

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Con Edison Energy, Inc.

Docket No. EL05-61-000

v.

ISO New England, Inc. and
New England Power Pool

ORDER ON COMPLAINT

(Issued April 1, 2005)

1. On February 2, 2005, Con Edison Energy, Inc. (CEE) filed a complaint under sections 206 and 306 of the Federal Power Act (FPA)¹ against ISO New England, Inc. (ISO-NE) and New England Power Pool (NEPOOL). CEE seeks review of the portions of NEPOOL Market Rule 1 and Revision 5 of NEPOOL Manual 20 regarding the conduct of monthly unforced capacity (UCAP) deficiency auctions. In this order, the Commission will hold the complaint in abeyance pending the outcome of a related hearing already before a presiding administrative law judge. This order benefits customers by ensuring that the issues surrounding capacity markets in New England are comprehensively addressed.

Background

2. Under Market Rule 1, ISO-NE and NEPOOL maintain an installed capacity (ICAP) requirement defining the level of capacity required to meet reliability needs for the New England control area. The ICAP requirement is translated to a UCAP requirement by adjusting for the forced outage rates of generating units in the control area. The ISO assigns each market participant a UCAP obligation prior to the beginning

¹ 16 U.S.C. §§ 824e and 825e (2000).

of each Capability Year, and updates this allocation monthly; the ISO allocates UCAP requirements to market participants based upon their customers' contributions to the previous calendar year's New England control area coincident peak load.²

3. To satisfy its individual UCAP obligation, a market participant can acquire UCAP through self supply or bilateral transactions. UCAP can also be procured by bidding in the monthly auction conducted by ISO-NE. If a market participant fails to procure sufficient UCAP, the ISO attempts to procure sufficient UCAP to cover the remainder of the market participant's obligation for the month through a UCAP deficiency auction. If there is no capacity available in the deficiency auction, market participants not covered are assessed a deficiency charge. UCAP not bid into the deficiency auction by a generator is submitted by ISO-NE in the deficiency auction at a price of zero, unless the resource has been de-listed in accordance with Market Rule 1.³ This procedure is referred to as the "zero-bid rule."

Complaint

4. CEE contends that the zero-bid rule suppresses market clearing prices in the UCAP deficiency auction to below competitive levels, rewards market participants who are deficient in capacity with lower prices, and brings about auction results that are not just and reasonable. CEE states that the 19 UCAP deficiency auctions administered between April 2003 and October 2004 have each resulted in a clearing price of zero dollars. According to CEE, had the zero-bid rule not been utilized, the market clearing prices for those auctions would have ranged between \$0.02 to \$1.00 per kW-month, with an average of \$0.44 per kW-month. CEE asserts that the zero-bid rule contravenes the Commission's direction in its order accepting Market Rule 1 that load-serving entities who are deficient in capacity not share in deficiency revenues, because such entities are enjoying a significantly below market price for the deficient capacity procured through the auction.⁴ CEE further argues that the zero-bid rule violates Commission precedent regarding the voluntary nature of New England's capacity markets,⁵ contravenes recent

² Coincident peak load is the demand that a load places on a system at the time the system itself experiences its maximum demand.

³ See Market Rule 1, section 8.5.1; NEPOOL Manual for Installed Capacity M-20 ("Manual 20"), section 4.12.

⁴ Complaint at 9-10, *citing New England Power Pool and ISO New England, Inc.*, 100 FERC ¶ 61,287 (2002).

⁵ Complaint at 11, *citing Devon Power LLC*, 107 FERC ¶ 61,240 (2004).

court precedent regarding automated mitigation procedures,⁶ and creates seams between ISO-NE and both PJM Interconnection, LLC (PJM) and the New York Independent System Operator (NYISO).

