

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. ER03-563-048
EL04-102-008

ORDER ON REHEARING

(Issued March 23, 2005)

1. In these proceedings, the Commission is comprehensively addressing a proposal by ISO New England, Inc. (ISO-NE), made in response to a Commission order, to establish a locational installed capacity (LICAP) mechanism in the New England market. In a June 2, 2004 Order¹ the Commission approved of the broad framework of ISO-NE's LICAP proposal, but set the specific details of the proposal for hearing procedures. On November 8, 2004, the Commission issued an "*Order on Compliance Filing*,"² which ruled on a recommendation by ISO-NE to establish a separate Southwest Connecticut (SWCT) ICAP region and corresponding energy load zone upon the implementation of the LICAP mechanism, and directed ISO-NE to establish the separate ICAP region and energy load zone.

2. In this order, the Commission addresses rehearing requests made in response to the *November 8 SWCT Order*. As discussed in more detail below, the Commission denies the requests for rehearing and reaffirms its determination in the *November 8 SWCT Order* that a separate SWCT ICAP region and energy load zone are appropriate. In a separate order issued contemporaneously, the Commission will consider requests for rehearing and clarification of its November 8 "*Order on Rehearing*" of the June 2 Order.³

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

² *Devon Power LLC, et al.*, 109 FERC ¶ 61,156 (2004) (*November 8 SWCT Order*).

³ *Devon Power LLC, et al.*, 109 FERC ¶ 61,154 (2004) (*November 8 Rehearing Order*).

The orders we issue today, in conjunction with the hearing procedures that are ongoing, will benefit customers by further clarifying and fully considering the issues surrounding the implementation of a LICAP market in New England.

Background

3. As we have recounted in other orders in these proceedings,⁴ the events leading up to the *November 8 Rehearing Order* at issue here began with the Commission's rejection of several reliability must run agreements (RMR agreements) filed by ISO-NE and several generators.⁵ These generators argued that New England Power Pool (NEPOOL) Market Rule 1 would not adequately allow their units (mostly older inefficient peaking units, all operating in the SWCT Designated Congestion Area) an adequate opportunity to recover their costs, due in-part to the lack of a location resource adequacy mechanism and the mitigation rules in place in Designated Congestion Areas.⁶ In rejecting the RMR agreements, the Commission acknowledged a concern expressed by ISO-NE that its then-current market rules and mitigation policies would deny some generators needed for reliability and located in Designated Congestion Areas an opportunity to recover their fixed and variable costs, threatening the future availability of the needed units.⁷ While noting this concern, the Commission stated generally that the use of RMR agreements to keep units needed for reliability in operation were not in the best interests of the competitive market because they tend to raise prices, affect the operation of other suppliers and impact on the ability of new generators to enter the market.⁸

4. As a short-term remedy for the compensation problems faced by certain generators in Designated Congestion Areas, the Commission directed ISO-NE to modify its market power mitigation rules to permit certain high cost but seldom run units in Designated Congestion Areas to raise their bids, to allow them to recover their costs through the market (called Peaking Unit Safe Harbor (PUSH) bidding).⁹ To work toward developing a long-term solution, the Commission directed ISO-NE to file, by March 1, 2004, "a

⁴ See *June 2 Order* at P 5-8; *November 8 Rehearing Order* at P 2-5.

⁵ *Devon Power LLC, et al.*, 103 FERC ¶ 61,082 (2003) (April 25 Order).

⁶ *Id.* at P 7.

⁷ *Id.* at P 28.

⁸ *Id.* at P 27-32.

⁹ *Id.* at P 32-33.

mechanism that implements location or deliverability requirements in the ICAP or resources adequacy market . . . so that capacity within [Designated Congestion Areas] may be appropriately compensated for reliability.”¹⁰

5. ISO-NE made a March 1, 2004 Filing (March 1 Filing) in compliance with the Commission’s directive in the *April 25 Order*. ISO-NE chose in its filing to propose a locational ICAP requirement (as opposed to a deliverability requirement) as a long-term solution to the compensation issues faced by capacity resources operating in constrained areas. 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 various contingencies. ISO-NE’s March 1 Filing proposed to add a locational element to the ICAP market by 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, and capacity transfer rights would be allocated to load or generators, depending on their location. Additionally, ISO-NE proposed to use a sloped demand curve in its monthly ICAP auctions which, in combination with the supply curve derived from suppliers’ bids, would establish the monthly ICAP price in each region.

6. In the *June 2 Order*, the Commission established hearing procedures regarding ISO-NE’s March 1 Filing and delayed the implementation of the LICAP mechanism from June 1, 2004 to January 1, 2006. Generally, the Commission approved of two broad concepts in ISO-NE’s compliance filing. 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 approved the 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, and 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 established hearing procedures before an Administrative Law Judge to determine the appropriate demand

¹⁰ *Id.* at P 37.

