

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Devon Power LLC, *et al.*

Docket Nos. ER03-563-038
EL04-102-001

ORDER ON REHEARING AND CLARIFICATION

(Issued November 8, 2004)

1. Several parties have requested rehearing and/or submitted motions for clarification of the Commission's order issued June 2, 2004 in Docket Nos. ER03-563-030 and EL04-102-000.¹ In the June 2 Order, the Commission acted on a compliance filing submitted by ISO New England, Inc. (ISO-NE) that proposed to establish a locational installed capacity (LICAP) mechanism in New England, in compliance with the Commission's April 25, 2003 Order issued in these proceedings.² Specifically, the Commission agreed with two broad concepts in ISO-NE's compliance filing (establishing ICAP regions and the use of a demand curve in each region), but set for hearing procedures certain details of the proposal, directed ISO-NE to submit a further filing addressing whether the Commission should order a separate LICAP region for Southwest Connecticut, and established an investigation and paper hearing in Docket No. EL04-102-000 regarding the implementation of a separate Southwest Connecticut (SWCT) energy load zone. Additionally, the Commission's order delayed the implementation of the LICAP mechanism to no later than January 1, 2006. In this order, the Commission will deny rehearing, deny clarification in part, and grant clarification in part. This order benefits customers by further clarifying the issues surrounding New England's implementation of the LICAP market.

¹ *Devon Power LLC, et al.*, 107 FERC ¶ 61,240 (2004) (June 2 Order).

² *Devon Power LLC, et al.*, 103 FERC ¶ 61,082 (2003) (April 25 Order).

I. Background

2. These proceedings began on February 26, 2003, when Devon Power LLC, Middletown Power LLC, Montville Power LLC, Norwalk Power LLC and NRG Power Marketing Inc. (collectively NRG) filed, pursuant to section 205 of the Federal Power Act (FPA)³ four cost-of-service reliability-must-run (RMR) agreements covering 1,728 MW of generating capacity located within Connecticut and the SWCT designated congestion area. These agreements were negotiated between NRG and ISO-NE pursuant to New England Power Pool (NEPOOL) Market Rule 17.3, which allows ISO-NE to negotiate agreements to provide compensation for generating units that ISO-NE determines are necessary for reliability.

3. In a series of orders addressing NRG's filing,⁴ the Commission rejected the majority of the RMR agreements, permitting NRG to collect only certain going forward maintenance costs through a tracking mechanism. Additionally, in these orders, and in several orders addressing other RMR agreements filed by entities in New England, the Commission rejected widespread use of RMR contracts out of concern about the effect such contracts have on the competitive market.⁵ The Commission stated that ISO-NE, "rather than focusing on and using stand-alone RMR agreements, should incorporate the effect of those agreements into a market-type mechanism."⁶ Accordingly, the Commission directed, pursuant to section 206 of the FPA,⁷ that revised bidding rules (called Peaking Unit Safe Harbor, or PUSH, bidding) be instituted on an interim basis to give low-capacity factor generating units operating in designated congestion areas the opportunity to recover their costs through the market.⁸ To replace the interim PUSH mechanism, the Commission directed ISO-NE to file by March 1, 2004, for

³ 16 U.S.C. § 824d (2000).

⁴ *Devon Power LLC et al.*, 102 FERC ¶ 61,314 (2003) (March 25 Order); April 25 Order; *Devon Power Company et al.*, 104 FERC ¶ 61,123 (July 24 Order).

⁵ *Id.*; *PPL Wallingford Energy LLC*, 103 FERC ¶ 61,185 (2003); *PPL Wallingford Energy LLC et al.*, 105 FERC ¶ 61,324 (2003) (collectively, PUSH Orders).

⁶ *See* April 25 Order at P 29.

⁷ 16 U.S.C. 824e (2000).

⁸ *See* April 25 Order at P 33; July 24 Order at P 25-31.

implementation by June 1, 2004, “a mechanism that implements location or deliverability requirements in the ICAP or resource adequacy market . . . so that capacity within [designated congestion areas] may be appropriately compensated for reliability.”⁹

4. On March 1, 2004, ISO-NE made its filing in compliance with the April 25 Order (March 1 Filing). In the compliance filing, ISO-NE proposed a locational installed capacity (LICAP) mechanism. Installed capacity (ICAP) obligations are currently imposed on load serving entities, requiring them to procure a specified amount of ICAP each month to ensure that there is sufficient capacity to supply system peak load under all contingencies. The ISO-NE’s March 1 filing proposed to add a locational element, establishing four ICAP regions with separate ICAP requirements: Maine, Connecticut, Northeast Massachusetts/Boston (NEMA/Boston), and the remainder of New England (Rest of Pool). Under the proposal, capacity transfer limits would be established to limit the amount of ICAP that load serving entities in one region could purchase from another region. Additionally, ISO-NE proposed to use a demand curve to establish the amount of ICAP which must be procured, and the price for that capacity. ISO-NE proposed phasing in the demand curve over a five-year period. As proposed, the LICAP mechanism included price caps during this phase-in period, as well as “transition payments” to low capacity factor units needed for reliability. Additionally, under the proposed LICAP mechanism, capacity transfer rights would be allocated to load or generators, depending on their location, to allow market participants to hedge against congestion costs. Under the proposal, holders of capacity transfer rights between two ICAP regions would receive the difference in ICAP prices between those regions.

5. In the June 2 Order, the Commission established hearing procedures regarding ISO-NE’s compliance filing, and delayed the implementation of the LICAP mechanism until January 1, 2006. The Commission stated that it agreed with two broad concepts in ISO-NE’s proposal. First, the Commission found it appropriate to establish separate ICAP regions, but questioned whether the regions proposed by ISO-NE adequately reflected where infrastructure investment is needed most, specifically noting the constrained area of SWCT. Second, the Commission agreed with the overarching concept of a demand curve, but found that more information was necessary to develop appropriate parameters for the curve. As a result of these findings, the Commission directed ISO-NE to submit a further filing addressing whether the Commission should revise the LICAP proposal to create a separate ICAP region for SWCT. Additionally, the Commission established a separate investigation and paper hearing in Docket No. EL04-102-000 to determine whether a separate energy load zone should be created for SWCT, and whether it should be implemented in advance of LICAP. Finally, the Commission

⁹ April 25 Order at P 37.

established hearing procedures to determine the appropriate demand curve parameters, the proper method for calculating capacity transfer limits, the appropriate method for determining the amount of capacity transfer rights to be allocated, and the proper allocation of capacity transfer rights.

II. Requests for Rehearing and Motions for Clarification and Commission Responses

A. Procedural Matters

6. Timely requests for rehearing and/or motions for clarification of the June 2 Order were filed jointly or individually by the parties listed on Appendix A to this order. Answers to certain of the requests for rehearing and/or motions for clarification were filed by ISO-NE, the Connecticut Department of Public Utility Control (CT DPUC), the Massachusetts Attorney General *et al.* (Massachusetts AG *et al.*),¹⁰ National Grid USA (National Grid), and the New England Power Pool Participants Committee (Participants Committee). Milford Power Company, LLC (Milford) filed an answer to CT DPUC's answer. Additionally, Exelon Generation Company, LLC and Exelon New England Holdings, LLC (Exelon) filed a renewed motion to intervene out-of-time, noting that it did not appear as an intervening party on Appendix A to the June 2 Order.

7. Rules 213(a)(2) and 713(d)(1) of the Commission's Rules of Practice and Procedure generally prohibit answers to requests for rehearing unless otherwise ordered by the decisional authority.¹¹ We will accept the answers because they have provided information that assisted us in our decision-making process. Answers to motions for clarification, however, are permitted by the Commission's regulations.¹² Also, while we note that Exelon was inadvertently omitted from Appendix A to the June 2 Order, we will

¹⁰ Included in this group filing a joint Request for Clarification or, in the Alternative, Request for Rehearing are the Attorney General of Massachusetts, Attorney General of Rhode Island, Massachusetts Division of Energy Resources, New Hampshire Office of Consumer Advocate, Rhode Island Division of Public Utilities and Carriers, Associated Industries of Massachusetts, National Grid USA, NSTAR Electric & Gas Corporation, Strategic Energy LLC, Vermont Electric Power Company, and The Energy Consortium.

¹¹ 18 C.F.R. §§ 385.213(a)(2), 385.713(d)(1) (2004).

