

129 FERC ¶ 61,101
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

ISO New England Inc.

Docket No. ER09-873-001

ORDER ACCEPTING COMPLIANCE FILING

(Issued November 3, 2009)

1. On July 13, 2009, ISO New England Inc. (ISO-NE) filed a compliance filing in response to the Commission's directives in its June 11, 2009 order¹ regarding the use of competitive offer requirements for energy transactions associated with installed capacity (ICAP) import contracts and related penalty provisions. As discussed below, the Commission accepts ISO-NE's compliance filing.

I. Background

2. On March 20, 2009, as corrected on May 6, 2009, ISO-NE and New England Power Pool (NEPOOL) (collectively, the Filing Parties) filed revised tariff sheets regarding the use of competitive offer requirements for energy transactions associated with ICAP import contracts and related penalty provisions.

3. Specifically, the Filing Parties proposed to establish a new requirement that market participants must submit energy offers associated with ICAP import contracts at prices that are deemed competitive. In order to determine what constitutes a competitive offer level, the Filing Parties also proposed rule changes that established a methodology to calculate competitive offer levels for energy transactions associated with ICAP import contracts.²

4. With respect to the penalty structure changes, the Filing Parties proposed, *inter alia*, to revise the penalty structure of section 8 of Market Rule 1 so that market participants importing capacity into New England are subject to performance penalties

¹ *ISO New England Inc.*, 127 FERC ¶ 61,235 (2009) (June 11 Order).

² *Id.* P 5.

during the transition period based on the hours that requested energy was delivered relative to the hours that energy was requested.³

5. The Commission found that the reformed penalty structure on the whole would provide a more meaningful incentive for suppliers to deliver energy when requested to do so. However, the Commission expressed some concern over the potential reliability ramifications of a proposed penalty exemption contained in section III.8.3.7.3.1.2(b) and found that it had not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. This penalty exemption specified conditions under which an hourly delivery shortfall penalty would *not* be assessed—specifically, when the price at the source location is higher than the price at the associated New England Control Area external node. Given that this package of proposed tariff revisions would provide important safeguards to the ISO-NE capacity market during the summer peak season and during the remainder of the transition period, the Commission accepted the proposed tariff revisions for filing but, in light of concerns about the proposed penalty exemption, suspended them for a nominal period and made them effective July 1, 2009, subject to refund.

6. The Commission directed ISO-NE to provide, within 30 days of the issuance of this order, more information regarding the effect this penalty exemption would have on reliability and the extent to which the exemption would not result in internal capacity resources being treated comparably to market participants with ICAP import contracts.⁴

II. Compliance Filing

7. ISO-NE states that the penalty exemption in question will have no adverse impact on reliability and is economically efficient. Since the exemption would not apply during system-wide OP4 events,⁵ and given that New England's system is, by definition, not in a

³ See ISO-NE, FERC Electric Tariff No. 3, Transmission, Markets and Services Tariff, Market Rule 1, Section III.8.3.7 (ICAP Import Contracts). Section III of the tariff is Market Rule 1.

⁴ June 11 Order, 127 FERC ¶ 61,235 at P 31-32.

⁵ I.e., Operating Procedure No. 4 (Action During a Capacity Deficiency). This procedure establishes criteria and guides for actions during capacity deficiencies, as directed by ISO-NE and as implemented by ISO-NE and the Local Control Centers. It may be implemented any time one or more among a list of events, or other similar events, occur or are expected to occur, for example, when available resources are insufficient to meet the anticipated load plus operating reserve requirements or “[a]ny other serious threat to the integrity of the bulk power system.” Operating Procedure No. 4, *available at* http://www.iso-ne.com/rules_proceeds/operating/isone/op4/op4_rto_final.pdf.

capacity deficiency absent OP4 conditions, ISO-NE states that the exemption will not have an adverse impact on reliability. It also clarifies that the exemption primarily reflects economic considerations associated with the arbitrage of prices between New York and New England. It reiterates that forcing market participants to sell energy from a high-cost area to a low-cost area is not economically efficient and states that a penalty designed to encourage such uneconomic flow cannot prevent other energy transactions from naturally arbitraging prices between the two regions.⁶