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.

7. On July 2, 2004, ISO-NE filed an analysis as to the possible creation of an import-constrained ICAP region and energy load zone for SWCT (July 2 Filing). The July 2 Filing stated that it would be appropriate to establish a separate ICAP region for SWCT. ISO-NE stated that such a region is warranted because of the differences in reliability and ICAP price between SWCT and the rest of Connecticut. ISO-NE's July 2 Filing evaluated the amount of capacity available in different sub-regions and the level of capacity that could be imported and calculated estimated capacity prices to provide a basis of comparison between the regions. ISO-NE evaluated levels of capacity using two sets of assumptions that established boundaries, within which a broad range of likely outcomes could be found. ISO-NE also stated that a separate energy zone must be created that is no larger than the new SWCT ICAP region. ISO-NE also stated that it is not necessary to implement the energy zone prior to the implementation of LICAP and that both should be implemented simultaneously.

8. Specifically, ISO-NE's analysis used scenarios for Connecticut as a whole, SWCT and a "Rest of Connecticut" ICAP region (comprising the remaining portion of Connecticut if SWCT were carved out). Using regional planning criteria for loss of load probability of one day in ten years, ISO-NE determined the capacity requirements for each region and then calculated the amount of capacity that must be located within each region (local sourcing requirement), taking into account transmission constraints while maintaining the one day in ten year criterion. The local sourcing requirement represents the point at which transmission limits prevent capacity from outside the region from being used to maintain the one day in ten year criterion.

9. In the *November 8 SWCT Order*, the Commission accepted ISO-NE's July 2 Filing and amended the earlier LICAP proposal to include a separate SWCT ICAP region and corresponding energy load zone. The Commission directed ISO-NE to establish a separate SWCT ICAP region and energy load zone, for implementation on the date the LICAP mechanism is implemented in New England.

Requests for Rehearing and Commission Determinations

10. Requests for rehearing of the *November 8 SWCT Order* were filed by several Connecticut entities (CT Parties)¹¹ and The United Illuminating Company (UI). ISO-NE filed an answer to the requests for rehearing.

Procedural Matters

11. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure¹² prohibits an answer to a request for rehearing 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.

SWCT ICAP Region as Incentive for Generation and Transmission

(a) Retirement

12. The CT Parties argue that there is no reasonable basis on which to conclude that a separate SWCT region will prevent existing generators from retiring or will alleviate constrained conditions. The CT Parties argue that SWCT's unique characteristic is not inefficient generators but rather transmission constraints that make most of those inefficient generators necessary for reliability.

13. Commission Determination. The Commission disagrees. A SWCT ICAP region within a LICAP mechanism is intended to adequately compensate generators in SWCT that are needed for capacity. To the extent that these generators are adequately compensated, there is an incentive to remain in operation and to avoid retirement or applying for out-of-market cost of service RMR contracts. The current ICAP regime has produced prices for ICAP that do not compensate a number of generators in SWCT; some of these generators have filed for RMR agreements. The Commission notes that there are

¹¹ The Connecticut Parties are: The Connecticut Department of Public Utility Control, The Connecticut Office of Consumer Counsel, Richard Blumenthal, Connecticut Attorney General, The Connecticut Light and Power Company, and Southwestern Area Commerce and Industry Association of Connecticut, Inc.

¹² 18 C.F.R. § 385.213(a)(2) (2004).

virtually no generation additions currently planned for installation between 2005 and 2008; it is vital that existing generation receive the appropriate capacity payments.¹³ Installation of phases I and II of the Southwest Connecticut Reliability Project appear to make it possible for existing generation in SWCT to retire. However, until that time a SWCT ICAP region will value capacity appropriately and avoid retirement or RMR applications.

(b) **New Generation and Transmission Incentives**

14. UI and CT Parties argue that the Commission erred by concluding that the creation of a separate SWCT ICAP region would create greater incentives to add new generation. UI and the CT Parties assert that a SWCT LICAP region will not stimulate new generation investment in SWCT because generation cannot be built until existing transmission constraints are eliminated. UI and the CT Parties assert that until the Southwest Connecticut Reliability Project is complete, SWCT's transmission infrastructure will remain insufficient to support any additional generation. UI also argues that completion of the Southwest Connecticut Reliability Project upgrades will in large part eliminate reliability problems in SWCT, and thus eliminate the need for a SWCT ICAP region. The CT Parties argue that completing Phase I of the SWCT Reliability Project (which will add 550 MW of transmission capacity between SWCT and the rest of Connecticut) will create substantial financial disincentives to complete other planned transmission upgrades. The CT Parties argue that, according to a model presented by ISO-NE in prepared testimony filed August 31, 2004 in the on-going hearing, projections of annual LICAP costs to Connecticut prior to completion of Phase I are \$24 million lower than those after completion of Phase I.¹⁴ UI argues that it is unlikely that completion of the SWCT ICAP region will speed up the completion of transmission projects that are already planned, scheduled, and underway. The CT Parties argue that a SWCT ICAP region will not create incentives for the timely development of transmission infrastructure.

