

127 FERC ¶ 61,040
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

ISO New England Inc.

Docket No. ER09-467-000

ORDER ACCEPTING RESULTS OF
FORWARD CAPACITY AUCTION

(Issued April 16, 2009)

1. In this order, the Commission accepts the results of the Forward Capacity Auction conducted by ISO New England Inc. (ISO-NE) in December 2008. We also deny motions to strike a party's comments.

I. Background

A. Forward Capacity Market (FCM)

2. On March 6, 2006, ISO-NE filed a Settlement Agreement establishing the framework for New England's FCM.¹ Under the FCM mechanism, ISO-NE will provide capacity payments to resources that provide capacity to the New England region, and capacity resources will compete to be selected to provide capacity (and receive payments) on a three-year forward basis through a Forward Capacity Auction (FCA) held every year. ISO-NE conducted its first FCA on February 4-6, 2008,² its second FCA (the subject of the instant filing) on December 8-10, 2008, and is preparing to conduct the third FCA in October 2009.

¹ See generally *Devon Power LLC*, 115 FERC ¶ 61,340 (FCM Settlement Order), *order on reh'g*, 117 FERC ¶ 61,133 (2006) (FCM Rehearing Order), *aff'd* in relevant part *sub nom. Maine Public Utilities Comm'n v. FERC*, 380 U.S. App. D.C. 257, 520 F.3d 464 (2008), *order on remand, Devon Power LLC*, 126 FERC ¶ 61,027 (2009).

² On June 20, 2008, the Commission accepted ISO-NE's filing of the results of the first FCA. See *ISO New England Inc.*, 123 FERC ¶ 61,290 (2008) (First FCA Order), *reh'g pending*.

B. The Instant Filing

3. On December 23, 2008, ISO-NE submitted a filing containing the results of the December 2008 FCA to the Commission. ISO-NE states that, pursuant to section III.13.8.2 of ISO-NE's Transmission, Markets and Services Tariff (Tariff), it is submitting the results of the FCA, including, *inter alia*, the final set of Capacity Zones resulting from the auction and the Capacity Clearing Price, to the Commission under section 205 of the Federal Power Act (FPA).³

4. ISO-NE states that the auction resulted in only one Capacity Zone for the entire New England region, with a Capacity Clearing Price of \$3.60/kW-month. ISO-NE further states that, under the formula contained in the Tariff, the Cost of New Entry (CONE) is adjusted based upon the results of each successful auction, and since this auction concluded with a price of \$3.60/kW month, CONE for the third FCA will be \$4.918/kW-month.⁴ ISO-NE asserts that the results of the auction demonstrate that the FCM continues to procure the necessary resources to provide reliable capacity supply for New England.⁵ ISO-NE states that it procured capacity equal to the region's Installed Capacity Requirement (ICR)⁶ of 32,528 MW.⁷ As required by the FCM settlement,⁸ ISO-NE modeled two Capacity Zones, Maine (as a potentially export-constrained zone) and

³ 16 U.S.C. § 824d (2000).

⁴ See P 7 below.

⁵ ISO-NE notes that the second FCA continued to attract demand resources, with more than 2,900 MW of demand resources clearing in the auction. Further, because no existing resources submitting de-list bids were needed for reliability, no resources will receive out-of-market reliability compensation from the second FCA.

⁶ The ICR is "the level of capacity required to meet the reliability requirements defined for the New England Control Area" (definition of ICR at ISO-NE Tariff at 3rd Rev. Sheet No. 7034) such that "the probability of disconnecting non-interruptible customers due to resource deficiency, on the average, will be no more than once in ten years." See § III.12.1 of the ISO-NE Tariff at 1st Rev. Sheet No. 7307A.

⁷ Because the auction cleared at the floor price with excess capacity above the ICR, resources may choose between a Capacity Supply Obligation of their full cleared capacity at a price of \$3.119/kW-month, or receiving the floor price of \$3.60/kW-month and prorating their Capacity Supply Obligation by the same ratio. Thus, the auction will purchase between 32,528 MW and 37,283 MW, depending on the proration elections of the auction participants.

Rest of Pool. ISO-NE states that no price separation occurred during this FCA, and therefore, the FCA resulted in a single Capacity Zone.

