions.

that the proposed price floor extension balances a desire to address the effect of past OOM activity while recognizing that the OOM entry was treated appropriately by the rules in effect at that time. In its briefs, ISO-NE reiterates that carrying forward this historical capacity would be inappropriate since it would constitute retroactive application of new rules, creating significant market uncertainty. Also, ISO-NE cites prior Commission guidance in a NYISO proceeding wherein we noted that mitigation should be directed at avoiding inefficient entry but should not apply to historical OOM capacity since the associated costs of this OOM capacity could no longer be avoided.[135]

b. Comments and Responses

193. The generator parties focus much of their briefs on the proposed treatment of historical OOM under ISO-NE's revised APR proposal. For example, while finding that ISO-NE's revised APR proposal will properly address OOM capacity on a prospective basis, NEPGA contends that the "single most significant flaw" in ISO-NE's revised APR proposal is that it allows for a "blanket exemption" for all currently existing OOM resources. NEPGA alleges that this proposed exemption not only permits existing OOM resources to receive the higher APR price but also allows these OOM resources to directly affect the APR price, as if they were in-market resources. NEPGA contends that due to the significant quantity of historical OOM capacity, allowing the APR price to be suppressed through existing OOM resources will render even the revised APR ineffective for the foreseeable future, "7 to 15 years, or perhaps even longer."[136] Further, NEPGA and BG Entities argue that, because the Commission's April 23 Order indicated its preference to eliminate the price floor coincident with a revised APR mechanism, allowing the historical OOM capacity to participate in setting the Capacity Clearing Price and Alternative Capacity Price will result in the FCM price approaching $0 and remaining there for many years. Boston Gen contends that if the Commission exempts historical OOM from mitigation, the FCM will fail. NEPGA argues that a transitional mechanism, such as the price floor or alternative pricing structures (including a demand curve), must continue as long as unmitigated OOM capacity is allowed to depress clearing prices.

194. NEPGA argues that, even if all of the other issues before the Commission in this hearing were resolved "in favor of competitive prices," the magnitude of existing OOM capacity and its resulting effect on FCA prices is "sufficient to doom the future of the FCM." As a result, NEPGA argues that there is no possibility that new competitive

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[135] Joint Filing Transmittal Letter at 23 (citing *N.Y. Indep. Sys. Operator, Inc.*, 122 FERC ¶ 61,211 at P 100-101, 118-119).

[136] NEPGA First Brief at 43.

entrants will appear since existing suppliers cannot expect to consistently recover even their going-forward costs. Rather, NEPGA contends that New England will be forced to rely on RMR contracts and bilateral agreements and forgo the efficiencies of competitive markets.

195. BG Entities notes that due to the sensitivity of the FCM's vertical demand curve to small changes in capacity, and because the amount of new capacity needed each year is relatively small, the IMM properly emphasized that even a relatively modest amount of out-of-market entry can displace in-market entry and prevent the auction from clearing based on competitively priced offers.[137]

196. In support of "carrying-forward" historical OOM capacity, NEPGA contends that there is "ample evidence" that load parties have sought to artificially suppress capacity prices below competitive levels during the FCAs held to date. For example, as discussed in the April 23 Order, NEPGA states that Connecticut entered into a contracting process with new resources that included specific requirements on how to bid into the FCM (as price-takers under contracts-for-difference), "driven by the objective of obtaining a New England-wide price impact in the FCA" to lower costs for Connecticut ratepayers.[138] BG Entities states that, regardless of whether the participation of state-supported OOM capacity in the first three FCAs is properly characterized as the exercise of buyer market power, it is indisputable that the ability to suppress prices without a proper corrective APR is a fundamental flaw in the design of the FCM. Boston Gen argues that exempting this "egregious" Connecticut historical OOM capacity would reward past exercises of buyer market power and market manipulation - Boston Gen argues that the CT DPUC's conduct in designing the RFPs to reduce the FCM market clearing price constitutes market manipulation within the meaning of section 222 of the FPA and section 1c.2 of the Commission's regulations. Boston Gen argues that what makes CT DPUC's scheme manipulative is not that it sought to increase the amount of installed capacity in Connecticut, but that it evaluated competing projects based on the portfolio-wide

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[137] BG Entities Second Brief at 4 (citing Internal Market Monitoring Unit, *Review of the Forward Capacity Market Auction Results and Design Elements*, Docket No. ER09-1282-000, at 5, 43 (June 5, 2009) (IMMU Report).

[138] NEPGA First Brief at 28-29 (citing *DPUC Investigation of Measures to Reduce Federally Mandated Congestion Charges*, Docket No. 05-07-14PH02, Second Interim Decision, Attachment 4 at 4 (Nov. 16, 2006)).

"benefits" of price suppression rather than determine whether projects were economic on a stand-alone basis.[139]

197. NEPGA similarly cites to reports produced by Synapse Energy Economics for load-serving entities, state regulators, and entities in New England that it alleges demonstrate that demand response was used as "political camouflage for an OOM strategy."[140] NEPGA argues that the 2007 Synapse Energy Economics report outlines a "game plan" to artificially distort FCM prices downward.[141] NEPGA notes that a supplier that engages in withholding faces sanctions including criminal indictment, yet "the buyer side of the market has become so desensitized" that "it sees nothing wrong with funding a study to determine what circumstances present profitable opportunities for the exercise of buyer market power."[142] BG Entities argues that states cannot use procurement policies to intrude upon the Commission's authority to set wholesale rates.

198. NEPGA states that this represents classic price discrimination since new resources receive their required revenues while existing resources receive a deflated capacity price. Further, NEPGA asserts that, because there is a large surplus of capacity in New England and FCA prices have fallen to the price floor, the "mass influx" of new capacity that has occurred in New England cannot be explained by competitive market forces but instead

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[139] Boston Gen contends that CT DPUC's strategy is similar to that described in the show cause orders alleging that Energy Transfer Partners, L.P., Amaranth Advisors L.L.C., and their respective affiliates sought to drive down clearing prices in physical and natural gas futures markets, respectively.

[140] NEPGA First Brief at 29, 35 (citing Rick Hornby, Avoided Energy Supply Costs in New England: 2007 Final Report, at 1-1 (Jan. 3, 2008), *available at* http://www.synapse-energy.com/Downloads/SynapseReport.2007-08.AESC.Avoided-Energy-Supply-Costs-2007.07-019.pdf and http://www.nationalgridus.com/non_html/eer/ne/2007_NE_AESC_Report.pdf (2007 Report) (identifying sponsors); Rick Hornby, Avoided Energy Supply Costs in New England: 2009 Report, at 1-1 (Oct. 23, 2009), *available at* http://www.synapse-energy.com/Downloads/SynapseReport.2009-10.AESC.AESC-Study-2009.09-020.pdf (2009 Report) (same).

[141] In addition, Boston Gen states that the FCM rules should be revised to treat demand response and generation resources comparably for purposes of identifying OOM since the current rules understate DR Resources' costs by failing to properly account for their opportunity costs and subsidies paid to consumers.

[142] NEPGA First Brief at 35.

was a product of OOM payments. In addition, NEPGA also notes that all of this new OOM entry occurred without the APR ever having triggered.

199. As relief, NEPGA argues that all of the previously classified OOM capacity[143] should automatically be mitigated in future auctions. In addition, NEPGA argues that the rules defining OOM entry "were so lax" under the previous APR that large quantities of new supply were able to bid in below their costs without being classified as OOM.[144] As a result, NEPGA proposes that each new resource that entered the capacity market during the first three FCAs should self-certify to the IMM that it received no out-of-market revenues. Absent such demonstration, NEPGA alleges that these resources should be required to either accept OOM status or demonstrate to the IMM that their bids were at actual cost levels. Boston Gen contends that a "proper accounting" for OOM capacity from the first three FCAs would demonstrate that the actual amount was "substantially greater" than the 2,350 MW acknowledged by ISO-NE and the IMM. BG Entities contends that historical OOM should be converted from OOM capacity to in-market existing capacity only when its adjusted (competitive) offer reflecting its marginal cost clears in the market.

200. NEPGA contends that the load parties' counterargument appears to be that they have a "reliance interest" in not having capacity prices mitigated for existing state-sponsored OOM, since under the pre-April 2010 APR mechanism their offers would never be subject to "effective" mitigation. NEPGA counters that it is "facially absurd" for load to argue that it has some defensible reliance interest in continued price suppression in future auctions. NEPGA asserts that this is akin to generators arguing that they should be excused from mitigation forever because there were no price caps when they first entered the market. NEPGA states that such an argument would never be successful, and the Commission has long rejected such claims. Further, NEPGA asserts that the Commission routinely applies new mitigation rules to existing resources for prospective auctions, and nothing should prevents it from applying new mitigation rules to existing OOM resources here to address rates that are unjust, unreasonable, and unduly discriminatory.

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[143] Under the pre-existing APR, a finding by the IMM that an offer was OOM did not trigger the APR. Rather, three specific conditions were required before the APR could trigger, including that the ICR exceeds the amount of existing capacity. *See* April 23 Order, 131 FERC ¶ 61,065 at P 38.

[144] For example, NEPGA notes that under the existing Tariff any resource that was offered at or above 0.75 * CONE has been treated as in-market, rather than as OOM.

201. Boston Gen avers that market participants have no entitlement to the continued availability of exemptions from mitigation, particularly where the exemption has been shown to have facilitated the exercise of market power. BG Entities similarly contends that that carryover of excess OOM from the first three auctions would not adversely affect participants who built generation based on market rules without an OOM capacity "carry forward" provision, since those participants would still receive a capacity obligation and the related capacity payments if their offers are carried forward into future auctions. Further, BG Entities notes that these OOM resources would continue to receive the same clearing price (the Capacity Clearing Price) that they would have received absent the changes proposed herein, which is the price anticipated at the time they bid the OOM resources into any of the first three FCAs. By contrast, BG Entities argues that not carrying forward the historical OOM capacity would prevent other market participants from receiving just and reasonable rates. Boston Gen argues that CT DPUC's request that the Commission accept the proposed exemption based on its purported detrimental reliance on the existing APR is barred by the doctrine of "unclean hands," which "closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief"[145] (since Boston Gen views the CT DPUC's procurements of additional capacity as a deliberate attempt to manipulate the capacity price). Boston Gen argues that the Commission must reject CT DPUC's claim, both to maintain the credibility of its policy to prevent the exercise of buyer market power and to ensure the long-term viability of the FCM.

202. Addressing load's concerns that mitigating historical OOM would be retroactive ratemaking, NEPGA, BG Entities, and Boston Gen state that they do not seek retroactive changes to prior auction results, nor to change what resources bid in past auctions. Instead, they state that they are concerned only with how the OOM supply that entered in the first three FCAs will be treated in future auctions and that treating this capacity as "carry-forward" OOM capacity is not retroactive ratemaking. In addition, addressing ISO-NE's regulatory uncertainty argument concerning any carry-forward of historical OOM capacity, Stoddard states that RTOs frequently change market rules that have material effects on the value of a supplier's investment, and, therefore, investors always face some amount of regulatory uncertainty. Stoddard contends that allowing a "hangover" from the excess OOM entry during the first three FCAs to suppress the FCM capacity prices for the foreseeable future is inconsistent with just and reasonable market design and will lead to a market structure that is not sustainable.

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[145] Boston Gen First Brief at 36 (citing *Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co.*, 324 U.S. 806, 814 (1945)).

203. NEPGA witness Milgrom similarly contends that, in order to promote competitive markets, mitigation should seek to quickly restore future market prices to competitive levels – ones unaffected by any attempt to exercise market power. Milgrom contends that a predictable policy of mitigating market power can achieve two kinds of benefits. First, it both corrects the market prices today to competitive levels and promotes a belief among market participants that future prices will be free from manipulations. Second, Milgrom states that such a policy will promote the expectation that "ill-gotten" gains from market manipulations will be small, because the benefits of long-term market manipulations will be cut short. NEPGA witness Kalt similarly notes that nothing will change the fact that state authorities control large blocks of load, allowing the underlying source of buyer market power to remain intact. However, he argues that addressing monopsonistic manipulation without addressing "benefits" attributable to prior "manipulative conduct" would inappropriately incentivize large buyers to look for other approaches to depress FCM prices.

204. NEPGA argues that, in this case, being subjected to mitigation is either a neutral or a positive thing since it will only increase the bid levels of OOM offers that clear anyway in this market design. As such, NEPGA states that mitigation would increase the capacity revenues paid to these resources. NEPGA argues that the only reason for historical OOM to oppose this outcome is if these resources are intentionally seeking to artificially distort auction clearing prices downward.

205. Addressing the NYISO precedent discussed in the April 23 Order and cited as support in the briefs of JFS,[146] NEPGA witness Shanker avers that the circumstances in NYISO are "materially different" from the instant circumstances. First, Shanker notes that, unlike in ISO-NE, there was no buyer-market power rule in place in NYISO during the periods when the contested new entry occurred, nor was there any definition of out-of-market entry. Further, Shanker notes that the new mitigation scheme in NYISO sets a floor price on the new capacity being offered that is directly linked to the cost of new

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[146] As the Commission noted in the April 23 Order, 131 FERC ¶ 61,065 at P 80-81, the Commission faced a similar issue in NYISO where 1,000 MW of OOM capacity was built before NYISO adopted rules to address OOM investment. The Commission stated that, in the NYISO proceeding, it approved NYISO's proposed rules to address future OOM investments but concluded that the rules should not be applied to the 1,000 MW of OOM capacity that entered the market prior to adopting the rules. The basis for this decision was that mitigation policy should be directed at avoiding inefficient and unneeded entry - whether or not the entry of past resources was efficient or needed, their entry and their associated costs could not now be avoided, so mitigation would no longer be effective.

entry for the reference capacity unit. As a result, if the market clears below the floor, the resource does not clear and the capacity can not be used to satisfy any capacity market obligations, and the new entrant is effectively removed from the market. Thus, Shanker argues that in the NYISO case, mitigation of existing OOM units constructed prior to the advent of any mitigation rules could have conceivably excluded the units from the entire market. By contrast, under ISO-NE's revised APR proposal, OOM resources would be allowed to enter and be compensated at least at their offer price. NEPGA also argues that the mitigation of historical OOM has a much larger role than merely deterring the entry of OOM supply that already exists. NEPGA contends that while it is true that in the NYISO case (as here) the new entrants' costs are already "sunk" and their decision to build can no longer be affected; the main purpose of mitigation is to ensure just and reasonable rates in future auctions.

206. Last, NEPGA seeks to distinguish the NYISO proceeding by noting that in that proceeding, the Commission found that the capacity clearing prices (even as depressed by the pre-existing OOM supply), resulted in reasonable capacity compensation. As a result, NEPGA argues, it was deemed appropriate to only apply the NYISO APR to future OOM capacity. By contrast, NEPGA argues that, in ISO-NE, such a rationale does not apply since absent some carry-forward treatment for historical OOM, "prices would likely fall to zero for many, many years."[147]

207. Public Systems, while supportive of the original Joint Filing, argues that ISO-NE properly recognizes in its revised APR proposal that reclassifying as carried-forward OOM those resources that entered in previous auctions would be inappropriate and inconsistent with the NYISO precedent. Public Systems states that the fact that New England had an APR in place while the NYISO rule was new "is a distinction without a difference."[148] Public Systems states that all of the relevant economic decisions - whether to build new units and how to offer them in the markets have already been made and were made based on the rules that existed at the time. As those decisions cannot be revisited, Public Systems argues that it would be unreasonable to change the rules in a way that results in different consequences here.

208. JFS first notes that NEPGA and Boston Gen are "simply wrong" in claiming that OOM capacity "flooded the market" in the first three FCAs and depressed clearing prices. Instead, JFS notes that ISO-NE has indicated that the market clearing prices in the first three FCAs reached the price floor because demand response and other resources remained in the auction, not because of OOM capacity. In addition, JFS finds Boston

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[147] NEPGA First Brief at 53.

[148] Public Systems Second Brief at 27.

Gen's accusations regarding the propriety of the CT DPUC procurements to be "baseless" as they ignore that: (1) CT DPUC undertook these procurements pursuant to the Connecticut General Assembly's directive; (2) the procurements address the Commission's and ISO-NE's concerns about resource adequacy in Connecticut; and (3) they relied on the terms of the FCM Settlement. JFS states that inefficient existing generators that accepted the floor price without de-listing should not be allowed to argue that the price they voluntarily accepted was inadequate.

209. Addressing Boston Gen's accusations that the CT DPUC procurements constitute a fraud in violation of section 222 of the FPA, JFS argues that section 201(b) of the FPA and precedent fully protect states' authority to award bilateral contracts to address their identified needs and to further state policy objectives. Further, JFS contends that states are protected by the state action doctrine from allegations that their official conduct constitutes an unlawful exercise of buyer monopsony power. JFS states that both the 2005 Connecticut Energy Independence Act and 2007 Act Concerning Electricity and Energy Efficiency responded to Commission guidance and addressed legitimate state objectives and provided significant social value. Addressing the allegations concerning CT DPUC's decision to employ a contract for difference (CFD) construct to pay these resources, JFS maintains that CT DPUC adopted the CFD provisions so that projects would recover their expected costs but would not set price and earn "excess profits" in the ISO-NE markets. Further, JFS states that it chose this approach because the FCM settlement provided a one-time allowance for new resources to participate as an existing resource during the first FCA to avoid triggering the APR. JFS contends that its procurements relied on the market rules that were in place and there is no basis for retroactively changing that construct to create a carry-forward for OOM capacity. Last, JFS contends that generator proposals that require the IMM to revisit prior OOM determinations are outside the scope of this proceeding and collaterally attack the Commission's prior order approving the FCM design changes rules.