¹² See 18 C.F.R. § 385.213(a)(3) (2004); see also *California Independent System Operator Corporation*, 93 FERC ¶ 61,104 (2000).

grant its renewed motion to intervene out-of-time, given its interest in this proceeding and the absence of any undue prejudice or delay.

B. NEMA/Boston as a LICAP Region

8. The Massachusetts AG *et al.* request that the Commission clarify that it did not rule in the June 2 Order that areas such as NEMA/Boston are to be designated as separate ICAP regions if the evidence shows that they have only short-term reliability issues (such as a shortage of local operating reserves), and not a general shortage of capacity. The Massachusetts AG *et al.* assert that, in the June 2 Order, the Commission failed to state whether the designation of NEMA/Boston as a separate ICAP region was appropriate given the evidence. Moreover, they argue that the real problem in NEMA/Boston — short term need for local operating reserves while transmission upgrades are being completed — will not be solved by the LICAP mechanism. Thus, they contend that the Commission should clarify that NEMA/Boston should not be designated as an ICAP region if the evidence shows that installed capacity within that area is sufficient to meet current and projected installed capacity requirements.

9. National Grid argues that the proposed NEMA/Boston ICAP region is unnecessary and would result in unjust and unreasonable rates. National Grid seeks clarification that the June 2 Order did not establish a NEMA/Boston ICAP region.

10. In its answer, ISO-NE argues that the Commission accepted ISO-NE's designation of NEMA/Boston as a separate ICAP region and did not set this issue for hearing. Thus, ISO-NE asserts, such requests for rehearing should be denied. ISO-NE also argues that it is more appropriate to err on the side of too many regions rather than too few regions. It states that too many regions will have no consequences because if a specific region is not needed, there will be no price differences between the regions.

11. Commission Response. To the extent that the June 2 Order was unclear, we reassert here that NEMA/Boston is an appropriate ICAP region. In the June 2 Order, the Commission compared NEMA/Boston, as a separate ICAP region, with the conditions in SWCT in order to raise the issue of whether SWCT should be a separate ICAP region as well.¹³ In the June 2 Order, the Commission found that the LICAP mechanism provides “an incentive to participants in the constrained areas to develop resources or transmission alternatives” to help mitigate potential rate impacts.¹⁴ According to information filed by

¹³ June 2 Order at P 50.

¹⁴ *Id.* at P 45.

ISO-NE, the application with the Massachusetts Energy Facilities Siting Board for the NSTAR 345 kV Transmission Reliability Project is currently pending, and a decision from the siting board is “expected around December 2004.”¹⁵ This project will install three new 345 kV transmission lines in two stages, with the first stage planned for service in 2006, and the second stage planned to be in service by 2007.¹⁶ The Commission finds that a separate ICAP region for NEMA/Boston is reasonable to ensure that needed infrastructure is actually installed. The Commission commends the parties in Massachusetts for their prudent actions in responding swiftly and successfully to changes in the New England markets. However, because the issue of installing needed transmission upgrades is of such vital importance, the Commission finds that the benefits of a separate ICAP region for NEMA/Boston justify its creation.

12. ISO-NE has stated that the creation of too many ICAP regions “will have no consequences because if a specific region is not needed there will be no price difference between the regions.”¹⁷ ISO-NE adds that too few regions produce cross-subsidization. The Commission agrees with ISO-NE and finds that classification of a particular region as an ICAP region does not necessarily entail higher ICAP prices than the Rest of Pool region. If there is sufficient transmission capacity for the NEMA/Boston region to import capacity from an adjacent ICAP region, there should be minimal price differential between the two ICAP regions. Further, designating NEMA/Boston as a separate ICAP region is consistent with its current designation as a separate energy load zone. Therefore, the Commission finds that it is reasonable to classify it as an ICAP region.

¹⁵ See Compliance Report of ISO New England Inc., filed in Docket Nos. ER03-563-043, EL04-104-003 (August 31, 2004) at 7.

¹⁶ *Id.* ISO-NE states that the project is critical for the reliability of the bulk power system in the Boston area by 2006 and is also necessary to address longer-term capacity shortages in the NEMA/Boston region.

¹⁷ Motion of ISO New England Inc. for Leave to File Answer to Protests, Answers and Comments and Answer, filed in Docket Nos. ER03-563-039 and EL04-102-002 (filed August 10, 2004) at 15.

C. ISO-NE Review of Delisting Requests

13. In its March 1 Filing, ISO-NE proposed to retain the authority to evaluate requests from resources in import-constrained regions to de-list and to deny such requests if certain criteria are not met.¹⁸ The Commission rejected ISO-NE's de-listing proposal in the June 2 Order, stating "that ISO-NE should not have the authority to second-guess a generator's business decisions regarding whether to sell into the ICAP market," especially given the fact that participation in the ICAP market is voluntary.¹⁹ On rehearing, the CT Movants²⁰ argue that ISO-NE should have the authority to deny the de-listing request of a generator located in an import-constrained area. The CT Movants are concerned about the potential for abuses of market power if a participant that owns several resources in an import-constrained region can de-list one or more resources in order to drive up LICAP prices. They argue that a chief objective of the proposed de-listing requirement was to ensure that import-constrained regions maintain adequate levels of capacity. The CT Movants do not advocate the particular measures proposed by ISO-NE, but argue that the issue of appropriate mitigation measures related to de-listing should be set for hearing. Massachusetts AG *et al.* similarly argue that, though the June 2 Order rejected ISO-NE's proposed delisting measures, the Commission should clarify that under the LICAP mechanism, a generator's de-listing request will be evaluated to protect against the exercise of market power. The Massachusetts AG *et al.* state that the Commission should also clarify that ISO-NE would be authorized to deny a delisting where it has concerns regarding system-wide or regional reliability.

¹⁸ ISO-NE stated that the resource requesting de-listing must demonstrate that the expected revenue associated with the external sale, the expected cost savings attributable to de-listing, would have exceeded the expected ICAP revenues, applicable transition payments, and other market revenues that said resource would receive if it did not de-list.

¹⁹ June 2 Order at P 74.

²⁰ The CT Movants are the CT DPUC, Connecticut Office of Consumer Counsel (CT OCC), Attorney General of Connecticut (CTAG), Connecticut Municipal Electric Energy Cooperative (CMEEC), and Northeast Utilities Service Company.

14. PSEG asserts that neither the June 2 Order nor the Commission's order accepting New England's Standard Market Design sets a date by which ISO-NE must implement partial de-listing.²¹ PSEG states that ISO-NE was not ready to implement partial de-listing coincident with its LICAP proposal and that the issue was to be discussed as part of the Regional Dialogue. ISO-NE committed to implementing partial de-listing no later than six months after the date of implementation of the LICAP Proposal, according to PSEG. PSEG requests clarification or rehearing, asking the Commission to require ISO-NE to file, no later than October 1, 2004, proposed revisions to Market Rule 1 implementing partial de-listing effective January 1, 2005.²²

15. On October 12, 2004, ISO-NE filed a Motion to Lodge in Support of Requests for Rehearing, seeking to lodge into the record additional evidence regarding its market power mitigation proposal and delisting. ISO-NE states in the motion that during the course of discovery in the hearing established by the June 2 Order, it discovered weaknesses in its earlier proposals for addressing market power concerns in the LICAP market. Specifically, ISO-NE states that it "found that the prior mitigation approaches will fail to prevent resource suppliers from having the ability to inappropriately raise the price of Locational ICAP in a particular region through physical withholding accomplished by delisting resources."²³ ISO-NE seeks to lodge its response to a data request of Commission Staff, in which it describes its revised proposal for addressing delisting and market power concerns. In that response, ISO-NE proposes to determine the price for capacity in each ICAP region according to the total supply available in the region. As a result, according to ISO-NE, a generator's decision regarding whether it will offer capacity to the market will not influence the price of capacity in a given region. ISO-NE asserts that this proposal responds to the Commission's concerns in the June 2 Order. ISO-NE also states that it supports the rehearing requests of the Massachusetts

²¹ June 2 Order at P 73 n. 72; also see *ISO New England, Inc.*, 100 FERC ¶ 61,287 at P 110 (2002) (September 20 Order). Market Rule No. 1 does not currently permit capacity resources in New England to de-list part of a generating unit in order to sell capacity to another market.

²² PSEG's Motion for Clarification and Rehearing actually requests clarification or rehearing "to require ISO-NE to file proposed revisions to Market Rule 1 no later than October 1, 2005 for implementation of partial de-listing effective January 1, 2005." PSEG Motion at p. 9. The Commission interprets PSEG's request to ask for revisions no later than October 1, 2004.