5. Under the FCM, resources may opt out of the market by submitting a de-list bid during the auction, so that if a unit is not needed for reliability, that resource is allowed to withdraw from the auction. ISO-NE states that it reviewed approximately 258 such de-list bids (518 MW).⁹ ISO-NE determined that none of these resources were needed for reliability, and therefore, did not reject any de-list bids.

6. Section III.13.2.4 of the Tariff specifies how CONE will be determined until three successful FCAs have been conducted for a Capacity Zone.¹⁰ Following the second successful FCA, but prior to the completion of the third FCA for each Capacity Zone, CONE for each Capacity Zone will equal \$1.88/kW-month plus 75 percent of the average Capacity Clearing Prices in the Capacity Zones in the first two successful FCAs. Accordingly, CONE for the upcoming third FCA will be \$4.918/kW-month.¹¹ The starting price for the third FCA will be \$9.835/kW-month (two times CONE), and certain de-list bids above \$3.934/kW-month were required to be submitted to the ISO-NE market monitor for review by February 3, 2009 in order to be permitted in the third FCA.

C. Notice of Filings

7. Notice of the filing was published in the *Federal Register*, with motions to intervene, notices of intervention, comments and protests due on or before January 13, 2008.¹² The Commission subsequently extended the intervention and protest date to February 6, 2009. Constellation Energy Commodities Group, *et al.* (Constellation), the New England Power Generators Association (NEPGA), Dynegy Power Marketing (Dynegy), Northeast Utilities Service Company and the FirstLight

⁸ ISO-NE Tariff § III.13.8.1(a) requires ISO-NE to inform the Commission of the locational capacity requirements of the FCA based upon the topology of the transmission system, including whether it is appropriate to model separate Capacity Zones.

⁹ Additionally, prior to the auction, ISO-NE reviewed 107 permanent, administrative, export, or static de-list bids (372 MW).

¹⁰ ISO-NE Tariff § III.13.2.5.2.5(b).

¹¹ The price floor for the third FCA will be \$2.95/kW-month (i.e., 60 percent of \$4.918/ kW-month).

¹² 74 Fed. Reg. 1207 (2009) and 74 Fed. Reg. 1669 (2009).

Parties¹³ (FirstLight) filed timely motions to intervene. The New England Power Pool Participants Committee (NEPOOL), the Connecticut Department of Public Utility Control (CT DPUC), and the New England Conference of Public Utility Commissioners (NECPUC) filed motions to intervene out of time.

8. FirstLight filed comments. NEPOOL filed an answer to FirstLight's comments, and CT DPUC together with NECPUC (collectively, New England States) and ISO-NE filed motions to strike FirstLight's comments, or in the alternative answers to those comments. FirstLight filed an answer to the motions to strike.

D. Protests, Comments and Answers

9. FirstLight argues that the results of the second FCA demonstrate that there are serious flaws in the FCM that undermine the principles and objectives which formed the basis for the FCM Settlement and its approval by the Commission. FirstLight acknowledges that the second FCA was conducted in accordance with the FCM market rules currently in effect, but states that those rules do not serve their intended purposes and need to be modified in time for the fourth FCA.

10. FirstLight argues that the current rules allow new entrants to offer their capacity below their actual costs with the net effect of depressing capacity prices. Thus, FirstLight argues, those rules are inconsistent with the FCM design objective that new entrants will set the clearing price at the true CONE. According to FirstLight, in the first FCA, new capacity resources were permitted to elect to be treated as existing capacity resources and participate as price takers without their bids being reviewed by the Market Monitor for consistency with long-run average costs. FirstLight asserts that this created an excess of capacity such that the market never even cleared and, instead, the auction simply stopped at the floor price of \$4.50/kW-month, and the excess capacity was carried into the second FCA.¹⁴

11. According to FirstLight, a number of large new entrants who bid into the first FCA as price takers are indifferent to the low FCM prices because they have long term contracts under which, FirstLight asserts, they are guaranteed recovery of their true costs of entry.¹⁵ First Light alleges that under these contracts, the new entrants are required to

¹³ FirstLight Power Resources Management, LLC, FirstLight Hydro Generating Company and Mt. Tom Generating Company LLC.

¹⁴ The second FCA also stopped at the administrative price floor.

