135 FERC ¶ 61,029
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

ISO New England, Inc. and New England Power Pool Participants Committee	Docket Nos. ER10-787-000 EL10-50-000 EL10-57-000
New England Power Generators Association v. ISO New England Inc.	ER10-787-004 EL10-50-002
PSEG Energy Resources & Trade LLC, PSEG Power Connecticut LLC, NRG Power Marketing LLC, Connecticut Jet Power LLC, Devon Power LLC, Middletown Power LLC, Montville Power LLC, Norwalk Power LLC, and Somerset Power LLC v. ISO New England Inc.	EL10-57-002

ORDER ON PAPER HEARING AND ORDER ON REHEARING

(Issued April 13, 2011)

Paragraph Numbers

I. Background ..... 2.
A. FCM ..... 2.
B. Instant Proceeding ..... 6.
1. The Joint Filing and Joint Complainants' and NEPGA's Complaints ..... 8.
2. The April 23 Order ..... 9.
C. The Paper Hearing ..... 11.
D. The Instant Order ..... 13.
I. Background ..nU-0.0.00234nTm.....5.....8.....

2. Commission Determination ..... 36.

III. Joint Filing ..... 49.
A. Alternative Price Rule ..... 50.
1. Triggering Conditions and Price Adjustment ..... 52.
a. Comments and Responses ..... 53.
b. Commission Determination ..... 58.
2. OOM Resources that Create Surpluses for Multiple Years ..... 64.
a. Historical OOM ..... 65.
b. Duration of APR Mitigation ..... 67.
B. Modeling of Capacity Zones ..... 70.
a. Comments and Responses ..... 72.
b. Commission Determination ..... 76.
C. Value of CONE ..... 79.
a. Commission Determination ..... 81.

IV. Paper Hearing ..... 82.
A. Procedural Issues ..... 83.
B. APR/Buyer-Side Mitigation ..... 86.
1. July 1 Proposal ..... 87.
Triggering Conditions ..... 87.
Carried-Forward OOM Capacity ..... 88.
APR Price Adjustment ..... 89.
a. Comments and Responses ..... 105.
2. Alternative Proposals ..... 152.
a. Commission Determination ..... 156.
3. Treatment of Imports ..... 180.
a. July 1 Proposal ..... 180.
b. Comments and Responses ..... 181.
c. Commission Determination ..... 189.
4. Treatment of Historical OOM ..... 192.
a. July 1 Proposal ..... 192.
b. Comments and Responses ..... 193.
c. Commission Determination ..... 213.
5. Self-Supply/Hedging ..... 221.
a. July 1 Proposal ..... 221.
b. Comments and Responses ..... 222.
c. Commission Determination ..... 230.
6. Demand Curve ..... 233.

8. Joint Complainants' Takings Argument ..... 248.
a. Joint Complainants' Argument ..... 248.
b. Commission Determination ..... 251.
C. Zones and Market Power Mitigation ..... 258.
1. April 23 Order ..... 258.
2. The July 1 Proposal ..... 259.
3. Model All Zones All the Time ..... 260.
a. Eight Energy Load Zones as Initial Capacity Zones ..... 261.
b. Stakeholder Process for Determining Future Zones ..... 278.
c. Expanded Use of De-List Bids to Determine Zonal Price ..... 284.
d. Revisions to the Descending Clock Auction to Accommodate Zonal Price Separation ..... 293.
e. Additional Issues ..... 299.
4. Revised Mitigation Rules ..... 304.
a. Revisions to the Dynamic De-List Bid Threshold ..... 305.
b. Revisions to the Calculation of Static and Permanent De-List Bids ..... 316.
c. Elimination of the Pivotal Supplier Test ..... 325.
d. Elimination of the Quantity Rule ..... 332.
D. CONE ..... 336.
1. April 23 Order ..... 336.
2. The Proper Value of CONE ..... 337.
a. July 1 Proposal ..... 337.
b. Comments and Responses ..... 339.
c. Commission Determination ..... 342.

V. Other ..... 346.
A. Complaints from NEPGA and Joint Complainants ..... 346.
B. NEPGA's Request for Rehearing of the August 12 Order ..... 349.
1. Request for Rehearing ..... 350.
2. Commission Determination ..... 358.
C. Mirant's Emergency Request for Clarification ..... 366.
D. Timing ..... 367.
E. Cost Impact Analysis ..... 369.
1. Maine PUC Request ..... 369.
2. Commission Determination ..... 372.

1. This order is the culmination of a paper hearing on certain proposed changes to the New England Forward Capacity Market (FCM) filed jointly by ISO New England Inc. (ISO-NE) and the New England Power Pool Participants Committee (NEPOOL) (collectively, the Filing Parties). In this order, the Commission rejects the Alternative Capacity Price Rule (APR) and the modeling of capacity zones and related mitigation aspects of the proposed changes that were the subject of the paper hearing, while finding, with one exception, that issues related to calculating the Cost of New Entry (CONE) are

moot; the Commission also finds that aspects of ISO-NE's July 1, 2010 proposal (July 1 Proposal) are just and reasonable, and approves them, subject to a compliance filing, as discussed below.

I. Background

A. FCM

2. Seven years ago, in response to a Commission order to include a locational component in New England's installed capacity market,[1] ISO-NE proposed to divide New England into multiple capacity regions, each with its own capacity requirement and monthly capacity auction (LICAP Proposal). As part of this design, the ISO proposed to establish a downward sloping demand curve to determine the amount of capacity that must be procured and the price to be paid for that capacity.

3. After more than two years of litigation, which included Congress requesting that the Commission carefully consider the objections of the New England states,[2] a full day of oral argument before the Commission, and settlement discussions involving 115 parties, the Commission approved a contested settlement agreement that replaced the LICAP Proposal with the FCM.[3]

4. The FCM departed from the LICAP Proposal in several significant respects. For example, rather than operate under a demand curve where the amount procured could be higher or lower than the ICR depending on supply conditions, the settlement instituted the Forward Capacity Auction (FCA) – an annual descending clock auction to procure an amount of capacity that was exactly equal to the ICR.[4] Providers whose capacity is taken in the FCA acquire Capacity Supply Obligations, which they must fulfill approximately

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three years later.[5] The settlement also established an APR mechanism to deter market participants from artificially lowering prices. The Commission explained that such a mechanism was necessary to address the same price suppression concerns raised in this proceeding.[6]

5. Thus far, ISO-NE has conducted four FCAs. The first two FCAs were conducted in 2008, the third in October 2009, and the fourth in August 2010. The fifth FCA is scheduled for June 2011.