²³ Motion to Lodge of ISO-NE in Support of Requests for Rehearing at 4.

AG *et al.* and the CT Movants, and seeks clarification that the issues related to this revised proposal are appropriately addressed in the hearing established by the June 2 Order.

16. Massachusetts AG *et al.*, CT Movants, Reading Municipal Light Department and Wellesley Municipal Light Plant (Reading and Wellesley), Capacity Suppliers, and LIPA each filed an answer to the motion to lodge. Massachusetts AG *et al.* express their general support for the motion and for ISO-NE's revised approach to market power mitigation, arguing that the revised approach appropriately responds to the issues raised regarding ISO-NE's initial market power mitigation proposal, and that it will significantly reduce the incentives and opportunities for capacity suppliers to withhold capacity in an effort to exercise market power. They argue that the Commission should grant the motion to lodge, treat it as an amendment to the March 1 Filing and direct that ISO-NE submit testimony in the ongoing hearing regarding its revised market power mitigation approach. Reading and Wellesley also support the motion to lodge, but urge the Commission to require ISO-NE to amend its March 1 Filing with a complete revised market power mitigation proposal, so that the Commission can notice the new proposal and solicit comments from interested parties. CT Movants express limited support for the motion to lodge, stating that they support the Commission's consideration of ISO-NE's response (but do not unqualifiedly support the proposal therein), and that they support ISO-NE's request to clarify whether issues regarding market power mitigation and delisting are appropriately considered at hearing. Capacity Suppliers, in contrast, oppose ISO-NE's revised proposal and argue that its mitigation proposal is not within the scope of the issues set for hearing. Similarly, LIPA argues that the motion to lodge should be denied, first because it represents an untimely request for rehearing of the Commission's June 2 Order. Further, LIPA contends that the Commission should not consider the proposal contained in the motion to lodge because it is incomplete and, according to deposition testimony by an ISO-NE witness, still being developed.

17. Commission Response. ISO-NE's motion to lodge, which we grant, reveals that it has significantly changed its position regarding delisting and market power mitigation since its March 1 Filing. The response to Commission Staff's data request, while providing significant information about ISO-NE's most recent proposed approach to addressing delisting and market power mitigation concerns, does not represent a complete proposal that the Commission can address on its merits. The parties in the hearing procedures appear to be addressing the issue of market power mitigation, and the Commission will allow the presiding judge and the parties to continue to address these issues on the merits in the hearing. The Commission notes that while it is adding this issue to those set for hearing, it intends for the hearing to be limited in scope, as noted elsewhere in this order. Further, the Commission reminds the parties of the findings in the June 2 Order that "ISO-NE should not have the authority to second-guess a

generator's business decisions regarding whether to sell into the ICAP market," and that "since participation in the ICAP market is voluntary, it is not appropriate to prohibit or limit a generator's decision to cease participating in the ICAP market."²⁴

D. Demand Curve

18. ISO-NE's March 1 proposal established an initial curve, which was then adjusted downward to account for infra-marginal revenues.²⁵ The CT Movants and Massachusetts AG *et al.* assert that the downward adjustment should include all infra-marginal revenues resources may be expected to receive, such as forward reserve market and scarcity pricing revenues.

19. Referring to its protest of the March 1 Filing, Calpine argues that several of the existing obligations and restrictions borne by all New England generators (which ISO-NE proposes to continue under its proposal) should apply only to ICAP generators but not to non-ICAP generators. For example, Calpine opposes the existing restrictions on the ability of non-ICAP generators to exit the market. Calpine is critical of the rule that prohibits a non-ICAP generator whose capacity is not fully taken in the day-ahead market from submitting a real-time energy bid that differs from its day-ahead bid. Calpine also objects to the market rule that prohibits a non-ICAP generator from selling non-recallable energy to a neighboring control area. Calpine does not object to imposing these (and other) obligations and restrictions on generators that have sold their capacity in the New England capacity market, but opposes them for generators that have not done so. Calpine argues that imposing these obligations and restrictions on all generators will artificially depress the ICAP price.

20. ISO-NE responds to Calpine's rehearing request in its answer. ISO-NE asserts that insofar as Calpine is arguing that the definition and obligations of the LICAP product must be defined and examined as part of the development of the demand curve in the evidentiary process, it agrees with Calpine and intends to present its position regarding the rights and obligations of ICAP resources in the ongoing hearing process.

21. The NEPOOL Industrial Customer Coalition (NICC) asserts that, as the proponent in the instant proceeding, ISO-NE bears the burden of demonstrating that the LICAP mechanism, including its Demand Curve proposal, is just and reasonable. NICC

²⁴ June 2 Order at P 74.

²⁵ The demand curve is adjusted by the annual average infra-marginal revenue for a gas turbine over the period of May 1999 through January 2004.

argues that ISO-NE has not provided evidence showing that the use of LICAP and a Demand Curve to calculate ICAP prices will stimulate investment in more efficient generation where needed or provide other customer benefits, and thus has not satisfied the just and reasonable requirement of section 205 of the FPA. NICC also argues that ISO-NE has not performed a cost-benefit analysis to examine if the LICAP Proposal provides customers in New England with benefits that are commensurate with the costs they will be expected to pay. The CT Movants argue that the Commission has not considered other price-setting methodologies and must articulate reasons why it believes a downward-sloping demand curve is superior.

22. Commission Response. The LICAP proposal in the March 1 Filing stated that the objective of the demand curve is to assure that revenues from all markets over the long run will equal the cost of new entry. Thus, ISO-NE proposed to establish the height and slope of the demand curve based on the cost of new entry, reduced by the expected value of the infra-marginal revenues that a gas turbine is likely to earn.²⁶ In the June 2 order, we set for hearing the issues surrounding the height and slope of the demand curve. Additionally, we suggested some possible methodologies to consider for determining the height and slope (including the cost of new entry or the estimated reliability value to loads of alternative levels of capacity), but we did not specify a particular methodology. Nor will we do so here. Each party is free to present arguments for the methodology that it believes is appropriate. For example, CT Movants and the Massachusetts AG *et al.* are free to argue in the hearing that the height and slope of the demand curve should be based on the net cost of new entry, and that the expected inframarginal revenues from all markets (including operating reserve payments, forward reserve market revenues, scarcity pricing, Automatic Generation Control (AGC) revenues and additional revenues from forward energy) should be deducted from the gross cost of new entry in determining the net cost. We expect that a full record on this issue at hearing will aid in determining the most appropriate resolution of this issue.

23. The restrictions and obligations on generators described in Calpine's comments are existing features of ISO-NE's market rules that ISO-NE has not proposed to change in the instant proceeding. To the extent that Calpine seeks to change these restrictions and obligations, its request is outside the scope of this proceeding, and we deny the request. However, to the extent that Calpine requests that these restrictions and obligations be explicitly considered in the hearing procedures to determine the height and slope of the ICAP demand curve, we grant the request. Calpine and any other interested party may submit evidence during the course of the hearing on this issue.

²⁶ March 1 Filing, Attachment G, "Development of the Demand Curve Component of the Locational ICAP Market Design," at 4.

24. In response to NICC, the Commission notes first that the LICAP proposal was presented as a compliance filing in response by ISO-NE to a Commission directive, and ISO-NE elected to include a demand curve as part of its proposal. As we stated in the June 2 Order, the LICAP mechanism will provide price signals to encourage investment that results in generation additions and improved reliability. Further, it will value capacity in a way that accounts for the transfer limits of the transmission system and thus produces capacity prices that are just and reasonable. Moreover, as the specific parameters of ISO-NE's demand curve have not been established—those will be set in the hearing process—the parties (including NICC) have an opportunity to participate in the determination of those parameters. The Commission has previously approved the use of a demand curve to determine capacity prices in New York,²⁷ and thus has found that a demand curve can produce a just and reasonable outcome with regard to capacity prices. Finally, in response to the CT Movants' argument concerning other price setting methodologies, the Commission notes that it was not presented with detailed alternatives, and thus it cannot consider other methodologies. The LICAP mechanism, including a demand curve, was presented to the Commission, and we found in the June 2 Order (and reiterate here) that such mechanism is a just and reasonable approach.