210. Boston Gen and NEPGA respond to JFS's argument concerning section 201(b) of the FPA and the state action doctrine, noting that this reliance is "misplaced." Boston Gen contends that because CT DPUC's actions were explicitly intended to affect rates in Commission-jurisdictional transactions, they unquestionably fall within the Commission's ratemaking jurisdiction under sections 205 and 206 of the FPA, and its anti-manipulation authority under section 222 of the FPA and are therefore not protected by section 201(b) of the FPA. Boston Gen alleges that the "state policy" pursued by the CT DPUC – to intentionally reduce FCA clearing prices – is not a "legitimate" goal of state policy to which the Commission must defer. Boston Gen contends that this strategy aims to transfer wealth from one group of private parties (suppliers) to another group of private parties (buyers) through the exercise of market power. Boston Gen further notes that the state action doctrine is an affirmative defense that may be raised where a state or state agency has mandated or engaged in anticompetitive conduct that would otherwise violate the antitrust laws. As such, Boston Gen contends that it has no place under the

FPA, which preempts state laws and regulations that mandate or authorize conduct prohibited by the FPA. Boston Gen states that jurisdictional sellers have a constitutional right under the Fifth Amendment of the U.S. Constitution and a statutory right under the FPA to receive compensatory compensation.

211. Similarly, NEPGA contends that the state action doctrine does not apply for several reasons. First, NEPGA argues that the state action doctrine is not a general ban on accusations that states may have exercised market power. In support, NEPGA argues that JFS fails to cite a single case where a court has found the state action doctrine to be applicable to the FPA. Further, NEPGA argues that the Commission has already rejected the state action doctrine in the wholesale rate context.[149] Last, NEPGA avers that even if the state action doctrine was applicable to the FPA, it would not further JFS's position. NEPGA states that the state action doctrine confers immunity against suit under the Sherman Act to states, but this case does not involve a suit under the Sherman Act against any state and any immunity that states may have in other contexts is irrelevant to this proceeding.

212. JFS notes that all of the proposals offered in the paper hearing include provisions that are implicitly or explicitly intended to set a price floor. By contrast, JFS states that the Joint Filing proposed an explicit temporary fixed floor. JFS states that the fixed floor from the Joint Filing is preferable to the implicit alternatives since, among other things, it is transparent and predictable. As such, JFS urges the Commission to consider whether the Joint Filing's proposed capacity floor through the sixth FCA may provide the best short-term solution to the historical OOM issue. In support, JFS notes that no party opposes a continuation of the price floor. JFS states that the stakeholders and the Commission can then address any additional need for a floor beginning with the seventh FCA.

c. Commission Determination

213. As noted previously, we accept the Joint Filing's proposal regarding the treatment of historical OOM. Specifically, we agree that historical OOM resources should not be subject to mitigation; however, as we have also stated, we agree that the price floor should remain in place until revisions to the current APR are implemented, after which the price floor should expire.[150]

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[149] NEPGA cites *S. Cal. Edison Co.*, 51 FERC ¶ 61,284, at 61,892 (1990).

[150] As stated previously, we note that this may require ISO-NE to make a subsequent filing to extend the price floor beyond the sixth FCA (depending on the

(continued…)

214. We acknowledge that the amount of historical OOM resources in the market has significantly contributed to a large capacity surplus in New England that is likely to last for many years. However, the investment in OOM capacity has already occurred. As noted previously, we believe that the purpose of buyer-side mitigation is to prevent uneconomic entry. But subjecting historical OOM resources to mitigation would not prevent the entry of these uneconomic historical OOM resources.

215. Our decision that historical OOM should not be subject to mitigation in this case is consistent with the NYISO proceeding in which the Commission declined to apply buyer-side mitigation to OOM resources that had entered the market before the buyer-side mitigation had gone into effect.[151] We disagree with Shanker that the circumstances underlying the NYISO proceeding are different in any relevant respect. Whether or not there was a buyer-side mitigation measure in effect at the time of the historical OOM investment, no mitigation can deter its entry into the market in either ISO, since such investment has already been made.

216. ISO-NE's revised APR proposal is silent on the issue of the price floor. The April 23 Order stated that the Commission expected to eliminate the current price floor coincident with the implementation of a revised APR from the instant proceeding.[152] After consideration of all of the arguments, including those presented by some of the load parties to retain the price floor proposal from the Joint Filing (which extended the price floor through the sixth FCA), we will preserve only this provision from the Joint Filing (which may need to be extended depending on the timing of the stakeholder process on offer-floor mitigation). Because historical OOM capacity is not carried forward under the revised proposal, it is reasonable to extend the floor for an additional period of time to address the effect of historical OOM capacity on market prices. We also find that the price floor should not be extended indefinitely, because a permanent price floor would send the wrong price signals regarding the need for capacity – effectively discouraging some old and inefficient existing capacity from retiring. We therefore find that an extension of the price floor at 0.6 * CONE is a just and reasonable solution.

217. As the fourth FCA already occurred (in August 2010), the net effect of our ruling will be to extend the price floor at its current value of 0.6 * CONE for at least the fifth and sixth FCAs. However, our ruling in this order accepts ISO-NE's July 1 Proposal to

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timing of the stakeholder process triggered by our requirement to develop market rules to implement offer-floor mitigation).

[151] *N.Y. Indep. Sys. Operator, Inc.*, 122 FERC 61,211 at P 100-101, 118-119.

[152] April 23 Order, 131 FERC ¶ 61,065 at P 19, 97.

eliminate any reference to the CONE parameter (as discussed later in this order). Therefore, we will require ISO-NE to retain only this function of the CONE parameter until the price floor is eliminated, and this requirement should be incorporated into the subsequent development of market rules stemming from this order; this does not otherwise affect our decision to approve ISO-NE's July 1 Proposal to eliminate all other functions of the CONE parameter on a prospective basis. Further, we find that the subsequent market rules should incorporate the elimination of this sole function for the CONE parameter upon our approval of revised buyer-side mitigation market rules.

218. Addressing the related arguments offered by NEPGA and Boston Gen that CT DPUC deliberately engaged in buyer-side market manipulation in violation of section 222 of the FPA and section 1c.2 of the Commission's regulations, we note that neither party seeks Commission enforcement action, nor does either allege that CT DPUC violated the FCM market rules or any other Tariff provisions.[153] Instead, these arguments are offered in order to support "carry-forward" treatment of historical OOM capacity, a proposal we deny above. We do agree, however, that the pre-existing APR rules did not effectively address the entry of OOM capacity into the FCM, a problem that our requirement that ISO-NE implement offer-floor mitigation should help address. In addition, our extension of the price floor through the sixth FCA (and potentially longer depending on the timing of the offer-floor mitigation stakeholder process) is intended to help offset the existence of this historical OOM capacity.

219. We find JFS to be in error that the state action doctrine prevents the Commission from considering the question of whether OOM capacity constructed by states can be mitigated through application of the APR. *Parker v. Brown*,[154] cited by JFS, involved the question of whether states could be held liable under the Sherman Act for antitrust violations; the Supreme Court found in that case that, given certain circumstances, they could not. This case does not involve Sherman Act or other antitrust liability; rather, the question before us is whether the APR rule should be revised to ensure that parties possessing buyer market power cannot impair the functioning of the FCM. Therefore, *Parker* is not on point. Further, the Commission has already ruled on the applicability of the state action doctrine in FERC proceedings involving questions similar to antitrust,

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[153] Indeed, NEPGA and Boston Gen could not prove the necessary fraud or material misrepresentation elements of such a violation, since it would appear that CT DPUC made no secret of its contracting practices or intentions, which were set out in acts of the Connecticut legislature and publications of state regulators. *See* JFS Second Brief at 111-118.

[154] 317 U.S. 341 (1943).

stating that ”the state action doctrine . . . does not preclude a finding that the proven price squeeze in this case constitutes undue discrimination requiring a remedy.”[155]

220. JFS has similarly not demonstrated that the APR as contemplated here will conflict with state jurisdiction over generating facilities. In *Connecticut DPUC v. FERC*,[156] the court noted that the Commission, under the FPA, “shall not have jurisdiction … over facilities used for the generation of electric energy.”[157] The court found, however, that the Commission did have express statutory jurisdiction over practices *affecting or relating to* wholesale rates and, on this basis, stated that the Commission did have jurisdiction over the review of the Installed Capacity Requirement in that case.[158] The court reasoned that because the Commission could directly set the price of capacity in order to incentivize procurement of resources adequate to meet the peak demand estimate and because this estimate would necessarily affect prices but not necessarily new capacity construction, there was no direct regulation of generation facilities in violation of FPA section 201.[159] Similarly, the Commission's consideration

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[155] *S. Cal. Edison Co*., 40 FERC ¶ 61,371, at 62,177 (1987), *rev’d in part on other grounds*, *City of Anaheim v. FERC*, 941 F.2d 1234 (D.C. Cir. 1991).

[156] 569 F.3d 477, 481 (D.C. Cir. 2009).

[157] *See CT DPUC*, 569 F.3d at 481 (quoting FPA § 201, 16 U.S.C. § 824(b)(1) (2006)).

[158] *See id.* at 478, 481; *see also* FPA § 206(a), 16 U.S.C. §824e(a) (2006).

[159] *CT DPUC*, 569 F.3d at 481-82. Previously, in *Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978), the same court had sustained the Commission’s jurisdiction to review the “deficiency charges” that NEPOOL charged as ISO-NE’s predecessor when member utilities failed to meet their share of NEPOOL’s reliability requirement. *See id.* at 1300-03. The court made this jurisdictional finding even though it found that “the purpose behind the deficiency charge” was “to motivate participants to develop sufficient capacity to meet their load requirements.” *Id.* at 1302. Similarly, in *Mississippi Industries v. FERC*, 808 F.2d 1525 (D.C. Cir. 1987), the court held that the Commission’s authority over practices affecting or relating to wholesale rates authorized it to review the allocation of capacity costs because “[c]apacity costs are a large component of wholesale rates” and “while these provisions do not fix wholesale rates, their terms do directly and significantly *affect* the wholesale rates at which the operating companies exchange energy.” The court acknowledged that the Commission had reasoned that “although allocating cost does, to some extent, result in the ‘regulation of matters relating to generation,’ such regulation is valid under the FPA when it is the

(continued…)

of the APR is an integral part of its regulation of capacity costs, which, as discussed, are a large component of wholesale rates. Although this proposal by definition results in the "regulation of matters relating to generation," such regulation is a byproduct of a legitimate exercise of the Commission's power to regulate wholesale rates under the FPA.

5. Self-Supply/Hedging

a. July 1 Proposal

221. In its revised APR proposal, ISO-NE proposes to continue to treat new self-supply as OOM capacity, consistent with its current Tariff.

b. Comments and Responses

222. Addressing the self-supply issue as it relates to the APR, EMCOS witness Wilson contends that the current market rules (specifically, section III.13.1.6 of Market Rule 1) preclude any possibility of price suppression by the simple means of concurrently removing both the self-supplied capacity and the load it is obligated to serve from the FCA. As a result, EMCOS argues that there is no price suppression resulting from self-supply that could require mitigation. Further, EMCOS states that because self-supply is capped at the relevant LSE's share of the ICR, self-supply cannot contribute to a surplus of capacity that suppresses future prices. Therefore, EMCOS argues that there is no justification for ISO-NE's proposal to re-price self-supplied capacity in accordance with a "silly" benchmarking pricing mechanism. Further, EMCOS contends that buyer-side market power is a "chimerical construct" that has no application to municipal self-supply.

223. EMCOS further contends that self-supply was never intended to be subject to price mitigation in the FCM, and therefore self-supply should remain outside of the scope of any APR developed in these proceedings. Rather, EMCOS argues that under the original APR, new self-supplied FCA resources were only "lumped" with OOM resources to "simplify the representation of those resources as price takers in the Forward Capacity Auction."[160] EMCOS contends that this "did not pose a problem" since any re-pricing under the original APR would reset to the lower of (i) $0.01 below the price at which the last bidder withdrew from the auction or (ii) CONE. EMCOS states that it takes no position on whether resetting FCM prices for OOM capacity that clears the FCA may be

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byproduct of a legitimate exercise of [the Commission's] power to regulate wholesale rates." *Mississippi Industries*, 808 F.2d 1525 at 1541-43.

[160] EMCOS First Brief at 4.

appropriate in contexts other than self-supply. EMCOS argues that the various proposals to re-price capacity from this proceeding would have three undesirable effects on self-supplied resources: (1) the ability of load-serving entities to hedge their ICR obligations through self-supply (either owned generation or purchased power) would be impaired or eliminated; (2) prices resulting from the FCA would be artificially increased over prices that would prevail if self-supply were allowed to operate as intended with no gain in efficiency or consumer welfare; and (3) increased reliance on administered pricing would promote inefficient entry at high prices, resulting in excessive costs to load. In order to avoid this scenario, EMCOS contends that any set of FCM revisions that may derive from this proceeding should specify that there should be no re-pricing of self-supplied FCA resources.

224. Public Systems contend that ISO-NE has not provided an answer to the Commission's question from the April 23 Order concerning how APR mitigation can be constructed so that load is able to hedge its capacity obligation outside of ISO-NE's capacity market with bilateral contracting. Public Systems contend that if self-supplied new resources and the associated load both "flow through the market," then there are concerns that two-tiered pricing could reduce self-supplied resources' value as hedges. Public Systems state that this could be an issue if self-supplied new resources are to be paid the Capacity Clearing Price regardless of whether they are OOM or in-market, while the associated load is required to pay a blended rate incorporating the Alternative Capacity Price. Public Systems contend that these concerns should be addressed in the stakeholder process provided for under the Commission-approved Participants Agreement.

225. ISO-NE notes that EMCOS's arguments are flawed in several respects. First, ISO-NE states that EMCOS is incorrect that self-supply is currently categorized as OOM merely to "simplify" the FCA. Rather, ISO-NE states that self-supply is designated as OOM because (absent the unusual circumstance of having zero capacity costs) it will be offering in the FCA at prices below its entry cost and can distort the FCA price like any other OOM resource. Second, ISO-NE argues that designating new self-supply as OOM does not limit the effectiveness of self-supply as a hedging mechanism since the OOM designation and the self-supply rules operate independently of one another. Third, ISO-NE contends that EMCOS is incorrect in stating that prices resulting from the FCA will be "artificially" increased over prices that would prevail if self-supply were allowed to operate as provided by the current market rule. Instead, ISO-NE notes that while counting self-supply as OOM may increase the Alternative Capacity Price, such an increase is appropriate and not "artificial." Fourth, in response to EMCOS's argument that the treatment of self-supply as OOM would promote inefficient entry at relatively higher prices, ISO-NE states that two-tiered pricing is specifically intended to address this concern, since it sends price signals to new resources that reflect the actual balance of supply and demand in the region.

226. NEPGA states that, because load parties now face the prospect of an "effective" APR, they seek a blanket exemption from OOM status for all self-supply resources; NEPGA argues that such a loophole should be denied. NEPGA states that the Commission's guidance that load have an opportunity to hedge its exposure through self-supply can be accommodated through a more "targeted remedy" that would prevent OOM resources from manipulating price. NEPGA alleges that the concern posed by an unlimited self-supply exemption is not hypothetical since the FCM has seen tremendous growth in self-supply, increasing 39 percent from the third FCA to the fourth FCA.[161] NEPGA states that this growth is not surprising due to the pro-rationing that occurs with the price floor and capacity surplus in New England – NEPGA notes that self-supplied capacity is exempt from pro-rationing, however, and is therefore worth relatively more in the market. As such, NEPGA contends that the addition of an unlimited APR exemption may result in a large fraction of capacity in ISO-NE being allocated on the basis of bilateral contracts and other self-supply arrangements, rather than through the auction process. NEPGA argues that, if new self-supply is granted an exemption from OOM status, the APR will remain ineffective since load parties wishing to exercise buyer market power would switch from bidding their OOM projects into the market at "anti-competitive" prices to designating them as self-supply. NEPGA avers that either approach creates exactly the same price suppression effect.

227. Responding to EMCOS witness Wilson's argument that self-supply cannot affect the FCM clearing price and thus cannot be a tool of price suppression, NEPGA contends that the unstated assumption implicit in this argument is that load interests would only add or designate an additional amount of self-supply if simultaneously choosing to add the same amount of load. NEPGA states that this argument is flawed since nothing in the Tariff requires load to add self-supply only when it chooses to increase load by the same amount. In support, NEPGA notes that, while there has been a "massive" buildup of load-sponsored capacity resources in the FCM, overall demand has remained flat. In addition, NEPGA notes that the cited Tariff section (III.13.1.6) specifically allows self-supply to be designated for either existing or new resources. Further, NEPGA argues that load entities could never commit to add self-supply exactly in step with increases in demand, since the overall level of load growth is not within their discretion but controlled by consumers. Thus, NEPGA argues that the only choice for load parties is whether to meet that demand through self-supply or by procurement in the auctions. NEPGA states that if a load party designates some quantity of capacity as self-supply, the effect is to pre-clear that capacity and remove it from the auction - with the exact same pricing effect as offering that capacity into the auction at a price of $0.

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[161] NEPGA Second Brief at 46.

228. NEPGA witness Shanker states that Wilson's argument suggests that as long as any procured self-supply equals or is less than demand, the fact that new resources can be used, even when there is a surplus, is irrelevant and does not impact the market. Shanker states that this argument is false since, if the decision were to procure *new* uneconomic supplies bilaterally when cheaper existing resources were available, the overall level of supply would be expanded, and prices, but for mitigation such as the proposed APR, would be artificially depressed. Shanker states that this is why the cited Tariff provision appropriately recognizes that new self-supply is OOM.

229. NEPGA contends that contrary to the arguments offered by load parties, an OOM designation does not lock a self-supplied resource out of the market. Instead, NEPGA states, the principal effect of an OOM designation is that, for purposes of setting the APR price, its offer is mitigated to a price reflecting its levelized cost of new entry while its offer in the FCA auction remains unaffected. NEPGA states that, for an efficient resource (with costs below the APR clearing price), this change has no effect. It clears, regardless of its offer, and the APR clearing price is the same as if the resource had not been designated as OOM. NEPGA notes that only inefficient new self-supply (self-supply with costs above the APR clearing price) would be affected by OOM designation, but it is unclear why load would be eager to protect inefficient new self-supply, which, by definition, costs more than the APR price.

c. Commission Determination

230. Although we are not approving ISO-NE's two-tiered pricing proposal, we disagree with EMCOS' contention that self-supply would not result in price suppression, and agree with ISO-NE that it is reasonable to continue to treat new self-supply as OOM capacity, consistent with the current Tariff.. We agree with ISO-NE that, compared to the capacity price that would exist in a base case where a new resource offered into the capacity market competitively at its full net entry cost, the effect of self-supplying the resource without buyer-side mitigation would be the same as if the resource were allowed to bid zero into the auction.