15. Commission Determination. Higher ICAP prices in SWCT, relative to other ICAP regions, will recognize that capacity has a higher value in that area due to transmission constraints. These higher values will encourage planned transmission upgrades to be

¹³ See transcript of *Technical Conference on Connecticut Infrastructure*, October 13, 2004 at p 17. [<http://www.ferc.gov/EventCalendar/Files/20041029100511-Connecticut%20transcript.pdf>].

¹⁴ The CT Parties also support this argument by pointing to an e-mail at issue in the hearing established by the *June 2 Order*.

completed promptly, to permit generation additions within SWCT as well as increased imports from outside SWCT. A SWCT ICAP region will ensure adequate compensation to generators through the market and thus will provide encouragement not only for construction of new generation, but for development of new infrastructure (including needed transmission improvements) generally.¹⁵ Contrary to protestors' arguments, the Commission did not state that a SWCT ICAP region would result in the immediate addition of generation in SWCT. Generally speaking, there is a critical capacity shortfall in Connecticut as a whole, and SWCT is the most critical load pocket in New England.¹⁶

16. In the *November 8 SWCT Order*, the Commission stated that not only are the transmission upgrades incomplete but the "process underway indicates that there is much uncertainty as to when they might be completed."¹⁷ Since issuance of the *November 8 SWCT Order*, the estimated completion dates for Phases I and II have been revised: ISO-NE recently stated that "Connecticut Light and Power Company (CL&P) revised its projected in-service date for Phase I to the end of 2006. On December 28, 2004 CL&P and UI revised their projected in-service date for Phase II to 2009."¹⁸ The Commission notes that the 2002 Regional Transmission Expansion Plan (RTEP) identified 2004 and 2006 as the projected completion dates of phases I and II respectively; the 2003 RTEP identified 2005 and 2007 as the respective projected completion dates of Phases I and II. Phase II has still not received permitting from the Connecticut Siting Council.¹⁹

¹⁵ As we discussed in the *November 8 Rehearing Order*, infrastructure upgrades will be encouraged because when finalized, the LICAP mechanism will produce just and reasonable prices for capacity in New England by recognizing the locational value of capacity resources. Infrastructure additions will be encouraged as a natural, market-oriented result of this appropriate value being recognized. *November 8 Rehearing Order* at P 44.

¹⁶ ISO-NE states that "Connecticut, and Southwest Connecticut specifically, face particular and immediate threats to the reliable and efficient provision of electric service." ISO New England, Inc., *Connecticut Energy Plan Framework: Recommended Solutions and Actions for the State of Connecticut*, January 4, 2005 (January 4 Report) at 6-7.

¹⁷ *November 8 SWCT Order* at P 30.

¹⁸ January 4 Report at 8.

¹⁹ The Connecticut Siting Council has committed to rendering a decision on Phase II in 2005. See transcript of *Technical Conference on Connecticut Infrastructure*, January 6, 2005, Docket No. PL04-14-000 at 108:3.

Moreover, Roger C. Zaklukiewicz of Northeast Utilities stated that, with regard to Phase II, “we’re assuming we can do this by 2009, as long as we can move forward expeditiously.”²⁰ For these reasons, the Commission continues to consider the ultimate completion date of both phases of the Southwest Connecticut Reliability Project as uncertain and thus considers the implementation of LICAP and a SWCT ICAP Region in 2006 as appropriate to recognize the constrained situation in that region, and believes that it will encourage the completion of needed transmission and generation upgrades in the area.

17. UI argues that completion of the Southwest Connecticut Reliability Project upgrades will in large part eliminate the need for a SWCT ICAP region. The Commission disagrees. Though the Southwest Connecticut Reliability Project may provide immediate relief for SWCT’s capacity shortage, peak load will continue to grow over time. If price differentials re-emerge, even due to temporary issues such as outages, a SWCT ICAP region will be helpful in assigning costs to the appropriate customers. Moreover, appropriate ICAP regions (and the overall LICAP mechanism, when finalized) will ensure that resources that cannot deliver capacity to import-constrained regions are not able to sell to such regions, which could undermine assessments of reliability in those areas.²¹

18. Regarding the CT Parties’ assertions that LICAP will create a disincentive to complete planned upgrades, we note that the projected costs reported by CT Parties were derived using the demand curve that ISO-NE proposed in its prepared testimony in the hearing below. At this time, the Commission cannot address the evidence submitted in the hearing but will review the record in that proceeding after issuance of the initial decision.

²⁰ *Id.* at 82:1.