8. Further, ISO-NE states that the exemption results in comparable treatment between capacity imports and internal New England generation. It states that it does not require internal generation serving as capacity resources to sell energy at a price that is less than their cost of producing the energy, and the exemption similarly ensures that market participants are not forced to provide the energy at a price that is less than their cost of acquiring such energy at the external interface. ISO-NE argues that it would not be treating capacity importers and internal resources comparably if ISO-NE required the capacity importer to sell its energy into New England, when the real-time market price it paid for the energy at the pertinent New York external node with New England is higher than the price at New England's external node with New York. ISO-NE points out that, while internal resources can sell energy to New York during normal system conditions, such energy from capacity resources is subject to recall from New York when certain steps during an OP4 event are reached, regardless of whether prices are higher in New York. Therefore, ISO-NE concludes that the exemption and the recall obligation are comparable mechanisms that help protect New England reliability during OP4 conditions.⁷

III. Notice and Responsive Pleadings

9. Notice of ISO-NE's compliance filing was published in the *Federal Register*, 74 Fed. Reg. 36,688 (2009), with interventions and protests due on or before August 3, 2009. Brookfield Energy Marketing Inc. (Brookfield) filed timely comments in support. The Long Island Power Authority filed a motion to intervene. NSTAR Electric Company, the Connecticut Department of Public Utility Control, and the United Illuminating Company (collectively, the Joint Commenters) jointly filed a protest on

⁶ ISO-NE Comments at 3-4.

⁷ *Id.* at 4-5. ISO-NE explains that a capacity importer does not export energy out of New York at the resource's clearing price. Instead, it must pay the real-time market price at the pertinent New York external (proxy) node, which reflects the clearing of all New York resources as well as transmission constraints.

August 3, 2009. Northeast Utilities Service Company and the Connecticut Department of Public Utility Control (NU/DPUC) filed a protest on the same date. On August 17, 2009, ISO-NE filed an answer.

10. The Joint Commenters state that they presume that the New York Independent System Operator, Inc. (NYISO) would recall capacity exports subject to New England capacity requirements if New York were in an OP4 condition. Considering the likelihood that both regions could be subject to a simultaneous OP4 condition, they ask why New England customers are paying for a resource that will likely be unavailable when it is needed the most. In addition, they note that a penalty for non-delivery during OP4 conditions would be meaningless since the supplier could likely claim a *force majeure* defense to any punitive actions if that supplier's capacity exports were recalled by NYISO.

11. Second, the Joint Commenters contend that ISO-NE's arguments about economic efficiency miss the point. According to Joint Commenters, ISO-NE claims that requiring external resources to supply energy at a price lower than the marginal cost of the physical generation resource would be inefficient. However, Joint Commenters state that ISO-NE's tariff revision imposes no such obligation.⁸ They contend that the new tariff provision simply requires the submission of a competitive bid, and a competitive bid is generally understood to be one that approximates the seller's marginal cost of production. Therefore, Joint Commenters argue that no aspect of the rule would require suppliers to provide energy at a loss.

12. They further note that, while they agree that economic efficiency is generally served by directing goods to the entities that value them the most, this situation is different. Here, they argue, the external suppliers at issue have entered into call options under which they receive monthly payments simply for having "iron in the ground" in return for a pledge to provide energy when called upon. The Joint Commenters argue that these call option contracts are essentially insurance agreements under which the purchaser pays continuously to protect itself in times of need. The idea "that a supplier may vitiate, without penalty or consequence, its contractual commitments simply because a higher price may be available on a rival spot market is antithetical to the notion of an options contract,"⁹ they contend. Indeed, they argue that the very purpose of the option is the acquisition of the right to acquire power in circumstances where the spot market price would be higher than the strike price. According to the Joint Commenters, by accepting

⁸ Joint Commenters Comments at 4.

⁹ *Id.* at 5.

the capacity payments, the strategic calculation of the supplier is that the value of accepting payment during periods when no performance is required outweighs the potential profit from periodic arbitrage opportunities.

13. NU/DPUC state that, by receiving transition payments, capacity importers have an obligation to dedicate their capacity resources to New England, and New England has a right to benefit from those dedicated capacity resources whenever they are needed.