5. CEE requests that the Commission: (1) order ISO-NE and NEPOOL to revise Market Rule 1 and Manual 20 such that UCAP deficiency auctions are voluntary, and only bids actually submitted by generators choosing to participate are recognized in the auctions; (2) direct ISO-NE not to submit bids in the UCAP deficiency auctions or otherwise attempt to affect participation in or conduct of the auctions except as authorized in advance by the Commission; and (3) direct ISO-NE not to conduct further UCAP deficiency auctions unless in conformance with (1) and (2), above.

Notice and Responsive Pleadings

6. Notice of CEE's complaint was published in the *Federal Register*,⁷ with answers, interventions, or protests due on or before February 23, 2005. ISO-NE and NEPOOL each filed timely answers to the complaint. Timely notices of intervention and motions to intervene were filed by the New England Conference of Public Utilities Commissioners (NECPUC), Select Energy, Inc. (Select Energy), the Maine Public Utilities Commission (MPUC), and ANP Funding I, LLC (ANP). Timely motions to intervene and comments in support of the complaint were filed by Northeast Utilities Service Company (NU), PPL Energy Plus, LLC, PPL Maine, LLC, and PPL Wallingford Energy, LLC (collectively PPL), PSEG Energy Resources & Trade, LLC, (PSEG), and Mirant Americas Energy Marketing, LP, Mirant New England, LLC, Mirant Canal, LLC, and Mirant Kendall, LLC (collectively Mirant). A timely motion to intervene and comments opposing the complaint were filed by NSTAR Electric and Gas Corporation (NSTAR). Additionally, on March 7, 2005, CEE filed a motion for leave to reply and a reply to the answers of ISO-NE and NEPOOL.

7. In their answers, ISO-NE and NEPOOL generally noted that the matters raised by CEE in the complaint have been explored a number of times in the stakeholder process, and that participants have consistently opposed the changes to the UCAP deficiency auction sought by CEE. ISO-NE and NEPOOL also answer that CEE has not met its burden of proof under section 206 of the FPA to show that the current procedures are unjust, unreasonable, or unduly discriminatory or preferential, and that the alternative is

⁶ Complaint at 11-12, *citing Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964 (D.C. Cir. 2005).

⁷ 70 Fed. Reg. 7095 (2005).

just and reasonable. They also contend that the capacity markets in New England are entirely voluntary, contrary to CEE's contention; generators may sell capacity outside of the region, and there are many options other than the markets and the UCAP deficiency auctions to meet UCAP obligations. Further, ISO-NE and NEPOOL argue that CEE's complaint fails to present enough evidence to support a finding that the current market rules are unjust and unreasonable, and instead relies on speculation about the decisions of generators to submit bids to the UCAP deficiency auction. Finally, they state that the zero-bid rule was included in Market Rule 1 to address market power concerns that could arise if generators were able to physically withhold excess capacity from the UCAP deficiency auction without committing that capacity to other markets, and was developed in response to actual exercises of market power. As a result, they assert that Con Ed's proposed alternative would require additional market power mitigation measures.

8. As noted above, both PSEG and PPL filed comments supporting CEE's complaint, while NSTAR filed comments opposing the complaint. NSTAR states that the Commission should reject CEE's complaint because it raises issues that are central to the ongoing Locational Installed Capacity (LICAP) proceeding in Docket No. ER03-563-030, and must be vetted through separate evidentiary hearings. NSTAR states that ISO-NE's proposal for establishing a LICAP market includes a market power mitigation scheme called the Modified Price Setting Mechanism, which ISO-NE developed to protect against physical withholding through the delisting of resources. According to NSTAR, the Modified Price Setting Mechanism would establish capacity prices based on the long-term balance of supply and demand. NSTAR states that a central issue in the ongoing LICAP proceeding is whether the Commission should adopt this price setting mechanism. Thus, NSTAR claims that CEE's complaint is an improper attempt to circumvent or bias the hearing process considering this price setting mechanism.

Discussion

9. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,⁸ the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure⁹ prohibits an answer to an answer unless otherwise ordered by the decisional authority. We will accept CEE's answer because it has provided information that assisted us in our decision-making process.