B. Instant Proceeding

6. In December 2008, the Filing Parties submitted a filing that identified FCM issues that required further attention and proposed a stakeholder process to address them (FCM Phase II Filing). Subsequently, ISO-NE's Internal Market Monitor (IMM) issued its initial assessment of the FCM and provided recommendations for improvements (IMM Report).[7] These recommendations included addressing the reliability criteria used for determining capacity zones and evaluating de-list bids, modifying the APR, and changing the use of the CONE parameter in determining the starting price for each FCA.

7. Based on the FCM Phase II Filing and the IMM Report, the NEPOOL stakeholders created the Forward Capacity Market Working Group (FCM Working

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[5] The Commission accepted a portion of the market rules that implemented the FCM on April 16, 2007 (*ISO New England Inc.*, 119 FERC ¶ 61,045, *order on reh'g*, 120 FERC ¶ 61,087 (2007)), and the remainder on June 5, 2007 (*ISO New England Inc.*, 119 FERC ¶ 61,239 (2007), *reh'g denied*, 122 FERC ¶ 61,171 (2008)).

[6] *Id.* P 113 ("In the absence of the alternative price rule, the price in the FCA could be depressed below the price needed to elicit entry if enough new capacity is self-supplied (through contract or ownership) by load. That is because self- supplied new capacity may not have an incentive to submit bids that reflect their true cost of new entry. New resources that are under contract to load may have no interest in compensatory auction prices because their revenues have already been determined by contract. And when loads own new resources, they may have an interest in depressing the auction price, since doing so could reduce the prices they must pay for existing capacity procured in the auction.").

[7] ISO New England Inc. Market Monitoring Unit, *Internal Market Monitoring Unit Review of the Forward Capacity Market Auction Results and Design Elements* (June 5, 2009) ("Internal Market Monitor Report"), *available at* http://www.iso-ne.com/markets/mktmonmit/rpts/other/fcm_report_final.

Group), chaired by representatives from NEPOOL, the New England Conference of Public Utility Commissioners (NECPUC), and ISO-NE, to provide a stakeholder forum specifically constructed to consider FCM design changes. The FCM Working Group also considered recommended rule changes related to the APR, as required by section III.13.2.5.2.5(f) of the ISO-NE Transmission, Markets, and Services Tariff (Tariff), which required ISO-NE to evaluate whether

provisions without suspension.

making new proposals.[15] As ISO-NE put it, "the Commission established a compact timeframe in which the ISO was challenged to develop and file a new design that addressed the issues the Commission found potentially unjust and unreasonable in the [Joint] Filing."[16] Any parties who wished to support the Filing Parties' proposed revisions were to submit briefs at that time as well. Parties with other positions on the issues set for hearing (such as the complainants in Docket Nos. EL10-50-000 and EL10-57-000) were to simultaneously submit briefs supporting their views. In the April 23 Order, the Commission also provided parties an additional sixty days in which to submit second briefs to respond to the arguments made in the first briefs.

12. The first briefs of most parties (including the complainants in Docket Nos. EL10-50-000 and EL10-57-000) largely addressed the Joint Filing proposals. However, ISO-NE's first brief disregarded the Joint Filing and instead contained an entirely new proposal on the paper hearing issues (July 1 Proposal). ISO-NE explained that, due to a lack of time, it could not completely vet the proposal with stakeholders, although it did present the conceptual framework of the July 1 Proposal to stakeholders at a meeting on June 15, 2010, and several subsequent meetings were planned. In light of ISO-NE's July 1 Proposal, the Commission provided parties the opportunity to file third briefs to respond to arguments made in second briefs.[17]

D. The Instant Order

1. Context

13. The backdrop against which we review these proposed changes is one of significant excess capacity. Every auction since the inception of the FCM has cl17.re.it

the FCA and obtain Capacity Supply Obligations.[19] (In contrast, the PJM and NYISO capacity markets both employ offer-floors that are intended to preclude such offers.[20])

14. Allowing OOM capacity to clear creates a significant design issue for the FCM; all other things being equal, it suppresses the clearing price below competitive levels. Since the inception of the FCM, there has been an APR – a buyer market power mitigation mechanism – in place, but it has ne

Docket No. ER10-787-000,

we find the feature of ISO-NE's July 1 Proposal that relies on these benchmark prices, coupled with limiting the amount of capacity purchased to the ICR, is just and reasonable, and, therefore, we will require ISO-NE to work with its stakeholders to develop an offer-floor mitigation construct akin to those in PJM and NYISO.

20. We also recognize in this order that states and state agencies may conclude that the procurement of new capacity, even at times when the market-clearing price indicates entry of new capacity is not needed, will further specific legitimate policy goals and, therefore, argue that certain resources that receive payments pursuant to state programs, which would otherwise trigger mitigation, should nonetheless be exempt from offering above a price floor. As discussed below, nothing in this order eliminates any rights entities may have under section 206 of the FPA to request a mitigation exemption.. Whether to grant an exemption will be based on each case's unique facts.

3. Historical OOM and Price Floor

21. We also accept in this order the Joint Filing proposal that OOM resources that cleared in the first three FCAs (so-called "historical OOM") should not trigger the APR. We do so even though the presence of historical OOM resources in the market has contributed to a large capacity surplus that is likely to last for many years. Our basis for

1. Comments and Responses

27. Many parties assert that the Commission's role under section 205 is only to determine whether a rate proposed by a utility, here the Joint Filing, is just and reasonable and is not to determine whether the Joint Filing is more or less reasonable than alternatives. Therefore, these parties argue, because the Joint Filing is properly filed under section 205 of the FPA, the Commission may not consider proposed alternatives without first finding that the Joint Filing will not produce just and reasonable results.

28. Other parties point out that ISO-NE itself has stated that all auctions, including the fourth auction that was conducted according to the Joint Filing rules, have produced just and reasonable results. Some state that the proponents of any alternative must therefore demonstrate materially changed conditions in order to show that the existing FCM rules, rules which were found by the Commission to be just and reasonable, are now instead unjust and unreasonable. Load parties emphasize that the FCM functions well, securing reliability, procuring capacity, and eliminating the region's reliance on reliability-must-run (RMR) agreements. These parties contend that there is no basis in the record to find that the existing FCM rules, as modified by the Joint Filing, are unjust and unreasonable. Other parties disagree, arguing that the FCM has missed almost all its design objectives, rendering the resulting rates unjust and unreasonable. For example, NEPGA asserts that the unrestrained exercise of buyer market power threatens to destroy the FCM.[26]

29. For various reasons, many parties continue to argue (consistent with their original comments on the Joint Filing) that the Commission should consider the Joint Filing's FCM revisions as a package. Some support this position because the Joint Filing was the result of a lengthy and careful process of discussion and compromise, with input from state regulators, the IMM, ISO-NE, and the NEPOOL stakeholders. Some argue that if the Commission were to pick and choose provisions from the Joint Filing, it would hamper future stakeholder efforts. Others emphasize that the complexity of the FCM dictates that provisions cannot be selected piecemeal from the Joint Filing, or, as ISO-NE argues, from its July 1 Proposal.

