

126 FERC ¶ 61,212
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

ISO New England Inc. and
New England Power Pool

Docket No. ER07-397-001

ORDER DENYING REHEARING

(Issued March 9, 2009)

1. On February 28, 2007, the Commission issued an order¹ finding that, inter alia, amendments filed to ISO New England Inc.'s (ISO-NE) Open Access Transmission Tariff (OATT) Schedule 2 – Reactive Supply and Voltage control from Generation Resources Service (reactive power) do not produce double recovery of capital costs for generating equipment used to generate energy and provide reactive service because Forward Capacity Market (FCM) transition payments, which are below the cost of new entry, do not compensate resources for their reactive power.² The Maine Public Utilities Commission (Maine Commission), the New Hampshire Public Utilities Commission, and the Central Maine Power Company (collectively, Parties) filed a request for rehearing. As discussed below, we deny the request for rehearing.

¹ *ISO New England Inc.*, 118 FERC ¶ 61,163 (2007) (February 28 Order).

² *Devon Power, LLC*, 115 FERC ¶ 61,340 (2006)(*Devon Power*), order on reh'g, 117 FERC ¶ 61,133 (2006), affirmed in relevant part sub nom, *Maine Public Utilities Comm'n v. FERC*, 520 F.3d 464 (2008). The FCM settlement agreement provides that fixed payments will be made to all installed capacity during a transition period (FCM transition payments) beginning December 1, 2006 and ending June 1, 2010, at which point payments from Forward Capacity auctions will commence. *Id.* P 30.

I. Background

A. Reactive Power Pricing

2. In Order No. 888,³ the Commission concluded that reactive power is one of six ancillary services that a transmission provider must offer in its OATTs.⁴ In Opinion No. 440,⁵ the Commission approved a method presented by American Electric Power Service Corp. (AEP) to compensate generators for providing reactive power. AEP identified three components of a generation plant related to the production of reactive power: (1) the generator and its exciter, (2) accessory electric equipment that supports the operation of the generator-exciter, and (3) the remaining total production investment required to provide real power and operate the exciter. Because these plant items produce both real and reactive power, AEP developed an allocation factor to sort the annual revenue requirements of these components between real and reactive power production. Subsequently, the Commission determined that all generators should use the AEP method when seeking to recover reactive power costs.⁶

3. The Commission later issued an order accepting a proposal by PJM Interconnection, LLC (PJM)⁷ to allow non-affiliated generators to be compensated for providing reactive power. The Commission explained that a transmission owner must

³ *Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036, at 31,705-06 and 31,716-17 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs., ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

⁴ Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,705. The *pro forma* OATT includes six schedules for each ancillary service. Reactive power service is offered in Schedule 2 of the *pro forma* OATT. *Id.* at 31,960.

⁵ *American Electric Power Service Corp.*, Opinion No. 440, 88 FERC ¶ 61,141 (1999). The methodology is discussed in detail in Opinion No. 498, 121 FERC ¶ 61,025 (2007).

⁶ *WPS Westwood Generation, LLC*, 101 FERC ¶ 61,290, at 62,167 (2002).

⁷ *PJM Interconnection LLC*, Docket No. ER00-3327-000, September 25, 2000 (unpublished letter order).

compensate a non-affiliated generator for providing reactive power to the extent that the transmission owner compensates an affiliated generator for providing reactive power. Order No. 2003⁸ requires generators to maintain a power factor range of 0.95 leading (absorbing) and 0.95 lagging (supplying), with the understanding that the transmission provider could establish a different power factor range under certain circumstances. The Commission also determined that the transmission provider must compensate the interconnection customer for reactive power during an emergency when the interconnection customer provides reactive power outside the power factor range. In Order No. 2003-A, the Commission clarified that if a transmission provider pays its own or its affiliated generators for reactive power within the established range, it must also pay the interconnection customer.⁹