231. For example, suppose that a new 200 MW resource would not clear if offered at its full net entry cost and, thus, that its full net entry cost was above the Capacity Clearing Price. Compared to this base case, self-supplying the resource would remove 200 MW of load from the auction without changing the amount of supply in the market that had cleared the auction in the base case. This 200 MW reduction in demand would tend to lower the Capacity Clearing Price. Alternatively, compared to the base case, allowing the new resource to offer a price of zero into the auction without any buyer-side mitigation would also lower the capacity price; doing so would add 200 MW of supply whose offer price is lower than the marginal cleared source of supply in the base case, without changing the amount of demand. The additional 200 MW of supply would have the same price-reducing effect as in the case of self-supply. That is, the 200 MW decrease in

demand in the self-supply case would have the same price effect as a 200 MW increase in supply when the resource offers a zero price.

232. Since new self-supply has the same price effect as offering the new resource at a price of zero, it is reasonable to treat the resource as OOM in both circumstances. Failure to classify new self-supply as OOM would allow the mitigation mechanism to be circumvented. Importantly (as noted by load parties), while the April 23 Order states that the briefs in this proceeding "should include a discussion of how APR mitigation can be constructed so that load is able to hedge its capacity obligation outside of ISO-NE's capacity market with bilateral contracting," it also states that "such bilateral contracting [should] not distort the capacity market clearing price."[162] As indicated in the prior example, we find that any new self-supplied capacity that clears (through a zero-price offer rather than at full net entry cost) would distort the market clearing price. Therefore, we find that new self-supply offers should be subject to offer-floor mitigation.

6. Demand Curve

a. Comments and Responses

233. ISO-NE contends that if the Commission rejects two-tiered pricing and instead directs that all resources clearing in the FCA receive payments based on the relatively higher Alternative Capacity Price, it would then be appropriate to consider including an administrative demand curve in the FCM design. ISO-NE states that it did not consider such a proposal since it would completely abandon one of the core FCM design elements – purchasing only the ICR in the FCA.[163] ISO-NE argues that if the ICR limit on capacity purchases were abandoned, then a demand curve would impose some "rationality" on the procurement process, reducing the cost to consumers of purchasing additional capacity.

234. While acknowledging that it would be controversial, NEPGA similarly requests that if the Commission does not fully reform the APR, it should adopt a sloped demand curve. Boston Gen states that the Commission should explore alternatives like a demand curve if it is not prepared to mitigate all OOM entry. NEPGA notes that such a design has been adopted by NYISO and PJM in order to avoid some of the problems at issue in this hearing. NEPGA states that the adoption of a demand curve need not interfere with the descending clock auction of the FCM design. Rather, NEPGA proposes that the

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[162] April 23 Order, 133 FERC ¶ 61,065 at P 77.

[163] ISO-NE notes that, by contrast, the two-tiered pricing mechanism seeks to keep the overpurchase to a minimum.

auction should open at the ceiling price for capacity and the minimum quantity required. NEPGA states that as the auction continues the price would gradually decrease and the quantity would gradually increase with the auction stopping when the amount of resources offered matches the current quantity.

235. Further, NEPGA states that the "sole argument" in favor of a vertical demand curve – that it assures that the amount of capacity procured exactly matches the ICR – should carry little weight since even a gently sloped demand curve could insure that the amount of capacity procured approximates the ICR. NEPGA also notes that the ICR is subject to error since it is an administrative forecast of requirements three or more years into the future. NEPGA also states that a demand curve is not a new idea within the FCM since, for example, the quantity rule, which defers purchases to replace high-priced de-listing capacity from the FCA to reconfiguration auctions, is an example of a demand curve "under another name." NEPGA also notes that other complicated features of the FCM, introduced to compensate for problems caused by the vertical demand curve, could be eliminated if a sloped demand curve was employed. For example, NEPGA states that sloped demand curves would allow separation of zones when the supply/demand balance or costs diverge without relying on higher offer prices from resources in a constrained import zone. Last, NEPGA states that a "ready model" already exists: the LICAP demand curve which was fully litigated and approved by the Presiding ALJ.

236. Boston Gen witness Bidwell avers that in contrast to the current vertical demand curve in the FCM, an administratively-determined demand curve would make the capacity market more resilient to OOM entry. Bidwell contends that a conventional, inelastic demand curve makes sense in other markets because the rapid price decrease discourages the addition of non-subsidized capacity in excess of the required amount. However, he argues that such a curve would allow a buyer in a market with significant OOM resources to manipulate the market. Thus, Bidwell contends that the "second-best approach" in New England would be some form of elastic demand curve that would allow the existing surplus to be worked off over time.

237. JFS states that NEPGA's proposed demand curve is "almost indistinguishable" from the LICAP demand curve that was considered prior to the current FCM construct. JFS states that a demand curve would be unjust and unreasonable for three reasons. First, JFS asserts that a demand curve does not ensure reduced volatility, noting that PJM's demand curve for its RPM has produced erratic prices, and the sloped demand curve is susceptible to the exercise of market power. Second, JFS states that the demand curve will result in capacity purchases in excess of the ICR; JFS notes that PJM's demand curve has resulted in large capacity surpluses, perhaps because it sends insufficient price signals for retirement. Last, JFS states that the LICAP demand curve itself was highly contentious and therefore could not be used for a very different function in the FCM.

238. JFS argues that Bidwell's proposed elastic demand curve contradicts his prior testimony in the LICAP proceeding on behalf of the CT DPUC and the CT OCC that no

demand curve could work. JFS states that Bidwell argued there that an administratively determined demand curve will rely on non-market inputs that are arbitrary in nature. JFS contends that in consideration of his prior LICAP testimony, the Commission should not credit Bidwell's position here. Further, JFS contends that Bidwell's proposed elastic curve would be unjust and unreasonable as it would be relatively flatter than previous curves considered for New England. As such, JFS avers that this demand curve would improperly require payment to virtually all existing resources with no price signal to retire when there is a capacity surplus.

b. Commission Determination

239. As we are requiring ISO-NE to implement offer-floor mitigation, we find the arguments addressing the pros and cons of a potential demand curve to be moot. To the extent that generator parties request a downward sloping demand curve to address other issues in this proceeding (including the revised dynamic de-list bid threshold under the July 1 Proposal), we note that our approval of the general framework of ISO-NE's July 1 Proposal on zones and market power mitigation also moots these additional rationales.

7. Demand Response Comparability in OOM Determination

a. Comments and Responses

240. Boston Gen argues that the FCM rules should be revised to treat demand response resources and generation resources comparably for the purposes of assessing whether capacity is OOM. Boston Gen asserts that the current rules understate demand response resources' costs by failing to account for their opportunity costs and subsidies paid to consumers. Boston Gen and NEPGA claim that, as a result, a substantial amount of these resources have entered in the market as unaccounted-for OOM capacity. Boston Gen contends that the subsidies provided to such resources have and will continue to affect the FCA price. In addition, Boston Gen states that the Tariff "appears" to require the IMM to calculate demand response resources' long-run average costs for OOM purposes in a manner that ensures that these costs will be less than or equal to zero, meaning that a demand response resource would not be considered OOM until the FCA clearing price drops to zero.

241. In response, the IMM reiterates that the relevant Tariff provisions approved in the April 23 Order were clarifying in nature and did not change the basic principle that differentiates OOM capacity from in-market capacity.[164] Further, the IMM notes that,

[164] The IMM states that the current rule applies standard accounting and valuation techniques to determine whether an offer below 0.75 * CONE is consistent with the

(continued…)

while the methodology is the same for demand resources and generating resources, the implementation (principally the input data) of the analytical framework differs for demand resources and generation, respecting the differences between the resources types. At a high level, the IMM states, the analysis of what determines whether an offer from a demand resource should be found to be OOM involves the following steps: (1) measure the total costs of the demand resource regardless of who incurs the costs;[165] (2) measure the total benefits incremental to the demand resource (using the market rules that define allowable revenues and excluding any capacity revenues) regardless of who obtains the benefits;[166] and (3) determine if the difference between costs and benefits on a present value basis exceeds 0.75 * CONE (or exceeds 0.8 * the relevant benchmark costs under the ISO's revised APR proposal). By way of comparison, the IMM states that if this evaluation involved an offer from a generating resource, it would consider both equipment and construction costs and operating and maintenance costs in Step 1 and wholesale electric market revenues and in-market benefits such as renewable energy credits in Step 2.

242. The IMM states that Boston Gen is incorrect in its claim that the IMM's OOM analysis inappropriately ignores two types of opportunity costs for demand resources (payments to consumers not to consume electricity and payments to consumers to install energy-saving devices). The IMM states that its offer evaluation analysis examines all costs expended to establish a demand resource, including those borne by the participant, end-use customer and any other entity, including incentive payments such as utility subsidies and the cost of foregone (deferred or lost) production. The IMM states that the analysis treats customer "rebates" and other expenditures by utilities or demand providers incurred either to encourage demand reduction by lowering the installed cost of program measures or as direct compensation for load curtailed as project costs. In addition, the IMM states that it requests data from participants in the FCA about the cost of lost productive activities for end-use customers from participating in demand resource projects. In summary, the IMM claims that all appropriate opportunity costs are included in its analysis of demand resources.

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present value of the project's expected future in-market net cash flows (revenues less costs).

[165] The IMM states that these costs include: (a) utility costs; (b) end-use customer costs; and (c) any third party costs, if applicable.

[166] The IMM states these benefits primarily are the value of avoided energy consumption.

243. Further, the IMM addresses Boston Gen's argument that, under the current Tariff, a demand resource could not be considered OOM until the FCA clearing price drops to zero or to negative prices, if possible. The IMM notes that the analysis and example supporting Boston Gen's conclusions are incorrect; the IMM states that Boston Gen's cited example does not include any opportunity cost for the reduction in consumption. The IMM notes that the "appropriate standard" for the review of offers is a comparison of the offer to the present value of the net cash flows to the project, regardless of the allocation of project costs and benefits among the different parties.

b. Commission Determination

244. Boston Gen and NEPGA continue to assert (consistent with their positions reflected in the April 23 Order and the August 12 Order) that (1) subsidized demand response is largely responsible for the FCM clearing at the price floor in all four auctions held to date and that (2) the IMM's analysis inappropriately ignores opportunity costs for demand resources when assessing whether their offers are OOM. We have previously noted that the IMM has stated that the first three FCAs would have reached the administrative price floor even absent the OOM capacity.[167] In addition, we also considered these arguments in our August 12 Order where we denied NEPGA's motion for disclosure of information considered by the IMM as it determined whether it considered resources to be OOM for prior FCAs. Our basis for denial was that "NEPGA has not provided any basis for the Commission to reexamine the IMM's OOM determinations from the first three FCAs."[168] The Commission noted that NEPGA failed to acknowledge the "uncontradicted representation" that the relevant rule clarifications "do not change the current Tariff's basic principle that differentiates out-of-market capacity from in-market capacity."[169] Last, we stated that "we will not permit NEPGA to expand the scope of the paper hearing in this case" to revisit the IMM's historical OOM determinations.[170]

245. In the paper hearing, the generator parties continue to assert that the IMM has not properly assessed OOM capacity to date, with Boston Gen and NEPGA arguing that demand resources have improperly entered this market in significant quantities without being determined to be OOM. For example, NEPGA witness Stoddard argues that,

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[167] April 23 Order, 131 FERC ¶ 61,065 at P 150.

[168] August 12 Order, 132 FERC ¶ 61,122 at P 56.

[169] *Id*. P 56 (citing Joint Filing, Transmittal Letter at 20).

[170] *Id*. P 58.

because in the third FCA, "every kilowatt of in-market new Demand Resources had as its lead participant either a utility or a state entity," then "there is reason to question whether" these resources should "have been categorized as OOM under the FCM Revision."[171] In fact, Stoddard's entire basis for arguing that demand resources were improperly categorized appears to be that these resources should be defined as OOM simply because they were offered by a state entity or utility. We do not find such an assertion to be an adequate basis for finding a resource to be OOM when specific Tariff rules exist in order to make that determination, rules that have not changed the OOM methodology. Further, we note that ISO-NE has already addressed this point in this proceeding. In response to Stoddard's same assertion in the proceeding that led to the April 23 Order, ISO-NE stated that Stoddard is incorrect that every kilowatt of in-market new demand resources was offered by a utility or state entity, since "utility and state sponsored demand response only constituted roughly 30 percent of the demand response resources that received obligations" in the first three FCAs.[172]

246. Likewise, Boston Gen asserts that the current rules understate demand response resources' costs by failing to account for their opportunity costs and subsidies paid to consumers. The IMM fully refutes these points in its September 1 brief as summarized above. In its brief, the IMM notes that Boston Gen's assertions are incorrect, since "the IMM applies the same methodology to both generating resources and demand resources," and the IMM's analysis "examines all costs expended to establish a demand resource, including those borne by the participant, end-use customer and any other entity."[173] Boston Gen does not respond to the IMM's brief, instead reiterating in its subsequent brief that "much of the 2,778 MW of demand response that entered during the first two FCAs likely would have qualified as OOM under ISO-NE's proposed FCM revisions."[174] Boston Gen provides no additional support for this statement, which contradicts our April 23 and August 12 Orders and the testimony of the IMM in the instant proceeding. We continue to find no support for the allegations NEPGA and Boston Gen raise in this regard and therefore will not require any Tariff modifications.

247. Last, since we are approving ISO-NE's proposal not to "carry forward" any historical OOM when assessing whether its revised APR should trigger, to the extent

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[171] NEPGA First Brief, Ex. 2 at 43 (Stoddard Testimony).

[172] ISO-NE April 6 Answer at 6.

[173] IMM September 1 Brief at 8-9.

[174] Boston Gen Third Brief at 10.

Boston Gen and NEPGA seek to update the historical OOM quantity, such analysis would be moot.

8. Joint Complainants' Takings Argument

a. Joint Complainants' Argument

248. Joint Complainants assert that "[t]he Commission has an obligation to ensure that capacity suppliers are afforded the opportunity to receive compensatory rates, which in this case means providing capacity suppliers a reasonable opportunity to recover their fixed and variable costs, plus a profit."[175] They state that this obligation is grounded in the prohibition against takings of private property for public use without just compensation, found in the Fifth and 14th Amendments to the U.S. Constitution. Joint Complainants cite to *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*,[176] which states that "[r]ates which are not sufficient to yield a reasonable return on the value of property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."

249. Joint Complainants state that the courts look to three factors in determining if an action constitutes a compensable regulatory taking: (1) the economic impact of the regulation on the seller; (2) the extent to which the regulation interferes with the seller's investment-backed expectations; and (3) the character of the governmental action. Applying these rules, Joint Complainants assert that the impact of dysfunctional FCM rules on the fair market value of generating resources in New England is substantial, with many units anticipated not to make a profit, even over the long run; it also states that many market participants, including NRG and PSEG, entered into the market in reliance on the Commission's assurance that the New England markets would permit units to have a reasonable chance of recovering their fixed costs of new entry, plus a profit, over a reasonable long-run horizon. Joint Complainants acknowledge that the Commission's stated goal has always been to ensure that capacity suppliers receive just and reasonable compensation, but assert that unless the Commission addresses the flaws in the FCM

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[175] Joint Complainants First Brief at 26.

[176] 262 U.S. 679, 690 (1923) (*Bluefield*). Joint Complainants also cites to *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (*Hope*) (stating that "just and reasonable" rates must provide "enough revenue not only for operating expenses but also for the capital costs of the business" and be sufficient for the utility to "maintain its credit and attract capital").

construct, the operation of the market rules in New England in their current form will have the effect of depriving capacity suppliers of the value of their private property.[177]

250. Joint Complainants further state that the Commission has recognized this principle in recent cases, citing to a case in which the Commission addressed concerns that "ISO-NE's market rules . . . could result in compelling an existing generating resource being required to offer capacity at a price less than its net risk-adjusted going forward and opportunity costs, [which] raise the possibility of confiscatory ratemaking, a result that is unjust and unreasonable."[178] Joint Complainants also cite to *PJM Interconnection, LLC*, in which the Commission stated that "[i]t is questionable whether PJM could impose, or the Commission could enforce, a requirement that generators continue to operate at a loss."[179]

b. Commission Determination

251. As is clear from the April 23 Order and this order, the Commission has required, and is continuing to require, that ISO-NE develop effective market rules to protect suppliers from the exercise of market power by buyers. We reject the view, however, that a resource that provides capacity in New England has a property right to be compensated at its desired level for that service such that an abrogation of that property right is prohibited by the Fifth Amendment.

252. The utility regulatory paradigm under which the Supreme Court decided *Hope* and *Bluefield* has changed:

> Historically, vertically integrated utilities owned generation, transmission, and distribution facilities. They sold generation, transmission, and distribution services as part of a "bundled" package. Due to technological limitations on the distance over which electricity could be transmitted, each utility served only customers in a limited geographic area . . . .
> Since enactment of the Federal Power Act in 1935, the electricity

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[177] Joint Complainants First Brief at 26-29.

[178] *ISO New England Inc.*, 120 FERC ¶ 61,087 at P 52.

[179] *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, at P 36 (2006) (*PJM*).

> industry has undergone significant change, both economically and technologically.[180]

253. In the era of *Hope* and *Bluefield*, each utility had a franchised service territory and was required to serve every customer in that territory; as a corollary, customers were permitted to take service only from that utility. It was understood that a utility's ability to provide service to its customers was dependent on its financial health; therefore, the Supreme Court recognized that, so as to ensure the provision of service at just and reasonable rates to the utility's customers as required by the Federal Power Act, it was necessary to require that the utility was able to recover its costs and a reasonable profit.

254. Today, however, the Commission regulates under another paradigm. Rather than requiring utilities and their customers to remain locked into a business relationship in perpetuity, we have endorsed – and been upheld by courts in endorsing – competition among utilities to serve customers as a mechanism to bring about just and reasonable rates.[181] And, as in all markets, regardless of what "investment-backed expectations" a resource may have had at the time that it chose to enter the ISO-NE markets, each market entrant was aware of the possibility that at some times, it might earn substantially more than a traditional cost-based rate, but that at other times, it might earn less than its

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[180] *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 681 (D.C. Cir. 2000), *aff'd*, *New York v. FERC*, 535 U.S. 1 (2002).