²¹ See *New England Power Pool*, 109 FERC ¶ 61,155 at P 44 (2004) (*Generator Interconnection Order*). In the *Generator Interconnection Order*, the Commission noted that much of the recent generation built in New England has not been constructed where it is most needed. Additionally, the Commission stated that “[b]ecause of a lack of investment in the New England transmission infrastructure, this generation is not deliverable to load in all regions of New England, and in some instances, to all load within the generator’s local region.” *Id.*

SWCT ICAP Region was not Supported by Substantial Evidence

19. The CT Parties argue that the Commission erred in its conclusion that it had a sufficient factual record to determine that a SWCT zone benefits customers, and that the Commission acted in an arbitrary and capricious fashion by relying on the record in this paper hearing when additional facts and analysis are being compiled in the hearing procedures. UI similarly asserts that the Commission's direction to establish a SWCT ICAP region was not supported by substantial evidence and is otherwise arbitrary and capricious. It argues that ISO-NE did not present evidence showing that a SWCT ICAP region is just and reasonable and failed to quantify the impact of the region on individuals or classes of customers. Additionally, UI contends that the Commission failed to satisfy the substantial evidence standard because it did not point to evidence supporting its decision, provide an appropriate explanation of its decision, or show identifiable benefits of its decision.

20. Particularly, CT Parties first contend that ISO-NE's July 2 Filing did not reasonably measure reliability or value capacity because ISO-NE assessed only two scenarios, the "as is"²² and "at criteria"²³ assumption. The CT Parties assert that assumptions do not use just and reasonable parameters applicable in New England and that the results are not a reliable basis on which to determine whether to create a separate SWCT region. The CT Parties initially note that ISO-NE has abandoned the "at-criteria" analysis, and argue that as a result only the "as-is" analysis is legitimate. The CT Parties state that the "as-is" analysis shows that SWCT and Rest of Connecticut show capacity surpluses of 6 percent and 22 percent, respectively, which both exceed accepted reliability standards. Based on these figures, they argue that there is no basis for creating a SWCT region simply because the Rest of Connecticut has a large capacity surplus.²⁴

²² "As is" analysis refers to an assessment of the levels of generation capacity available within each ICAP region. Under the "as is" analysis, it is assumed that all generation capacity currently installed in New England is available when calculating the levels of generation each ICAP region must procure within its own ICAP region.

²³ "At criteria" analysis simulates the condition that there is just enough capacity within the entire New England region to meet the reliability standards and that there is no surplus, resulting in less pool-wide capacity available to be transferred into the constrained region.

²⁴ Moreover, the CT Parties state that in recent working-papers, ISO-NE's studies show capacity surpluses of 8.3 percent and 10.9 percent and argue that it would be unreasonable and unjust to impose disproportionate costs on SWCT ratepayers for a small disparity.

Further, CT Parties assert that based on a recent filing made by ISO-NE in the LICAP hearing, the price separation between the two zones appears much smaller, and that ISO-NE's use of illustrative demand curves in the July 2 Filing²⁵ fails to provide reasonable predictions for ICAP prices in SWCT and Rest of Connecticut. CT Parties specifically contend that ISO-NE's recent submission in the hearing proceeding shows a price differential between SWCT and Rest of Connecticut as 40 percent, far less than that contemplated in the July 2 Filing and used to justify the creation of a SWCT ICAP region.

21. Second, the CT Parties note that a report submitted by ISO-NE on July 1, 2004, in a separate docket,²⁶ reached the conclusion that the existing energy pricing zones should not be reconfigured. They argue that the Commission erred in not considering this report in its analysis, and in not using the analytical approach used in developing that report.

22. Commission Determination. CT Parties and UI raise no additional arguments on rehearing which persuade the Commission to alter its decision regarding the separate SWCT ICAP region. We disagree with CT Parties' contention that the two scenarios forming the basis of ISO-NE's analysis in its July 2 Filing (the "at criteria" and "as is" assumptions) were not reasonable bases on which to make a determination as to the SWCT ICAP region. These two sets of assumptions formed a broad range of likely outcomes, and as the Commission noted, significant price and capacity differentials exist between SWCT and the Rest of Connecticut throughout that range. CT Parties also do not show why ISO-NE's subsequent decision not to use the "at-criteria" analysis makes it any less useful in assessing a range of possible results from establishing a SWCT ICAP region.

²⁵ ISO-NE used the ICAP demand curve currently employed by the New York Independent System Operator (NYISO) and the ISO-NE demand curve proposed in its March 1 Filing and set for hearing to develop prices for illustrative purposes, showing differences in price and reliability between ICAP regions.