E. Commission Consideration of RMR Agreements

25. In the June 2 Order, the Commission stated that it would consider the renewal of existing RMR agreements or additional RMR contracts negotiated with ISO-NE and filed under section 205 of the FPA, for a single term expiring when the LICAP mechanism is implemented.²⁸ Duke and Milford Power each submitted motions for clarification, or in the alternative requests for rehearing, regarding the Commission's consideration of RMR agreements in the interim period before the implementation of the LICAP mechanism. Specifically, they argue that uncertainty exists as to whether submission of a petition to retire or suspend operation of a unit pursuant to section 18.4 of the Restated NEPOOL Agreement (RNA) is a prerequisite to filing an RMR agreement under section 205 of the FPA. They argue that nothing in Market Rule 1, the RNA, the June 2 Order, or the Commission's prior orders requires a generator to petition to retire or suspend operation before negotiating an RMR agreement with ISO-NE. Accordingly, they request that the Commission clarify the June 2 Order, or in the alternative grant rehearing, and confirm that submission of a plan under section 18.4 of the Restated NEPOOL agreement to retire or suspend operation of a unit is not a prerequisite to negotiating and/or filing a single-term RMR agreement.

²⁷ *New York Independent System Operator, Inc.*, 103 FERC ¶ 61, 201 (2003).

²⁸ June 2 Order at P 72.

26. CT DPUC *et al.* filed an answer in response to the requests of Duke and Milford Power. CT DPUC *et al.* argue that Duke and Milford Power are seeking to substantially expand the use of the RMR mechanism, which not only contravenes the Commission's December 20, 2002 Order,²⁹ but would affect the stability of the markets. CT DPUC *et al.* further argue that granting the clarification would allow resources to move back and forth between RMR contracts and the competitive market.

27. Commission Response. The Commission will grant Duke and Milford Power's requested clarification. We do not read the applicable NEPOOL procedures, and particularly Market Rule 1, Appendix A, Exhibit 2, section 3.3, as establishing a rigid requirement that a unit apply to retire or cease operation before it can negotiate an RMR agreement with ISO-NE. Further, while we have discouraged the use of RMR agreements as a default out-of-market tool for providing generators with cost recovery for reliability services they provide, Duke and Milford Power correctly point out that we have not previously required units that have submitted RMR agreements for filing to have taken the affirmative step of beginning retirement procedures in order to negotiate the agreements with ISO-NE.³⁰

28. The Commission acknowledges the concerns of the CT DPUC that RMR agreements not proliferate as an alternative pricing option for generators. The Commission believes, however, that the circumstances in New England under the PUSH mechanism and the existing NEPOOL procedures protect against an unwarranted increase in the number of RMR agreements. As we have noted elsewhere, the PUSH mechanism has allowed certain generating units to recover more of their costs through the market,³¹ and thus we expect that few additional units that have not already applied for them will need RMR agreements. Second, the applicable NEPOOL procedures limit

²⁹ *New England Power Pool, Inc. et al.*, 101 FERC ¶ 61,344 (2002) (December 20 Order).

³⁰ *See, e.g., New England Power Pool and ISO New England, Inc.*, 100 FERC 61,287 at P 50 (2003) (noting ISO-NE's ability under its Standard Market Design to "negotiate individual RMR agreements as are required to maintain and/or improve system reliability," and the flexibility required to address specific RMR situations); *Devon Power LLC et al.*, 106 FERC ¶ 61,264 (2004) (Applicants submitting RMR agreements, while acknowledging that they were preparing for the possibility of retiring their units, negotiated such agreements with ISO-NE pursuant to Market Rule 1, Appendix A, Exhibit 2, section 3.3).

³¹ *See, e.g., Devon Power LLC et al.*, 106 FERC ¶ 61,264 at P 18.

the use of RMR agreements to situations in which ISO-NE determines that the units are necessary for reliability and that out-of-market financial arrangements are required to ensure that the unit will be available. Further, any RMR agreement must be filed with the Commission under section 205 of the FPA. As we stated in the June 2 Order, “[t]he Commission will consider the need for these contracts, and the justness and reasonableness of the rates proposed therein, as they are filed.”³² The Commission believes that the combination of these procedures and circumstances addresses concerns about the unwarranted expansion of the use of RMR agreements.

29. Additionally, in response to CT DPUC’s contention that granting the requested clarification will allow generators to move back and forth between RMR contracts and the competitive market, we note that in the June 2 Order, the Commission required any RMR contracts that are filed to be for a single term that expires when the LICAP mechanism is implemented in New England.³³ As a result, a generator will not be able to switch between a cost-of-service RMR agreement and the market because any contract it negotiates with ISO-NE will be limited to a single term expiring upon the implementation of LICAP.

F. Implementation Date and Deferral

30. The CT Movants, NICC and Braintree Electric Light Department *et al.* (Braintree *et al.*)³⁴ argue that the Commission erred in setting a specific date by which the LICAP mechanism must be implemented. These parties ask the Commission to forgo fixing a firm implementation date and, as part of the hearing process, to consider a practical and realistic LICAP implementation schedule. Braintree *et al.* further ask that the Commission use the hearing process to develop appropriate mitigation measures to ensure against the exercise of localized market power in sub-regional capacity markets. Braintree *et al.* also argue that the June 1, 2005 deadline for the initial decision will not give market participants sufficient notice to develop new infrastructure, implement appropriate hedges, or otherwise respond in an efficient manner before January 1, 2006. The CT Movants assert that, without upgrades, the transmission system in SWCT cannot provide for significant generation additions before the January 1, 2006 implementation

³² June 2 Order at P 72.

³³ *Id.*

³⁴ Joining Braintree Electric Light Department in a Joint Request for Rehearing are Massachusetts Municipal Wholesale Electric Company, Reading Municipal Light Department, Taunton Municipal Light Department, and Wellesley Municipal Light Plant.

date, and thus the LICAP mechanism will provide a windfall to generators until upgrades are in place. The CT Movants further ask the Commission to review the compliance reports filed by ISO-NE³⁵ and to use such reports to encourage market participants to develop and implement local generation, load response and/or transmission solutions.

31. Commission Response. The Commission will not alter the January 1, 2006 implementation date. The January 1, 2006 implementation date serves two important purposes. The first, as stated in the June 2 Order, is to provide participants in the constrained areas of New England with an incentive to progress with needed transmission infrastructure improvements and to add generation resources to help mitigate the rate impact associated with the implementation of the LICAP market. The second purpose of setting this date is to ensure that, in the event planned transmission upgrades are not in place by the appointed date, a mechanism is in place in New England to appropriately value capacity resources according to their location, which we believe is a necessary step to help resolve the reliability compensation issues identified in the region.

32. The Commission considers the implementation schedule outlined in the June 2 Order to be “realistic.” The Commission has been stating since September 2002 that the region must develop a locational mechanism.³⁶ In an order issued April 25, 2003³⁷, the Commission again directed ISO-NE to implement a “mechanism that implements location or deliverability requirements in the ICAP or resource adequacy market” for implementation no later than June 1, 2004.³⁸ The Commission believes that setting a firm date of January 2006 for implementation of the LICAP mechanism is absolutely necessary, so that a mechanism is in place to appropriately value capacity resources according to their location.

³⁵ In the June 2 Order, the Commission directed ISO-NE “to file reports updating progress made in the siting, permitting and construction of transmission and generation upgrades within the New England control area, with particular emphasis on progress within designated congestion areas. ISO-NE is directed to file these reports every 90 days, beginning 90 days after the date of this order.”

³⁶ September 20 Order at P 101.

³⁷ See April 25 Order, *supra*.

³⁸ *Id.* at P 37.

G. Standard Offer Service

33. Select states that several solicitations for Default or Standard Offer Service will be conducted for New England in the fall of 2005.³⁹ Select argues that uncertainty regarding the final LICAP market rules, regions, and the shape of the demand curve will create challenges for participants in these wholesale procurement solicitations and thus urges the Commission to ensure that the LICAP market rules are clearly laid out well in advance of January 1, 2006. Select asserts that the Commission should issue an order addressing these issues no later than September 1, 2005, in order to give wholesale suppliers timely information to effectively participate in the 2006 Default/Standard Offer solicitations.

34. Commission Response. The Commission recognizes the need to resolve the issues relating to the design of the LICAP market sufficiently in advance of the intended implementation date to allow for market participants to plan and procure capacity. This is reflected in the June 2 Order, which directed the presiding ALJ to issue an initial decision by June 1, 2005.⁴⁰ The Commission intends to deal with the issues that are currently being litigated expeditiously upon the conclusion of the hearing process.