⁸ 18 C.F.R. § 385.214 (2004).

⁹ 18 C.F.R. § 385.213(a)(2) (2004).

10. As the Commission has noted recently, certain capacity resources in New England have faced difficulty receiving adequate compensation under the current market rules.¹⁰ The Commission initiated the ongoing LICAP proceedings to address, on a long-term basis, these issues.¹¹

11. Nevertheless, as ISO-NE and NEPOOL note, the zero-bid rule was created to address significant market power concerns that have arisen historically. Specifically, the rule was intended to remove the possibility of sudden price spikes and incentives to physically withhold capacity from the market. The Commission is concerned that, absent the zero-bid rule, the incentive to withhold from the market would still exist today. Thus, while we understand that the rule is an imperfect solution to the possibility of the exercise of market power through physical withholding, the Commission finds that the rule remains necessary in the short-term, while the Commission and New England's stakeholders finalize the ongoing LICAP proceedings. Furthermore, in Docket No. ER05-531-000, the Commission has conditionally accepted revisions to Market Rule 1 that will permit generators to partially de-list as qualified resources and make sales of capacity and firm, non-recallable energy to neighboring control areas.¹² The Commission believes that the ability to partially de-list will give generators a greater level of flexibility and control in allocating their capacity, and minimize involuntary exposure to the zero-bid rule.

12. Additionally, as NSTAR notes, an evidentiary hearing is currently ongoing before a presiding administrative law judge at the Commission in Docket No. ER03-563-030 regarding the proposed LICAP mechanism, which will alter the way in which capacity obligations are satisfied in New England. In a June 2, 2004 Order, the Commission initially found that the broad framework of ISO-NE's proposal (including the establishment of LICAP regions and the use of a demand curve to price capacity) acceptable, but set the details of the proposal (including the demand curve parameters) for hearing before a presiding administrative law judge.¹³ In a November 8, 2004

¹⁰ See, e.g., *Devon Power LLC*, 103 FERC ¶ 61,082 (2003), *order on reh'g*, 104 FERC ¶ 61,123 (2003); *Devon Power LLC*, 107 FERC ¶ 61,240.

¹¹ See *Devon Power LLC*, 103 FERC ¶ 61,082 at P 37.

¹² *New England Power Pool and ISO New England, Inc.*, 110 FERC ¶ 61,396 (2005).

¹³ *Devon Power LLC*, 107 FERC ¶ 61,240.

Order,¹⁴ the Commission considered a motion to lodge from ISO-NE seeking to lodge additional evidence regarding its proposals for market power mitigation and delisting. In that motion, ISO-NE stated that it had found weaknesses in its earlier proposals for addressing market power in the capacity market, and offered a revised market power mitigation proposal to address concerns regarding the potential for physical withholding of capacity.¹⁵ The Commission granted the motion, and set the issue of market power mitigation for hearing along with the other issues set for hearing in its June 2 Order.¹⁶

13. Given that the LICAP mechanism will take effect on January 1, 2006, and the parties to the evidentiary hearing in the LICAP proceedings are already considering issues surrounding market power mitigation in capacity markets, the Commission finds it appropriate to hold this complaint in abeyance pending the outcome of the LICAP proceedings. As we note above, the zero-bid rule is essentially a measure for mitigating the potential for market power through physical withholding of capacity. Since changes to the capacity markets are currently in hearing and will be implemented in the near term, and market power mitigation is an issue currently being addressed in that hearing, deferring action until the conclusion of the LICAP procedures will permit those procedures to continue without interference or prejudice, and avoids making potentially disruptive piecemeal changes to the structure of the capacity markets in New England.

The Commission orders:

CEE's complaint is hereby held in abeyance until the conclusion of the proceedings in Docket No. ER03-563-030, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

¹⁴ *Devon Power LLC*, 109 FERC ¶ 61,154 (2004).

¹⁵ *See Id.* at P 15.

¹⁶ *Id.* at P 17.