

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
Nora Mead Brownell, and Joseph T. Kelliher.

ISO New England Inc.

Docket Nos. ER04-23-001  
ER04-23-004

ORDER ON REHEARING

(Issued June 2, 2004)

1. In this order, we deny United Illuminating Company's (UI) request for rehearing of the Commission's December 1, 2003 Order Accepting Amended Reliability Agreement for Filing and Suspending Proposed Rates, Subject to Refund, and Establishing Hearing and Settlement Judge Procedures (December 1 Order)<sup>1</sup> with respect to the Amended Reliability Agreement (Amended Agreement) between Devon Power, LLC (Devon) and ISO New England Inc. (ISO-NE). In addition, we accept an informational filing made by ISO-NE that notifies the Commission that one of the Devon units subject to the Amended Agreement is no longer needed for reliability purposes.

**Background**

2. In its December 1 Order, the Commission accepted the Amended Agreement between ISO-NE and Devon governing the operation of Devon generating units 7 and 8 located in southwest Connecticut. The Commission conditionally accepted the agreement and suspended the rates (proposed Reliability Charge), made them subject to refund, and instituted hearing and settlement judge procedures.

3. The Amended Agreement provides for an extension of the term of an existing Reliability-Must-Run (RMR) Agreement (Prior Agreement) between Devon and ISO-NE for an additional 12-month period, until October 1, 2004.<sup>2</sup> The amendments to the Prior Agreement primarily reflect changes to the New England Power Pool (NEPOOL) market that occurred with the implementation of New England Standard Market Design (SMD)

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<sup>1</sup> ISO New England, Inc., 105 FERC ¶ 61,263 (2003).

<sup>2</sup> See ISO-NE, 101 FERC ¶ 61,341 (2002), reh'g pending.

on March 1, 2003.<sup>3</sup> Prior to entering into the Prior Agreement with ISO-NE, Devon applied to ISO-NE to deactivate Devon generating units 7 and 8. In July 2002, ISO-NE denied the application after concluding that the generating units were needed to maintain reliability until new generation (Milford Station) is activated. The Prior Agreement was entered into in August 2002 under the assumption that the Milford Station would achieve commercial operation by October 2003.

4. In its October 2, 2003 extension request, ISO-NE stated that Milford Station was not yet commercially operational; and therefore, an extension of the Prior Agreement was needed until Devon generating units 7 and 8 are no longer needed to address regional capacity shortages and transmission constraints. The Amended Agreement, negotiated pursuant to sections 18.4 and 18.5 of the Restated NEPOOL Agreement (RNA), reflects the need to compensate Devon for the continued operation of these units.<sup>4</sup>

5. On February 27, 2004, in Docket No. ER04-23-004, ISO-NE submitted an informational letter (February 27 Letter) to the Commission stating that ISO-NE had notified Devon that “one of the generating units” currently covered by the Amended Agreement is no longer needed for reliability purposes. ISO-NE stated that it would terminate the Amended Agreement with respect to the unneeded unit effective 60 days following the date of the letter it sent to Devon.

### **UI’s Request for Rehearing**

6. UI argues that the Commission should not have accepted the Amended Agreement insofar as it provides for cost recovery for the Devon 7 and 8 units beyond the recovery available to similarly situated units required to assure reliability. UI stated that in other recent orders, the Commission provided for cost recovery for such units via the Peaking Unit Safe Harbor (PUSH) bidding mechanism. UI claims that treating the Devon units differently from similarly situated units in terms of cost recovery results in unjust and unreasonable rates that are unduly discriminatory and preferential.

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<sup>3</sup> New England Power Pool and ISO New England, Inc., 100 FERC ¶ 61,287 (2002), order on reh’g, 101 FERC ¶ 61,344 (2002).

<sup>4</sup> ISO-NE states that it negotiated the Amended Reliability Agreement pursuant to sections 18.4 and 18.5 of the Restated NEPOOL Agreement rather than Market Rule 1 because it is an extension of the Prior Agreement that was negotiated in accordance with the RNA. Additionally, ISO-NE states that the Commission affirmed the authority of ISO-NE to enter into RMR agreements in the order accepting the New England Standard Market Design. See 100 FERC ¶ 61,287 at P 50.

7. UI adds, that at minimum, the Commission should not have endorsed such disparate treatment without identifying any basis on which the Amended Agreement or the Devon units are distinguishable from the RMR agreements recently rejected by the Commission or the units subject to those agreements.

8. UI claims that even if the Commission appropriately concluded that the Devon units are unique, the Commission should not have allowed these units to recover full cost of service. UI argues that the Commission should assure that any guaranteed cost recovery mechanism applied to the Devon units is limited to the units' marginal cost of production and on-going maintenance costs. UI states that Devon has acknowledged that it would be able to recover its marginal costs of production via the PUSH bidding mechanism. UI states that a guarantee of recovery of sunk costs is not necessary to assure continued operation of the Devon units, and that such recovery is inconsistent with market principles and would result in unjust and unreasonable rates and discriminatory and preferential treatment for these units.

9. UI also argues that the Commission should not have allocated the costs under the Amended Agreement only to customers in the local areas where the units are satisfying reliability requirements. UI claims that because the Amended Agreement extends an agreement that predates the current SMD, to the extent the Commission allows continuation of RMR treatment for these units, it also should require continued allocation of the costs of the agreement across NEPOOL.