30. On the other hand, Boston Gen asserts that the Commission is not required to consider either the Joint Filing or the July 1 Proposal as an integral package and notes that the Commission has already rejected this argument as to the Joint Filing. NEPGA observes that, on rehearing, the Commission stated that it cannot "defenestrate" its duty to ensure just and reasonable rates under any circumstances, even when, as NEPGA puts it, "a super-majority of likeminded stakeholders have agreed to a one-sided package

[26] NEPGA First Brief at 19.

Docket No. ER10-787-000,

economic soundness of the APR proposal. For its part, ISO-NE states that it developed its July 1 Proposal in response to the Commission's determination *not* to entrust the further development of the capacity market design to the stakeholder process, instead establishing a compact timeframe in which the ISO was challenged to develop and file a new design that addressed the issues the Commission found potentially unjust and unreasonable in the Joint Filing. ISO-NE asserts that a very detailed Commission order placing a compliance obligation on ISO-NE that minimizes the opportunity for re-argument during the rule drafting process will help achieve the Commission's goal of swiftly putting into place changes to the market rules that will remedy the flaws in the FCM.[37]

2. Commission Determination

36. Given the complexity of the procedural issues presented by this case, it is helpful for us to refer back to our specific findings, and our specific directives to the parties, contained in the April 23 Order. It is that order that provides the framework in which we analyze the parties' comments and positions. In pertinent part, in the April 23 Order, the Commission stated (at P 15):

> We find certain aspects of the [Joint Filing] to be just and reasonable, as set forth in P 16 below, and we accept those provisions without suspension. Our preliminary analysis indicates that the remainder of the Rules Changes Filing has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. In consideration of the fact that ISO-NE must conduct its next FCA in August 2010, and of the uncertainty that would result from not having replacement tariff provisions in place to govern that auction, we will accept those remaining proposed tariff provisions for filing, suspend them for a nominal period, and make them effective April 23, 2010.

37. Thus, in the April 23 Order, the Commission, pursuant to its section 205 authority, accepted without suspension a portion of the Joint Filing, effective as of April 23, 2010. We also found that other aspects of the Joint Filing had not been shown to be just and reasonable but, for the reasons set forth above, accepted those provisions effective as of the date of that order, suspended them, and also set them for paper hearing.[38] With

[37] ISO-NE Third Brief at 8-9.

[38] April 23 Order, 131 FERC ¶ 61,065 at P 15.

respect to the suspended provisions of the Joint Filing, the Commission stated (at note 11): "To provide parties sufficient certainty regarding the August 2010 auction, we intend to make any changes to the FCM tariff

considered in the context of the whole, it does not follow that each rule change we accept must have been filed as part of a single proposal. Our consideration of any rule change will include consideration of its interaction with other FCM rules or rule changes.

42. We next turn our attention to ISO-NE's July 1 Proposal. Parties offer a multitude of opinions as to the nature of this filing, ranging from Boston Gen's assertion that the July 1 Proposal is, in fact, an amendment to the Joint Filing that must be evaluated under section 205, to HQUS' assertion that the July 1 Proposal is procedurally improper and violates both the FPA and the TOA, to NEPOOL's assertion that the July 1 filing is a section 206 filing entitled to no more weight than the filing of any other party.

43. We first note that, in accordance with the Participants Agreement, absent exigent circumstances, ISO-NE cannot make a proposal to change market design under section 205 without first taking that proposal through the NEPOOL Participants Committee.[41] The July 1 Proposal was not taken through the Participants Committee; consequently, it cannot be treated as a section 205 submission. While the July 1 Proposal was not expressly presented to us under section 206, we agree with NEPOOL that it is effectively a proposal under section 206 to replace rates found unjust and unreasonable, and thus we will accord it no more weight than the filing of any intervenor to the proceeding. We believe that this approach best balances the rights of all parties to the proceeding and best adheres to the express terms of the Participants Agreement with respect to the prerequisites that ISO-NE must follow before submitting a section 205 filing with the Commission. Further, our actions in this order to find certain portions of the FCM construct unjust and unreasonable, and to put a just and reasonable replacement into place, are also taken pursuant to complaints filed under section 206 by NEPGA and Joint Complainants, who have asserted that both the Joint Filing and additional pre-existing aspects of the FCM construct are unjust and unreasonable.

44. We do not believe that the fact that prior FCAs, including the fourth, may have resulted in just and reasonable outcomes precludes ISO-NE or any other party from arguing, or the Commission from finding, that some specific provisions of the existing FCM rules or of the Joint Filing are unjust and unreasonable. First, taken to its logical conclusion, parties' arguments in this regard would mean that no section 206 challenge to any market design rates on file could succeed and that any such rate on file, once approved, is just and reasonable in perpetuity unless and until the utility itself files a proposed change under section 205. Second, a claim that previous FCAs may have resulted in just and reasonable outcomes has no relevance to the Commission's express finding in the April 23 Order that some aspects of the Joint Filing may produce unjust

that ISO-NE must demonstrate materially changed conditions in order to challenge the Joint Filing.

45.

below. In addition, we note that ISO-NE and NEPOOL will still be required to file tariff provisions reflecting our decisions here which the Commission will subsequently review.

48. In conclusion, in this order we will review the Joint Filing under FPA section 205. And, as discussed below, we find certain aspects of the Joint Filing to be unjust and unreasonable. We will next review alternative proposals, including the July 1 Proposal, under FPA section 206. We note that parties to this proceeding received notice of and an opportunity to respond to all the proposals before us. Parties were first put on notice that the Commission had difficulties with certain aspects of the Joint Filing upon issuance of the April 23 Order. Parties then had several opportunities to provide further support for the Joint Filing or to propose alternative solutions. After ISO-NE filed its July 1 Proposal with the Commission, all parties were given two subsequent opportunities, on September 1, 2010 and September 29, 2010, to provide non page-limited briefs to the Commission regarding ISO-NE's July 1, or any other, proposal. As discussed above, we will confer upon ISO-NE's July 1 Proposal no more (and no less) weight than we will confer upon any other alternative proposal provided to us during the paper hearing. Throughout the remainder of this document, we carefully consider the thousands of pages that constitute the paper hearing record and weigh all the arguments supporting and opposing all of the proposals before us and reach what we believe to be reasoned decisions based on substantial record evidence.