B. ISO-NE's Schedule 2 and the FCM

4. Schedule 2 of ISO-NE's OATT governs eligibility for compensation and payment for reactive power supply and voltage control service in New England. Under the existing Schedule 2, Reactive Supply and Voltage Control is to be provided from Qualified Reactive Resources Service through ISO-NE, and the transmission customer must purchase the voltage support capability service through ISO-NE as it or the applicable Local Control Center dispatching center so determines.¹⁰ As initially filed in 1996, the costs for providing reactive power from generators in the NEPOOL Control Area are recovered by the generators exclusively through Schedule 2 and shared by transmission customers on a pro rata basis according to their shares of regional network load and reserved capacity for Through or Out Service. Schedule 2 currently provides for reactive power compensation based on three cost components: (1) the lost opportunity cost (LOC) component, which compensates for the value of a generator's lost opportunity in the energy market when a generator that would otherwise be economically dispatched

⁸ *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, FERC Stats. & Regs., ¶ 31,146 (2003), *order on reh'g*, Order No. 2003-A, FERC Stats. & Regs., ¶ 31,160, *order on reh'g*, Order No. 2003-B, FERC Stats. & Regs., ¶ 31,171 (2004), *order on reh'g*, Order No. 2003-C, FERC Stats. & Regs., ¶ 31,190 (2005), *aff'd sub nom. Nat'l Ass'n of Regulatory Util. Comm'rs v. FERC*, 475 F.3d 1277 (D.C. Cir. 2007).

⁹ Order No. 2003-A, FERC Stats & Regs. ¶ 31,160 at P 146.

¹⁰ As discussed further below, ISO-NE filed in this proceeding amendments to Schedule 2 of the ISO-NE OATT that, among other actions, extended compensation for reactive power and voltage support to include non-generator dynamic reactive power resources.

is instead directed by the ISO to reduce real power output to provide more reactive power; (2) the cost of energy consumed component, which compensates for the cost of energy consumed by a generator solely to provide reactive power support; and (3) the capacity cost (CC) component, which compensates the generator for the fixed capital costs it incurs with the installation and maintenance of equipment necessary to provide reactive power. The charge for the CC component was originally set at \$0 to reflect an agreement among the parties.

5. In 2001, the Schedule 2 compensation formula was revised to include an additional component labeled PC (cost of energy produced), which is defined as the portion of the amount paid to Market Participants for the hour of energy produced by a generating unit that is considered under Schedule 2 to be paid for VAR support. The PC component is designed to compensate a generator that was not economically dispatched, but which the ISO directs to come online or to increase its output above its economic loading point to provide reactive power. The PC component also compensates the generator for the difference between the locational marginal price (LMP) and its offer price, if the LMP is lower than the offer price, for each hour that the generator provides reactive power. Also in 2001, NEPOOL filed the Schedule 2 CC component rate to allow for a non-\$0 charge to compensate a Qualified Generator for maintaining its capability to provide reactive power support.

6. In order to maintain transmission voltages within acceptable limits, ISO-NE may direct Qualified Generator Reactive Resources to supply or absorb reactive power, that is, to provide reactive service. These qualified resources are compensated for such reactive service under Schedule 2 of the ISO-NE OATT. More specifically, the qualified resources are compensated for providing reactive power as well as for the associated energy costs of providing the reactive service. Moreover, these generation facilities are compensated for their capability of providing such reactive service.

7. Both the FCM and the interim transition payments are intended to provide the revenues needed by capacity resources to keep them in operation to preserve reliability. More specifically, the Commission has found that the FCM construct, when fully implemented after June 2010, will provide a market-based mechanism to appropriately value capacity resources based on their location, satisfying cost-causation principles.¹¹ The forward-looking nature of the FCM will provide appropriate signals to investors when new infrastructure resources are needed, giving sufficient lead time to allow that

¹¹ *Devon Power*, 115 FERC ¶ 61,340 at P 65 & n.73 (citing *PJM Interconnection, L.L.C.*, 107 FERC ¶ 61,112, at P 19-20 (2004); *PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,079, at P 49-51 (2006)(*PJM Interconnection*)).

such infrastructure be put into place before reliability is sacrificed.¹² The locational component of the FCM will ensure that new infrastructure is added to where reliability problems are most imminent. Furthermore, during the transition period, fixed payments will be paid to all installed capacity. These payments are intended to serve as a bridge to the FCM and are not locational-based. All suppliers, regardless of type (e.g., fossil-fueled, nuclear, etc.) or ability to provide reactive service, will receive the same transition payments, although these payments will be netted against Reliability-Must-Run payments, as well as adjusted to account for outages. The Commission has found that transition payments serve as a reasonable transitory mechanism that enables the New England region to shift to the FCM.¹³