H. Clarification of Issues Set for Hearing

35. Several parties sought clarification of the matters set for hearing. The Maine PUC asserts that three “critical” objectives of ISO-NE’s LICAP mechanism that were to be addressed in the Regional Dialogue⁴¹ do not appear to be among the issues the Commission has set for hearing. According to Maine PUC, these three objectives are: (1) provide an adequate basis for financing new plant and reconfiguring existing capacity, (2) recognize the lead times required to develop new resources, and (3) clearly define the rights and obligations of capacity resources. The Vermont PSB similarly states that there

³⁹ Select expects that solicitations for approximately 2,800 MW of peak load in NEMA/Boston (for 2006 Default or Standard Offer service) will be issued August through November 2005; another solicitation for approximately 3,000 MW of peak load in the rest of Massachusetts is expected in August through November 2005.

⁴⁰ June 2 Order at P 59.

⁴¹ The ISO proposed the Regional Dialogue process to discuss nine separate objectives in the development of a long-term solution to regional resource adequacy.

were a number of issues—particularly relating to the development of capacity markets and reliable system operation—that were to be discussed within the Regional Dialogue but do not appear to be among the issues the Commission has set for hearing.

36. Further, the Vermont PSB requests clarification on where and when these broader issues are to be addressed. It argues that the concept of resource parity must be applied where generation, distributed generation, demand response or transmission could each provide solutions to congestion, reliability, or resource adequacy concerns. The CT Movants, Vermont PSB and Massachusetts AG *et al.* ask that the hearing proceedings not preclude the consideration of other market mechanisms that may achieve the Commission’s reliability objectives or promote consideration of one means of solving reliability compensation issues. Similarly, FPL and Mirant seek clarification that the hearing may include consideration of the “nested” clearing process used by the New York Independent System Operator (NYISO), whereby Capacity Transfer Limits would be set at zero and Capacity Transfer Rights would be unnecessary, as an appropriate clearing methodology to be used by ISO-NE. FPL and Mirant also ask that the Commission clarify that the hearing may consider how ISO-NE will account for capacity imports from outside of New England and how exports from municipal utilities’ pool-planned units will be counted.

37. Calpine argues that the Commission should clarify that it intended a comprehensive examination of the issues at hearing. Calpine points out that the June 2 Order states that the hearing is intended to “allow for a comprehensive examination of the issues,” while ordering paragraph A of the June 2 Order suggests a narrower scope for the hearing. Calpine assumes that the Commission intended that the comprehensive examination of the issues applies to the parameters of the demand curve, but seeks clarification. Additionally, Calpine requests that the Commission clarify that the issues raised in its protest are within the scope of the hearing.

38. Commission Response. As noted, in the June 2 Order, the Commission agreed with ISO-NE’s basic overarching proposal to establish a LICAP market with separate ICAP regions and a demand curve for determining the amount of capacity required and the price in each region. The Commission set for hearing, however, the specific parameters underlying this basic framework. Specifically, the Commission found that ISO-NE had not justified the specific parameters it proposed to use to determine the slope and height of the demand curve and set those parameters for hearing procedures.⁴²

⁴² June 2 Order at P 58-59.

Additionally, the Commission set for hearing the related issues of the appropriate method for determining Capacity Transfer Limits and the appropriate allocation of Capacity Transfer Rights.⁴³

39. In response to the requests for clarification, the Commission notes that its intent in the June 2 Order was to establish hearing procedures narrowly focused on the specific parameters underlying the basic framework of ISO-NE's proposed LICAP mechanism. With regard to those specific parameters, however, the Commission directed "a comprehensive examination of the issues."⁴⁴ Therefore, issues related to the parameters setting the slope and height of the demand curve and to the methodologies for determining Capacity Transfer Limits and allocating Capacity Transfer Rights should be broadly examined. To the extent the issues raised by FPL and Mirant concerning the NYISO "nested" clearing process are linked with the specific issues set for hearing by the June 2 Order, the presiding judge may consider them at the hearing. As discussed further below, however, the Commission does not intend that the hearing should consider alternatives to the overarching framework and features of the LICAP mechanism that the Commission approved in the June 2 Order.

40. With regard to the "critical objectives" and issues raised by the Maine PUC, the broader issues raised by the Vermont PSB, and the issues raised by Calpine in its earlier protest, the Commission will clarify that to the extent those issues have bearing on the specific parameters set for hearing, they may be raised at the hearing. If the parties cannot satisfy the presiding ALJ that the issues they raise are sufficiently related to the specific parameters set for hearing, then the presiding judge may refuse to consider them.

41. Finally, in response to the arguments from the CT Movants, Vermont PSB, Massachusetts AG *et al.* asking that the Commission clarify that the hearing may include the consideration of alternatives to ISO-NE's proposed LICAP mechanism, we will deny clarification. As noted above, the Commission agrees with the basic framework of the LICAP mechanism proposed by ISO-NE and established hearing procedures for the limited purpose of determining the specific underlying parameters of that market mechanism. Given this scope and purpose of the hearing, it would be inappropriate to consider alternative market mechanisms in that proceeding.

⁴³ *Id.* at P 63, 68.

⁴⁴ *Id.* at P 1.

I. Incentive Ratemaking

42. NICC argues that the June 2 Order fails to address NICC's concerns regarding the sufficiency of the evidence underlying the demand curve proposal and its consistency with case law on incentive ratemaking. Specifically, NICC argues that the June 2 Order is silent as to whether approval of the Demand Curve proposed by ISO-NE is consistent with federal case law regarding the Commission's incentive ratemaking authority. NICC contends that these cases require that incentive rates be "reasonably calculated to achieve a specific policy objective," and require the Commission to ensure that any rate increases used to achieve a policy goal are "in fact needed, and . . . no more than needed."⁴⁵ NICC asserts that neither ISO-NE's filing nor the June 2 Order references any studies or analyses showing that the incentives related to the Demand Curve will encourage new generation investment. NICC argues that without such studies or support, it cannot be concluded that the "incentives" related to the Demand Curve are reasonably calculated to stimulate new generation investment in the areas where it is needed. Thus, NICC argues that Commission approval of the proposed Demand Curve is inconsistent with the cases it cites concerning incentive ratemaking.

43. Commission Response. NICC mislabels the LICAP mechanism as an incentive ratemaking proposal like those considered in the court precedents it cites. In contrast, LICAP concerns cost recovery. This proceeding concerns generators in New England, most particularly in SWCT, that were receiving insufficient revenue to justify continued operation but were required to continue operating to ensure system reliability. In its prior orders in this proceeding, the Commission found that the market mechanisms in place in New England did not allow capacity suppliers a sufficient opportunity to recover their costs and earn a fair rate of return.⁴⁶ In the April 25 Order, the Commission directed

⁴⁵ Request for Rehearing of NICC at 15-16, citing *Pub. Service Comm'n of the State of New York v. FERC*, 589 F.2d 542 (D.C. Cir. 1978) and *City of Detroit v. FPC*, 230 F.2d 810, 817 (D.C. Cir. 1955). In its argument on rehearing regarding incentive ratemaking, NICC also cites the following cases: *City of Charlottesville v. FERC*, 661 F.2d 945 (D.C. Cir. 1981); *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984); *Pub. Util. Comm'n of the State of California v. FERC*, 367 F.3d 925 (D.C. Cir. 2004).

⁴⁶ See, e.g., April 25 Order at P 31; July 24 Order at P 16.

ISO-NE to file “a mechanism that implements location or deliverability requirements in the ICAP or resource adequacy market . . . so that capacity within [designated congestion areas] may be appropriately compensated for reliability.”⁴⁷

44. ISO-NE’s LICAP proposal and the Demand Curve that is a component of that proposal directly responds to this Commission directive. It is intended to ensure that capacity resources within New England are appropriately valued (and compensated) based on their location and that price volatility is reduced, thus lessening the need to use RMR agreements to ensure just and reasonable rates. The Demand Curve component is not an incentive rate proposal like those considered in the cases cited by NICC. In each of those cases, the court considered the approval by the Commission (or its predecessor) of a rate structure designed to provide direct incentives aimed at increasing energy supplies by increasing prices.⁴⁸ In contrast, the Demand Curve and the other features of ISO-NE’s LICAP proposal will produce just and reasonable rates that appropriately value and compensate capacity in constrained and unconstrained regions in New England. The Demand Curve does not offer a direct, added incentive to increase supply like the programs considered in the cases cited by NICC. Further, the Demand Curve will not necessarily involve a price increase to incent an increase in supply. The purpose and effect of the Demand Curve is not to raise prices, but to reduce their volatility. The prices it produces may increase or decrease in a given region at a particular time depending on the supply and transmission situation in that region. The incentives produced by this market structure are not direct, but instead are the natural result of the

⁴⁷ April 25 Order at P 37.