III. Joint Filing

49. As discussed above, in the April 23 Order, the Commission found that the Filing Parties had not demonstrated that certain aspects of the Joint Filing were just and reasonable. In order to allow parties to provide additional argument, the Commission set certain issues for paper hearing: (1) issues related to the APR; (2) the modeling of capacity zones and related mitigation; and (3) whether the value of CONE should be reset. After considering the additional argument both for and against these aspects of the Joint Filing, we find that the Joint Filing is unjust and unreasonable as to these issues, with the exception of its proposed treatment of historical OOM,[45] which we find to be just and reasonable. We discuss each issue in turn below.

A. Alternative Price Rule

50. APR is a market power mitigation rule intended to discourage buyers who have the incentive and ability to suppress market clearing prices below a competitive level

[45] "Historical OOM" for purposes of this order is capacity that was found to be OOM in the first three FCAs.

from doing so.[46] Generally speaking, the APR functions by first identifying OOM capacity, that is, new resources that offer into the FCM at a price deemed by the IMM to be below their long-run average costs. Specifically, under the current Tariff, OOM capacity is capacity whose offer price, in the opinion of the IMM, is below the resource's long run average costs net of expected non-capacity market revenues.[47] Depending on circumstances that will be described below, the presence of OOM resources in an auction may or may not trigger APR mitigation under the Joint Filing's proposed rules.

51. In the April 23 Order, the Commission found that the Joint Filing's APR revisions improved upon the then-existing APR in most or all respects.[48] However, the Commission noted that certain concerns raised by commenters warranted further investigation and therefore set three APR-related issues for hearing: (1) the appropriate APR triggering conditions, if any; (2) the treatment of OOM resources that create capacity surpluses for multiple years; and (3) the appropriate price adjustment under APR. We will first discuss (1) and (3) together, and then discuss (2).

1. Triggering Conditions and Price Adjustment

52. Under the preexisting and Joint Filing rules, the fact that resources deemed to be OOM are taken in an auction is not enough by itself to "trigger" APR – that is, the presence of OOM capacity is not enough to prompt price mitigation. The Joint Filing proposes three different APRs, each triggered under a mutually exclusive set of conditions such that only one of the APR mechanisms can be triggered per capacity zone per FCA. "APR-1" is a revised version of the preexisting APR and triggers only when new capacity is needed and new OOM capacity fully satisfies the need.[49] "APR-2"

46

addresses the situation in which a sufficiently large amount of OOM capacity from previous FCAs may eliminate the need for new capacity, thus depressing the price in a subsequent FCA.[50] If either of these APRs is triggered, the market clearing price is adjusted upward to the lower of: (1) a penny below the lowest price offered by a new in-market resource or (2) CONE, which is the same re-pricing mechanism that was used under the preexisting rules. "APR-3" is designed to mitigate the price-suppressing effects of de-list bids that are rejected for reliability rather than to mitigate buyer-side market power.[51] APR-3 employs a re-pricing mechanism in which the ISO determines the FCA price that would have resulted if de-list bids had not been rejected for reliability.[52]

a. Comments and Responses

53. Allowing that the Joint Filing revisions still enable OOM capacity to enter the market without triggering the APR, supporting parties argue that these triggers strike a just and reasonable balance between the need to prevent the "artificial" suppression of capacity prices and the need to preserve legitimate opportunities for bilateral contracts and self-supply. JFS emphasizes that these limited triggering conditions are necessary in the context of the Joint Filing's broad definition of OOM. JFS asserts that these limited

[50] Specifically, APR-2 is triggered when (1) no new capacity is needed; (2) there is adequate supply offered into the FCA to meet the ICR; and (3) at the Capacity Clearing Price, the amount of new capacity required

60. Parties arguing in favor of the Joint Filing's APR revisions have allayed neither our concerns that the Joint Filing's triggering conditions are too narrow, nor our concerns

Docket No. ER10-787-000,

treatment of historical OOM, inclusive of its proposed extension of the price floor.[72] We will provide our detailed discussion of parties' argument on historical OOM and our response on APR in the paper hearing section, in which we discuss ISO-NE's revised APR proposal (which retains this aspect of the Joint Filing).

b. Duration of APR Mitigation

zones.[77] After considering parties' additional arguments, we find the zonal modeling proposal from the Joint Filing to be unjust and unreasonable.

a. Comments and Responses

72. Load parties, who support the Joint Filing's zonal modeling proposal, are generally opposed to always modeling zones on the grounds that doing so carries a heightened risk of the exercise of supplier market power due to the smaller resulting zones. JFS states that the Joint Filing represents a just and reasonable approach that balances the two competing needs: (1) to model zones whenever practical to set appropriate locational rates and (2) to prevent existing generators from creating a separate zone through the exercise of market power. In their view, the revisions included in the Joint Filing will virtually eliminate the need for ISO-NE to reject de-list bids for reliability reasons.[78] Other parties argue that modeling all zones all the time is unnecessary and will undermine the development of transmission infrastructure. On the other hand, generator parties, who favor always modeling zones, note that pre-auction tests for establishing separate import-constrained capacity zones have not been met in any FCA to date, despite the need to reject de-list bids in these same auctions. Therefore, these parties assert that the modeling and mitigation rules accepted in the Joint Filing will still prevent locational pricing. Further, they contend that market power concerns ought to be addressed by strengthening market power mitigation measures rather than by compromising market design by not always modeling the zones.

73. Parties supportive of the Joint Filing point out that allowing certain de-list bids to trigger formation of a zone during an FCA will result in zones being modeled more frequently. These parties support the Joint Fi

to achieve an economically rational and sustainable outcome, arguing that such de-list bids, at less than 0.8 * CONE, by definition pose minimal risk of market power abuse.

74. Parties in favor of the Joint Filing's proposed use of a pivotal supplier test in order to allow only non-pivotal static de-list bids to be considered in determining zones assert that not doing so could permit the exercise of market power by a pivotal supplier. On the other hand, NEPGA argues that applying a pivotal supplier test to static de-list bids would amount to over-mitigation, since static de-list bids are already subject to IIoi.021 Two7hld 0079

78. Last, because we find unjust and unreasonable the Joint Filing's proposal to model zones only in advance of the auction under specific circumstances, the issue of whether the accompanying pivotal supplier test is necessary has been mooted.

C. Value of CONE

79. The Joint Filing proposed (and the April 23 Order explicitly accepted) certain revisions to the methodology for updating CONE in the FCM construct.[79] Although the Commission stated that the CONE value itself was not part of the Joint Filing, the April 23 Order directed parties to address the issue of the proper value of CONE, as this value is "intrinsically tied to the OOM determinations that are part of the APR Issue."[80]

80. In the paper hearing, generator parties reiterate their arguments that the value of CONE under the preexisting and Joint Filing rules grossly understates the actual cost of constructing a new peaking plant. Load parties reiterate their prior arguments that the current CONE value properly reflects clearing price trends and dispute the idea that CONE should be based on the costs to construct a peaking unit.

a. Commission Determination

81. As the Commission noted in the April 23 Order, the value of CONE is most significant for its role in the determination of mitigation review thresholds. In light of

A. Procedural Issues

83. On August 30, 2010, NRG filed an answer to Mirant's Emergency Request for Clarification filed on August 20, 2010. On November 16, 2010, HQUS filed a Motion for Leave to File Limited Response and Limited Response to ISO-NE's third brief.