C. ISO-NE and NEPOOL's Filing and the February 28 Order

8. In this proceeding, ISO-NE and NEPOOL jointly filed a comprehensive set of proposed amendments to Schedule 2 of the ISO-NE OATT. The Schedule 2 amendments provide for, among other things, a broadening and clarification of eligibility criteria for payment of dynamic reactive power resources under the ISO-NE OATT. More specifically, the revised Schedule 2 did the following: (1) extended the current compensation for reactive power and voltage support to include non-generator dynamic reactive power resources; (2) clarified the eligibility criteria for all dynamic reactive power resources, including both generator and non-generator resources; (3) updated the CC component of the rate design to account for changes in the cost-basis and mix of reactive power resources in New England since 1998; (4) expanded the current testing program to include testing for leading capability for the purpose of using both leading and lagging VAR capability to determine the CC Rate payment; and (5) identified alternative means under the OATT by which a non-generator dynamic reactive power resource can receive payment if it does not elect to recover its costs under Schedule 2.

9. ISO-NE and NEPOOL stated that they recognized that there may be an issue of double payments between the CC Rate and the FCM in the future, but that resolution of this issue would occur in the final FCM rules. The Maine Commission stated that the proposal failed to recognize the significant revenues that generators are already receiving under the FCM Settlement, and that to ignore these revenues would allow a double recovery of the generators' revenue requirement. The Maine Commission contended that FCM payments already compensate generators for their investment in generation equipment, which is used to produce energy and to provide reactive power service.

¹² See *PJM Interconnection*, 115 FERC ¶ 61,079 at P 67-72.

¹³ *Devon Power*, 115 FERC ¶ 61,340 at P 65, 75, 102.

10. In the February 28 Order, the Commission found, inter alia, that transition payments do not compensate resources for their reactive power capabilities because they are below the cost of new entry.¹⁴ However, the Commission also stated that it was concerned that double recovery could occur during the first FCA since the payments equal the cost of new entry. Accordingly, the Commission required ISO-NE to implement, prior to the commencement of the first FCA commitment year beginning June 1, 2010, tariff provisions to ensure that resources eligible for CC payments under Schedule 2 that provide reactive supply and voltage control do not receive double compensation.¹⁵

11. On March 30, 2007, Parties filed a request for rehearing. ISO-NE, NEPOOL and the New England Conference of Public Utility Commissioners each filed answers.

D. Requests for Rehearing

12. Parties argue that the Commission's conclusion that there is no double recovery during the transition period because the transition payments do not equal or exceed the FCM Settlement's cost of new entry is inconsistent with the finding in an order¹⁶ issued June 16, 2007 that the transition payments result in reasonable rates for existing generators.¹⁷ Parties argue that because the Commission has ruled that transition payments provide reasonable capital cost compensation for existing generation, and the equipment used for generation is the same as that used for providing reactive service, the logical conclusion is that the additional stream of revenue from the CC component of Schedule 2 is not necessary, and the resulting doubling of that revenue would result in excessive rates. Parties contend that because the Commission has an obligation to protect consumers from excessive rates, it should grant this request for rehearing and reject the proposed rate increase to the CC component of Schedule 2.¹⁸

¹⁴ February 28 Order, 118 FERC ¶ 61,163 at P 30.

¹⁵ *Id.*

¹⁶ *Devon Power, LLC*, 115 FERC ¶ 61,340 at P 30 (2006).

¹⁷ On September 17, 2007, parties to this proceeding filed an Offer of Settlement resolving the issues in this proceeding except for the issue of double recovery. The Commission accepted the settlement. *ISO New England Inc.*, 122 FERC ¶ 61,056 (2008), *order on reh'g*, 123 FERC ¶ 61,294 (2008).

¹⁸ Parties' March 30, 2007 Request for Rehearing at 13.