10. In response to arguments that the Devon units do not qualify for PUSH treatment because they have capacity factors in excess of 10 percent, UI argues that the Commission established the 10 percent threshold "to provide a market mechanism for high cost, seldom run units to recover their fixed costs." UI states that the Commission presumably concluded that units operating in excess of the threshold amount would be able to obtain recovery sufficient to permit continued operation via normal market procedures. UI notes that Devon has acknowledged that it will recover its marginal costs of production by virtue of the PUSH bid mechanism notwithstanding its ineligibility to submit PUSH bids.

11. UI claims that the Commission did not offer support in its December 1 Order, that "the only avenue open to ISO-NE to ensure these units remain in operation for reliability in southwest Connecticut is to offer an RMR agreement." UI argues, that at most, Devon should be guaranteed recovery of its costs of production plus going-forward maintenance costs. UI argues that at the very least, the Commission should reject the Amended Agreement to the extent that it purports to permit Devon to recover the premiums it, in retrospect, paid to purchase the Devon units. It argues that recovery of these sunk costs would have no impact on the ability of Devon to continue to operate the units, but would be unjust to Devon's customers and their ratepayers.

### **ISO-NE's Motion for Leave to Respond and Response to UI's Request for Rehearing**

12. On January 15, 2004, ISO-NE filed a Motion for Leave to Respond and Response to UI's Request for Rehearing. ISO-NE states that UI argues that costs associated with the Reliability Agreement should be allocated to the entire NEPOOL region, rather than to the local reliability area in which the units are located. ISO-NE claims that this issue is not before the Commission in this proceeding and represents an improper collateral attack on previous Commission orders.

### **Procedural Matters**

13. Notice of ISO-NE's February 27 Letter was published in the Federal Register, 69 Fed. Reg. 56,281 (2004), with comments, protests, or interventions due on or before March 24, 2004. None was filed.

14. Notwithstanding that Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R § 385.213 (2003), generally prohibits the filing of an answer to a rehearing, we find that good cause exists to grant ISO-NE's answer in that it assisted in our understanding and resolution of the issues.

### **Discussion**

15. The December 1 Order addressed the concerns that UI raised in its rehearing request. Despite UI's claims that the Devon generating units 7 and 8 should operate under the PUSH rules, the Commission again notes that Devon generating units 7 and 8 are not eligible for PUSH treatment because their capacity factors for 2002 exceeded the 10 percent threshold.

16. UI argues that the units can recover their marginal costs through PUSH (without PUSH bidding) and that Devon must recover any additional costs in the market. However, as mentioned above, Devon is not eligible for PUSH treatment, and thus cannot recover any additional costs through the market as long as it has an RMR Agreement with ISO-NE. Devon has stated that absent the RMR Agreement, it would recover only a minimal amount of going forward costs. In support of this assertion, Devon has presented the Commission with projections of inframarginal and installed capacity (ICAP) revenues that these units could expect from the market. While the revenues received when the Devon units are called on to operate may cover variable costs, they are not sufficient to adequately cover fixed costs. We find that Devon has demonstrated its need to recover its fixed and variable costs through its Amended Agreement with ISO-NE because: 1) ISO-NE would not allow Devon to deactivate either of its units when ISO-NE determined that these units were needed for reliability in southwest Connecticut;

and 2) Devon does not have any other viable options for recovering its fixed costs other than through its Amended Agreement. The Amended Agreement sets forth that all market revenues (including those from a future locational ICAP market) generated by Devon be credited against the cost-of-service rates (which include fixed costs).

17. Regarding UI's claims that the Amended Agreement should be rejected, the Commission previously stated that while a unit covered by an RMR contract could not also operate in the market as a PUSH unit, it did not state that when an RMR contract expired the unit could not be subject to a new RMR contract.<sup>5</sup> Additionally, ISO-NE provided reliability studies (performed by the ISO) indicating that the capacity shortage and transmission constraints that led to the original RMR agreement were expected to continue, and thus, demonstrated its need for the Amended Agreement.

18. UI argues on rehearing that the costs of the Amended Agreement should be allocated regionally across NEPOOL. We deny UI's rehearing request. This issue was decided in proceedings that established Market Rule 1, and the Commission simply applied its prior ruling in the December 1 Order and did not reopen the issue for discussion. As we stated in the December 1 Order, the Prior Agreement was entered into before SMD when the costs were socialized across NEPOOL. The implementation of Market Rule 1 under SMD requires that the costs of RMR agreements be borne by the customers in the zones in which the units are located.<sup>6</sup> Accordingly, in the December 1 Order, we directed ISO-NE to affirm and ensure that the costs of the Amended Agreement are allocated only to those customers in the local areas where these units are satisfying reliability requirements in accordance with the existing market rules.

### **February 27 Letter**

19. We accept the filing of the February 27 Letter that provides the Commission with a copy of the notice given by ISO-NE to Devon that the ISO is terminating the Amended Agreement with respect to the unneeded Devon unit in accordance with the Agreement's provisions. In this filing, ISO-NE reiterated and demonstrated that its need for the Amended Agreement would last until the Milford Station becomes fully operational (at which time neither Devon unit would be needed to maintain reliability).

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<sup>5</sup> Devon Power LLC, et. al., 103 FERC ¶ 61,082 (2003), order on reh'g, 104 FERC ¶ 61,123 (2003) at P 56.

<sup>6</sup> 100 FERC ¶ 61,287 at P 61-62.

The Commission orders:

(A) UI's request for rehearing is hereby denied, as discussed in the body of this order.

(B) The filing made by ISO-NE on February 27, 2004 in Docket ER04-23-004 is hereby accepted for informational purposes.

By the Commission. Commissioner Kelly not participating.

( S E A L )

Linda Mitry,  
Acting Secretary.