[181] *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) (court upholds Commission's reliance on market-based pricing, where there is a competitive market sufficient to assure just and reasonable rates); *Louisiana Energy & Power Auth. v. FERC*, 141 F.3d 364, 365 (D.C. Cir. 1998) (where there is a competitive market, Commission may rely on market-based rates in lieu of cost-of-service regulation to ensure that rates are just and reasonable); *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the Cal. Indep. Sys. Operator and the Cal. Power Exchange*, 95 FERC ¶ 61,418, at 62,559 (2001) (Commission is free to adopt market-based rates), *order on reh'g*, *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 97 FERC ¶ 61,275 (2001), *order on reh'g*, *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Serv.*, 99 FERC ¶ 61,160 (2002), *remanded on other grounds*, *Port of Seattle v. FERC*, 499 F.3d 1016 (9th Cir. 2007), *order on remand*, *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange*, 129 FERC ¶ 61,147 (2009).

costs.[182] The Commission has made clear that "'in a competitive market, the Commission is responsible only for assuring that [a resource] is provided the *opportunity* to recover its costs,' not a guarantee of cost recovery."[183]

255. Moreover, resources are not compelled to participate in the FCM; the FCM market design provides each resource with the ability to choose whether or not to remain in the FCM. Each existing capacity resource chooses each year what kind of de-list bid to submit, and, if it anticipates that the capacity price may not meet its needs, may choose a type of bid that will permit it to retire its resource if it does not receive an acceptable price. If, however, a resource chooses not to do so, then it must accept the price at which the market ultimately clears. The Commission made clear in a recent case that resources should choose their capacity bids carefully, with attention to the consequences, recognizing that, if a resource so wished, it could select a de-list bid that would not require it to provide capacity at what it might consider to be an unacceptable price.[184]

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[182] If we were to allow a rate that recovered more than a traditional cost-based rate when the market rate exceeded that traditional cost-based rate, but then allowed a traditional cost-based rate when the market rate dropped below that traditional cost-based rate, such a "higher of cost or market" regime would inevitably produce a rate that not only would guarantee cost recovery (not just the opportunity for cost recovery), but likely would guarantee more than cost recovery. Such a rate would be unjust and unreasonable.

[183] *ISO New England Inc.*, 132 FERC ¶ 61,187, at P 10 (2010) (citing *ISO New England Inc.*, 128 FERC ¶ 61,023, at P 34 (2009); *Bridgeport Energy, LLC*, 113 FERC ¶ 61,311, at P 29 (2005) (*Bridgeport*) ("While we do not deny Bridgeport's right to file for a cost-based rate, the Commission has no obligation in a competitive marketplace to guarantee Bridgeport its full traditional cost-of-service. Rather, in a competitive market, the Commission is responsible only for assuring that Bridgeport is provided the *opportunity* to recover its costs." (emphasis added))).

[184] *ISO New England Inc.*, 132 FERC ¶ 61,044, at P 29 (2010):

> By submitting static de-list bids, . . . Dominion chose to preserve its opportunity to participate in the FCM and to offer into the energy and ancillary services markets in future years, with the associated possibility of receiving revenues in excess of its costs. Dominion made this choice even though, as Dominion was aware, it could potentially be required to accept a capacity price that would not, in Dominion's view, enable it to fully recover its costs. If, by contrast, Dominion had chosen to submit a permanent de-list bid or a Non-Price Retirement Request, it would have been eligible to receive compensation covering its cost-of-service, including the disputed

(continued…)

Thus, there can be no question of confiscation of a resource's property by compelling it to continue providing service.

256. The two cases Joint Complainants cite are not on point. In the 2007 ISO-NE case where the Commission addressed the possibility that "ISO-NE's market rules, as proposed, could result in compelling an existing generating resource being required to offer capacity at a price less than its net risk-adjusted going forward and opportunity costs," so that "confiscatory ratemaking" might result,[185] the Commission was addressing a situation in which a generator had already chosen to submit a de-list bid that would require it to stay in the market, and that required discussions with the IMM before the de-list bid could be entered in the auction. The Commission's concern was to ensure sufficient fairness to the resource during discussions with the IMM, and ISO-NE submitted a compliance filing resolving the Commission's concerns which the Commission subsequently accepted.[186] Similarly in *PJM*, the Commission was considering a different kind of problem – namely, whether existing capacity resources could be required to continue providing capacity to PJM for longer than a specified brief period, once they indicated their intent to retire – and it was in response to this question that the Commission stated that "[i]t is questionable whether . . . the Commission could enforce[] a requirement that generators continue to operate at a loss."[187] We emphasize that we have thoroughly reviewed all the various proposals and comments submitted in these consolidated proceedings and considered the various parties' concerns and positions. Given this, we reject the claim that our actions in approving any specific modifications to the FCM rules amount to a "taking" without due compensation.

257. It is, therefore, inaccurate for Joint Complainants to suggest that as a general matter, they are being compelled to provide capacity to ISO-NE at a confiscatory price. As shown above, each capacity resource in ISO-NE is provided with a choice. If a resource decides, after assessing its own business plan and needs, that participation in the FCM is right for it, it must accept the capacity price that results from the operation of the FCM auction, which may or may not be a price that enables a resource to cover its costs and earn a satisfactory profit. But if a resource does not wish to take that risk, nothing

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> costs at issue here, for the period when its resource was needed for reliability, while giving up the opportunity to receive revenues in excess of its costs in future years.

[185] *ISO New England Inc.*, 120 FERC ¶ 61,087 at P 52.

[186] *ISO New England Inc.*, 121 FERC ¶ 61,070 (2007).

[187] *PJM*, 115 FERC ¶ 61,079 at P 36 (footnote omitted).

compels it to do so. Thus, there can be no question of confiscation under the Fifth Amendment.

C. Zones and Market Power Mitigation

1. April 23 Order

258. While accepting certain revisions related to the modeling of zones outright,[188] in the April 23 Order establishing this paper hearing, the Commission directed parties to comment on the following: whether zones should always be modeled, whether all de-list bids should be considered in the modeling of zones, whether a pivotal supplier test is needed, and whether market power mitigation should be revised if zones were always modeled. Importantly, while the April 23 Order approved certain rule revisions that made it more likely that certain de-list bids would trigger the formation of additional zones (pending the outcome of this paper hearing), that zonal determination still was performed before the auction.[189]

2. The July 1 Proposal

259. In response to the April 23 Order, ISO-NE proposes to model all zones all the time in order to allow for a greater possibility of price separation during an auction.[190] Key elements of the zonal proposal are: (1) the use of eight energy load zones as initial capacity zones; (2) the use of a stakeholder process for vetting future zonal designations; (3) the expanded use of de-list bids to trigger zone formation; and (4) revisions to the descending clock auction. However, because smaller zones are more vulnerable to the exercise of market power, ISO-NE also proposes corresponding revisions to the market power mitigation measures. Key elements of the proposed market power mitigation rules are: (1) revisions to the dynamic de-list bid threshold; (2) revisions to the calculation of

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[188] For example, the Commission approved setting the LSR for an import-constrained zone equal to the capacity needed to satisfy the higher of (i) the LRA or (ii) the TSA.

[189] Capacity zones would be established only when the existing internal resources for an import-constrained zone could not satisfy the LSR.

[190] In other words, ISO-NE will model zones regardless of whether the projected installed capacity in the import-constrained load zone is less than the load zone's LSR.

static and permanent de-list bids;[191] and (3) elimination of the pivotal supplier test. Additionally, ISO-NE proposes to eliminate the quantity rule.

3. Model All Zones All the Time

260. In its July 1 Proposal, ISO-NE emphasizes that its current use of large zones makes it difficult to properly reflect electrical constraints, resulting in the need to reject de-list bids and to pay these resources an out-of-market price. ISO-NE states that this scenario happened during the first and third FCAs. Under the current rules, the rejection of a de-list bid results in a resource being compensated at its offer price while the other resources in the zone receive the pool-wide price. If capacity zones are modeled all of the time, ISO-NE argues that a local reliability need would have a greater chance of being met with resources clearing in the market rather than rejected de-list bids. However, ISO-NE notes that modeling all zones all the time does not necessarily mean that price separation will occur. Rather, explicitly modeling all zones only allows for the possibility of zonal price separation during the auction.

a. Eight Energy Load Zones as Initial Capacity Zones

261. ISO-NE proposes to use the eight energy load zones as capacity zones for the sixth FCA.[192] ISO-NE asserts that the existing energy load zones capture most, but not all, of the relevant electrical constraints in the transmission system. ISO-NE states that the capacity zones modeled in each FCA will be used for subsequent annual reconfiguration auctions associated with the same capacity commitment period.[193]

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[191] Permanent de-list bids enable a resource to leave the FCM permanently, and they must be reviewed by the IMM if they exceed 1.25 * CONE.

[192] The eight load zones are Connecticut, Maine, New Hampshire, Rhode Island, Vermont, Northeastern Massachusetts/Boston, Southeastern Massachusetts, and Western/Central Massachusetts.

[193] ISO-NE's proposal to use the eight existing energy load zones as capacity zones and to model those zones in subsequent annual reconfiguration auctions was also proposed in the Joint Filing. However, since we find the Joint Filing zonal modeling proposal to be unjust and unreasonable, we must reassess ISO-NE's proposal to use the eight existing energy load zones as capacity zones in the context of ISO-NE's expanded zonal modeling proposal.

i. Comments and Responses

262. Load parties favor retention of the status quo and do not generally support ISO-NE's proposal to use the eight energy load zones as capacity zones for the sixth FCA. As stated previously, JFS and Mass DPU are satisfied that the zonal proposal accepted in the April 23 Order is a just and reasonable approach to balancing the need to set appropriate locational rates and prevent existing generators from creating a separate zone through the exercise of market power. In their view, ISO-NE's current zonal modeling that uses the higher of the TSA or the LRA to determine the LSR will virtually eliminate the need for ISO-NE to reject de-list bids for reliability reasons.

263. JFS argues that ISO-NE has not adequately justified the use of the eight energy load zones. For example, they claim that ISO-NE has not adequately addressed what relevant electrical constraints were not captured by the current zonal methodology or how market power concerns raised by these new potential zones might be mitigated. In fact, JFS is not confident that any revisions to market power mitigation can satisfactorily address market power concerns that would be raised by ISO-NE's proposal to model all zones. Mass DPU questions whether new generation could effectively respond to any additional zonal price signals because siting new generation in small zones in congested urban and suburban areas is difficult. However, if the Commission agrees that zones should be modeled all the time, Mass DPU asks that the Commission revisit whether using the higher of the TSA and LRA to set the LSR continues to be appropriate.

264. JFS and National Grid raise the concern that ISO-NE's proposal will result in the balkanization of markets. According to JFS, it would be unjust and unreasonable for the Commission to set a zonal modeling standard that attempts to guarantee that the resources within a zone will be enough to meet the system reliability needs under all circumstances. JFS points to the PJM RPM as an example of zonal pricing that is not having the desired impact of attracting and retaining capacity in constrained zones. In their view, even though price separation occurred in PJM's RPM, zones with high clearing prices have not attracted or retained relatively more capacity compared with the rest of the RTO zone.

265. Generator parties generally support ISO-NE's July 1 Proposal to model all zones all the time.[194] They note that the current rules largely prevent zonal separation from occurring, and localized reliability needs have required out-of-market actions. Further, NEPGA contends that the modeling and mitigation rules accepted in the April 23 Order will not permit locational pricing, noting that even if the Joint Filing's revisions had been

[194] ISO-NE's EMM also filed comments supporting ISO-NE's proposal to model all zones all the time.

in place during previous FCAs where de-list bids were rejected for reliability, zonal price separation still would not have occurred. Therefore, NEPGA states that modeling all zones all the time is necessary to permit price separation in all circumstances when price separation should occur but asserts that even more zones may need to be modeled.

266. Specifically, NEPGA questions ISO-NE's statement that the use of the existing energy load zones as capacity zones only "partially coincides with the natural electrical boundaries that would be consistent with 'pure' capacity reliability zones."[195] According to Stoddard, ignoring important physical realities is not acceptable. NEPGA argues that additional sub-zones may be necessary in certain situations (i.e., if a de-list bid is again rejected for reliability reasons without any locational price differences).[196]

267. In its response, ISO-NE states that while both suppliers and load have objected to some aspects of its revised zonal modeling provisions, no party has raised a credible reason to reject or modify the proposal.

268. Although load parties support the Joint Filing's revisions to zonal modeling, ISO-NE disagrees that these revisions are adequate, since the revisions do not provide a locational price to resources in zones that have an amount of capacity that is at or near the zone's LSR, and, without a locational price, it is difficult to maintain reliability with in-market options.[197] Further, consistent with NEPGA's comments and our finding in the April 23 Order,[198] ISO-NE notes that, even if the requirement to use the higher of the LRA or TSA in calculating LSR had been in place prior to the first FCA, in none of the auctions to date would the "higher of" requirement triggered the modeling of a zone despite bids being rejected for reliability. ISO-NE also objects to Mass DPU's proposal that the Commission re-examine the appropriateness of using the "higher of" LSR value, since modeling zones all the time has no bearing on or relation to the level of the actual reliability requirement but rather is the "means to the end" of actually meeting that requirement. ISO-NE argues that the load parties are trying to improperly connect two

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[195] ISO-NE Second Brief at 30.

[196] NEPGA's concerns regarding the situation in which a de-list bid is rejected for reliability reasons is discussed later in the order.

[197] ISO-NE cites the Kleen Energy accident and potential closure of Vermont Yankee, which could require ISO-NE to issue Gap RFPs to maintain reliability to illustrate the consequences of failing to model zones.

[198] April 23 Order, 131 FERC ¶ 61,065 at P 134.

separate and discrete issues in a manner that reduces the probability that locational value will be reflected in market outcomes.

269. ISO-NE also contends that it is not seeking to set a zonal modeling standard that "captures every possible combination of constraints that may arise."[199] Rather, ISO-NE agrees that the LSR should be set "at a level sufficient to cover most reasonably anticipated events, [but] it will not be set at a level high enough to guarantee that every combination of obligated resources within the zone will meet system needs."[200]

270. Moreover, ISO-NE asserts that JFS's statements regarding PJM's RPM represent an attack on locational capacity markets – an issue long ago addressed by the Commission. Further, ISO-NE argues that the other RTO capacity markets (including PJM's) are different in many respects and thus are not directly comparable to New England. Similarly, NEPGA asserts that JFS's claim that locational pricing in RPM has not attracted new entry ignores whether it would have been profitable for a new entrant to build in a constrained zone in PJM, RPM's bias in favor of transmission solutions when constraints are binding, and the effect of state-sponsored OOM entry in PJM.

271. In response to the generator parties, ISO-NE contends that the existing energy zones captures most of the relevant electrical constraints in the transmission system and are therefore an appropriate starting point for determining which capacity zones to model. While ISO-NE examined different options for modeling capacity zones, ISO-NE states that, due to the complexity of implementation of some of the options presented, known auction and settlement software limitations, and the benefits of using existing energy load zones, it was decided that energy load zones and/or their subdivision(s) would be used as potential capacity zones in the FCA.

ii. <u>Commission Determination</u>

272. We accept ISO-NE's proposal to use the eight energy load zones as initial capacity zones.[201] More comprehensive zonal modeling permits greater market transparency

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[199] ISO-NE Third Brief at 68-69 (citing Joint Filing Supporters Second Brief at 32).

[200] *Id.* at 69 (citing FCM Redesign Filing, Transmittal Letter at 25).

[201] While ISO-NE states that it will commit to such a change in time for the sixth FCA, as stated elsewhere in this order, we will require ISO-NE to file a proposed schedule for filing market rules in accordance with this order on paper hearing (including on this issue) within 30 days of its issuance.

because it reduces the likelihood of rejecting de-list bids and relying on out-of-market solutions. While this greater transparency is preferable, load parties have noted that the Commission has previously not required ISO-NE to model all zones all the time because smaller zones enhance market power concerns.[202] As discussed further below, ISO-NE and its IMM have proposed revised market power mitigation provisions to address this concern. Therefore, we see no reason to further delay the modeling of all zones all the time.

273. Both load parties and generator parties agree that locational pricing is appropriate; however, these parties disagree as to what extent revisions are necessary. As noted previously, load parties believe that ISO-NE's current Tariff provisions regarding zonal modeling are sufficient. By contrast, generator parties support the revisions proposed in the July 1 Brief but suggest that even more zones may need to be modeled (including whenever de-list bids are rejected for reliability). As discussed further below, we reject both parties' arguments, and we accept ISO-NE's July 1 Proposal.

274. As discussed previously, we find the Joint Filing zonal modeling proposal unjust and unreasonable because it continued to rely on the rejection of de-list bids to support local reliability. We find that the July 1 Proposal addresses many of the deficiencies in the Joint Filing with respect to zones. Instead of modeling a separate zone only when the projected installed capacity in the import-constrained load zone is less than the load zone's LSR, ISO-NE proposes to determine the appropriate capacity zones in advance of the auction and then to continue to model those specific capacity zones for that capacity commitment period. Therefore, a zone could be modeled, even if projected installed capacity in the zone was slightly higher than the LSR or if a localized need develops in a reconfiguration auction. This creates a greater likelihood that zonal price separation will be allowed to reflect actual locational needs. We also note that, contrary to concerns

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[202] *See* Joint Filing Supporters First Brief at 39 (citing FCM Settlement Order, 115 FERC ¶ 61,340 at P 123):

> [I]f auction results were used to force local capacity zones/local auctions, …sellers of capacity would have the incentive to withhold capacity to create price separation and separate capacity zones where they are not necessary. These constraints would bind only because of the exercise of market power, and not because of actual physical limitations arising from competitive market conditions. The locational feature of the [FCM] Settlement Agreement, in contrast, will be based on an objective analysis of actual transmission system constraints.

expressed by load parties, this does not mean that price separation will result; prices will only separate if constraints bind. Further, as discussed below, ISO-NE's revised proposal to always model zones also includes revised mitigation rules.