13. Parties argue that there are two overlapping revenue streams for the same equipment and that these overlapping revenue streams provide an over-recovery of capital cost compensation for this equipment. They contend that the fact that the transition payments do not equal the FCM Settlement cost of new entry does not determine the degree to which there is an over-recovery of capacity payments for generation resulting from the two streams. Parties argue that the Commission must determine the degree to which the two payment streams overlap, and contend that failure to examine whether the rate increase is actually needed given the revenues from the FCM transition payments fails to protect consumers from excessive rates. Parties argue that if the Commission does not reject the proposed rate increase in its entirety, it should set for hearing matters raised by the relationship of the cost of new entry and the transition payments.

II. Discussion

A. Procedural Matters

14. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2008), prohibit answers to a request for rehearing. Accordingly, we will reject the answers filed by ISO-NE, NEPOOL and the New England Conference of Public Utility Commissioners.

B. Commission Determination

15. The Commission denies the request for rehearing. Parties have failed to persuade us that the CC Rate component of Schedule 2 produces any double recovery of capital costs for generating equipment used to generate energy and provide reactive service when combined with either transition payments or payments from the Forward Capacity Auctions.¹⁹ First, we emphasize that these are two distinct services designed to achieve different purposes. Under the FCM construct, the Forward Capacity Auction procures sufficient capacity to meet the Installed Capacity Requirement for the given Capacity Commitment Period. The Installed Capacity Requirement is a resource adequacy standard that reflects the amount of resources needed to meet the reliability requirements defined for the New England Control Area of disconnecting non-interruptible customers, a loss of load expectation of no more than once every ten years.²⁰ Capacity resources, regardless of type (and whether they are capable of providing reactive service or not),

¹⁹ The Commission rejected similar arguments in a recent order. *Maine Public Utilities Commission v. ISO New England, Inc.*, 126 FERC ¶ 61,090 (2009).

²⁰ *ISO New England Inc.*, 125 FERC ¶ 61,102, at P 22 n.17 (2008) (*ISO-NE*).

will receive the same Forward Capacity Auction clearing price.²¹ In short, Forward Capacity payments are designed to ensure resource adequacy.

16. With respect to the transition payments that precede payments from the Forward Capacity Auctions, nothing that Parties have argued persuades us to revisit, much less reverse, our earlier finding that “transition payments do not compensate resources for their reactive power capabilities since they are below the cost of new entry.”²² We reiterate that capacity payments that were negotiated as part of the FCM transition period are at rates well below the agreed-to full (or gross) cost of new entry; they are not intended to allow full recovery of capital costs. Thus, as we found in a recent order, the transition payments alone are not necessarily fully “compensatory,” much less result in double recovery of capital costs.²³

17. Furthermore, the Commission has previously found that, with respect to reactive service, “if generators are asked to provide additional services including VAR support or regulation, they will be compensated for those services through the appropriate ISO tariff or markets, not through the FCM.”²⁴ Thus, we previously found that reactive service is a unique service the compensation for which is not covered by capacity payments, whether transition payment or auction revenues. Again, nothing in Parties’ request for rehearing persuades us to reverse our previous determination that the provision of reactive power service requires payment separate from, and in addition, to those received in the FCM.

²¹ *Devon Power*, 115 FERC ¶ 61,340 at P 16.

²² February 28 Order, 118 FERC ¶ 61,163 at P 30.

²³ *Maine Public Utilities Commission v. ISO New England, Inc.*, 126 FERC ¶ 61,090, at P 40 (2009).

²⁴ *ISO-NE*, 125 FERC ¶ 61,102 at P 54 (quoting *ISO New England, Inc.*, 119 FERC ¶ 61,239, at P 37 (2007)).

18. Further, as discussed in our prior order, the Commission has required ISO-NE to implement, prior to the commencement of the first FCA commitment year beginning June 1, 2010, tariff provisions to ensure that resources eligible for CC payments under Schedule 2 do not receive double compensation.²⁵

The Commission orders:

The request for rehearing is denied, as discussed in the body of this order.

By the Commission. Commissioner Kelliher is not participating.

(S E A L)

Kimberly D. Bose,
Secretary.

²⁵ February 28 Order, 118 FERC ¶ 61,163 at P 30.