²⁶ On July 1, 2004, ISO-NE and NEPOOL submitted, in Docket No. ER02-2330-029, a report regarding two alternatives to full nodal pricing for load (Nodal Pricing Report). This Nodal Pricing Report was submitted in compliance with a Commission order of January 28, 2004 (*New England Power Pool and ISO New England, Inc.*, 106 FERC ¶ 61, 059 (2004)). The two alternatives analyzed in the Nodal Pricing Report were: (i) a reconfiguration of ISO-NE's existing load zones; and (ii) the implementation of nodal pricing on a voluntary "special case" basis. In that study, ISO-NE determined that the eight load zones for pricing energy should not be modified, though they should be reviewed at least every two years.

23. The Commission also rejects CT Parties' assertion that the different amounts of capacity surplus in SWCT and Connecticut (6 percent and 22 percent, respectively) do not alone justify a SWCT ICAP region because both regions exceed "accepted reliability standards." The Commission is not establishing minimum reliability criteria in this proceeding, as we have noted, and whether the capacity surpluses in each area meet or exceed reliability standards is not relevant in our analysis in this proceeding. As we have repeatedly noted the primary purpose of the LICAP mechanism is to ensure that capacity resources are appropriately valued based on their location so that the resources remain in operation. Appropriately valuing capacity resources ensures that they are adequately compensated, and higher prices in a given region will also reflect the need for investment and demand response in that area. The capacity surplus differentials between SWCT and the Rest of Connecticut, as the Commission stated in the *November 8 SWCT Order*, can be expected to produce different values for capacity in each region, reflecting the relative needs for investment in each area.

24. CT Parties' argument that the price differences between SWCT and the Rest of Connecticut now appear to be smaller than originally reported by ISO-NE is also unpersuasive. The 40 percent price differential between SWCT and the Rest of Connecticut offered by CT Parties in their request for rehearing is significant and illustrates that a considerable constraint exists. We believe these price differences, in combination with the differing capacity surplus levels between SWCT and the Rest of Connecticut, continue to justify the establishment of a SWCT ICAP region. Moreover, as ISO-NE has stated, 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."²⁷ The Commission agrees with ISO-NE and finds that classification of SWCT as an ICAP region does not necessarily result in higher ICAP prices in SWCT than in other regions. If there is sufficient transmission capacity for the SWCT ICAP region to import capacity from an adjacent regions, there should be minimal price differential between regions.

25. Finally, CT Parties' reference to ISO-NE's Nodal Pricing Report and suggestion that it sheds light on the issues considered in this proceeding are misplaced. The Nodal Pricing Report was prepared in a different context and considered what alternatives to full nodal pricing could be adopted in the New England energy markets.²⁸ One

²⁷ 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.

²⁸ Nodal pricing entails pricing electricity for buyers and sellers at each node in New England, which would mean pricing at roughly 900 locations.

alternative which that report considered and rejected was a reconfiguration of the energy load zones into additional zones. The analysis of such a broad change to the way energy is priced in the entire region is necessarily different from the analysis used to determine the appropriate ICAP regions, and the corresponding energy load zones that might be required. The focus of the Nodal Pricing Report was to determine whether there were variances in energy prices throughout the New England control area that justified reconfiguring energy load zones across the entire control area. The focus of the LICAP mechanism, however, is to identify areas where there are capacity constraints and price capacity accordingly, recognizing those constraints. The existence of price variances is measured by energy prices in different areas, whereas, the existence of capacity constraints is measured by a comparison of existing demand with (1) existing generation capacity and (2) availability of existing transmission to import power. The Commission finds that these are different inquiries, particularly since variances in energy prices are directly affected by mitigation measures and the bid cap, whereas, the existence of capacity constraints are not. Moreover, the relevant inquiry in the Nodal Pricing Report was whether variances in energy prices warranted establishing zones throughout the ISO-NE control area, whereas, the issue raised here is whether the variances in capacity constraints within Connecticut are great enough to establish a separate SWCT ICAP region within the state. Variances within Connecticut will have a greater impact in resolving the latter question, rather than the former.

26. Further, ISO-NE produced the Nodal Pricing Report in response to a Commission directive to identify an alternative to full nodal pricing. ISO-NE rejected zonal reconfiguration in part because another alternative was cheaper and simpler than zonal reconfiguration and had substantial stakeholder support. In the case of the SWCT ICAP region, the alternative is a single zone for CT, which we believe is inappropriate. The Nodal Pricing Report did, however, take into account the fact that an additional SWCT ICAP region might be created in these proceedings, and stated that energy load zones should be consistent with the zones established for other markets.²⁹

Hearing on the SWCT ICAP region

27. UI argues that the Commission should have set for hearing the issue of whether a SWCT ICAP region is appropriate. UI states that the establishment of a separate SWCT ICAP zone is inextricably linked with the other issues related to the LICAP proposal that have been set for hearing. Accordingly, UI asserts that the Commission should have combined the SWCT ICAP region issues with the pending proceeding relating to LICAP market design issues.

²⁹ See Nodal Pricing Report at 21.