275. We dismiss arguments by both load and generator parties that basing potential capacity zones on the existing energy load zones might not be appropriate. Specifically, load parties argue that ISO-NE has not sufficiently justified the need for the proposed eight capacity zones, while generator parties question whether the proposed eight capacity zones reflect the physical realities of the system. ISO-NE has explained the benefits of using the existing energy load zones as the basis for potential capacity zones, including: (1) avoiding the creation of another zonal system in the ISO markets; (2) conforming to existing ISO settlement systems and market trading patterns; (3) ensuring that capacity zones will not cross state or utility boundaries; and (4) partially coinciding with the electrical boundaries of what could be considered "pure" capacity zones.[203] We recognize that the development of zones is not a simple task, and we therefore find it reasonable that ISO-NE use the existing energy load zones as the basis for potential capacity zones.

276. We also disagree with load party arguments that zonal pricing in PJM has failed to achieve the objectives of attracting and retaining capacity in constrained zones; RPM has consistently acquired sufficient resources to meet capacity needs. Further, JFS's arguments concerning RPM fail to establish that ISO-NE's proposal to always model capacity zones is an unjust and unreasonable approach to addressing local reliability concerns. As ISO-NE notes, there are important differences between the two markets. Moreover, we note that capacity markets, such as RPM and FCM, provide only one source of market-based revenue for capacity resources. Other factors that influence investment decisions included expected energy and ancillary service revenues, the estimated cost of transmission expansions and upgrades, and risks created by an uncertain economic climate and regulatory actions that could affect long-term profitability. Accordingly, decisions by a resource to enter the market cannot be attributed solely to an increase in a capacity market price for a particular future one-year period.

277. We also dismiss Mass DPU's request that the Commission revisit the use of the higher of the TSA or LRA to set LSR. The Commission approved the use of the "higher of" method in the April 23 Order; therefore, this issue is not properly within the scope of the paper hearing.[204]

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[203] ISO-NE Second Brief at 31 (citing Joint Filing, Karl Testimony at 5).

[204] April 23 Order, 131 FERC ¶ 61,065 at P 108.

b. Stakeholder Process for Determining Future Zones

278. Prospectively, ISO-NE states that it will develop the zones to be used subsequent to the sixth FCA and will vet these changes through the ISO-NE system planning stakeholder process prior to any subsequent section 205 filing.

i. Comments and Responses

279. NEPGA cautions against any process that gives stakeholders decision-making authority to determine when to add zones because many stakeholders fundamentally oppose locational pricing and higher local prices that a new zone may entail. Instead, NEPGA suggests that a standard distribution factor (DFAX)[205] analysis be utilized to develop the zones.

280. JFS objects to ISO-NE's proposal to develop zones to be used subsequent to the sixth FCA using as yet undisclosed criteria.

281. In response to NEPGA's argument that stakeholders should not have input into the decision of when to add zones, ISO-NE notes that the development of zones is not a simple task and a black and white solution is not easily achieved. ISO-NE states that it is not opposed to the use of the DFAX analysis but cautions that its application to the determination of zones is still in development and requires certain assumptions. For example, ISO-NE states that one of the many critical factors in such an analysis is the cutoff threshold (distance threshold) at which the steady-state thermal impact of a resource is no longer a concern. ISO-NE argues that technical judgment plays a role in this analysis, and therefore zonal modeling can not be a purely data-driven formulaic process, as advocated by NEPGA.

282. According to ISO-NE, JFS's arguments regarding this issue are misplaced, since future zones will be developed or changed through the stakeholder process with a section 205 filing.

ii. Commission Determination

283. We accept ISO-NE's proposal to develop any future zones through ISO-NE's system planning stakeholder process. We dismiss NEPGA's arguments that the stakeholder process should not be used and that a standard DFAX analysis would better develop the zones. We agree with ISO-NE that zonal modeling requires technical

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[205] The DFAX analysis would group together resources that have similar steady-state thermal impacts on key system constraints.

judgment, and we believe that the stakeholder process will give parties the opportunity to discuss potential improvements in designing capacity zones. Alternate methods of modeling capacity zones, such as NEPGA's proposal that a DFAX analysis determine capacity zones, are more appropriately addressed in this forum. Likewise, we note that JFS may raise its concerns through this process.

c. Expanded Use of De-List Bids to Determine Zonal Price

284. In contrast to its current Tariff provisions, ISO-NE generally proposes (in concert with revised mitigation rules as discussed below) to allow all de-list bids, mitigated as appropriate, to set zonal prices in the auction. However, ISO-NE notes that "[t]here may be unique, unit-specific constraints that lead to the rejection of de-list bids even under the new proposed design, but in those cases it would not be appropriate to adjust the zonal price to reflect this."[206] Instead, the resource with the rejected de-list bid would be paid its de-list bid price, and the rest of the zone would not have its price adjusted.

i. Comments and Responses

285. Load parties strongly object to ISO-NE's proposal to allow all de-list bids to set zonal prices. JFS states that the current limitations on the bids that can trigger zonal price separation are essential protections against the exercise of market power because even "competitive" de-list bids from pivotal suppliers can be used to exercise market power. For example, JFS contends that a supplier may set a zonal price by strategically submitting de-list bids at levels the IMM presumes to be "competitive" even though such bids exceed the resource's net going-forward costs.

286. Mass DPU contends that ISO-NE's statement that "[t]here may be unique, unit-specific constraints that lead to the rejection of de-list bids even under the new proposed design" requires further explanation. Specifically, Mass DPU asserts that ISO-NE must explain the criteria it would use to determine that certain units are unique and therefore would not set the zonal price.

287. Generator parties generally support allowing additional de-list bids to set price. However, NEPGA raises concerns with ISO-NE's statement that, under the proposed revisions, a resource with a rejected de-list bid might still be paid its de-list bid price and would not set capacity price for the rest of the zone. NEPGA argues that this action would suppress the price paid to other existing resources and suggests that additional sub-zones may be necessary when a de-list bid is rejected for reliability reasons. NEPGA witnesses Stoddard and Shanker have presented two methods that address this situation.

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[206] ISO-NE First Brief at 38.

Specifically, Stoddard suggests that, in subsequent auctions, the constraint leading to the rejected de-list bid should be expressly modeled to avoid additional payments outside of the market and to permit locational pricing. Alternatively, Shanker suggests that, when such de-list bids are rejected, the auction process should be modified to incorporate the constraint and the auction should be re-run.

288. Responding to NEPGA's concerns, ISO-NE states that modeling all constraints under all circumstances is not a desirable goal given the existence of local needs, which may only be capable of being met by a single particular resource. Instead, ISO-NE notes that as many constraints should be modeled as "reasonably" possible in establishing zones, since the objective of establishing zones should not be to model every possible constraint in order to eliminate the need to ever reject a de-list bid. Essentially, ISO-NE contends that given the zonal market design (and given the fact that not all de-list bids are submitted in advance of the auction), it may be impossible to develop a configuration that captures every possible combination of constraints that may arise.

289. However, ISO-NE states that it is amenable to Stoddard's proposal of examining whether it would be appropriate following the rejection of a de-list bid to model the revealed constraint within the zonal configuration used in the subsequent auction. ISO-NE states that no change to the current market rules is necessary to reach this outcome; if a constraint indicates a broader adequacy or security issue, that issue would be reviewed in the zonal development process for the subsequent FCA and the zone might be modeled for that auction. Regarding Shanker's proposal, ISO-NE states that stopping the auction, reconfiguring zones, and re-running the auction would cause substantial disruption to the market. Therefore, ISO-NE contends that Shanker's proposal should be summarily rejected.

ii. <u>Commission Determination</u>

290. We approve ISO-NE's proposal to allow static and dynamic de-list bids from all resources to establish zonal prices. As discussed further below, by definition static de-list bids have already been screened by the IMM. Under ISO-NE's July 1 Proposal (and as discussed below), dynamic de-list bids must now be below a relatively stricter $1.00/kW-month threshold, a threshold that we agree is competitive. Under such a construct, we agree that it is likely that any "higher" zonal price would be justified by market conditions and would not reflect an exercise of market power.

291. Regarding ISO-NE's statement that "[t]here may be unique, unit-specific constraints that lead to the rejection of de-list bids even under the new proposed design," we agree with ISO-NE that that it would not be practicable to develop a zonal configuration that captures every possible combination of constraints that may arise. Addressing Mass DPU's concern over which criteria will be employed to determine that certain units should not set a zonal price, ISO-NE explains that situations in which it may be necessary to reject a de-list bid could occur when a single resource causes the

constraint, and explicitly modeling that resource would result in a tiny, highly concentrated zone. In such situations, we agree with ISO-NE that it is more efficient to reflect the binding sub-area constraint through a de-list bid rejection.

292. Moreover, we find that ISO-NE has adequately addressed NEPGA's concerns that the rejection of de-list bids may signal the need for additional zones. Specifically, ISO-NE has stated that it is amenable to Stoddard's proposal –to model the revealed constraint following a de-list bid rejection within the zonal configuration in the subsequent auction. We find that ISO-NE's approach of reviewing such rejected de-list bids in the zonal development process for subsequent FCAs to determine if additional zones are needed is appropriate.

d. Revisions to the Descending Clock Auction to Accommodate Zonal Price Separation

293. ISO-NE states that it will have to revise the auction clearing mechanism used in its descending clock auction structure in order to model all zones all the time. Specifically, ISO-NE states that it will apply something similar to a locational marginal pricing (LMP) clearing mechanism. ISO-NE states that the objective function of the new market clearing mechanism will seek to minimize long-run costs by selecting the set of resources that maximizes social welfare while recognizing bi-directional and mesh network constraints, in a manner similar to that currently used in the New England Energy Market and the Locational Forward Reserve Market.

i. Comments and Responses

294. JFS states that ISO-NE has not even provided a sketch of how a hypothetical new market-clearing design would operate. JFS asserts that such an untested and unproven clearing design increases the "risk of unintended, unexpected, and inefficient outcomes" that will produce "incorrect and inefficient prices and capacity supply obligation awards."[207] Therefore, JFS states that the Commission should not embark on such a risky new approach with no clear specification of how ISO-NE will address these difficult problems and with no assurance at all of success. Likewise, Public Systems state that ISO-NE provided little concrete information about its proposed revised clearing mechanism.

295. Maine PUC raises concerns over ISO-NE's statements that the mechanism seeks "to minimize long-run costs by selecting the set of resources that maximizes social

[207] Wilson Testimony (included in First Brief of Joint Filing Supporters) at 46:17-19 and 47:7-48:4.

welfare while recognizing bi-directional and mesh network constraints" and that it "is likely to result in an optimization problem that requires extensive use of heuristic solution methods and is likely to produce multiple locally optimal solutions that the solution software would not be able to consistently identify."[208] Specifically, Maine PUC states that these comments suggest a certain level of subjectivity in the determination of how zones will clear. According to Maine PUC, this subjectivity may result in significant litigation. Therefore, Maine PUC states that ISO-NE should be required to provide more information about its proposed mechanism before the Commission rules on whether or not it is workable.

296. In response, ISO-NE notes that its proposed LMP optimization model is essentially the same process used in the ISO-NE, NYISO, PJM, and MISO energy markets and is similar to the processes used in the PJM capacity market. Specifically, each capacity zone would be assigned its share of the total pool-wide capacity ICR and the local requirement (set at the higher of the LRA or TSA requirement) would be reflected through transfer constraints through the LMP model, rather than directly expressed as local sourcing requirements. The clock would continue to run until the zone in question cannot meet its LSR. The resulting "final offer" prices and quantities would then make up the supply curve for the zone. The clearing engine would then run and select the combination of resources that meets the total capacity requirements of each zone, while respecting all the constraints and optimizing social welfare. The clearing price in each zone would be the cost of the marginal resource selected in each zone.

ii. Commission Determination

297. We agree that, given our acceptance of ISO-NE's proposal to model all zones all the time, changes to the clearing mechanism used in ISO-NE's descending clock auction structure are necessary in order to select the appropriate set of resources for a given commitment period. As ISO-NE previously explained, the existing descending clock auction structure may not capture the full complexity of the adequacy requirement of the market if all zones are modeled all the time. For example, ISO-NE notes that mesh networks, where each zone is connected to more than one adjacent zone, may not be represented with the current structure.[209]

298. While we are sympathetic to the arguments raised by the load parties, the premise of this paper hearing is solely to establish just and reasonable market design features, such as modeling zones all of the time. The highlighted statements from ISO-NE clearly

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[208] Maine PUC Second Brief at 8-9 (citing ISO-NE First Brief at 58).

[209] ISO-NE's March 30, 2010 Answer at 25.

speak to the complexity of modeling zones all of the time; however, ISO-NE's subsequent response provides a fairly clear, high-level explanation of how such a market design would clear. It is not obvious based on the relatively condensed timeframe of the paper hearing that significant implementation details of such a design could be provided at this point, nor do we find ISO-NE's July 1 Proposal to be unjust and unreasonable on this issue. We note that stakeholders will have the opportunity to offer their input/critiques of the auction clearing mechanism during the subsequent development of market rules stemming from the instant order.

e. Additional Issues

i. Comments and Responses

299. Load parties express concerns that modeling all zones all the time will interfere with ISO-NE's regional system planning process. Specifically, National Grid states that, because transmission does not respond to the market price signals sent by modeling zones but is developed through a central planning function carried out by ISO-NE and NEPOOL, under the July 1 Proposal, generation solutions may be selected even when transmission solutions would be more cost effective. According to National Grid, this situation occurred in PJM; PJM's planning process failed to recognize and eliminate transmission constraints until consumers were forced to endure high capacity charges. National Grid requests that a process requiring modeling all zones all the time not be approved until ISO-NE and the NEPOOL stakeholders review the regional system planning process Tariff provisions to ensure that alternative solutions to zonal capacity requirements are considered.

300. Other load parties question whether ISO-NE's proposed revisions to the FCM market rules are necessary, given significant investments in New England's transmission system. For example, EMCOS notes that the investments in the transmission system will cause ISO-NE's Regional Network Service rate to increase to approximately $115/kW-month by 2013 (greater than a sevenfold increase since 1997). Mass DPU requests that, if the Commission approves ISO-NE's proposal to model all zones all the time, the Commission require ISO-NE to provide greater transparency in the regional system planning process so that market participants can address any potential constraints in the most cost-effective manner.

301. Regarding National Grid's request that ISO-NE's proposal to always model zones not be approved until the regional system planning process is reviewed, ISO-NE contends that this argument should be rejected as a collateral attack on the concept of locational pricing, asserting that National Grid is requesting to delay zonal modeling until locational

pricing differences no longer exist.[210] Further, ISO-NE argues that the implementation of the July 1 Proposal should not be dependent upon the regional system planning process because the transmission planning process does not neatly coincide with the operation and schedule of the FCM. ISO-NE states that the transmission planning process is an ongoing, forward looking process with a ten year or longer horizon, while the FCM has a three year horizon. However, ISO-NE asserts that market resources that respond to locational or regional market signals and acquire obligations through the FCM can and have had an influence on overall system reliability and the need for or timing of transmission system upgrades. Additionally, ISO-NE notes that it has committed to work with stakeholders to provide more information and greater transparency to market participants well ahead of the likelihood of constraints arising on the system.

302. Likewise, NEPGA states that increased zonal modeling will not devalue recent transmission investment. Instead, NEPGA notes that if recent transmission upgrades have eliminated constraints, ISO-NE's examination of the system to establish the LSR for each capacity zone will reflect that fact.

ii. Commission Determination

303. We dismiss arguments that modeling all zones all the time will interfere with ISO-NE's transmission planning process and thus should be delayed. ISO-NE's proposal seeks to provide additional pricing transparency to potential reliability issues. While the best long-term solution to any given reliability issue may indeed be a transmission solution, that fact does not justify delaying revisions to the FCM which will likely assist in highlighting these reliability issues. In fact, ISO-NE's Tariff expressly requires that ISO-NE take steps to address certain reliability issues identified by the FCM.[211] If National Grid seeks specific revisions to the regional system planning process, it should raise them in that forum. Further, we note that ISO-NE has committed to work with

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[210] In response to ISO-NE, National Grid submits that it is not arguing that locational differences should not be modeled until they no longer exist but that such locational differences, where they are found to exist, should be relieved using the most cost-effective and market-beneficial option available.

[211] *See, e.g.*, *ISO New England, Inc.*, 133 FERC ¶ 61,230. In this order, the Commission found that section III.13.2.5.2.5(g) of ISO-NE's Tariff required it to, following the rejection of static de-list bids for Salem Harbor Units 3 and 4, identify alternatives to resolve the reliability need for the Salem Harbor Units 3 and 4, as well as the time needed to implement those solutions.

stakeholders to increase transparency in the planning process, as well as to ways to more effectively assess non-transmission alternatives.[212]

4. Revised Mitigation Rules

304. As mentioned previously, in order to permit modeling all zones all the time, ISO-NE proposes to adopt new market power mitigation rules.

a. Revisions to the Dynamic De-List Bid Threshold

305. ISO-NE proposes a reduced threshold for dynamic de-list offers, i.e., those requiring no IMM review, of $1.00/kW-month instead of the current value of 0.8 * CONE. ISO-NE notes that the current threshold of 0.8 * CONE bears no particular relationship to a resource's opportunity or going forward costs and is a reasonable threshold only under the former approach to determining zones (where zones are only determined before the auction; i.e., dynamic de-list bids can not trigger zonal separation). ISO-NE states that the $1.00/kW-month level is based on the lowest market clearing price achieved in the three annual reconfiguration auctions held to date – auctions that (unlike the FCAs that have occurred) are not subject to a price floor. Because the market clearing prices determined in these auctions actually represent prices that suppliers were willing to accept in exchange for a Capacity Supply Obligation, ISO-NE argues that, subject to on-going review, this is a reasonable threshold value for a competitive dynamic de-list bid.

i. Comments and Responses

306. Joint Complainants, BG Entities, and NEPGA argue that the mitigation proposed by ISO-NE in its July 1 Proposal would over-mitigate suppliers. According to Joint Complainants and NEPGA, the $1.00/kW-month dynamic de-list threshold is too low, and the current threshold value of 0.8 * CONE should be retained.[213] The parties assert that the 0.8 * CONE threshold is necessary to limit the volatility of the market on the downside and that this is an intentional design feature of the FCM.

