

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

New England Power Pool
and ISO New England Inc.

Docket No. ER06-613-001

ORDER DENYING REHEARING

(Issued October 25, 2006)

1. In this order, the Commission denies the request by Massachusetts Municipal Wholesale Electric Company and Reading Municipal Light Department (collectively, the Municipals) for rehearing of the order issued in this proceeding on May 12, 2006.¹ The May Order accepted revisions to sections II and III of ISO-New England Inc.'s (ISO New England) FERC Electric Tariff No. 3. A primary feature of the revisions, which collectively are known as Phase II of the Ancillary Services Market project (ASM Phase II), is the locational reserve requirement. It is this issue that is the subject of the Municipals' request for rehearing.

Background

2. As it relates to this proceeding, ASM Phase II includes a number of improvements, including: (1) a mechanism for addressing the reliability requirement to locate a portion of operating reserves within specific areas of the system; (2) allows suppliers to manage their forward reserve resources on a portfolio basis and allows bilateral trade of obligations; and (3) provides the software systems and business processes necessary to integrate demand resources into the forward and real-time operating reserve markets. The intent of the locational aspect of ASM Phase II is to encourage the addition of fast-start resources in load pockets through the use of more efficient economic signals. As explained in the May Order, ASM Phase II contains no specific language enabling the Municipals to use their entitlements for pool-planned units (PPUs) located outside of the relevant reserve zone to satisfy locational forward reserve market obligations.²

¹ 115 FERC ¶ 61,175 (2006) (May Order)

² *Id.* P 42.

3. Several parties intervened in opposition on the grounds that the proposed locational forward reserve market is flawed.³ The Municipals argued that the proposal does not properly recognize pre-existing, life-of-unit investments by Northeast Massachusetts/Boston (NEMA) municipally-owned utilities in PPUs, nor does the proposal account for the need to minimize the impact of a new regulatory paradigm upon long-term investments. The Municipals stated that although the PPUs are located outside of the import-constrained region in which the loads are located, the NEMA municipals should be able to use their PPU entitlements to meet their locational forward reserve market obligations where the PPU is capable of supplying the requisite type of reserve service. The Municipals object to the proposed locational forward reserve market because it lacks a guarantee that market participants who decide to self-supply ancillary services will enjoy a guarantee of cost neutrality through self-supply.

4. ISO New England answered that the Commission should reject the argument urging modification of ASM Phase II to provide special treatment of PPU entitlements with respect to reserve obligations. ISO-New England argued that the Municipals failed to demonstrate that their PPU entitlements include a right to special treatment with respect to locational reserve requirements under any relevant contracts, and that the Municipals failed to show that their pool-planned unit entitlements provide for anything other than capacity and energy. ISO-New England also noted that the changes it proposes to the existing forward reserve market design will continue to offer entities such as the Municipals a reasonable opportunity to self-supply reserves.⁴

5. In the May Order, the Commission denied the Municipals' request to impose a special condition to allow NEMA municipally-owned utilities with PPU entitlements to use them to meet their locational forward reserve market obligations. The Commission also denied the Municipals' request to set this matter for hearing. The Commission explained that due to the likelihood of congestion, ISO-New England is not able to guarantee that the Municipals in NEMA will remain cost-neutral when using PPU resources outside of NEMA to self-supply locational reserves.

6. The Commission explained that under the interim forward reserves market, ISO-New England has procured additional resources in NEMA to meet local second contingency requirements, with the costs for these resources allocated through uplift charges that the Municipals, among others, must pay. The Commission noted that the

³ *Id.* P 43-44.

⁴ ISO-New England stated that market participants in the revised market may effectively self-supply by offering reserve resources in the appropriate locations at low or zero bids such that their resources are sure to clear, with the result that the participant's costs and revenues are approximately equal and offsetting.

idea behind the locational forward reserve market is to convert these uplift costs into transparent market costs by establishing separate locational reserve requirements with locational prices. As we stated in the May Order, the combination of a forward reserve market along with the special treatment that the Municipals sought would eliminate the Municipals' current uplift payments and not require them to pay the higher reserve prices that are likely for the NEMA load pocket. The Commission agreed with ISO-New England that the remedy the Municipals sought would be contrary to the underlying basis for locational reserve requirements. The locational forward reserve market is founded on the premise that location matters; resources outside of NEMA cannot physically satisfy the reserve needs for loads inside NEMA when transmission constraints are binding. The forward reserve market is not just a financial market, as argued by the Municipals. Rather, ISO-New England uses the forward reserve market to procure physical resources located where they are needed to meet their operational reserve requirements.