⁴⁸ See, e.g., *Pub. Service Comm’n of the State of New York*, 589 F.2d 542 (considering an FPC “optional certification program,” designed to give gas producers “favorable rate procedures and standards” to encourage an increase in exploration and development of new gas supplies); *City of Charlottesville*, 661 F.2d 945 (considering a Commission decision allowing pipeline companies to include “stand-alone” tax costs in rates, instead of accounting for the tax savings realized by the companies through filing a consolidated corporate tax return, so that the savings could be used by exploration and development affiliates whose losses in part made the tax savings possible); *Farmers Union Cent. Exch.*, 734 F.2d 1486 (Commission set maximum rates for oil pipelines at high levels to ensure generous returns on investment, reasoning that doing so would help alleviate underinvestment in oil pipelines); *Pub. Util. Comm’n of the State of California v. FERC*, 367 F.3d 925 (considering a Commission decision approving a 200 basis point incentive on a utility’s return on transmission facilities it constructed or upgraded, intended to provide an incentive to alleviate longstanding transmission constraints in California).

appropriate value the demand curve will place on capacity based on its location and the corresponding just and reasonable rate that will be charged for that capacity. Therefore, the incentive rate cases are inapplicable to the instant matter.

J. Miscellaneous Issues Raised on Rehearing and Clarification

(1) Entity Responsible for Procuring Capacity

45. In the June 2 Order, the Commission stated, in response to an inquiry by ISO-NE in the March 1 Filing,⁴⁹ that “it is load serving entities that have the primary responsibility for longer-term capacity procurement and obtaining sufficient supplies to ensure long-term reliability.”⁵⁰ Calpine states that further clarity is needed as to “who the load serving entity is for purposes of long-term planning.” Calpine notes that, in New England, the full term of default service contracts range from as short as quarterly (NSTAR), to as long as three years (United Illuminating). Calpine states that none of these default service programs assigns load serving responsibilities from the distribution company to a default service provider over the full planning horizon, and, thus, no non-distribution company load serving entity can currently assume that it will be the future service provider, nor can it be assumed it is holding the long-term capacity procurement responsibility. Calpine requests that the Commission provide additional clarification that the load serving entity referenced in the June 2 Order is the entity that has the obligation to serve retail customers over the long term.

46. The Maine Public Utilities Commission (Maine PUC) states that roughly 40 percent of Maine load is served by competitive suppliers, while the remaining load is served under standard offer contracts that are awarded through competitive bidding and have terms of one to three years. The Maine PUC states that generators need either longer-term contracts or a substantial risk premium before they will be able to voluntarily invest in new capacity. Further, they assert that load serving entities would incur significant risk if they were to contract for capacity beyond the term of their own contracts with customers. The Maine PUC contends that given the relatively short-term nature of the standard offer contracts, it is difficult to foresee why load serving entities

⁴⁹ Specifically, ISO-NE had sought guidance from the Commission on the issue of what entity should bear the responsibility for longer-term capacity procurement and long-term reliability.

⁵⁰ June 2 Order at P 75.

would enter into bilateral contracts with generators that have terms long enough to attract financing. The Maine PUC asks the Commission to articulate what types of mechanisms may be available to deal with this retail market problem.

47. Commission Response. Resource adequacy is a matter that has traditionally rested with the states, and it should continue to rest there. States have traditionally designated the entities that are responsible for procuring adequate capacity to serve loads within their respective jurisdictions. In response to Calpine's request, we conclude that each state should continue to establish policies that determine which entities are responsible for procuring adequate capacity for loads. In those states that permit loads to switch suppliers on a frequent basis and where no one entity may be designated by the states as having the responsibility to procure capacity for loads on a long-term basis, we will not override the states' decisions on this matter. We will, however, require that the benefits and costs of individual state policies should rest with loads within the state. Thus, the RTO or ISO should have in place operating policies that ensure that loads in states that have procured adequate capacity are not curtailed as a result of inadequate capacity procurement by load serving entities in other states. Those with inadequate capacity procurement are responsible for the concomitant costs and should not be subsidized by other regions. In response to the question posed by the Maine PUC, we will not at this time restrict the options that a state may consider to ensure resource adequacy for loads within its state, other than to require that the costs of those options not be imposed involuntarily on entities in other states.

(2) Deliverability

48. National Grid argues that the LICAP mechanism will neither alleviate the fundamental constraints that lead to load pockets, nor resolve market power issues. National Grid asserts that only adequate transmission infrastructure can achieve these goals. Thus, National Grid argues that the Commission should only approve a LICAP regime with a provision for continued study of new transmission infrastructure and a transition from LICAP to a more robust capacity adequacy regime.⁵¹ National Grid argues that approving a permanent LICAP mechanism would, in effect, install a long-term capacity mechanism that is less efficient and more expensive than alternatives that ensure and are based on adequate transmission infrastructure. Consequently, National Grid requests that the Commission clarify that its approval of the LICAP regime is conditional, subject to revision if and when adequate transmission infrastructure is constructed, which makes the LICAP mechanism unnecessary.

⁵¹ National Grid asserts that the ultimate responsibility for taking action on the basis of these continued studies should rest with the independent ISO-NE.

49. National Grid asserts that, as part of the periodic reports to be submitted by ISO-NE⁵², the ISO should be required to include an analysis of the effects of transmission infrastructure construction on the continued need for LICAP. National Grid argues that once ISO-NE is able to justify modifications to the LICAP rules, it should be required to file proposed modifications to move New England from the LICAP mechanism toward a regime based on adequate transmission infrastructure.

50. The Massachusetts AG *et al.* argue that the Commission should clarify that it will consider a deliverability proposal as an alternative to the LICAP mechanism.

51. Commission Response. In the June 2 Order, the Commission stated that it would welcome a proposal to implement a deliverability requirement, if and when ISO-NE and New England stakeholders collectively choose to pursue such a proposal. While the Commission reaffirms that statement here, we note that a region-wide deliverability requirement may not be considered as an alternative to the LICAP mechanism within the hearing process established in the June 2 Order. The Commission has consistently provided ISO-NE and the participants with options to resolve the reliability compensation issues in New England, because we did not want to mandate a solution.⁵³ ISO-NE elected to pursue a LICAP mechanism at least in part because, “the short term, a deliverability requirement is not practical or cost-effective due to the substantial investments, construction, and timeline involved, among other things.”⁵⁴ The Commission believes that the LICAP mechanism is an appropriate and reasonable solution at the present time and will consider any deliverability proposal ISO-NE and its stakeholders may file in the future. Moreover, the Commission will not condition its approval of the final LICAP mechanism on the possible construction of adequate transmission infrastructure between LICAP zones. Neither the Commission nor ISO-NE believes that the LICAP mechanism precludes the adoption of a deliverability requirement in the future.⁵⁵ The Commission notes that in an order on ISO-NE’s compliance with the Commission’s Final Rule on Generator Interconnection Agreements

⁵² The June 2 Order directed ISO-NE to file reports updating progress made in the siting, permitting and construction of transmission and generation upgrades within the New England control area every 90 days. *See* June 2 Order at P 1, 71.

⁵³ *See* September 20 Order at P 101; April 25 Order at P 37.

⁵⁴ Transmittal letter filed in Docket No. ER03-563-030 (March 1, 2004) at p. 3.

⁵⁵ ISO Answer filed in Docket No. ER03-563-030 (April 2, 2004) at p. 25.

and Procedures (Order 2003), the Commission discusses its concerns regarding deliverability within LICAP zones and has directed ISO-NE to make a future filing to address these concerns.

52. The Commission will not require ISO-NE to include an analysis of the effects of transmission infrastructure construction on the continued need for LICAP in the periodic reports it submits pursuant to the June 2 Order. With the addition of transmission upgrades, price differentials between ICAP regions should shrink as these upgrades will alleviate capacity transfer limits and allow for greater delivery of capacity between ICAP regions. However, maintaining the LICAP mechanism and ICAP regions will continue to provide the needed incentive to maintain the deliverability that is achieved. Should the system degrade again in the future, there will be a structure in place to allow capacity prices within the region to rise, appropriately valuing that capacity and creating incentives for investment.