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[212] See ISO-NE's Second Brief at 44; ISO-NE's Third Brief at 73.

[213] While BG Entities also disagrees with the $1.00/kW-month threshold, BG Entities proposes that all existing resources that wish to have the option to submit a de-list bid during the auction should be required to submit their going forward and opportunity costs to the IMM for review prior to the auction.

307. For example, Joint Complainants' witness Bidwell asserts that without the 0.8 * CONE threshold, annual prices will fall so far below CONE that it will be effectively impossible for a capacity supplier to recover its fixed operating costs over the expected life of the facility, after only a few annual FCAs. Joint Complainants states that, without the 0.8 * CONE threshold, consumers will end up paying more in the long run since rational suppliers will not enter and stay in a market that does not provide even the opportunity to earn a return on their investment. Similarly, NEPGA notes the price stabilizing role of the 0.8 * CONE threshold and suggests that if dynamic de-list bids are no longer permitted at this threshold, the Commission should implement a demand curve.

308. According to Joint Complainants, there are already extensive mitigation measures in place to protect against market power abuse by capacity sellers. These measures include: (1) a 0.8 * CONE threshold, which will mitigate bids to below the year-over-year rate necessary for suppliers to receive just and reasonable compensation; (2) the ability of new participants to enter the market if an incumbent raises its price above the actual levelized cost of new entry; and (3) the substantial capacity surplus that exists in FCM.

309. Generator parties also disagree that the lowest market clearing price in the reconfiguration auctions held to date is a competitive proxy for determining the threshold for dynamic de-list bids. For example, NEPGA witness Stoddard concludes that, because these reconfiguration auctions have a shorter procurement period and much less trading volume than FCAs, their outcome is an inappropriate basis for setting a threshold for FCA mitigation. Stoddard recommends instead that data from historical New England RMR filings offer better information for this purpose, noting that an examination of these filings show that a wide range of plants have fixed operation and maintenance costs of $3.16 to $7.45/kW-month.

310. On the other hand, JFS is not convinced that proposed lower thresholds alone are adequate to preclude pivotal suppliers from exercising market power, and it supports the zone and market power mitigation rules in the Joint Filing proposal that would prevent bids from pivotal suppliers from creating a separately priced zone. In particular, JFS worries that a supplier may set a zonal price by strategically submitting de-list bids below the $1.00/kW-month threshold but higher than the plant's net going-forward costs. Thus, notwithstanding the currently effective price floor in excess of $1.00/kW-month, load is concerned that there are opportunities for pivotal suppliers to seek to de-list below $1.00/kW-month in order to exert market power. Additionally, ISO-NE's reliance on the outcome of reconfiguration auctions to support the $1.00/kW-month threshold for dynamic de-list bids is not acceptable to JFS because these auctions have cleared little capacity, and JFS believes prices determined in reconfiguration auctions may not be representative of competitive market results in New England.

311. The IMM, however, supports the $1.00/kW-month threshold price as an appropriate value initially, subject to future review. By choosing the lowest price from

the reconfiguration auctions, the IMM reasons that it increases the likelihood that auction outcomes will be competitive. The IMM emphasizes that the competitive de-list threshold does not prevent sellers from submitting competitive offers that exceed the threshold. Rather, competitive offers that exceed the threshold must be submitted as static (reviewed by the IMM prior to the auction) rather than dynamic de-list bids. Furthermore, the IMM emphasizes that the FCM is not intended to guarantee any particular cost recovery or return on investment but only an opportunity "to receive market prices that make a contribution to fixed cost recovery."[214]

312. In response to generator parties' proposal, JFS asserts that using the threshold for submitting dynamic de-list bids to limit volatility on the downside would permit existing resources to maintain a *de facto* price floor by strategically de-listing capacity. JFS states that the Commission has already rejected the temporary extension of a price floor, and there is no basis to accept an indirect proposal seeking to accomplish the same objective.[215]

ii. Commission Determination

313. The Commission finds that the proposed $1.00/kW-month threshold is a reasonable threshold for determining when IMM bid review is necessary. Generator parties suggest that this lower threshold will result in over-mitigation. However, we note that the $1.00/kW-month threshold is simply a boundary below which the IMM believes that market power is not a concern. Because the IMM has expressed concerns that a threshold higher than $1.00/ kW-month could provide an opportunity to exercise market power, applying a threshold based on a higher reconfiguration auction value or data from historical RMR filings would not be appropriate. It is important to note that generators are not precluded from submitting a de-list bid over $1.00/kW-month; such a de-list bid must simply be submitted as a static de-list bid, which is by definition subject to IMM review. Accordingly, we find this a reasonable approach to mitigating supplier market power – an approach that gives most existing sellers the flexibility to offer capacity at un-reviewed competitive levels while providing little ability to withhold and increase market clearing prices.

314. Although load parties show concern for the possibility of an exercise of supplier market power at offers below this proposed threshold, we agree with the IMM that the

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[214] IMM Third Brief at 10 (citing *ISO New England, Inc*, 125 FERC ¶ 61,102, at P 35 (2008)).

[215] Joint Filing Supporters Second Brief at 100 (citing April 23 Order, 131 FERC ¶ 61,065 at P 97; August 12 Order, 132 FERC ¶ 61,122 at P 41).

likelihood of a significant price effect below $1.00/kW-month is limited and does not warrant review of every de-list bid. The $1.00/kW-month threshold is based on the lowest price submitted in a reconfiguration auction to date and represents a reasonable estimate of the cost of providing capacity. Moreover, the IMM agrees that reconfiguration auctions should be monitored and reviewed to assess whether their market clearing prices remain a reasonable basis on which to base the threshold for the FCAs.

315. Additionally, we disagree with the argument offered by generator parties that the 0.8 * CONE threshold for dynamic de-list bids is necessary to limit the volatility of the market on the downside. A resource's de-list bid is not intended to serve as a price stabilizer; it is intended to represent the offer a competitive supplier would accept voluntarily to commit its resource as a capacity resource. Such capacity revenues would make a contribution to the supplier's fixed costs, as would infra-marginal energy and ancillary services revenues. No assurance for cost recovery is made for participating in competitive markets, only an opportunity to do so.[216]

b. Revisions to the Calculation of Static and Permanent De-List Bids

316. Under the July 1 Proposal, all static and permanent de-list bids must be submitted to the IMM for review.[217] While ISO-NE proposes to continue basing its review of acceptable static and permanent de-list bids on net risk-adjusted going forward and opportunity costs, the proposed revisions would assume that the seller continues participating in energy and ancillary services markets rather than leaving these markets (as assumed currently). Since most generators are likely to continue to sell energy and ancillary services even if they do not provide capacity, according to ISO-NE, its proposed change better reflects the actual status of most generators. As a result, ISO-NE states that it is expected that most acceptable static or permanent de-list bids under this revision will be nearly zero since a resource providing energy and ancillary services would incur few or no additional costs in order to provide capacity. However, ISO-NE states that, during the review process, suppliers would be able to provide evidence to support a higher static or permanent de-list bid. For example, ISO-NE states that higher bids may be authorized for a resource that intends to deactivate, since by deactivating the resource would incur additional costs to mothball a unit. This change, in combination with the lower proposed

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[216] *Bridgepor*, 113 FERC ¶ 61,311 at P 29.

[217] However, a resource need not submit a static de-list bid below $1.00/kW-month for review, since this is the threshold level for dynamic de-list bids.

threshold discussed above, may increase the number of static and permanent de-list bids that the IMM must review.

i. Comments and Responses

317. Generators are concerned that ISO-NE's proposed change misdirects the focus of the FCM from permitting capacity resources to recover expected out-of-pocket costs net of expected earnings from participating in energy and ancillary services markets to what costs are saved if a resource does not take on a Capacity Supply Obligation. NEPGA witness Stoddard argues that the near zero permanent and static de-list bids that result from this change could cause capacity resources to be cash negative over the course of the year. NEPGA asserts that no other RTO mitigates in this way. For example, Stoddard notes that PJM caps existing generators' capacity supply offers at their Avoidable Cost Rate, net of historical energy and ancillary services earnings. This Avoidable Cost Rate includes the full range of out-of-pocket expenses that are required to operate the plant and could be avoided by mothballing the unit for one year.

318. Additionally, Stoddard states that this mitigation proposal would require that any resource seeking to bid its going-forward costs mandatorily cease operation if its de-list bid clears (i.e., if the unit does not receive a Capacity Supply Obligation). According to Stoddard, maintaining the option to operate in the future is of value to suppliers; asking suppliers to surrender this value in order to be able to bid their costs into the capacity market is unreasonable and could raise costs to consumers if they are required to purchase from higher cost resources in the reconfiguration auctions.

319. Further, NEPGA states that every supplier with legitimate costs above $1.00/kW-month will need to file a static de-list bid with the IMM. NEPGA asserts that this review will overburden the IMM and be burdensome to suppliers, since it is costly to prepare such a bid; bidders must commit to a static de-list bid months before the auction and cannot modify their bids to reflect changing costs or new opportunities that may arise. Moreover, NEPGA states that review to the $1.00 kW/month threshold requires that the market monitor correctly account for costs. However, according to NEPGA, several of the cost assumptions used by the market monitor drive allowed costs to levels that are too low.[218]

[218] In particular, NEPGA states that, for example: (1) the de-list rules explicitly prohibit use of company-specific risk factors; (2) the market monitor has refused to include corporate overheads allocated to plants; (3) offerors cannot use their own calculation of the likely Peak Energy Rent (PER) adjustment but must use ISO-NE's historic PER; (4) it is unclear if company-specific projection of opportunity costs of selling into the New York capacity market will be allowed; and (5) capital improvements

(continued…)

320. The IMM defends the default assumption that a unit submitting a static de-list bid will continue to participate in the energy and ancillary services markets. The IMM asserts that, absent evidence to the contrary, this is a reasonable assumption for a resource that seeks to leave the capacity market for a single year, since a generating resource earns revenue by providing energy and ancillary services. However, the IMM states that, if a resource does intend to leave the energy and reserve markets, the resource's costs will be calculated on that basis. Further, ISO-NE states that there is no requirement that an existing resource must cease operations if the unit does not receive a Capacity Supply Obligation; the revised proposal simply requires that a resource's de-list bid be based on a correct assumption about whether a resource intends to remain in the energy and ancillary services markets.

321. Additionally, the IMM asserts that NEPGA overstates the burden of submitting static de-list bids given their importance, but it does not anticipate that the IMM department will be overburdened in meeting its obligations. Moreover, the IMM notes that market participants are allowed to suggest costs that they believe are relevant going forward costs, and the IMM reviews them for appropriateness. If there are disputes, market participants can contest the results included in the ISO-NE's information filing after each FCA.

ii. Commission Determination

322. We accept ISO-NE's proposed revisions to the calculation of static and permanent de-list bids. Since the typical generator will be participating in energy and ancillary services markets regardless of whether it is also providing capacity, we agree with the IMM that it is appropriate to base the calculation of net, risk-adjusted going forward costs on this assumption. Generators that intend to withdraw from the energy and ancillary services markets, absent a Capacity Supply Obligation, may present such information to the IMM and receive a higher static or permanent de-list bid as a measure of their competitive offer.

323. We dismiss generator parties' arguments that ISO-NE's proposal will drive allowed costs to levels that are too low. As the IMM explains in its third brief, in submitting de-list bids, market participants are allowed to suggest costs that they believe are relevant going forward costs and the IMM reviews them for appropriateness. If the market participants disagree with the IMM's decision, they can contest the results in ISO-NE's informational filing.

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that support a de-list request must be amortized over a period of years determined by ISO-NE to reflect a useful economic life.

324. Finally, we dismiss concerns that the IMM will be overburdened by additional static and permanent de-list bids submitted as a result of the July 1 Proposal. According to the IMM, it does not anticipate being overburdened in meeting its obligations.

c. Elimination of the Pivotal Supplier Test

325. Because all bids above the $1.00/kW-month dynamic de-list bid threshold would be assessed for competitiveness in advance of the FCA, ISO-NE states that the pivotal supplier test that was part of the Joint Filing is no longer necessary and proposes to eliminate it.

i. Comments and Responses

326. JFS states that their sponsored testimony by Blumsack supports the necessity of a pivotal supplier test, a view shared by Mass DPU, National Grid, and EMCOS. JFS is concerned that, without a pivotal supplier test, existing resources may have an incentive and ability to create zonal separation not based on actual physical limitations. JFS is not convinced that proposed lower thresholds alone are adequate to preclude pivotal suppliers from exercising market power. Specifically, Blumsack argues that pivotal suppliers in an import-constrained zone could profit by using a de-list bid to trigger the creation of a capacity zone. In his Supplemental Testimony, in particular, Blumsack emphasizes that dynamic de-list bids should not be considered in the definition of capacity zones and that, even with the proposed $1.00/kW-month threshold, a need for a pivotal supplier test remains.

327. Likewise, Mass DPU cautions against removing the pivotal supplier test because it is concerned that doing so may allow for the exercise of market power in some circumstances. It requests that the Commission require ISO-NE to retain the pivotal supplier test and revisit the issue in five years.

328. National Grid also believes that a pivotal supplier mechanism is necessary on the basis that suppliers often have an incentive to force price separation even if they de-list their entire portfolio/resource. Although such a supplier would fail to receive a Capacity Supply Obligation in the FCA, National Grid raises the concern that such pivotal suppliers might nevertheless benefit from higher prices in future reconfiguration auctions or in bilateral contracts.

329. EMCOS states that, if the Commission proposes to pursue a requirement that ISO-NE expand its modeling of capacity zones, it should both (1) retain structural protection against market power afforded by the pivotal supplier test proposed in ISO-NE's Joint Filing and (2) augment the pivotal supplier test with a concurrent, flat prohibition against zonal pricing in any capacity zone with a Herfindahl-Hirschman Index (HHI) in excess of the 1800 "highly concentrated" threshold.

330. Stoddard agrees with ISO-NE that, under its proposed market power mitigation, a pivotal supplier test is unnecessary.[219] Additionally, in response to EMCOS, NEPGA states that EMCOS misuses and misreads the DOJ/FTC Horizontal Merger Guidelines in supporting a concurrent, flat prohibition against zonal pricing in any capacity zone with an HHI in excess of the 1800 highly concentrated threshold. First, NEPGA argues that EMCOS used an outdated version of the guidelines, and a market with an HHI of 1800 is only "moderately concentrated," not "highly concentrated." NEPGA also argues that the guidelines do offer a standard for determining what constitutes a separate market for purposes of legal and economic analysis, but this analysis is not based on HHI levels which can only be determined after a market has already been defined; instead, products markets are defined by the "Hypothetical Monopolist Test."[220] Finally, NEPGA states that the guidelines use concentration thresholds not for defining markets but to determine whether agencies should subject a proposed merger in a market with unregulated prices to scrutiny.

ii. Commission Determination

331. We agree with ISO-NE that with the revised $1.00/kW-month dynamic de-list bid threshold, the pivotal supplier test is no longer necessary. The purpose of the pivotal supplier test was to identify which capacity suppliers offering static de-list bids are non-pivotal and thus likely to offer competitively. The pivotal supplier test was part of the Joint Filing proposal which sought to allow additional de-list bids (including non-pivotal static de-list bids) to trigger zonal price separation. However, under ISO-NE's revised mitigation proposal, the IMM will continue to review all static de-list bids to ensure that they are competitive, while the threshold for submitting dynamic de-list bids has been revised to provide little opportunity to exercise market power. Given this level of review, we do not find load parties' arguments that pivotal suppliers can still profit by using a de-list bid to trigger the creation of a capacity zone convincing. Additionally, since we are accepting ISO-NE's proposal to eliminate the pivotal supplier test, we will not address

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[219] However, should the pivotal supplier test be retained, NEPGA proposes certain changes to the pivotal supplier test accepted in the April 23 Order. Specifically, NEPGA suggests that the pivotal supplier test should take newly qualified resources into account in calculating the total capacity within a zone, since new capacity is a perfect substitute for incumbent capacity. Additionally, NEPGA suggests that a resource should be considered non-pivotal if: (1) it has only one resource within a zone or (2) its portfolio within the zone is not larger than some reasonable threshold size.

[220] Under this test, a group of products constitute an independently priced market if a hypothetical monopolist of all the products likely would impose at least a small but significant and non-transitory increase in price (typically of 5 percent).

the revisions to the pivotal supplier test suggested by EMCOS and NEPGA or Mass DPU's request to revisit the issue in five years.

d. Elimination of the Quantity Rule

332. ISO-NE proposes to eliminate the quantity rule, which is a market power mitigation mechanism designed to prevent very high de-list bids from setting prices.[221] ISO-NE explains that the quantity rule has not been invoked in the FCAs held to date, since there have been few high priced static or permanent de-list bids, and there has been sufficient capacity in the FCA that it has not been necessary to invoke the quantity rule to replace the few high-priced de-list bids that have been submitted. ISO-NE states that the revised mitigation rules proposed in the July 1 Proposal will render the quantity rule largely irrelevant, since they will provide for a stricter reading of going forward costs, making it even less likely that high priced de-list bids will occur.

333. Moreover, ISO-NE asserts that the quantity rule suppresses efficient pricing because it reduces the amount of capacity purchased below the ICR in the presence of relatively high-priced de-list bids, delaying these purchases until the annual reconfiguration auction. ISO-NE notes that this price depression will occur only when capacity is in relatively short supply, which is a time when sending the proper price signals is especially important for inducing competitive new entry. ISO-NE states that another unintended consequence of the quantity rule is that, since certain purchases are delayed until the annual reconfiguration auctions, the development timeline for new resources is reduced by nearly one third. ISO-NE states that this can increase the risk of having insufficient capacity to meet reliability needs.

i. Comments and Responses

334. NEPGA states that it agrees with ISO-NE's proposal to eliminate the quantity rule. NEPGA asserts that the quantity rule was intended as a further check on the potential for economic withholding by suppliers; however, the quantity rule does not work as intended with the current, low value of CONE. Specifically, NEPGA explains that, if CONE is not a reasonable estimate of the costs of new capacity, even if there were ample new supply resources available to replace higher-cost resources, the quantity rule would have ISO-NE attempt to procure additional needed capacity in a subsequent incremental auction. Further, NEPGA agrees that the quantity rule should be eliminated since it has never been invoked, unduly complicates the FCA design, suppresses efficient pricing, and increases reliability risks through reducing the new capacity development timeline.