28. Commission Determination. The Commission denies rehearing on this point. In the *June 2 Order*, the Commission established two separate procedures; (1) a hearing before an Administrative Law Judge regarding the parameters of the demand curve, issues related to the level of capacity that can be transferred between ICAP regions and the allocation of rights thereto; and (2) an investigation and paper hearing in Docket No. EL04-102-000 regarding whether a separate energy load zone should be created for SWCT, and whether it should be implemented in advance of the implementation of LICAP. The Commission separated the two processes because a paper hearing is an appropriate procedure for determining whether a SWCT ICAP region is needed. The discrete number of issues concerning whether the Commission should establish a SWCT ICAP region lend themselves to resolution in a paper hearing, without the cross examination that a hearing before an Administrative Law Judge would provide. On the other hand, the specific parameters of the demand curve and other specific issues (such as the method for calculating capacity transfer limits) set for hearing would benefit from the scrutiny that a hearing before the Administrative law Judge provides. Additionally, we note that the Commission has broad discretion to fashion its own proceedings.³⁰

Reliability Compensation Issues

29. CT Parties argue that the Commission erred by disregarding its own Reliability Compensation principles and that the Commission neglected to apply them here to assess the appropriateness of zonal reconfiguration. The CT Parties state that, according to the Commission's own framework, it will evaluate market-design approaches to solving Reliability Compensation Issues on whether there has been a "demonstration that the solution proposed is feasible, implementible, and expected (with a high degree of probability) to solve the problem."³¹ The CT Parties assert that it is clear that a separate SWCT ICAP region is neither feasible, implementible, nor can it be expected to solve the problem. The CT Parties first argue that creating a separate LICAP region for SWCT will produce financial disincentives to complete transmission upgrades. Second, the CT Parties assert that a SWCT ICAP region raises ownership concentration issues but the Commission has not analyzed or demonstrated safeguards that will mitigate market power. Third, the CT Parties argue that the Commission failed to analyze whether a separate SWCT ICAP region would eliminate the need for RMR agreements or other

³⁰ See *ANR Pipeline Company*, 60 FERC ¶ 61,145 at 61,541 (1992), citing *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 524-25 (1978) and *Fort Pierce Utility Authority of the City of Fort Pierce v. FPC*, 526 F.2d 993, 999 (5th Cir. 1976).

³¹ *PJM Interconnection, LLC*, 107 FERC ¶ 61,112 (2004) at P 18 (*May 30 Order*).

out-of-market mechanisms. Finally, the CT Parties assert that the value of reliability throughout New England will not be apparent if capacity is not fully deliverable to or within SWCT.

30. Commission Determination. The Commission disagrees with the CT Parties. A separate SWCT ICAP region is feasible because it is supported by ISO-NE, which will establish the software and protocols necessary to integrate the SWCT ICAP region into the LICAP structure. A separate SWCT ICAP region is implementable for many of the same reasons. In addition, the parameters for operation of a SWCT ICAP region are being addressed in the hearing before the Administrative Law Judge to promote the smooth implementation of the SWCT ICAP region. The Commission also expects a SWCT ICAP region to help alleviate the increasing number of RMR contracts and eliminate the subsidy New England customers pay to support reliability in capacity-constrained SWCT. Moreover, the Commission believes that as Massachusetts will be segmented in a similar way, there is no reason to believe that Connecticut cannot or should not be similarly segmented. With regard to the mitigation issue, the Commission addressed mitigation measures for the LICAP mechanism in the *June 2 Order* and notes that the CT Parties did not raise this issue in response to the July 2 Filing. Additionally, in the *November 8 Rehearing Order*, we set the issue of market power mitigation for hearing.³² Concerning RMR agreements, the Commission has ruled that current RMR agreements will expire with implementation of LICAP and a SWCT ICAP region. As the ISO-NE Appendix A to Market Rule 1 will continue to have a provision for RMR agreements, thereafter, applications for RMR agreements will be evaluated by ISO-NE. The CT Parties have not demonstrated that there are generation resources within SWCT that are not deliverable to other parts of SWCT. Therefore, SWCT is an appropriate ICAP region. The Commission addresses the issue of financial disincentives to complete planned upgrades earlier in the body of this order.³³

Incentives for Demand Response

31. The CT Parties argue that the Commission erred in concluding that a separate SWCT LICAP region would more accurately reflect the need for and incent participation in demand response programs.³⁴ The CT Parties assert that ISO-NE's LICAP proposal

³² *November 8 Rehearing Order* at P 17.

³³ *See supra* at P 15-18.

³⁴ "Demand response" refers generally to programs which encourage conservation by end-users of electricity, and the voluntary participation of end-users in electricity markets.

focuses too heavily on building generation facilities and not enough on programs involved load-side resources. The CT Parties argue that ISO-NE's proposal does not provide equal parity to demand response resources and thus "higher ICAP prices" are unlikely to encourage greater participation from SWCT loads in demand response programs.