(3) Capacity Transfer Right Allocation and Eligibility

53. The Maine PUC seeks clarification that Capacity Transfer Rights may be allocated to Maine generators if they serve Maine as load serving entities. The Maine PUC states that under the transmission cost allocation amendments approved by the Commission⁵⁶, Maine load pays for upgrades in congested areas of Southern New England. Thus, the Maine PUC argues, Maine load should be entitled to a Capacity Transfer Right allocation. The Maine PUC asserts that the June 2 Order permits allocation of Capacity Transfer Rights to load indirectly through load serving entities. The Maine PUC states that to ensure that Maine load is not precluded from the Capacity Transfer Right allocation, it seeks clarification that to the extent Maine generators serve load in Maine as load serving entities, they are entitled to Capacity Transfer Right allocations.

54. Commission Response. We will not grant the Maine PUC's requested clarification at this time. In our June 2 Order, we set the issue of Capacity Transfer Right allocation for hearing, in order to obtain a full record upon which to render a decision on this issue. The Maine PUC is free to present testimony and argument in the hearing that Maine generators serving load in Maine as load serving entities are entitled to Capacity Transfer Right allocations. However, it would be premature for the Commission to decide here whether Maine generators are entitled to Capacity Transfer Right allocations

⁵⁶ See *New England Power Pool and ISO New England, Inc.* 105 FERC ¶ 61,300 (2003).

until the hearing process has been completed. The appropriate allocation of Capacity Transfer Rights to entities in Maine raises important issues of efficiency, economic incentives and equity.

(4) Responsibility for PUSH Uplift Costs

55. Under the current market rules in New England, in order to set the locational marginal price a resource must operate above the Economic Minimum Limit (Eco-Min). A unit that has not been dispatched to provide energy may be called upon, operating at Eco-Min, to provide operating reserves for reliability purposes (RMR operating reserves). This unit is ineligible to set the locational marginal price. The owner of such a resource is paid a credit based on the difference between its offer price and the applicable LMP. For RMR operating reserves credits in the real-time market, ISO-NE allocates charges to generators and load that deviate from their day-ahead schedules.

56. PSEG argues that entities deviating from their day-ahead schedules should not bear the cost of real-time RMR operating reserves because they have not created the need for this service. PSEG asserts that the day-ahead unit commitment produces a least-cost dispatch that is insufficient to provide second contingency coverage. PSEG contends that dispatch of units for RMR operating reserves results from the need to substitute generation for transmission to ensure system reliability, rather than from the supply and demand interplay or participants' actions. Further, PSEG argues that while PUSH bidding remains in effect until the LICAP mechanism is implemented, higher bids from PUSH-eligible units will increase the cost of real time RMR operating reserves to market participants that did not cause such costs. Thus, PSEG argues that where ISO-NE procures such operating reserves, additional uplift resulting from PUSH bidding should be borne by network load, as it is the ultimate beneficiary of these reliability commitments.

57. In its answer, ISO-NE states that the March 1 filing did not propose to modify the allocation of uplift costs, nor did the Commission address the issue in the June 2 Order. ISO-NE argues that the proceeding should not be expanded to include a matter not contained in the initial proposal and the Commission should deny such requests.

58. Commission Response. The Commission agrees with ISO-NE that the allocation of uplift costs is an issue outside of the scope of the instant order on rehearing and clarification. ISO-NE did not propose a modification of the allocation of costs associated with RMR operating reserves credits in its March 1 LICAP filing, and thus the Commission finds that PSEG's request falls beyond the scope of the instant order.

(5) **De-rating of Resources in Constrained Areas**

59. In the March 1 Filing, ISO-NE proposed a new section 8.6.3 of Market Rule No. 1, titled “De-rating of Resources due to Localized Constraints.” The provisions of this section would prorate, or “de-rate,” the installed capacity rating of existing resources upon the addition of a new facility that creates a constraint. Further, under these provisions, ISO-NE will prorate the ICAP rating of each resource when new capacity additions create localized transmission constraints that “regularly prevent the simultaneous operation” of two or more ICAP resources at closely related nodes. The resources will be prorated so that the sum of the prorated ICAP ratings shall equal the total amount of capacity that may be reliably supplied to the market by the affected resources.

60. PSEG contends that that the stakeholder process never considered the language ISO-NE submitted in its filing. PSEG argues that de-rating existing units could impair the access of existing facilities to the transmission grid. PSEG requests rehearing as necessary to reject the proposed language outright, or at a minimum to return this issue for a more thorough consideration by New England’s stakeholder process.

61. Commission Response. The proposed language in section 8.6.3 of Market Rule 1 will fairly adjust the ICAP capacity of affected resources when additional capacity resources create transmission constraints that require such adjustment. PSEG gives no reason why existing resources should have preferential access (over new entrants) in the ICAP market to constrained transmission capacity, and the Commission concludes that all resources should have equal access to such capacity.

62. However, the Commission is concerned that ISO-NE’s proposal may unnecessarily deny access to low-cost capacity resources when some generators within the constrained area are not selected in the ICAP auction because they have bid too high. For example, if two equal-sized generators are each prorated by 50 percent due to a local transmission constraint and one generator bids \$2, while the second bids \$5, and the market-clearing price in the region is \$3, the second generator would not be taken in the auction because its \$5 bid is above the market-clearing price. In this situation, the fact that the second generator was not selected releases the transmission capacity it required, and would thus eliminate the need to prorate the capacity of the lower-cost first generator. However, under ISO-NE’s proposal, the first generator’s ICAP capacity would be prorated even though the second generator’s bid is not accepted in the ICAP auction. This is not a reasonable result, since it would needlessly keep low-cost capacity out of the ICAP market. The Commission directs ISO-NE to modify section 8.6.3 so that in locally-constrained areas, ICAP will be allocated only among winning bidders. That is, the sum of the prorated ICAP ratings of generation capacity whose ICAP bids are at or

below the region's market-clearing ICAP price will equal the total amount that may be reliably supplied given the transmission constraint. Generators whose bids exceed the region's ICAP price would thus receive a seasonal ICAP rating of zero.

(6) **Reliability Compensation Issues Analysis**

63. In the June 2 Order, the Commission concluded that the ISO-NE region exhibits both short and long-term reliability compensation issues.⁵⁷ NICC argues on rehearing that the Commission's finding is premised on anecdotal evidence (in the form of filings for RMR contracts in NEMA/Boston and SWCT) which is insufficient to support findings that short-run and long-run reliability compensation issues exist in New England. NICC asserts that the Commission provides no analysis of the revenue adequacy of the RMR applicants or the revenues of other generators in New England. Further, NICC argues that the Commission must establish a clear standard for its analysis and set this issue for evidentiary hearing. NICC contends that the Commission's analysis does not account for the prospective impact of ongoing transmission upgrades referred to in the Regional Transmission Expansion Plan (RTEP) reports, as well as the impact of recently approved Gap Request For Proposals⁵⁸ results for SWCT.

64. The Massachusetts AG *et al.* ask that the Commission clarify that the long-term objective of the LICAP mechanism is to create appropriate markets to maintain the required reliability, rather than to ensure revenue adequacy for existing suppliers.

65. Commission Response. We disagree with NICC's characterizations. There are both short-run and long-run reliability compensation issues in New England. There is ample documentation of the infrastructure deficiencies and reliability problems and the need for a market solution, both in the history of this docket and in other ISO-NE filings

⁵⁷ See *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112 (2004).

⁵⁸ When ISO-NE determines that critical near-term power supply reliability problems and no participant that has proposed or committed to implement a viable solution, ISO-NE may issue a Gap Request For Proposal and enter into contracts according to section 10 of Market Rule 1. The Gap Request For Proposal program is intended to address near-term reliability concerns while long-term solutions are being implemented.

and reports on reliability.⁵⁹ In particular, generation cannot be added and inefficient generators are not permitted to retire due to inadequate infrastructure in SWCT, and, as the ISO-NE has found, there is limited time to construct new generation to meet growing load in the region even with new transmission and the capacity that has responded to the Gap Request For Proposals. Pricing capacity to reflect the value of its location will help to incent additional investment in generation, transmission, or demand-side resources. While NICC protests the Commission's directive to implement a LICAP mechanism by January 1, 2006, we note that NICC did not comment on the original directive from the April 25 Order for an effective date of June 1, 2004.