84. Rule 213(a)(2) of the Commission's Rule of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2010), prohibits an answer to a protest, comments, or answer unless otherwise ordered by the decisional authority. We accept the answer filed by HQUS because it has provided information that assisted us in our decision-making process. We will reject NRG's answer to Mirant's emergency request for relief, on the basis that both Mirant's request and NRG's answer have now become moot (see P 367 below).

85. Because we have found the Joint Filing Proposal to be unjust and unreasonable as it concerns the issues set for paper hearing (outside of its proposed treatment of historical OOM), we will now consider the alternative proposals under section 206. Though we will accord the ISO-NE July 1 Proposal no more weight than we accord proposals submitted by any other party to this proceeding, for readability's sake, we structure the remainder of this document around the July 1 Proposal. This is appropriate given that the July 1 Proposal is the only comp

APR as proposed in the Joint Filing) that applies whenever new or carried-forward OOM capacity clears in the FCA.[81]

Carried-Forward OOM Capacity

provide the Alternative Capacity Price to new resources since these resources typically have not yet committed to entry and would generate additional excess capacity that would be carried in this and future FCAs. ISO-NE contends that the appropriate price signal for new resources is the relatively lower Capacity Clearing Price – the price from the FCA with OOM resources as offered and not re-priced. ISO-NE contends that the Capacity Clearing Price sends appropriate signals to new investors about the need for new capacity.

92. Under the revised APR mechanism, all resources that clear in the FCA receive a Capacity Supply Obligation, with new resources receiving capacity payments for a fixed timeframe of five consecutive Capacity Commitment Periods at the price from the first FCA in which the resource clears. ISO-NE states that new resources receive this price for a fixed period to provide these resources with an incentive to offer based on the cost of entry rather than based on the possibility of obtaining the higher Alternative Capacity Price in subsequent FCAs.

93. Under the revised APR mechanism, existing resources that did not clear in the FCA but that offered in an FCA at or below the Alternative Capacity Price also receive a Capacity Supply Obligation, since these are the resources that were displaced by the OOM resources. As a result, ISO-NE notes that this higher Alternative Capacity Price does not send an accurate signal about the need for new capacity.

94. ISO-NE states that if all resources were paid the higher Alternative Capacity Price, too much new capacity would be installed creating significant inefficiency. By contrast, ISO-NE argues that the two-tiered pricing model addresses the oversupply problem that is introduced when paying the Alternative Capacity Price to existing resources by sending a price signal to new capacity that reflects the actual quantity in the market. ISO-NE states that the two-tiered approach is not harmful to new resources since (by definition) the Capacity Clearing Price is the price that new resources clearing in the FCA indicated that they were willing to accept.

95. Thus, ISO-NE contends that its July 1 Proposal on APR represents the best balancing of three high-level design elements that are fundamentally in tension: (1) allowing new capacity submitting OOM offers to clear in the FCA and to provide capacity; (2) ensuring that the market for existing resources is not distorted by the presence of that OOM capacity; and (3) ensuring that total purchases do not exceed the ICR. ISO-NE argues that, if OOM capacity is allowed to clear in the FCA, the only way to insulate existing resources from the price effects of that OOM capacity is to impose additional costs on load by procuring capacity in excess of the ICR. Similarly, ISO-NE maintains that if the Commission imposes a requirement that the FCA procure no capacity in excess of the ICR, existing resources will be disadvantaged by the clearing of any OOM capacity.

96. ISO-NE maintains that the first element – allowing OOM capacity to clear in the FCA and to provide capacity – has been an element of the FCM design since its inception and has been generally supported by stakeholders, the states, ISO-NE, and the Commission. ISO-NE contends that if such resources are going to be built to meet state policy objectives, it would be inefficient to exclude them from the FCA, which would result in the procurement of alternate, essentially redundant sources of capacity. ISO-NE states that the second element – ensuring that the market for existing resources is not distorted by the presence of OOM capacity – is strongly supported by some generator parties and is the basis for the current APR in the FCM design. Further, ISO-NE notes that the Commission expressed its concern in the April 23 Order that the currently effective APR "fail[s] to fully adjust for the effect of OOM investment on the capacity price." Last, ISO-NE states that the third element – that total purchases not exceed the ICR – has been an integral part of the FCM since its initial design and this requirement is extremely important to many load parties and the states.

97. ISO-NE argues that the July 1 Proposal is the best approach, as it allows new OOM resources to clear while fully insulating existing resources from the price effects of this OOM capacity. ISO-NE states that its two-tiered pricing mechanism effectively accomplishes both of these goals while excess procurement above ICR is minimized by providing a price signal to potential new entrants that reflects the actual capacity supply situation in the region.

Imports

98. ISO-NE states that its proposal treats imports similarly to resources within New England; new imports that require a significant investment (similar to the level required for existing resources to become new under the current market rules) to provide capacity to New England would be treated as a new resource and would be eligible for the Alternative Capacity Price after the expiration of the initial five-year commitment. Otherwise, the imports would receive the Capacity Clearing Price, since this price reflects the actual supply-demand situation in the region.

Sunsetting of the Alternative Capacity Price for Existing Resources

99. ISO-NE states that under the July 1 Proposal, after the 20th FCA in which a resource participates, that resource will no longer be eligible to receive capacity payments based on the Alternative Capacity Price. Instead, beginning with the 21st FCA in which a resource participates, the resource will receive capacity payments based on the Capacity Clearing Price in each FCA. ISO-NE notes that the basis for this provision is that the rationale for providing the higher Alternative Capacity Price becomes less compelling over time – after 20 years, the incremental expected revenue has little impact on the expected price at which a new entrant would offer. Further, as a resource faces a retirement/de-list decision, ISO-NE contends that such a decision is better informed by

the Capacity Clearing Price which reflects the supply-demand balance in the market, providing a more appropriate price signal. Of note, ISO-NE proposes that this sunsetting not be applied retroactively, such that for all currently existing resources, the fourth FCA (conducted in August, 2010) will be the first year of the 20-year count. The basis for this proposal is that it balances the goal of holding existing resources harmless from the price effects of OOM resources and the goal of sending the best possible long-term price signals.