32. Commission Determination. The Commission recognizes the achievements that Connecticut is making with respect to the development of demand-side resources; however, the specifics of ISO-NE's proposal are currently in hearing, and intervenor concerns that demand side resources would be disenfranchised in the LICAP market are appropriately addressed in that proceeding. The Commission cannot rule on that issue until after an initial decision is issued in June 2005.

SWCT Energy Load Zone

33. The CT Parties argue that the Commission erred in directing ISO-NE to create a separate SWCT energy load zone. The CT Parties argue that because ISO-NE has not justified a separate SWCT ICAP region, the Commission should follow the recommendation in the Nodal Pricing Report, which did not identify a separate energy load zone for SWCT. The CT Parties argue that the analysis in the July 2 Filing is deficient and that the demand curve presented in the Prepared Direct Testimony and Supporting Exhibits of ISO-NE, filed August 31, 2004, does not support a SWCT ICAP region based on price or reliability differentials. The CT Parties request rehearing in Docket No. EL04-102-002 and that the Commission direct ISO-NE to file a second compliance filing consistent with certain recommendations made in the Nodal Pricing Report.³⁵ The CT Parties argue that without such an analysis, the Commission has no reasonable basis on which to assess the benefits and costs of a SWCT energy load zone.

34. Commission Determination. In the *November 8 SWCT Order*, the Commission found that ISO-NE had justified the creation of an energy load zone for SWCT on the basis of avoiding ISO settlement system redesign and contracting complications for load serving entities. The Commission directed that ISO-NE implement a SWCT energy zone when LICAP became effective. The CT Parties provide no evidence to suggest that the

³⁵ In the Nodal Pricing Report, ISO-NE recommended that analysis of alternative energy load zones should be conducted when changes to system conditions (*e.g.*, substantial load growth, transmission system changes, additional generation in constrained areas, the introduction of new markets) occur that would likely affect prices significantly. ISO-NE also stated that an analysis of alternative energy load zones should be conducted every two years; this analysis should consider all markets simultaneously rather than in isolation, and should develop a list of criteria with stakeholder input.

settlement system would not have to be redesigned or that there would be no contracting complications without a SWCT energy load zone. Instead, the CT Parties argue that a SWCT ICAP region is unwarranted—as evidenced by ISO-NE’s Prepared Direct Testimony and Supporting Exhibits and the demand curve presented therein—and thus a SWCT energy zone is unnecessary. At this time, the Commission cannot address the evidence submitted in the hearing but will review the record in that proceeding after issuance of the initial decision. Because the Commission reaffirms in this order that a SWCT ICAP region is justified and the protestors have not shown that a corresponding energy load zone is not appropriate, the Commission denies rehearing on this point.

Commission Conclusions on Deliverability of ICAP Resources

35. The CT Parties argue that the Commission has reached contradictory conclusions regarding a generator’s entitlement to receive ICAP payments based on its ability to deliver capacity to the purchasing load. In the *November 8 SWCT Order*, the Commission addressed a proposal from CT Parties that LICAP fees paid to generators that cannot physically deliver to SWCT load be held in escrow. The Commission noted that under LICAP, load within SWCT will need to procure capacity within the limits of the capacity transfer limits. Given this limitation, the Commission concluded that CT Parties had not stated how its escrow proposal would further the goals of the LICAP mechanism. CT Parties state that on the same day, the Commission reached a contradictory conclusion in its order regarding NEPOOL’s compliance with Order No. 2003³⁶ by directing ISO-NE to investigate whether generators should be subject to an intra-zonal deliverability test in order to qualify as an ICAP resource.³⁷

36. Commission Determination. The *November 8 SWCT Order* and the *Generator Interconnection Order* are not inconsistent in their treatment of the issue of ICAP resource deliverability. In the *Generator Interconnection Order*, the Commission stated its concern that it may not be just and reasonable for a generator in one location to sell its capacity to another location if it is not deliverable to the purchaser. The *Generator Interconnection Order* recognized that the LICAP mechanism will address this issue of deliverability through the use of capacity transfer rights,³⁸ and the *November 8 SWCT*

³⁶ *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs. ¶ 31,146 (2003), *order on reh’g*, Order No. 2003-A, 106 FERC ¶ 61,220, *order on reh’g*, Order No. 2003-B, 109 FERC ¶ 61, 287 (2004), *reh’g pending*.

³⁷ See *Generator Interconnection Order*, *supra*.

³⁸ *Id.* at P 44.

Order stated that the CT Parties' escrow proposal would not further advance these goals. That is, under LICAP, a generator in one region will not receive ICAP revenues from load in another LICAP region if the generator cannot make use of available capacity transfer capabilities.