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[221] Specifically, the quantity rule defers purchasing replacement capacity for high priced de-list bids from the FCA to the annual reconfiguration auctions.

NEPGA suggests that if market participants want to systematically purchase less capacity when prices are higher than some benchmark, then the capacity market should simply include a demand curve.[222]

ii. Commission Determination

335. We accept ISO-NE's proposal to eliminate the quantity rule. We agree with ISO-NE that the quantity rule is no longer necessary, since it was never invoked in any of the FCAs to date and since ISO-NE's revised mitigation rules, which we are accepting, will make it even less likely that the quantity rule would be invoked. Moreover, we note that ISO-NE's proposed mitigation measures are a more efficient way to prevent economic withholding, since the quantity rule may result in certain unintended consequences including the suppression of efficient pricing, and the reduction in lead time to develop new resources.[223]

D. CONE

1. April 23 Order

336. In the April 23 Order, the Commission accepted Filing Parties' proposal to decouple the FCA starting price from CONE as well revisions to CONE's updating mechanism.[224] However, noting that "the proper CONE value is important, since it is tied to numerous aspects of the FCM," the Commission set for hearing "[w]hether the value of CONE should be reset."[225] The Commission agreed with generator parties that, because of the manner in which the review of potential OOM capacity was triggered,[226] at very low levels of CONE, parties seeking to affect the FCM price had the ability to

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[222] NEPGA First Brief, Ex. 2 at 96-98 (Stoddard Testimony).

[223] As discussed previously, ISO-NE's proposed mitigation measures will: (1) reduce the threshold for dynamic de-list bids to $1.00/kW-month and (2) revise the calculation of net risk-adjusted going forward and opportunity costs for static and permanent de-list bids to assume that sellers continue participating in the energy and ancillary services markets.

[224] April 23 Order, 131 FERC ¶ 61,065 at P 16, 139, 150.

[225] *Id.* P 18, 151.

[226] Under the preexisting and Joint Filing rules, new capacity offers below 0.75 * CONE are reviewed to assess whether they are OOM. Thus, as CONE values decrease, this threshold becomes relatively low.

offer new capacity at well below their resource costs yet at a level that would avoid review. Because "the CONE value is intrinsically tied to the OOM determinations that are part of the APR Issue," the Commission directed parties to address "the issue of the proper value of CONE."[227]

2. The Proper Value of CONE

a. July 1 Proposal

337. Rather than address the proper value of CONE, ISO-NE's July 1 Proposal eliminates or replaces CONE entirely. For example, the OOM and mitigation rule revisions proposed by ISO-NE result in the elimination of many of the most significant uses of CONE. As discussed above, offer floors will replace CONE as the threshold for IMM review of OOM resources for buyer market power, and $1.00/kW-month will replace 0.8 * CONE as the threshold for dynamic de-list bids, the maximum non-reviewed supplier de-list bid. ISO-NE's proposal to remove the quantity rule will eliminate an additional use of CONE.

338. In its July 1 Proposal, ISO-NE proposes that the remaining uses of CONE be replaced with other indices, such as the FCA starting or clearing price. These remaining uses include the price at which ISO-NE will buy replacement capacity in annual reconfiguration auctions; the price at which resources must submit offers to "cover" Capacity Supply Obligations on which they cannot deliver; the price paid to existing resources when there is inadequate supply or insufficient competition in the FCA; and setting the level of financial assurance required for new capacity clearing the FCA.

b. Comments and Responses

339. Commenters are generally supportive of ISO-NE's proposal to eliminate or replace the uses of CONE. NEPGA opposes two of ISO-NE's proposed alternatives to using CONE but does not oppose the others, although it notes that the justness and reasonableness of the threshold for OOM review depends upon the benchmark values. NEPGA opposes, for reasons discussed earlier, replacing CONE's role in setting the threshold for dynamic de-list bids with a new mitigation regime. NEPGA also suggests a modification to ISO-NE's proposal to replace the price paid to existing resources in the event of inadequate supply or insufficient competition, currently set at 1.1 * CONE, with a new payment of 1.1 * the Capacity Clearing Price from the last competitive FCA.

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[227] *Id.* P 151.

NEPGA proposes to instead pay slightly above the benchmark cost of a peaker, so as to provide the proper incentive for new entry.

340. JFS agrees with ISO-NE that many of CONE's uses can be eliminated by substituting another value, so long as the other value is close to the FCA clearing price. In support, JFS asserts that a de-list bid threshold significantly higher than the clearing price would exempt offers from review at levels that far exceed the competitive price and allow sellers the opportunity to exercise market power. JFS notes that ISO-NE does not specify a threshold for IMM review of static and permanent de-list bids, but agrees that the threshold need not be tied to CONE as long as it is relatively close to the clearing price. The exception JFS makes to its proposition that CONE can be replaced with a value close to the FCA clearing price is in setting the threshold for OOM review, a value JFS states is not intrinsically linked to the clearing price.

341. Several generator parties agree with NEPGA that, even if CONE is removed entirely from the Tariff, it should nevertheless be reset because the cost of new entry of a peaking unit will remain an important calculation. According to NEPGA, this is so because (1) a new peaking unit is one of the principal technologies for which ISO-NE will have to calculate a benchmark and (2) in order to be just and reasonable, the FCM must support, on average and over time, the cost of new entry of a peaking unit.

c. Commission Determination

342. We find ISO-NE's proposal to eliminate or replace CONE to be just and reasonable.[228] In its July 1 Proposal, ISO-NE proposes entirely new mitigation rules to address buyer and seller market power that do not rely on CONE.[229] We find the seller market power revisions to be just and reasonable elsewhere in this order and also require a stakeholder process to develop market rules to implement offer-floor mitigation to address buyer market power. As neither of these mitigation constructs will require the retention of the CONE parameter, we find just and reasonable the elimination of these uses of CONE. We also find ISO-NE's proposal to replace CONE in its remaining functions with the starting price or clearing price of the FCA to be just and reasonable, because such values reasonably reflect market conditions. We reject NEPGA's suggestion that the price paid to existing resources in the event of inadequate supply or

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[228] As noted previously, we are requiring ISO-NE to retain the CONE parameter only in reference to the appropriate price floor. The market rules developed based upon this order should reflect the elimination of this last function of CONE upon the implementation of revised APR rules.

[229] ISO-NE also proposes to eliminate the quantity rule.

insufficient competition should be slightly above the benchmark cost of a peaker. In the context of the revised mitigation regimes proposed by ISO-NE and accepted by the Commission, we find this suggested modification unnecessary.

343. We find all proposals to recalculate CONE to be unnecessary and, in light of our requirement to implement offer-floor mitigation, reject them as moot. In the April 23 Order, the Commission noted the importance of CONE in determining OOM capacity and observed that, at very low levels of CONE, parties seeking to affect the FCM price had the ability to offer new capacity well below their resource costs, yet at a level above the IMM threshold for review. The Commission wrote, "[A]s the CONE value is intrinsically tied to the OOM determinations that are part of the APR Issue, we will require the Filing Parties and others to address . . . the issue of the proper CONE value."[230] In this order the Commission approves and requires changes to the FCM mitigation schemes that remove reliance on CONE. Therefore, the Commission's primary rationale for directing parties to address the proper value of CONE has been obviated, and all proposals to reset CONE have been mooted.

344. We find unconvincing NEPGA's argument that ISO-NE should nevertheless calculate a value called "CONE" that represents the actual cost of new entry. While it is certainly likely that (based on our requirement to employ offer-floor mitigation) ISO-NE will find it necessary to calculate an offer floor for the cost of a new peaking unit, nothing requires that this value be labeled "CONE" nor that it serve any purpose other than as an offer floor for a particular resource. We find equally uncompelling the argument that CONE should be reset to reflect the true cost of new entry of a peaking unit because it is that cost that the FCM must sustain. Whatever the theoretical merits of this proposition, no party demonstrates how calculating the cost of new entry of a peaking unit (which NEPGA asserts will be done anyway) and labeling it "CONE" will have any effect on the market. We decline to order ISO-NE to "reset" a value that will essentially be written out of the market rules. We therefore reject the proposals to reset CONE.

345. Our acceptance of ISO-NE's proposal to eliminate the CONE parameter also moots arguments concerning CONE not addressed here such as, for example, NEPGA's proposal that CONE reflect cost of service values raised in historical New England RMR proceedings.

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[230] April 23 Order, 131 FERC ¶ 61,065 at P 151.

V. Other

A. Complaints from NEPGA and Joint Complainants

346. As mentioned at the opening of this document, prior to the issuance of the April 23 Order, NEPGA and Joint Complainants filed complaints arising out of the Joint Filing. Both sets of parties had already submitted protests of the Joint Filing in the Joint Filing's docket, and stated that they filed the complaints in order to eliminate any argument that the relief they sought could not be granted in response to their protests. In the April 23 Order, the Commission consolidated the dockets of the two complaints with the Joint Filing's docket. The Commission stated that, so as to ensure that NEPGA and Joint Complainants "are able to obtain full consideration of the arguments and alternative proposals they have raised in their complaints," they would be required "to raise those same concerns in the paper hearing."[231]

347. Both sets of complainants requested that the Commission find unjust and unreasonable aspects of the existing FCM construct and the Joint Filing proposal, a proposal they asserted was insufficient to fix the flaws in the FCM. Complainants were especially troubled by the Joint Filing's APR proposal and its zonal modeling proposal. The complainants requested that the Commission order ISO-NE to instead accept their own proposals or, in the alternative, set the issues for a trial-type hearing. If the Commission declined to order trial-type hearings, NEPGA requested an expedited paper hearing, including expert presentations.

348. As discussed throughout this order, we have considered the aspects of the FCM construct and the Joint Filing proposal that complainants asserted were unjust and unreasonable, and we have considered the complainants' alternative proposals. To the extent that complainants requested that we summarily accept their alternative proposals by a date certain, we have rejected their complaints. To the extent that complainants requested a full hearing of their concerns, we have granted their complaints.

B. NEPGA's Request for Rehearing of the August 12 Order

349. In its August 12 Order, the Commission rejected NEPGA's request that, as part of its consideration of this combined proceeding (both the section 205 filing in Docket No. ER10-787, and the section 206 complaints filed by NEPGA and Joint Complainants), it should reopen the question of whether, in the first three FCAs, the IMM properly determined whether capacity was OOM or in-market. The Commission stated that it would not reopen the IMM's prior determinations. It stated that "[t]he questions before

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[231] April 23 Order, 131 FERC ¶ 61,065 at P 17.

the Commission are the resetting of CONE and the treatment of historical OOM in future FCAs" and that "[g]ranting NEPGA's motion for disclosure would . . . permit NEPGA to enlarge this proceeding beyond the scope of the issues set for paper hearing by the Commission." Additionally, the Commission rejected a motion filed by NEPGA seeking disclosure of information related to this question.

1. Request for Rehearing

350. NEPGA requests rehearing of the August 12 Rehearing Order, arguing that rehearing lies because the Commission ruled there, for the first time, that it would exclude from the hearing evidence that relates to the IMM's decision not to classify certain new entry as OOM in first three FCM auctions. NEPGA also requests rehearing of the Commission's denial of its motion for disclosure.

351. In its request for rehearing, NEPGA recounts ISO-NE's explanation of how an OOM classification should be made by the IMM and references the market rule governing the IMM's review of offers from new capacity resources that are below 0.75 * CONE.[232] NEPGA points out that, in addition to its protest in the section 205 proceeding, NEPGA also filed a separate section 206 complaint (later consolidated with the section 205 proceeding) contending that ISO-NE's proposed FCM revisions fail to fully identify or correct the problems its proposal purports to address, and stated there "that the real level of OOM supply is much greater than the current classifications reflect, and that this underlying error will cause future FCM auction prices to be unjust and unreasonable."[233]

352. NEPGA maintains that, notwithstanding that two of the issues the Commission set for hearing "concern[ed] the appropriate treatment for resources designated as OOM,"[234] the Commission failed to address the merits of NEPGA's argument and stated that "to the extent that the generator parties contend that the IMM analysis fails to properly consider all of the OOM capacity in its analysis, we note that they have not supported such an allegation."[235] NEPGA reiterates its prior assertion that resources were deemed to be in-market by the IMM in prior auctions, no matter how uneconomical or heavily subsidized,

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[232] NEPGA Request for Rehearing at 2-3 & n.1 (quoting ISO New England Inc. Transmission, Markets and Services Tariff (ISO-NE Tariff) § III.13.1.1.2.6).

[233] *Id.* at 4, 14 (quoting NEPGA Protest at 13; Complaint at 13).

[234] *Id.* at 7 (referring to April 23 Order, 131 FERC ¶ 61,065 at P 18).

[235] *Id.* at 8 (quoting April 23 Order, 131 FERC ¶ 61,065 at P 150).

and were therefore permitted to bid at 0.75 * CONE and thus depressed the price up to 25 percent below CONE without any IMM scrutiny.[236] Further, NEPGA maintains that it had submitted substantial publicly-available evidence in support of this contention.[237]

353. NEPGA also takes issue with the Commission's denial of NEPGA's motion for disclosure on the ground that it is beyond the scope of the hearing proceeding to revisit the IMM's historical OOM determinations.[238] NEPGA argues that it understood its question to fall within the first of the three APR issues the Commission set for hearing, namely, "the appropriate condition that should trigger mitigation under the APR."[239] NEPGA contends that this is merely a broader way of phrasing NEPGA's question as to what resources properly should be classified as OOM. NEPGA maintains that it does not seek in any way to overturn past auction outcomes, but that, to the extent that flaws in the prior definition have led to erroneous classification decisions, those decisions need to be corrected going forward, as incorrect OOM determinations will affect FCM capacity prices for many years to come.

354. NEGPA disputes the Commission's finding that "no party has provided any evidence to support …a claim," that the market rules are flawed.[240] Rather, NEPGA argues, the record before the Commission contained "a substantial amount of evidence and sworn testimony from numerous acknowledged experts in this field that the ISO-NE capacity market is on the brink of collapse and the FCM Revisions are a wholly inadequate response."[241] NEPGA remarks that "the Commission could not rationally fault NEPGA for failing to support its allegations with sufficient evidence on this point

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[236] *Id.* at 8-9 (quoting NEPGA, Disclosure Motion, Docket No. ER10-787-000, at 4 (May 28, 2010)).

[237] *See, e.g.*, *id.* at 11 (referring to Synapse 2007 Report and "numerous orders and reports from state actors").

[238] *Id.* at 11, 16 (citing August 12 Order, 132 FERC ¶ 61,122 at P 58; *see id.* P 56 & n.68).

[239] *Id.* at 15 (quoting April 23 Order, 131 FERC ¶ 61,065 at P 77).

[240] *Id.* at 19 (quoting August 12 Order, 132 FERC ¶ 61,122 at P 58), 25.

[241] *Id*. NEGPA refers to affidavits and sworn testimony from Dr. Roy Shanker, Mr. Robert Stoddard, Prof. David McAdams, and Mr. Christopher Ungate. *Id.* & n.6; *see also id.* P 26 ("ISO-NE's submission of the FCM Revisions acknowledges these flaws by seeking to correct them.").

while simultaneously depriving NEPGA of any opportunity to evaluate evidence in the in the sole possession of ISO-NE and the IMM."[242]

355. NEPGA further states that its arguments are not inconsistent with the IMM's statement that "because of the large amount of new, in-market resources (primarily new demand resources) that remained in the auction until the floor price was reached, both [the first and second FCM auctions] would have cleared at the floor price even if no out-of-market resources had participated in the auctions."[243] NEPGA asserts that it is precisely because of the flawed FCM market rules, which erroneously permitted the IMM to classify certain capacity as in-market when it should have been classified as OOM, that so much capacity remained in the market that the price was suppressed. Thus, NEPGA argues, the validity of the IMM's prior OOM determinations is squarely at issue in this case.

356. NEPGA argues that the April 23 Order did not exclude from the scope of the hearing proceeding reexamination of the IMM's prior determinations that certain resources were not OOM. But even if this is not the case, NEPGA contends that this question is indisputably within the scope of its section 206 complaint: it states that "[t]he Complaint itself controls the scope of the case, *not* the Commission."[244]

357. Finally, NEPGA argues that the Commission's denial of its disclosure motion is arbitrary and capricious, in that the Commission may not place an evidentiary burden on a party, but then deny that party access the evidence that is necessary to meet that burden.

2. <u>Commission Determination</u>

358. We deny NEPGA's request for rehearing of the Commission's determination in the August 12 Order that it would not consider whether the IMM incorrectly classified certain capacity as in-market, rather than OOM, in the first three FCAs. Accordingly, we also deny NEPGA's request for rehearing of our denial of its motion for disclosure of the specific IMM determinations. We note that this requested relief is moot since (as noted earlier in this order) we are not approving any carry-forward treatment of historical OOM capacity.

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[242] *Id.* at 9.

[243] *Id.* at 21-22.

[244] *Id.* at 24 (emphasis in original).

359. While addressing arguments that OOM capacity was responsible for suppressing prices in the FCM, the April 23 Order also clearly specified which issues were set for paper hearing, including, as relevant for this issue: (1) the appropriate APR triggering conditions, if any; (2) the treatment of OOM resources that create capacity surpluses for multiple years; and (3) the appropriate price adjustment under the APR. Contrary to NEPGA's assertion, the Commission did not set for paper hearing either implicitly or explicitly the issue of whether resources were properly determined to be OOM in the first three FCAs. Rather, the Commission stated that, because the IMM notes that OOM entry had no effect on FCA pricing during the first three FCAs, "arguments that OOM entry has triggered the current CONE value appear to be flawed."[245] NEPGA argues on rehearing that when the Commission established a paper hearing on the "appropriate APR triggering conditions," it was, in effect, setting the historical OOM determinations for hearing since this phrasing by the Commission represented "merely a broader way of phrasing the question 'what resources properly should be classified as OOM?'"[246] We disagree. First, the plain language of the April 23 Order does not support NEPGA's view of what issues the Commission set for hearing. Given that the precise issue of the IMM's previous designations of OOM had been raised and was discussed in the April 23 Order, there would have been no need for the Commission to be coy or to "speak in code" when it could have been direct. In other words, if the Commission had intended to set this issue for paper hearing, it would have done so expressly.