66. We deny NICC's rehearing request for a defined list of reliability compensation issues. As we stated in the May 6 PJM Order, since "one size might not fit all", developing a standard definition of material short-run and long-run reliability compensation issues is not feasible. The determination of whether reliability compensation issues are present has to be assessed on an individual ISO/RTO and region basis. We also deny NICC's request to set the question for an evidentiary hearing. There is sufficient support in the record and in ISO-NE reports and analysis to support the findings on reliability compensation in the June 2 Order.

67. In response to the Massachusetts AG *et al.*, we note that the purpose of the LICAP mechanism, as originally envisioned in our April 25 Order, is to ensure that markets are established which appropriately value capacity resources based on their locations. We directed ISO-NE to propose a deliverability requirement or locational capacity market because existing generators needed for reliability were not receiving adequate revenues to stay in operation, thereby requiring the use of out-of-market RMR agreements, which we found had a negative impact on competitive markets. The LICAP mechanism, by ensuring that capacity is valued appropriately based on its location, will not only substantially reduce the need for out-of-market RMR agreements, but will also

⁵⁹ For example, the ISO-NE's filings that requested approval of requests for proposals for SWCT in dockets ER02-1392 and ER04-335 highlighted the near-term reliability need. Recent RTEP reports and presentation prepared by the ISO-NE cited significant reliability problems and additional resource requirements, both system-wide and in the load pockets of SWCT and NEMA/Boston (see the 2002 and 2003 ISO-NE RTEP reports and ISO-NE's presentation on the 2004 RTEP at the September 9, 2004 RTEP04 Public Meeting, both available at http://www.iso-ne.com/smd/transmission_planning/Regional_Transmission_Expansion_Plan/.) In particular, the RTEP04 presentation stated that in New England load pockets "even with new 345 kV transmission, only a limited time for re-powering or developing new resources will exist."

provide an incentive to construct new transmission infrastructure and capacity resources where they are needed most, since the market will produce the highest prices in those areas. As a result, the LICAP mechanism will not only maintain the required reliability, by helping to ensure that existing resources needed to maintain that reliability will be economically able to stay in operation, but will also attract new resources.

K. States' Concerns

(1) State's Role in Hearing

68. The Maine PUC and the Vermont PSB both argue that the Commission articulated a central role for states in resource adequacy issues in its White Paper on Wholesale Power Market Platform and seek clarification as to whether the New England States and the New England States Committee on Electricity (NESCOE)⁶⁰ have input into the process of considering the LICAP mechanism, other than as participating as a litigant in the hearings. The Maine PUC and Vermont PSB argue that participating as conventional litigants in the hearing process would compromise their ability to serve the public interest. They seek guidance on how states may provide recommendations in the litigated proceedings in a manner consistent with the Commission's *ex parte* rules. According to the Maine PUC and Vermont PSB, one option would be to allow state departments and commissions to make recommendations prior to the evidentiary hearing. Additionally, they suggest that if the state commissions elect not to participate as parties in the hearing, the Commission might consider their post-hearing recommendations consistent with Rule 2201(e)(1)(v) of the Commission's Rules of Practice and Procedure.⁶¹

69. In a response filed on July 19, 2004, the NEPOOL Participants Committee opposed the Maine PUC and Vermont PSB requests for clarification on the role of states in the hearing process to the extent that they seek "super-litigant" status in the process. They argue that there is no legal basis for giving states such a preferential role, and that the states may, and have already, participated in the ongoing hearing. They state that

⁶⁰ NESCOE will serve as New England's regional state committee (RSC). On June 24, 2004, in Docket EL04-112-000, the Governors of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont filed a Joint Petition to form NESCOE which is pending before the Commission.

⁶¹ 18 C.F.R. § 2201(e)(1)(v) (2004).

they support active participation by the states, but oppose giving the states a special, non-traditional litigant role in these proceedings where there is no basis for that role under the FPA, and where such a role may violate the Commission's *ex parte* rule.

70. Commission Response. The Commission remains committed to ensuring states have a central role in determining resource adequacy. Nothing in the June 2 Order should be construed as limiting the states' ability to participate in these proceedings or present recommendations regarding the design of New England's capacity markets. However, the Commission agrees with the NEPOOL Participants Committee that there is no basis in the FPA for giving the states a "super litigant" role in the ongoing hearing procedures. State commissions and governmental bodies have the right to participate in all Commission proceedings, and may participate as a litigant in litigated hearing procedures before the Commission.⁶² Additionally, state commissions will have the right, as will the other parties to these proceedings, to file briefs on exceptions following the presiding judge's initial decision.⁶³

71. Rule 2201(e)(1)(v) of the Commission's Rules of Practice and Procedure cannot be used to consider the pre-hearing recommendations of the states, as suggested by the Maine PUC and Vermont PSB. That *ex parte* rule is reserved for off-the-record communications with federal, state, local and tribal regulatory authorities regarding matters before the Commission that are also within their responsibilities. While the Commission recognizes that the design of the capacity market in New England will necessarily impact state regulatory programs, the design of the market itself is not within the states' regulatory jurisdiction. Given that the states have opportunities to provide meaningful input to the hearing procedures, as noted above, the Commission finds that the states' views and concerns will be fully aired and addressed on the record in this proceeding.

(2) Local Scarcity Pricing

72. The Massachusetts AG *et al.* argue that the Commission should clarify that although the Commission directed ISO-NE to consider modification of its scarcity pricing mechanism so that it would trigger as a result of local scarcity conditions, the Commission is not advocating any particular solution to reliability issues associated with

⁶² See 18 C.F.R. §§ 385.214(a)(2), 385.1306 (2004).

⁶³ 18 C.F.R. § 385.711 (2004).

localized operating reserves. Moreover, the Massachusetts AG *et al.* request that the Commission clarify that it intends that ISO-NE propose a comprehensive approach to short-term and long-term reliability issues prior to implementing the LICAP mechanism.

73. Commission Response. The Commission will objectively evaluate ISO-NE's report on the advantages and disadvantages of modifying its existing scarcity pricing mechanism when the report is filed within 180 days of the June 2 Order. Based on that report and any other relevant information available to us, we will consider whether further action is appropriate at that time.

74. As we stated in our June 2 Order, we established hearing procedures regarding ISO-NE's LICAP proposal, and deferred implementation of the proposal, to allow for a comprehensive examination of the specific issues set for hearing, as well to allow for the completion of needed infrastructure upgrades in New England. The goal in establishing the hearing procedures is to arrive at a final LICAP market design that will appropriately compensate generators needed for reliability, and thereby retain current infrastructure critical to maintaining reliability in the short-term while attracting new infrastructure investment necessary to assure long-term reliability. At this time, we do not intend to require ISO-NE to propose yet another approach to reliability that is separate from the issues being examined in the hearing process.

The Commission orders:

- (A) The requests for rehearing are granted in part and rejected in part, as discussed in the body of this order.
- (B) The motions for clarification are granted in part and rejected in part, as discussed in the body of this order.
- (C) ISO-NE's motion to lodge is granted, as discussed in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Deputy Secretary.

Appendix A

Associated Industries of Massachusetts
Richard Blumenthal, Attorney General for the State of Connecticut
Attorney General of Massachusetts
Attorney General of Rhode Island
Braintree Electric Light Department
Connecticut Department of Public Utility Control
Calpine Eastern Corporation
Calpine Energy Services, L.P.
Connecticut Municipal Electric Energy Cooperative
Connecticut Office of Consumer Counsel
Duke Energy North America, LLC
The Energy Consortium
FPL Energy, LLC
Maine Public Utilities Commission
Massachusetts Division of Energy Resources
Massachusetts Municipal Wholesale Electric Company
Milford Power Company, LLC
Mirant Americas Energy Marketing
Mirant New England Inc.
Mirant Canal, LLC
Mirant Kendall, LLC
National Grid USA,
NEPOOL Industrial Customer Coalition
New Hampshire Office of Consumer Advocate
Northeast Utilities Service Company
NSTAR Electric & Gas Corporation
PSEG Energy Resources & Trade LLC
Reading Municipal Light Department
Rhode Island Division of Public Utilities and Carriers
Select Energy, Inc.
Strategic Energy LLC
Taunton Municipal Lighting Plant
Vermont Department of Public Service
Vermont Electric Power Company
Vermont Public Service Board
Wellesley Municipal Light Plant