37. Also, in the *Generator Interconnection Order* the Commission recognized that, while LICAP is intended to address deliverability between regions, there may be an issue of deliverability within regions, *i.e.* intra-zonal deliverability. Because deliverability within LICAP regions has not been fully discussed and is not yet defined, it is premature to conclude whether there are generators that cannot deliver their capacity to load within LICAP regions. The Commission simply identified intra-zonal deliverability as an issue that may need to be addressed and directed ISO-NE to further investigate.³⁹ Therefore, we dismiss the CT Parties' claim of contradiction as being without merit.

Responsibility for Resource Adequacy

38. The CT Parties argue that the Commission has no jurisdiction to designate SWCT as an ICAP region and thereby to set generator resource adequacy requirements in the SWCT and Rest of Connecticut regions. They refer us to arguments they make in Docket Nos. ER03-563-047 and EL04-102-007 for support for these arguments.

39. Commission Determination. CT Parties have not explained precisely how designating SWCT as an ICAP region will set resource adequacy requirements in that region, and we deny rehearing on this point. As we state in an order issued concurrently with this order in Docket Nos. ER03-563-047 and EL04-102-007, the Commission recognizes the scope of its jurisdiction under the Federal Power Act (FPA) and cases cited by CT DPUC *et al.* over matters of resource adequacy and reliability. The LICAP mechanism does not change the jurisdiction of the Commission or the states. The LICAP mechanism, as accepted by the Commission and set for hearing, merely remedies a flaw in the design of the installed capacity market which is already in a Commission-filed tariff.

40. We explain in our concurrent order, and again here, that currently, ISO-NE calculates capacity requirements in New England to achieve the "Objective Capability," or the total amount of capacity required by the system to meet peak load, plus a margin of reserve capacity to take into account contingencies and to maintain reliability. The Objective Capability is calculated by ISO-NE each year according to standards set by the Northeast Power Coordinating Council (NPCC). Once the Objective Capability is

³⁹ *Id.* at P 43 and P 49.

determined, this capacity requirement is allocated among the load-serving entities in the region. Load-serving entities may then procure the capacity bilaterally, through self-supply or via ISO-NE-administered auctions.⁴⁰

41. For many years, New England has chosen to include in its tariff an ICAP market to facilitate procurement of capacity to meet Objective Capability. Even before the formation of ISO-NE, NEPOOL required its member utilities to have, or pay for, their allocable share of the capacity needed to meet the region's demand. Under the current market rules, to the extent load serving entities have not satisfied their capacity obligations bilaterally, ISO-NE administers regularly scheduled monthly ICAP auctions to facilitate the procurement of capacity to satisfy the resulting residual individual and pool-wide Objective Capability requirements. As we have noted in the past, the current ICAP market on file with the Commission is flawed because generators needed for reliability and located in load pockets cannot earn sufficient revenues to justify continued operation, and because of wide price fluctuations that have been observed.⁴¹

42. The proposed LICAP mechanism and its demand curve feature will not change how resource adequacy determinations are made, and the issue here is not whether load serving utilities should be responsible for their share of the capacity needed to serve the region. Instead, the issue here is how prices for capacity are determined in the wholesale market, to remedy the flaws that have been identified. Currently, prices for ICAP are undifferentiated across New England; under LICAP, prices will reflect the reality that additional capacity is needed in some parts of New England more than in others. For example, ISO-NE states that SWCT specifically faces immediate threats to reliable and efficient electric service.⁴² In essence, the effect of this proceeding is not to impose a regional resource adequacy requirement, but merely to change the pricing from being regionally uniform to prices that reflect local differences in supply and demand. This will minimize subsidies that customers outside of SWCT are now paying to safeguard reliability in SWCT. Under the LICAP mechanism, ISO-NE will continue to set the Objective Capability, and the demand curve will determine the amount of capacity that load serving entities purchase each month. The prices that load will pay for capacity are

⁴⁰ See ISO New England, Manual for Installed Capacity, section 2.5.

⁴¹ See *supra* at P 15, noting the compensation problems experienced by generators needed for reliability and their resulting requests for RMR agreements. See also *ISO New England, Inc.*, 91 FERC ¶ 61,311, 62,080 n.97 (2000), where the Commission cited to evidence received from ISO-NE regarding dramatic price spikes (from \$0 to \$10,000 per MW for a month) in the ICAP market.

⁴² January 4 Report at pp. 6-7.

a function of the demand curve parameters currently being addressed in the ongoing hearing, and are as yet undetermined. It may be that the demand curve that we ultimately approve will result in total bills to customers for procuring ICAP in amounts greater than Objective Capability are less than the total bills for procuring ICAP at Objective Capability. But these are the issues that the Commission set for hearing, and it is premature to anticipate a result.

The Commission orders:

The requests for rehearing are hereby denied, as discussed in the body of this order.

By the Commission. Commission Kelly not participating.

(S E A L)

Linda Mitry,
Deputy Secretary.