Treatment of Historical OOM

100. Consistent with its Joint Filing, ISO-NE's revised APR mechanism in its July 1 Proposal does not carry forward any OOM capacity from the first three FCAs. ISO-NE states that carrying forward this historical capacity would be inappropriate since it would constitute retroactive application of new rules, creating significant market uncertainty.[83] Also, ISO-NE cites prior Commission guidance in a NYISO case where the Commission noted that mitigation should be directed at avoiding inefficient entry but should not apply to historical OOM capacity since the associated costs of this OOM capacity could no longer be avoided.[84]

OOM Capacity Determination

101. Under the revised APR mechanism, ISO-NE proposes to modify the IMM's review process to determine whether offers from new resources are OOM capacity. Rather than continuing to review offers from resources submitted at prices below 0.75 * CONE in order to assess whether the offer is OOM, the IMM will now calculate benchmark offers for different types of resources to reflect what a resource would seek from the capacity market, [illegible] prices from other wholesale markets and other generally

Docket No. ER10-787-000,

an important detail since it is conceivable that an economically rational participant may offer a short-run commitment below its long-run costs. As such, the EMM recommends that ISO-NE establish a threshold within which a participant may offer relative to its verified costs.

106. NEPGA states that ISO-NE's July 1 Proposal is the most "elegant" solution to reconcile the divergent requirements of the instant proceeding. First, NEPGA notes that the revised APR is properly triggered whenever OOM capacity is included in the auction. NEPGA argues that there is no alternative to this triggering condition unless the Commission wishes to allow OOM capacity to be used to manipulate capacity price. Second, NEPGA states that when the APR is triggered, two parallel auctions establish two prices – in the FCA auction, only seller-side mitigation is applied, while when the APR price is set, OOM offers are also subject to buyer-side mitigation. Thus, NEPGA states that under this methodology, all supplier prices are prevented from being uneconomically high and all OOM prices are prevented from being uneconomically low. Further, NEPGA states that as long as OOM capacity is allowed to clear in the FCM (unlike in NYISO and PJM Interconnection, L.L.C. (PJM)), these dual clearing prices cannot be avoided. NEPGA states that failing to protect existing in-market resources from artificial price suppression would "heavily discourage" any further competitive entry into the capacity market, while paying OOM resources the lower FCA price diminishes their incentives to distort capacity markets..

NEPGA states that the historical APR was "too full of loopholes to work" and, therefore, a restoration of balance first requires an effective APR.

114. NEPGA states that any proposed APR exemptions for state-supported resources have no basis in law or economics. In support, NEPGA argues that the states are not neutral arbiters but instead represent interests on the buyer side of the capacity market and NEPGA contends that it is "unaware of the Commission ever having granted such an extraordinary privilege to an interested party."[90] On a legal basis, NEPGA argues that this exemption is analogous to the states' argument in an earlier proceeding that the FPA grants them the authority to set an FCM parameter affecting capacity prices – ICR. NEPGA states that this prior argument was "resoundingly rejected."[91] NEPGA argues that the states do not have the authority to override Commission decisions setting wholesale capacity prices since wholesale capacity prices are "undisputedly" within the Commission's exclusive jurisdiction. Rather, NEPGA contends that in the New England capacity markets, state or load-sponsored actions to seek short-term gains pose the greatest threats to competitive markets since in the long-run, investors will be discouraged from investing. NEPGA witness Kalt further contends that it is not a defense to point out that states exercise market power on behalf of buyers rather than sellers since seller market power equally distorts the relationship between prices and costs.

115. ISO-NE states that JFS witness Wilson's argument that the APR should only be applied to resources that are being used to inappropriately suppress prices demonstrates a misunderstanding of the objective of the APR. ISO-NE states that the objective of the APR is to establish the price that would have prevailed if the OOM resources had submitted offers based on their full cost of entry and not based on OOM revenues that other resources do not receive. ISO-NE states that the objective of the APR is not as Wilson contends, i.e., to remedy a situation where there is an exercise of buyer market power. ISO-NE argues that the intent issue is irrelevant since prices are suppressed regardless of the intent behind the offer. ISO-NE notes that while the states can subsidize

that neither the Commission nor ISO-NE is able to arbitrate between a legitimate and an illegitimate program.

116. The IMM states that the inclusion of the word "inappropriately" in the description from the April 23 Order[92] of potential bright-line tests to distinguish OOM capacity that should trigger mitigation, from capacity that should not trigger mitigation, raises the issue of whether some price suppression is appropriate. The IMM states that as a result of this language, some parties (like JFS) have advocated that in order to determine that an offer is OOM, the IMM must find that the offer was submitted with the *intention* of suppressing price. Addressing this position, the IMM argues that the Commission should not alter the current definition of an OOM offer to include an element of intent since intent is not directly observable and without plain documentation of intent, it becomes a matter of subjective interpretation.

117. NEPGA and Boston Gen agree with the IMM, arguing that the Commission should reject proposals to exempt OOM offers from mitigation absent evidence of intent to suppress prices. In support, NEPGA argues the following: (1) the Commission recently rejected such a requirement in a NYISO capacity market case;[93] (2) the intent requirement would be extremely burdensome to implement on a case-by-case basis; (3) it is unnecessary as in many cases the sponsors of OOM resources have publicly professed their desire to artificially suppress capacity prices; and (4) to the extent that the sponsors of OOM resources truly do not intend to artificially suppress prices, they should have no objection to the appropriate correction of such price suppression effects. Further, Boston Gen notes that the buyer-side mitigation rules in PJM and NYISO use bright-line tests, which define uneconomic entry in terms of offers that are below some minimum fraction of actual or assumed costs. Boston Gen contends that the advantage of such quantitative measures is that they allow for objective application and Commission review.

118. NEPGA states that the Commission's findings in *NYISO I*[94] disprove the idea that an intent test could ever be a "simple bright-line test" as portrayed by the load parties.[95] NEPGA witness Kalt contends that all OOM resources artificially suppress prices regardless of intent and should thus be mitigated. However, Kalt argues that states should be free to pursue whatever social benefits they desire but should not benefit from

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[92] April 23 Order, 131 FERC ¶ 61,065 at P 77.

[93] *NYISO I*, 124 FERC ¶ 61,301.

[94] *Id.*

[95] NEPGA cites *NYISO I*, 124 FERC ¶ 61,301 at P 28.

Docket No. ER10-787-000,

present value of zero for the project, with the benchmark offer set to equal the year one capacity price derived from the model.[98]

130. Addressing a related point, the IMM states that under the existing rules, the minimum in-market offer price is calculated as the year-one value from a set of levelized break-even capacity prices for the project based on total project costs and revenues over the life of the project. Thus, the current methodology incorporates all costs in determining long-run average net levelized costs, rather than including only those costs that can be categorized as incremental costs at the time the decision is made to enter the capacity market. The IMM states that the assumption underlying the use of total project costs as opposed to incremental costs was that: (i) most project costs would be incurred

participated in the FCM, the IMM states that in that circumstance, the IMM would evaluate whether the offer is OOM based on the benchmark offer for a resource of the same type, not on its going forward costs.