14. NU/DPUC similarly comment that there is no reason the Commission should presume that the capacity importer would submit an offer at a loss under the new market rules. They opine, “If the Capacity Importer’s intent is to merely arbitrage energy prices between New England and New York, it should be penalized if it does not undertake the obligation to deliver energy to New England when it clears in the Day-Ahead market.”¹⁰

15. Brookfield states that it generally supports ISO-NE’s compliance filing. It reiterates that removing the exemption would be economically inefficient and would nevertheless fail to increase the flow of energy into New England, and thus there would be no effect on reliability. Brookfield also notes that the Commission has found in past orders that when a market participant responds to the market prices, such behavior is appropriate and does not constitute market manipulation.¹¹

16. In response to Joint Commenters’ comments, ISO-NE answers that NYISO does in fact “permit export transactions supported by resources located in New York that provide capacity to New England to flow when both control areas are experiencing capacity shortages (so long as the resource backing the import capacity is online and there are no transmission constraints that would limit its deliverability).”¹²

IV. Discussion

A. Procedural Matters

17. Pursuant to Rule 214 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2009), the timely, unopposed motion to intervene serves to make the Long Island Power Authority a party to this proceeding.

¹⁰ NU/DPUC Comments at 4.

¹¹ Brookfield Comments at 3 (citing *N.Y. Indep. Sys. Operator, Inc.*, 128 FERC ¶ 61,049 (2009) (addressing loop flow issues in the Lake Erie region and Commission Enforcement staff’s conclusion that market participants were not engaging in market manipulation but rather following market rules)).

¹² ISO-NE Answer at 4.

18. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2009), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept ISO-NE's answer because it has provided information that assisted us in our decision-making process.

B. Commission Determination

19. The June 11 Order accepted ISO-NE's proposed tariff revisions, suspended them for a nominal period, and directed ISO-NE to explain the effect the penalty exemption would have on reliability and the extent to which the exemption would not result in internal capacity resources being treated comparably to market participants with ICAP import contracts. We are persuaded that the proposed exemption will not present a reliability concern and that, with the exemption in place, internal capacity resources will be treated comparably with those participating in the market with ICAP import contracts. Therefore, we will accept ISO-NE's compliance filing, as discussed below.

20. ISO-NE explains that the New England system is, by definition, not in a capacity deficiency absent OP4 conditions, and thus, since the exemption does not apply during an OP4 event, there will be no adverse impact on reliability as a result of the exemption.¹³ ISO-NE further states that the primary function of the proposed penalty exemption is economic. ISO-NE explains that forcing the uneconomic flow of energy—i.e., failing to sell energy where it is valued the most—will not prevent other energy transactions from naturally arbitraging prices between the two regions. That is, if prices are higher in the neighboring New York region, energy will flow from New England into New York until prices reach equilibrium between the two regions and, presumably, the net flow of energy across the intertie will be in the direction of New York at near capacity of the line. We agree that not applying the exemption in that circumstance may encourage uneconomic behavior and, since having the exemption would not increase the flow of energy into New England if the prices in New York remain higher than in New England, there would be no practical impact on reliability. Moreover, as noted above, the exemption would not apply during an OP4 event; system reliability is safeguarded by ISO-NE's option to call on a capacity importer during an OP4 event to provide the energy for which that importer had been receiving capacity payments.

21. Next, ISO-NE avers that the exemption results in comparable treatment between internal capacity resources and market participants with ICAP import contracts. ISO-NE does not require internal capacity resources to sell energy at a price that is less than their cost of procuring the energy. Similarly, with the exemption in place, ISO-NE is ensuring that market participants importing capacity from New York under ICAP import contracts

¹³ ISO-NE states that other reliability concerns, such as the loss of a generating resource or transmission line, are addressed by the dispatch of system operating reserves.

are not required to provide the associated energy at a price that is less than their cost of acquiring such energy at the external interface. Importantly, a capacity importer does not export energy out of New York at the resource's marginal cost. Instead, the capacity importer must pay the real-time market price at the relevant New York proxy node. Therefore, the commenters' presumption that a capacity importer clearing in the New England market would not be selling below its costs is not necessarily accurate, because the "cost" for such an importer is not the resource's own marginal cost but rather the cost of acquiring that energy at the external interface.

22. Furthermore, Market Participants in New England are able to sell energy into New York during normal (i.e., non-OP4) system conditions—presumably when the prices in New York are higher than in New England—but this energy is subject to recall when certain steps in the OP4 procedure are taken. The penalty and the recall obligation are thus comparable mechanisms for external and internal resources, respectively, that help protect New England reliability during OP4 conditions.

23. For the reasons discussed above, we find that ISO-NE has sufficiently complied with the directives in the June 11 Order.

The Commission orders:

ISO-NE's compliance filing is hereby accepted, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.