Request for Rehearing

7. On rehearing, the Municipals state that the May Order errs in failing to condition approval of the locational forward reserve market so as to ensure that NEMA municipally-owned utilities that have PPU entitlements at remote locations are able to use these entitlements to meet their locational forward reserve market obligations in instances in which the PPU resource is capable of supplying the requisite reserve service.⁵

8. The Municipals distinguish the locational forward reserves market from the "existing rules" for an auction-based mechanism, in which wholesale loads are given the opportunity to hedge reserve costs through self-supply.⁶

9. The Municipals state that the Commission mischaracterized the Municipals' objection as a request for "special treatment," and ignored the actual grounds on which the Municipals sought relief.⁷ The Municipals explain that the imposition of a locational procurement regimen for reserves that does not permit self-supply, although those remote PPU entitlements are capable of providing reserves service, uniquely, unreasonably and unfairly prejudices the Municipals' investment-backed expectations with respect to those entitlements.⁸ The Municipals explain that they are not similarly situated to other NEMA market participants with obligations under the locational forward reserve market.⁹ Unlike

⁵ Request for *Reh'g* at 2.

⁶ *Id.* at 12.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at 11.

those participants, the NEMA municipally-owned systems have remained vertically integrated and continue to rely upon regionally-planned PPU resources to meet their energy, capacity and reserve needs. This continued integration, they argue, is the reason for the Municipals' request to condition approval of the locational forward reserve market.¹⁰ Further, in support of their request for rehearing, the Municipals reference section II.4 of ISO-New England's Open Access Transmission Tariff (OATT), which states that customers are to be given the option to self-supply their own ancillary services, including reserves.¹¹

10. In response to the Commission's finding in the May Order (at P 55) that the locational forward reserve market is more than just a financial market, the Municipals argue that, however the locational forward reserve market is characterized, its design is consistent with the design of New England's existing locational energy market and proposed locational capacity market.¹²

11. The Municipals argue that the Commission is inconsistent in its treatment of these remote PPU entitlements in the locational forward reserve market here relative to its prior decisions in the energy and capacity markets. Specifically, regarding the energy market, Municipals cite *ISO New England Inc.*¹³ in arguing that the Commission previously approved a proposed increase in the allocation of Auction Revenue Rights (ARRs) to certain NEMA municipally-owned utilities in recognition of their pre-existing contracts to acquire energy outside of NEMA. Similarly, Municipals note that an Administrative Law Judge found that PPU entitlement holders should be allocated sufficient capacity transfer rights to enable them to use their PPU entitlements to meet locational installed capacity (LICAP) obligations, irrespective of location.¹⁴

12. On June 23, 2006, NSTAR Electric & Gas Corporation (NSTAR) filed an answer to the Municipals' request for rehearing. In its answer, NSTAR generally argues that system reliability is critical and would be compromised by the plan the Municipals propose. NSTAR explains that reliability would be jeopardized to the extent that any portion of the reserves that ISO-New England determines are needed to be provided

¹⁰ *Id.*

¹¹ *Id.* at 4.

¹² *Id.* at 11.

¹³ 91 FERC ¶ 61,311 (2000) (*ISO New England*).

¹⁴ See *Devon Power LLC*, 111 FERC ¶ 63,063 (2006). As the Municipals note in their July 10, 2006 response, the Commission adopted this recommendation on June 16, 2006. See *Devon Power LLC*, 115 FERC ¶ 61,340 (2006).

within a zone are instead permitted to be procured from a remote location within NEPOOL, although they cannot physically be made available to the relevant reserve zone.¹⁵ In short, NSTAR argues that any zonal locational reserve requirements must, by definition, be procured from within the relevant reserve zone.¹⁶

13. NSTAR also states that nothing in ASM Phase II affects the eligibility of the PPU generators to participate in the forward reserve market in other reserve zones and receive associated revenue.¹⁷ NSTAR also responds to the Municipals' argument that under ASM Phase II the Municipals should be able to enjoy the fully integrated firm transmission benefits due to their investments in the PPUs. NSTAR states that locational forward reserves are a new product defined by very specific rules that are needed to maintain reliability – namely quick-start capacity located within the zone to meet reserve requirements – and that PPUs in Northern Maine and Southern Connecticut, for example, cannot satisfy a local quick-start capacity need within NEMA.¹⁸

14. On July 10, 2006, the Municipals filed a response to NSTAR's answer. The Municipals reiterate that the Commission has approved a proposed increase in the allocation of ARR to certain NEMA municipally-owned utilities, and that the incremental ARRs were accorded "in recognition of pre-existing contracts with municipals to acquire energy outside NEMA."¹⁹ The Municipals further state that the pre-existing contracts are the same life-of-unit PPU entitlement contracts at issue in the instant proceeding.²⁰ The Municipals again cite *Devon Power LLC*²¹ as support for their position.²²

¹⁵ NSTAR Answer at 4.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 5.

¹⁹ Municipals' Answer at 2 (quoting *ISO New England, Inc.*, 91 FERC ¶ 61,311).