¹⁵ As an example, FirstLight cites the State of Connecticut's recent decision to offer long term cost-of-service contracts to generators who agree to construct new

(continued...)

bid into the FCA as price takers, and then will receive both the auction clearing price and "contract for difference" (CFD) side payments from their counterparty to make up the difference between the auction price (\$3.60/kW-month in the second auction) and what FirstLight alleges to be these entrants' true costs (between \$11-12/kW-month). FirstLight contends that the current market rules encourage buyers to enter into such contracts well in advance of the auction, so that allowing uneconomic bidding of new capacity defeats the FCM's objective of setting capacity clearing prices based on CONE.¹⁶

12. In addition to the separate CFD arrangements, FirstLight asserts that the current market rules allow participants to intentionally avoid the conditions necessary to trigger the price floor mechanism of the Alternative Price Rule. Specifically, FirstLight notes that the Market Monitor reviews bids from new capacity resources below 0.75 X CONE to determine whether the bid is consistent with the resource's long-run average costs. If the bid is found to be inconsistent with the resource's long-run average costs, then the amount of capacity clearing from that offer is considered Out-of-Market Capacity for purposes of determining the applicability of the Alternative Capacity Price Rule. However, FirstLight notes that under the terms of the Alternative Price Rule, three separate conditions – including that new capacity is required to meet the ICR – must be met before the Alternative Price Rule price floor is triggered. FirstLight contends that when adequate capacity exists in the capacity zone even such "denied" bids remain in the auction. FirstLight thus argues that the CFD uneconomic bids, along with these additional "denied" bids below 0.75 X CONE, were significant contributors to the first two auctions reaching the price floor with excess capacity. FirstLight asks the Commission to require ISO-NE to take steps to assure that uneconomic bidding by new entrants is not permitted to depress clearing prices, and to implement appropriate adjustments in the auction mechanics for subsequent years.

13. FirstLight argues that unless the current rules for resetting CONE are changed, CONE will fall to levels so far below the actual CONE that the auction starting price for subsequent auctions, at two times CONE, will be too low to attract new capacity when it is needed. FirstLight claims that the downward spiral of auction prices caused by the acceptance of multiple new entrants whose bids were below their long-run average costs caused CONE and the auction starting price to be set lower and lower, leading the starting price of future auctions to be well below the actual costs of new entry. Thus, FirstLight argues that if CONE bears no relationship to true cost, the use of CONE as a

facilities and sell their capacity into the FCM as price takers.

¹⁶ FirstLight states that the Alternate Price Rule is designed to respond to uneconomic bidding by setting a floor price at least equal to CONE, but that the Alternate Price Rule is not operative when there is excess existing capacity in the auction.

benchmark for the Market Monitor to review de-list bids and new capacity offers will be meaningless. FirstLight asserts that as market prices fall, numerous existing capacity resources may seek to exit the market because their net risk-adjusted going forward costs are greater than 0.8 of a fictitious CONE. Therefore, FirstLight states that the Commission should direct ISO-NE to develop a mechanism that will reset CONE so that it again has a direct correlation to the actual cost of new entry.

14. FirstLight also expresses concern about the reliability implications of dramatically increased reliance on demand resources, as well as about their limited operating obligations and non-performance liabilities as compared with generation resources. FirstLight contends that demand resources do not have the same market obligations, have different performance obligations, and are subject to different non-performance penalties, compared to generation resources. FirstLight explains that the demand resource effectively has a free option to supply or not to supply the energy, effectively being able to switch from non-firm to firm service at its own choosing, which will adversely affect system reliability. FirstLight argues that a comprehensive review of the reliability and comparability issues presented by the continued rapid growth of demand resource participation in the FCM is needed and a common set of service obligations and financial risks for under-performance needs to apply to all resources consistent with the substitutability of capacity supply inherent in a single clearing price.

15. FirstLight notes that ISO-NE's Internal Market Monitoring Unit must file a report by June 8, 2009 analyzing the operations and effectiveness of the FCM. FirstLight argues that this report should include a comprehensive review of price formation, CONE, and demand response issues as well as proposals for needed market improvements for implementation in the fourth auction.

E. ISO-NE's and the New England States' Motions to Strike

16. ISO-NE and the New England States filed separate motions requesting that the Commission strike FirstLight's comments. They note that this is the second time that FirstLight has improperly sought modification of the FCM rules in the context of the Commission's approval of an FCA. They contend that all of the concerns raised by FirstLight – the impact on the clearing price of new capacity resources participating in the FCA as price takers, the calculation of CONE, and the reliability of demand resources – were considered and rejected in the Commission's order approving the results for the first FCA.¹⁷

¹⁷ First FCA Order.