360. While it is true, as noted by NEPGA, that the April 23 Order made no "definitive statement that this issue would not continue to be addressed in the hearings,"[247] that argument is akin to saying that any conceivable issue not formally dismissed by a hearing order must be addressed in the hearing by default. NEPGA's position would then obviate the need for the Commission to set out any list of issues for hearing, since the parties would not need to abide by it. Obviously, this is not our practice.

361. To the contrary, in the April 23 Order, the Commission noted that the OOM revisions that were part of the Joint Filing (which NEPGA seeks to use as the basis for reviewing the IMM's historical OOM determinations) "provid(e) additional transparency to this process"[248] and "will not change the determination of whether a specific project is

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[245] April 23 Order, 131 FERC ¶ 61,065 at P 150.

[246] NEPGA Request for Rehearing at 15.

[247] *Id*.

[248] April 23 Order, 131 FERC ¶ 61,065 at P 156.

found to be in-market or out-of-market."[249] The Commission repeated this point in the August 12 Order, stating that "NEPGA fails to acknowledge the Filing Parties' uncontradicted representation that the relevant rules will not change the determination of whether a specific project is found to be in-market or out-of-market,"[250] a point that NEPGA's own expert witness concedes.[251] As a result, the Commission would have had no basis for setting these historical OOM determinations for hearing, given they have already been approved by this Commission in orders issued prior to each respective FCA.[252] NEPGA also argues that, even if these determinations would have remained unchanged under the clarified OOM rule, "factual errors" may have resulted in the IMM failing to recognize that certain capacity should have been classified as OOM. We find that NEPGA fails to support this argument, misconstruing its allegations concerning subsidized demand response resources (as discussed elsewhere in this order) as support for its position.

362. To the extent that NEPGA is also arguing that certain other offers were not reviewed by the IMM to assess whether they were below the true costs of a given resource, NEPGA is correct that this occurred, which is consistent with the tariff in place at that time. Those tariff provisions trigger the review of new offers for buyer market power only for offers below 75 percent of CONE. (This is consistent with the current parallel Tariff requirement whereby the IMM only reviews supplier offers above 80 percent of CONE (dynamic de-list bid threshold) to assess supplier market power.) NEPGA appears to be arguing that regardless of the Tariff rules on file, offers from new capacity above 75 percent of CONE should also have been reviewed to assess whether this capacity should have also been found to be OOM since these offers might have been

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[249] *Id*. P 153.

[250] August 12 Order, 132 FERC ¶ 61,122 at P 56.

[251] NEPGA April 13, 2010 Answer, Supplementary Ex. 2, at 1.

[252] NEPGA did not challenge the IMM's in-market and OOM determinations in the informational filings with the Commission prior to each FCA as to the qualification of resources for that auction, which the Commission accepted (*ISO New England Inc.*, 128 FERC ¶ 61,266 (2009); *ISO New England Inc.*, 125 FERC ¶ 61,155 (2008); *ISO New England Inc.*, 122 FERC ¶ 61,018 (2008)), nor did NEPGA request rehearing of those orders. Any party seeking to challenge the IMM's determination as to a specific resource must do so in response to that qualification filing. *See generally* ISO-NE Tariff, § III.13.1; 13.1.1.2.6; and 13.8.1. NEPGA failed to exercise its rights in timely fashion, and therefore may not seek to reopen final determinations on which other parties may have relied.

below the resource's true costs. We disagree, as reviews under that standard would be outside of the approved Tariff.

363. Further, NEPGA's rehearing request misconstrues the language from our August 12 Order in order to argue that the Commission's analysis (specifically our decision to not set the IMM's historical OOM analysis for hearing) was incorrect since the Commission implied elsewhere that the IMM's analysis was flawed. As NEPGA notes, our August 12 Order stated that "we disagree with NEPGA's assertion that the prior market rules were 'flawed,' as no party has provided any evidence to support such a claim."[253] The basis of our statement was NEPGA's allegation in its motion for disclosure that prior to our acceptance of revised language in the April 23 Order, the IMM "determined whether a resource was OOM on the basis of criteria that were much narrower than the definition ISO-NE uses now" and that this led to "flawed OOM determinations"[254] We disagree with this allegation. As the Commission noted in the August 12 Order, the clarified tariff language concerning OOM determinations would not change specific OOM determinations, and therefore the Commission did not agree with NEPGA's assertion that these determinations were flawed. Instead, as stated in the April 23 Order, our stated concerns (which NEPGA misconstrues as flaws concerning OOM capacity determinations) involved the specific triggering conditions and re-pricing mechanisms for OOM capacity, not on whether past OOM determinations were correctly made. That is why the Commission set the former issues for hearing and not the latter.

364. Further, as discussed above, because we are denying NEPGA's request to expand this proceeding to include the issue of the IMM's prior OOM determinations, NEPGA's request for rehearing of its motion for disclosure of information relating to those determinations is moot.

365. We therefore deny NEPGA's request for rehearing of the Commission's determination not to reconsider the IMM's OOM capacity determinations in the first three FCAs, and of our denial of NEPGA's motion for disclosure of the specific IMM determinations.

C. Mirant's Emergency Request for Clarification

366. In the August 12 Order, the Commission noted that it was "cognizant of the practical constraints on ISO-NE and its market participants, the milestones that precede each auction, and the requirements associated with developing market rules in the

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[253] August 12 Order, 132 FERC ¶ 61,122 at P 58.

[254] NEPGA Motion for Disclosure at 3-4.

NEPOOL stakeholder process."[255] A few days later, on August 20, 2010, the Mirant Parties[256] filed an *Emergency Request for Clarification Or, In The Alternative, Rehearing* addressing the October 1, 2010 qualification deadline for existing capacity. Specifically, the Mirant Parties sought clarification that either (1) any existing FCM rules applicable to the then-upcoming Existing Capacity Qualification Deadline would also be applied in the corresponding fifth FCA or (2) if new FCM rules emerge from the paper hearing and are made effective for the fifth FCA after market participants have undertaken pre-auction activities required under the Tariff for the fifth FCA, market participants will be given the opportunity to modify such acts or submissions. NRG[257] filed an answer in support of the emergency request for clarification. Although the relevant deadline has passed, we reiterate our earlier statement in the August 12 Order that the rules the Commission approved in the April 23 Order will remain in effect pending any new rules. As discussed below, ISO-NE's compliance filing will address the specific timing of revised market rules stemming from this order.

D. Timing

367. Recognizing that ISO-NE would conduct the fourth FCA in August 2010, and to eliminate the uncertainty that would result from not having Tariff provisions in place to govern that auction, in the April 23 Order the Commission accepted the Tariff provisions that related to the issues set for paper hearing. The Commission noted that it anticipated that, if practicable, it would issue an order accepting revised market rules before March 1, 2011 in time to govern subsequent auctions.

368. In its *Request for Clarification or, in the Alternative, Rehearing* of our April 23 Order, ISO-NE requested that the Commission "order the ISO to work with stakeholders to develop a schedule for filing rules in accordance with the order and file the proposed schedule within 30 days of the Commission's decision on the issues set for paper hearing."[258] We will grant this request and expect ISO-NE to file a proposed schedule for filing market rules in accordance with this order on paper hearing within 30 days of

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[255] August 12 Order, 132 FERC ¶ 61,122 at P 36.

[256] Mirant Energy Trading, LLC, Mirant Canal, LLC Canal, and Mirant Kendall, LLC.

[257] NRG Power Marketing LLC, Connecticut Jet Power LLC, Devon Power LLC, Middletown Power LLC, Montville Power LLC, Norwalk Power LLC, and Somerset Power LLC.

[258] ISO-NE May 5 Request for Rehearing at 2.

its issuance. That filing should also address the timeframe for consideration of the two issues that we are requiring ISO-NE to further examine with stakeholders – the development of market rules to implement an offer-floor mitigation construct, and the proper offer floor price for long-lead-time resources.

E. Cost Impact Analysis

1. Maine PUC Request

369. Maine PUC requests that ISO-NE perform an analysis comparing the cost impact of the proposal outlined in the Joint Filing against the cost impact of the July 1 Proposal. While Maine PUC recognizes that there is no Commission order mandating such cost analysis, Maine PUC believes that this information should be part of the decision making process. JFS notes that ISO-NE has committed to conduct cost studies to support new rules and to provide those studies to stakeholders.[259]

370. In response, ISO-NE states that it has satisfied the request for a statement of the cost impact of the July 1 Proposal. Specifically, ISO-NE notes that it issued an analysis to stakeholders showing the potential impact of the APR contained in the July 1 Proposal had it been in effect for the first three FCAs.

371. However, Maine PUC and JFS disagree that the material submitted by ISO-NE is sufficient. Maine PUC notes that ISO-NE's analysis only examines how ISO-NE's proposal might have worked in past FCAs. Further, according to Maine PUC, the analysis provides unreliable estimates of what the likely cost impacts would have been in the first three FCAs, since the analysis assumes that resources would withdraw from the FCA "evenly" between the floor price and a price of zero and since the analysis uses generalized and unsupported assumptions about benchmark prices for OOM resources to determine resultant APR prices. Therefore, Maine PUC requests that the Commission direct ISO-NE to provide an analysis that clearly compares the prospective costs of ISO-NE's new proposal with the costs of the proposed changes described in the Joint Filing. Maine PUC also requests that ISO-NE be directed to use reliable data for the OOM benchmarks and to use more detailed assumptions for the purpose of clearing the auction down to the ICR.

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[259] JFS Second Brief at 22 (citing the April 28, 2009 filing of ISO-NE and NEPOOL in response to Order No. 719 (Docket No. ER09-1051-000)).

2. Commission Determination

372. We dismiss the requests that ISO-NE perform a more detailed analysis of the cost impacts of the July 1 Proposal. Maine PUC appears to be arguing that ISO-NE should complete an accurate prospective analysis of the July 1 Proposal's cost impact despite the fact that the ISO concedes that it has not yet developed benchmarks, a process that it has committed to vet through the stakeholder process. In addition, while the Maine PUC criticizes ISO-NE's decision to examine how its proposal would affect prior FCAs, any analysis ISO-NE would offer at this point would employ a considerable number of assumptions, any one of which can be debated. In addition, given the accelerated nature of this paper hearing, we do not believe it would be reasonable to expect that ISO-NE would have developed the price cost estimate Maine PUC seeks.

The Commission orders:

(A) The Commission hereby rejects the APR provisions and the provisions relating to the modeling of capacity zones and related mitigation that were filed as part of the Joint Filing.

(B) The Commission hereby accepts the Joint Filing's proposal not to mitigate historical OOM going forward.

(C) The Commission accepts ISO-NE's July 1 Proposal with regard to zonal modeling.

(D) The Commission hereby accepts ISO-NE's July 1 Proposal to eliminate CONE.

(E) The Commission hereby accepts the Joint Filing's proposal to retain the price floor through the sixth FCAs subject to extension as necessary.

(F) The Commission hereby requires ISO-NE to make a compliance filing, within 30 days of the date of this order, in which ISO-NE will file a proposed schedule for filing market rules in accordance with this order on paper hearing. That filing should also address the timeframe for consideration of the two issues that we are requiring ISO-NE to further examine with stakeholders – the development of market rules to implement an offer-floor mitigation construct, and the proper offer floor price for long-lead-time resources.

(H) The Commission hereby grants Mirant's emergency request for clarification of its August 12 Order, and denies NEPGA's request for rehearing of its August 12 Order. The Commission also denies rehearing of NEPGA's motion for disclosure of prior OOM determinations.

By the Commission. Commissioner LaFleur and Chairman Wellinghoff are concurring with a separate statement attached. Commissioner Spitzer is dissenting in part with a separate statement to come at a later date.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Appendix A: Parties that filed briefs

First Briefs

The Boston Gen Companies are Boston Generating, LLC; Mystic I, LLC; Mystic Development, LLC; and Fore River Development, LLC. (Boston Gen)

Consolidated Edison Energy, Inc. (ConEd)

Eastern Massachusetts Consumer-Owned Systems (EMCOS)

HQ Energy Services U.S. (HQUS)

ISO New England Inc. (ISO-NE)

The Connecticut Department of Public Utility Control (CT DPUC), the New England Conference of Public Utility Commissioners (NECPUC),[260] NSTAR Electric Company, the Northeast Utilities (NU) Companies,[261] The United Illuminating Company, National Grid USA,[262] The Energy Consortium, Martha Coakley, Attorney General for the Commonwealth of Massachusetts, and the Connecticut Office of Consumer Counsel (collectively, the Joint Filing Supporters (JFS))

Maine Public Utilities Commission (Maine PUC)

Massachusetts Department of Public Utilities (Mass DPU)

National Grid USA (National Grid)

New England Power Generators Association, Inc. (NEPGA)

New England Power Pool Participants Committee (NEPOOL)

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[260] In the vote on NECPUC's joining the Joint Filing Supporters' pleading, the Maine Public Utilities Commission and the Massachusetts Department of Public Utilities abstained.

[261] The NU Companies are: The Connecticut Light and Power Company, Western Massachusetts Electric Company, and Public Service Company of New Hampshire.

[262] National Grid USA's New England utility operating subsidiaries include: New England Power Company, Massachusetts Electric Company, The Narragansett Electric Company, and Granite State Electric Company.

Potomac Economics (the External Market Monitor, or EMM)

PSEG Energy Resources & Trade LLC; PSEG Power Connecticut LLC; NRG Power Marketing LLC; Connecticut Jet Power LLC; Devon Power LLC; Middletown Power LLC; Montville Power LLC; Norwalk Power LLC; and Somerset Power LLC (Joint Complainants)

Connecticut Municipal Electric Energy Cooperative (CMEEC), Massachusetts Municipal Wholesale Electric Company (MMWEC), and New Hampshire Electric Cooperative, Inc. (NHEC) (Public Systems)

Second Briefs

Brookfield Energy Marketing Inc. (BEMI)

Boston Gen

BG Dighton Power, LLC (BG Dighton), Lake Road Generating, L.P., MASSPOWER and BG Energy Merchants, LLC. (BG Entities)

EMCOS

HQUS

ISO-NE

ISO-NE Internal Market Monitor (IMM)

Joint Complainants

Joint Filing Supporters

Maine PUC

Mass DPU

National Grid

NEPGA

Public Systems

Third Briefs

Boston Gen

BG Entities

EMCOS

HQUS

ISO-NE

ISO-NE IMM

Joint Complainants

Joint Filing Supporters

Maine PUC

National Grid

NEPGA

NEPOOL

Public Systems

Fourth Briefs

HQUS

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ISO New England, Inc. and New England Power Pool Participants Committee	Docket Nos. ER10-787-000 EL10-50-000 EL10-57-000
New England Power Generators Association v. ISO New England Inc.	ER10-787-004 EL10-50-002 EL10-57-002
PSEG Energy Resources & Trade LLC, PSEG Power Connecticut LLC, NRG Power Marketing LLC, Connecticut Jet Power LLC, Devon Power LLC, Middletown Power LLC, Montville Power LLC, Norwalk Power LLC, and Somerset Power LLC v. ISO New England Inc.	

(Issued April 13, 2011)

LaFLEUR, Commissioner, and WELLINGHOFF, Chairman concurring:

In today's order, the Commission finds that applying offer-floor mitigation to ISO-NE's capacity market is a just and reasonable way to address the competing objectives involved in this proceeding: (1) allowing new OOM capacity to clear and obtain a capacity supply obligation; (2) preventing new OOM capacity from distorting the market for existing capacity; and (3) ensuring that total purchases do not exceed the ICR. We strongly support this conclusion and the reasoning behind it.

We write separately to highlight the order's discussion of the opportunity state and individual entities have to seek an exemption from mitigation for new resources by filing a section 206 proceeding.

While it is true that all OOM capacity, regardless of intent, will have the same effect on the market-clearing price, it is also true that some OOM capacity is not intended to suppress the market-clearing price, but to further legitimate public policy goals, such as the progressively escalating renewable portfolio standards present in each of the six New England states. This OOM capacity is not intended to suppress the market-clearing price, but to comply with legal requirements that advance the states' environmental objectives.

We believe that the ability to seek exemptions from mitigation may be a critical

component of entities' efforts to satisfy their renewable portfolio standard obligations, and that the Commission should be willing to consider such requests.[1]

Alternatively, the Commission has permitted PJM to exempt certain types of generation resources from mitigation. We encourage ISO-NE and its stakeholders to consider whether similar exemptions are appropriate for New England. More broadly, we are conscious that just as today's order involved trade-offs among difficult choices, ISO-NE and its stakeholders will continue to face difficult decisions as they respond to this order and otherwise consider aspects of the capacity market. We encourage all interested parties to think creatively about the purposes and goals of the market, particularly in light of increasing participation from new types of resources.

Cheryl A. LaFleur Commissioner	Jon Wellinghoff Chairman

[1] *See NYISO*, 124 FERC ¶ 61,301, at P 38 (2008) ("Nevertheless, the Commission recognizes that the NYPSC [New York Public Service Commission] may conclude that the procurement of new capacity, even at times when the market-clearing price indicates entry of new capacity is not needed, will further specific legitimate policy goals, such as renewable portfolio standards. We agree that it may be appropriate to exempt such new resources from the price floor proposed by NYISO . . . . The NYPSC may make a filing under section 206 of the FPA to justify a mitigation exemption for entry of new capacity that is required by a state-mandated requirement . . . . At that time, we will evaluate the merits of the proposed exemption, but at this time, the NYPSC has provided inadequate justification either for a general exemption or for a finding that the appropriate mechanism for supporting its goals is, in fact, an exemption from the price floor for new capacity."); *order on reh'g*, 131 FERC ¶ 61,170, at P 137 (2010) (stating that "it is not the [Commission's] intent to interfere with state programs that further specific legitimate policy goals" and exempting certain payments to Special Case Resources, which are demand resources, from the calculation of NYISO's price floor.).