133. NEPGA argues two points concerning the economic cost of a resource. First, it argues against JFS' position that the OOM benchmark price should be determined solely on the basis of going-forward cost after discounting all state subsidies. NEPGA contends that this would "eviscerate" the APR. In support, NEPGA states that such a rule would permit states to escape OOM mitigation since no resource would ever be found to be OOM. Second, NEPGA contends that the appropriate benchmark for OOM revenue should be full economic cost, rather than merely the lower going-forward cost. Shanker agrees with Wilson that an existing resource may offer at its net going forward costs but states that Wilson's proposal ignores the ultimate issue that the facility was uneconomic when it was built in the first place. Shanker contends that once a new unit is built, its going-forward costs provide no useful information about whether a new resource should be classified as OOM. Instead, Shanker argues that the correct measurement of costs in the context of entry decision-making is the long-

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135.

harmed by exposure to costs associated with purchases above ICR, or existing resources are harmed by depressed clearing prices and in some cases by not clearing at all due to the presence of the OOM capacity. ISO-NE states that since it is clear that load wishes for OOM capacity to clear in the FCA, then the remaining choice is whether to: (i) hold existing resources harmless for the presence of the OOM capacity by procuring capacity in excess of ICR or (ii) hold load harmless by procuring no capacity in excess of ICR, lowering the clearing price paid to existing resources and displacing some existing resources entirely. ISO-NE states that it is implicit in load's arguments (which seek to both allow OOM capacity to clear and limit the total capacity purchased to ICR) that existing resources should be required to bear the costs of allowing OOM capacity to clear in the FCM. ISO-NE counters that load has offered no justification for such an outcome, and ISO-NE believes that it would be the wrong design decision because it would undermine the effectiveness of the FCM.

138. ISO-NE argues that there are several reasons why the associated costs should be allocated to load if OOM capacity is to be permitted to clear in the FCA. First, ISO-NE states that load is "directly responsible" for the presence of OOM capacity, and therefore it is appropriate for load to bear the costs associated with having OOM capacity in the FCM, as this may provide some incentive to minimize its use. Second, ISO-NE states that sound market design requires holding existing resources harmless for the presence of OOM capacity in the FCM since they formulated their entry prices without being able to foresee the price suppressing effect of OOM capacity. ISO-NE notes that this is consistent with Commission guidance from the April 23 Order where the Commission stated its concern that the existing APR failed to fully adjust for the effect of OOM capacity on the clearing price. In addition, ISO-NE states that, as detailed previously, the two-tiered pricing element of its July 1 Proposal would provide the correct incentives to minimize the amount of capacity in excess of ICR that is procured. Last, ISO-NE argues that any purchases in excess of the ICR result in increased reliability.

139. ISO-NE argues that, for the same reasons that the costs of allowing OOM capacity to participate in the FCA should be allocated to load, the load parties' call to continue pro-rationing should also be rejected. ISO-NE states that pro-rationing imposes on existing resources the costs of

140. Addressing JFS witness Wilson's argumen

147. NEPGA witness Stoddard contends that the 20-year sunset provision[106] is unjust and unreasonable, arguing that there should be no sunset provision and the APR price should remain the default price in the market. In support, Stoddard argues that ISO-NE implicitly acknowledges that the Capacity Clearing Price represents "special case" pricing. As a result, Stoddard argues that it is inefficient to drive older yet viable resources out of the market, only to replace them with expensive new resources. Further,

resources that National Grid has already committed to acquire under contract or may prospectively procure.

150. Addressing Stoddard's argument that the sunset provision should not trigger and the Alternative Capacity Price should remain the default price in the market, ISO-NE states that fundamental in the ISO's July 1 Proposal is the assumption that decisions at the margin should face the appropriate price signals at the margin. Thus, ISO-NE argues that with respect to a new unit not yet committed or an older unit that may be facing a retirement or mothball decision, the appropriate price signal at the margin is the Capacity Clearing Price, not the Alternative Capacity Price. ISO-NE argues that Stoddard's argument that it is inefficient to drive existing resources out of the market by replacing them with expensive new resources fails to recognize that new resources (for the first five years) and existing resources that first cleared in an FCA over 20 years ago will both face the same price, the Capacity Clearing Price. ISO-NE also responds to Stoddard's 20-year "time bomb" argument by noting that the intent of this mechanism is to ensure that the market produces a just and reasonable result and does not discriminate against existing capacity – it is not in place solely to reduce the incentive to lower market prices through uneconomic entry. Further, ISO-NE contends that the proposal properly balances market objectives, and Stoddard has no quantitative analysis to support his allegation.

Carry-Forward Period for OOM Resources

151. The Mass DPU notes that, because the July 1 Proposal would carry forward OOM resources into future FCAs until offset by load growth and retirements, doing so could result in OOM resources being carried forward for "tens of years." By contrast, the Mass DPU notes that in the Joint Filing, the Filing Parties agreed on a six-year carry-forward period. The Mass DPU states that while it agrees that some carry-forward period is reasonable, there should be a limit to the carry-forward provision. JFS argues that ISO-NE's proposal is flawed since it would continue to use the IMM's estimated benchmark value to set the APR Price until this carry-forward capacity has been absorbed through load growth or retirement, despite the fact that the OOM resource itself would only receive the lower new capacity price for five years and only after that point be treated as any other existing resource.

2. Alternative Proposals

JFS Proposal

152. As noted previously, JFS states that it supports the Joint Filing as a unified package of modifications to the FCM. However, JFS states that if the Commission finds that the Joint Filing's revised APR provisions are nonetheless unjust and unreasonable and chooses to expand their applicability, it must do so in such a way that there remains a properly limited role for the APR. Reiterating the intent argument, JFS contends that the APR should not trigger when OOM does not have a price-suppression purpose. JFS

states that in order to make this distinction, the Commission should require a bright-line test to differentiate between offers from resources that seek to distort the FCA clearing price and should be mitigated and offers from resources that are either owned by those

a. Commission Determination

156. The generator parties generally support ISO-NE's revised two-tiered pricing proposal, while noting that it mistakenly fails to consider the effects of historical OOM capacity on future FCM pricing. By contrast, the load parties generally argue that no significant revisions are necessary to any aspect of the FCM as it stands today, yet if any changes are to be made, they should be the changes that were proposed in the Joint Filing which were vetted through the stakeholder process. ISO-NE states that this proceeding largely focuses on the issue of market power because "each side believes that it is fully justified in exercising market power to affect prices, but loudly decries the ability of the opposing side to exercise such market power."[107] In the context of the APR discussion, the market power issue focuses on the allegations by the generator parties that load

cost of the subsidized new resource is higher than the market price, which on first impression would seem to be financially harmful to buyers. But buyers as a whole may benefit from the subsidized resource because the lower market price may reduce the total bill for acquiring existing capacity, and this bill reduction may outweigh the net cost of the new resource.