17. ISO-NE notes that in the First FCA Order, in addressing the same issues FirstLight raises here, the Commission found that concerns about the proper value of CONE were a collateral attack on previous Commission orders and were better addressed in the ISO-NE stakeholder process. Similarly, ISO-NE states that the Commission specifically rejected FirstLight's demand resource concerns, finding that these concerns were outside the scope of the proceeding. Finally, ISO-NE states that the Commission rejected arguments that new capacity resources bidding into the market as existing capacity resources affected the clearing price in the first FCA, also noting that future auction values for CONE would not be affected by this one-time exception.¹⁸

18. Referencing the First FCA Order, both the New England States and ISO-NE contend that the sole issue before the Commission in this proceeding is whether the FCA was conducted in accordance with the Commission-approved FCM rules.¹⁹ ISO-NE and the New England States contend that FirstLight's comments, by contrast, do not request relief within this proceeding, but instead seek a Commission ruling on findings that ISO-NE is required to make in its report on the operation of the FCM, to be filed 180 days after the second FCA.²⁰ However, ISO-NE states that the Market Monitor's Auction Report will be filed in a different proceeding outside the scope of the FCA results filing. Further, ISO-NE notes that in support of that filing, it has already solicited comments from stakeholders on the operation and effectiveness of the FCM. As such, ISO-NE requests that the Commission not pre-determine the outcome of a process which is already underway. In addition, the New England States contend that FirstLight's request for ISO-NE to re-design the FCM is a collateral attack on the Commission's order accepting the FCM.

19. The New England States contend that FirstLight's argument that Connecticut's long-term contracts lead to the depressing of capacity prices is flawed for two reasons. First, the New England States argue that Connecticut's request for proposal for long-term contracts has not determined the FCM clearing price in any auction, because the

¹⁸ In addition, both the New England States and ISO-NE argue that for the second FCA, because the surplus of capacity was 4,755 MW when the clearing price reached the floor, subtracting the 1,118 MW of out of market capacity would not have prevented the clearing price from reaching the floor.

¹⁹ New England States' motion to strike at 10 n.38 and ISO-NE motion to strike at 6 n.21, *citing* First FCA order at P 17.

²⁰ Section III.13.8.4 of the Tariff requires the ISO's Internal Market Monitoring Unit to issue a report on the operations and effectiveness of the FCM after the second FCA and annually thereafter.

substantial amount of excess capacity in both auctions would have brought the clearing price down to the administrative price floor regardless of Connecticut's actions. Second, the New England States contend that, in contrast to the Commission's guidance in the order approving the FCM Settlement, FirstLight is seeking Commission action to block the states' "reasonable efforts" to assure adequate resources in their jurisdictions, and to preclude investors from entering into long-term bilateral contracts.²¹ The New England States also state that the ability for new resources to be treated as existing was part of the FCM Settlement, unique to the first FCA, and as such did not affect the results of the second FCA.

20. The New England States further state that FirstLight has provided no basis to assume that demand resources will not fulfill their capacity commitments with at least the same level of reliability as generation resources. They argue that if demand resources fail to meet the FCM's strict performance requirements for capacity resources, there will be sufficient opportunity to address any concerns due to the substantial amount of excess capacity in New England through at least May 2012.

21. ISO-NE acknowledges that the Commission denied its previous motion to strike certain comments filed in response to the first FCA results filing. However, ISO-NE contends that the First FCA Order demonstrated that this proceeding should only concern the results of the FCA and that challenges to the FCM rules or the design of the FCM market are outside the scope of this proceeding. Additionally, the New England States note that FirstLight was a full participant during the FCM Rules proceedings, yet failed to raise these issues during those proceedings.

22. ISO-NE and the New England States argue that FirstLight's comments, which challenge the market rules governing the FCA rather than the filing itself, constitute a complaint filed in a section 205 case, and the Commission has found that a section 205 proceeding is not the proper forum for submission of a complaint.²² As such, ISO-NE argues that parties should not use this proceeding as a forum to challenge the FCM market design. In the alternative, both ISO-NE and the New England States ask the Commission to accept their pleadings as replies to FirstLight's comments.

²¹ New England States motion to strike at 6-7.