²⁰ *Id.* at 2-3.

²¹ 115 FERC ¶ 61,340 at P 144 (2006).

²² Municipals' Answer at 3-4.

Discussion

Procedural Issues

15. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits answers to a petition for rehearing, and answers to answers, unless otherwise ordered by the decisional authority. We will accept NSTAR's answer to Respondents' petition for rehearing and the Municipals' answer to NSTAR's answer because they provided information that assisted us in our decision-making process.

Analysis

16. The Commission will deny the Municipals' request for rehearing and will not impose a special condition on the ASM Phase II proposal to allow NEMA municipally-owned utilities with remotely-located PPU entitlements to use them to meet their locational forward reserve obligations. As we stated in the May Order, the Municipals' proposed remedy is contrary to the underlying basis for locational requirements.²³ This determination does not contradict the Municipals' right under the ISO-New England OATT to self-supply ancillary service requirements. The May Order is also consistent with the Commission's previous decisions to increase the allocation of ARR to certain NEMA municipally owned utilities in recognition of their pre-existing contracts to acquire energy outside of NEMA and to allocate sufficient capacity transfer rights to enable them to use their remote PPU entitlements to meet locational installed capacity obligations.

17. The Municipals are requesting special treatment regarding their PPU entitlements. In the interim forward reserve market, the Municipals are essentially insulated from out-of-pocket costs, not because of any special recognition of their PPU entitlements (as in the energy and capacity markets), but because the interim reserve market is non-locational, leading to uniform reserve pricing. By comparison, under the locational forward reserve market, it is likely that reserve prices in the NEMA load pocket will be relatively higher than other reserve zones, as current second contingency requirements will become transparent market costs. However, the purpose behind the locational forward reserve market (and resulting reserve zone price differentials) is to incent quick start capacity within import-constrained reserve zones like NEMA. As we stated in the May Order, the locational forward reserve market is more than just a financial market; rather, it addresses a reliability issue. Because location matters, resources outside of

²³ May Order, 115 FERC ¶ 61,175 at P 54.

NEMA cannot physically satisfy the reserve needs for NEMA when transmission constraints are binding.²⁴ As such, granting the Municipals' request potentially jeopardizes reliability. The Municipals do not address this point in their rehearing request.

18. Our decision here is not inconsistent with our decision in *ISO New England*, in which the Commission approved the allocation of additional ARR to entities with remote PPU entitlements. Here, rather than being inconsistent as alleged by the Municipals, we find that the additional ARRs that the Municipals currently receive (and resulting extra financial transmission rights that can be purchased from the ARR revenues) will help defray any higher costs that the Municipals must pay for reserves in NEMA, which preserve the value of these PPU entitlements. This is due to the fact that the Municipals receive the same ARR revenues (and the same congestion revenues from the financial transmission rights that they purchase) regardless of whether the PPUs produce energy, or provide reserves from capacity that is not producing energy. Thus, if the Municipals want to import energy from the PPUs, financial transmission rights from the PPUs to their loads will effectively allow the Municipals to acquire energy from the PPUs without having to pay congestion charges to move the energy from the PPUs to the loads in NEMA; the financial transmission rights' congestion revenue will defray the congestion charges. Similarly, if the Municipals want to provide reserves from the PPUs (and thus, forgo producing energy from the PPUs), the same financial transmission rights will help defray the price difference in reserves between NEMA and the PPUs' location. These additional ARRs address the fact that the NEMA municipally-owned systems are vertically integrated and continue to rely upon regionally planned PPU resources to meet their energy, capacity and reserve needs.

19. Further, in support of their request for rehearing, the Municipals reference section II.4 of the ISO-New England OATT, which states that customers are to be given the option to self-supply their own ancillary services, including reserves. We note that under ASM Phase II, Municipals *will* be able to self-supply reserves; as ISO-New England stated in its March 14, 2006 Answer, "Market Participants in the revised market may effectively self-supply by offering reserve resources in the appropriate locations at low or zero bids such that their resources are sure to clear, with the result that the Participant's [sic] costs and revenues are approximately equal and offsetting."²⁵ Thus, the Municipals may bid these resources into the forward reserves market, with any out-of-pocket costs reflecting the locational value of reserve resources. By contrast, what the Municipals are seeking is guaranteed cost-neutrality, something that is not pledged in the referenced

²⁴ *Id.* at P 55.

²⁵ Answer of ISO-New England at 16-17 (Docket No. ER06-613-000).

section of the ISO-New England OATT. The Municipals' proposal would insulate them from facing these potentially higher reserve prices, greatly reducing (if not eliminating) their current uplift payments without requiring the Municipals to pay the higher reserve prices likely for the NEMA load pocket.

20. For the reasons discussed above, we will deny the Municipals' request for rehearing.

The Commission orders:

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

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.