²² ISO-NE motion to strike at 6 n.22, citing *ISO New England Inc.*, 112 FERC ¶ 61,060 at PP 13-14 (2005); *Southern Company Services, Inc.* 116 FERC ¶ 61,070 at P 26 (2006) (citations omitted).

23. NEPOOL, in its answer, requests that the Commission reject FirstLight's attempt to expand this second FCA results proceeding into a proceeding to predetermine or otherwise direct future FCM changes. NEPOOL states that along with ISO-NE and the NECPUC, it has jointly formed a Forward Capacity Market Steering Group aimed specifically at addressing improvements to the FCM. NEPOOL argues that the only issue before the Commission in this proceeding is whether the results from the second FCA are just and reasonable and not what revisions to the FCM may be necessary in the future. NEPOOL states that given the complexity of the issues raised by FirstLight, the overlap with other FCM issues currently under stakeholder consideration, and competing FCM priorities in the region,²³ the Commission should – consistent with the First FCA Order - direct FirstLight to address its concerns in the NEPOOL stakeholder process.

24. FirstLight, in its answer, argues that its comments are not beyond the scope of this proceeding and are intended to inform the ongoing stakeholder process to address FCM. Further, FirstLight contends that the provision from the first FCA that allowed new resources to bid as existing resources has carried over to the second FCA (and likely subsequent FCAs) allowing new resources to bid below their costs. As such, FirstLight states that a comprehensive review by the Market Monitor is required if the market rule “defects” are to be corrected in time for the fourth FCA.

II. Discussion

A. Procedural Issues

25. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214 (2008)), the unopposed motions to intervene, both timely and out of time, serve to make the entities filing them parties to this proceeding. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties.

26. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2008), prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We will accept the answers filed by NEPOOL, the

²³ For example, NEPOOL notes that under section III.13.7.3.1 of the tariff, ISO-NE is required to file the region's recommendations on the need for a reconstitution methodology for demand resources by September 1, 2009. In addition, NEPOOL and ISO-NE are required to address by February 10, 2010 fundamental FCM design issues associated with local sourcing requirements, transmission security analysis, and reliability reviews.

New England States, and ISO-NE because they have provided information that has assisted us in our decision-making process.

B. Analysis

27. The Commission accepts ISO-NE's filing of the results of the second FCA.

28. We deny the motions by the New England States and ISO-NE to strike FirstLight's protest. With regard to price formation under FCM, we note that FirstLight has made broad allegations that could suggest, if substantiated, that adjustments may be needed to the FCM to ensure that it fulfills its function of eliciting new capacity when necessary. Those concerns, however, are not properly raised in "comments" to this filing, in which ISO-NE was obligated solely to demonstrate that it conducted the FCA pursuant to its own market rules. No party has alleged that ISO-NE failed to comply with the rules during the conduct of the auction, and FirstLight itself acknowledges that ISO-NE complied with the market rules. As we similarly stated in the First FCA Order:

The Commission notes that the methodology for resetting CONE in auctions subsequent to the first FCA was accepted by the Commission in both the FCM Settlement and the FCM rules. ISO-NE points out in its answer that the determination of CONE in future FCAs was a "fundamental" aspect of the FCM Settlement; the Commission agrees, and finds the protests filed by the various parties challenging the determination of CONE to be a collateral attack on past Commission orders accepting the FCM Settlement and FCM rules. The concerns raised [in this regard] are more appropriately raised in the ISO-NE stakeholder process, rather than in response to the instant filing, which relates solely to the results of the first FCA.^[24]

29. With regard to FirstLight's concerns over the reliability implications of increased reliance on demand resources under the FCM, we reiterate our position from the First FCA Order that these concerns are outside the scope of this proceeding.

²⁴ First FCA Order at P 17 (citations omitted).

30. ISO-NE has demonstrated, and FirstLight concedes, that the second FCA was conducted according to the FCM market rules. Thus, FirstLight's arguments are, in essence, an attempt to relitigate the Commission's original acceptance of those market rules. FirstLight may disagree with the outcome of the auction (specifically, the determination of CONE for future auctions), but if so, its recourse is to seek to change the market rules, whether through the Forward Capacity Market Steering Group stakeholder process to which NEPOOL refers in its comments, or otherwise.

The Commission orders:

ISO-NE's filing of the results of the second FCA is hereby accepted.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.