159. ISO-NE's July 1 Proposal would remove the financial incentive to exercise buyer market power because it would raise the price paid for existing capacity back to the level that would have occurred if the new OOM capacity had offered into the auction at a competitive price reflecting its cost of entry, that is, at its benchmark price. Under the July 1 proposal, anytime an OOM resource clears the auction, two clearing prices result. All new resources, whether OOM or in-market, that offer below the Capacity Clearing Price would receive the Capacity Clearing Price, which is based on parties' actual offers. On the other hand, ISO-NE also procures all existing resources that bid below the comparatively higher Alternative Capacity Price (and pays these resources the Alternative Capacity Price), which is arrived at through the use of benchmark pricing. This mechanism would reduce or remove the incentive for buyer-side entities to subsidize uneconomic entry. However, since ISO-NE procures all existing capacity that bid below the Alternative Capacity Price as well as all capacity that bids below the Capacity Clearing Price, the mechanism results in ISO-NE procuring capacity in excess of ICR.

160. As JFS points out, requiring customers to purchase more than the ICR when the APR triggers risks causing a material increase in customers' capacity charges. These excess purchases are not needed under the FCM market design to meet New England's reliability objectives.[109] In balancing the cost of proc

161. The ISO states that it has designed its July 1 Proposal so as to balance three competing objectives: (1) allowing new OOM capacity to clear and obtain a capacity supply obligation; (2) preventing new OOM capacity from distorting the market for existing capacity; and (3) ensuring that total purchases do not exceed the ICR.[111]

162. The ISO's July 1 Proposal attempts to accomplish the first and second objectives by allowing new OOM capacity to clear while simultaneously raising the price paid for existing capacity to the price that would have prevailed if the OOM capacity had offered into the auction at a price approximating its full cost of entry. In order to make this balance work, the July 1 Proposal requires customers to purchase more capacity than is necessary to satisfy the ICR.[112] The ISO frames this feature of its proposal as a necessary consequence of clearing OOM and protecting the market.

163. However, ISO-NE has not offered a persuasive reason why, in the particular context of the design, purpose, and history of New England's FCM it is just and reasonable to require customers to incur unnecessary costs in order to purchase more capacity than the FCM was established to procure and that is needed for reliability.

164. While the capacity market designs of NYISO and PJM employ sloped demand curves that allow for the procurement of capacity in excess of their respective capacity targets, these sloped demand curves also allow for procuring less capacity than their respective capacity targets. These markets are designed such that the average amount of capacity procured over time is close to the capacity target, but the actual amount procured in any one period may be higher or lower than the target.[113] Allowing the procurement in excess of the capacity target in some periods is reasonable in these markets to offset the potential for procuring less than the capacity target in other periods. By contrast, the New England market design contains no possibility of procuring less than its capacity target. We agree with JFS that limiting purchases to the ICR is a "bedrock" principle of the FCM model. Thus, in light of the design and history of the FCM, we find the tradeoff

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[111] *See* above at P 95.

[112] Under the July 1 Proposal, customers would purchase all new capacity offered below the Capacity Clearing Price and all existing capacity offered below the Alternative Capacity Price. As a result, the total amount of capacity purchased would exceed the ICR.

[113] *PJM Interconnection, L.L.C.*, 129 FERC ¶ 61,090, at P 71 (2009).

proposed by ISO-NE, that is, requiring purchases in excess of the capacity target in order to permit all OOM to clear, to be unjust and unreasonable.

capacity market. Offer-floor mitigation would essentially eliminate one of the "rounds" of the auction proposed by ISO-NE to be employed in the two-tiered pricing proposal. Specifically, offer-floor mitigation would eliminate the auction round that permitted new resources to clear at offers below their entry costs. Instead, under offer-floor mitigation, the supply offers of all new resources (except those that are exempted from mitigation) would reflect their entry costs. The auction would select the lowest-cost set of resources needed to meet the ICR, and no more. Thus, unlike the two-tiered pricing proposal, offer-floor mitigation would spare customers the cost of procuring capacity in excess of the ICR – excess capacity that is not needed to meet ISO-NE's reliability objectives.

168. Under such a regime, not only will the FCM procure just the ICR and no more, but resources initially classified as "OOM" will not necessarily be precluded from clearing, because a resource seeking to offer below its benchmark will have the opportunity to justify its costs with the IMM. If justified, such a resource will be permitted to bid its actual costs. Furthermore, as we state elsewhere/below, nothing in this order shall be construed to limit the ability of any party to come before the Commission to argue that it should be exempt from the minimum offer price.

169. Accordingly, we will require ISO-NE to address offer-floor mitigation through the stakeholder process. As noted in the "Timing" section below, we will require ISO-NE to include the expected timeframe for this stakeholder process in its schedule for filing market rules in accordance with this order on paper hearing within 30 days of the issuance of this order. Specifically, this stakeholder process should develop tariff revisions to implement buyer-side mitigation in the FCM that would impose offer floors on new resources offering into the FCM auctions. The filing should include a description of all of the details needed to implement the mitigation method, as well as support for the proposed specifics. Among other things, the filing should include proposals to address the following issues. First, consistent with ISO-NE's proposal to implement benchmark pricing under the July 1 Proposal, the filing should include a set of proposed estimates of the applicable costs of new entry for various categories of new resources, a process for revising these estimates over time, and a proposal establishing offer floors for various categories of resources based on these cost estimates (e.g., whether the offer floor threshold should equal 80 percent of the applicable cost of entry versus some other level). The second issue is the process for individual resources to request a different, resource-specific, offer floor based on resource-specific data. The third issue is how long a resource should be subject to an offer floor and/or what conditions should be met before

State Policy

170. The Commission acknowledges the rights of states to pursue policy interests within their jurisdiction. Our concern, however, is where pursuit of these policy interests allows uneconomic entry of OOM capacity into the capacity market that is subject to our jurisdiction, with the effect of suppressing capac

the FPA to request a mitigation exemption. At that time, we will evaluate the merits of a proposed exemption.

Benchmark Pricing/Offer Floor Price

172. As noted previously, among other issues, the load parties argue that ISO-NE's proposal to employ benchmark pricing as part of its two-tiered pricing proposal is flawed, contending that the ISO does not submit any "defensible"[119] criteria to identify an objective benchmark bid. Further, in contrast to ISO-NE's proposal to replace the bids for that resource in every FCA where the resource is carried-forward, the load parties aver that even if the IMM applies the correct replacement offer for a resource in the first FCA in which the resource offers, such an offer "will have no bearing" on the bids for that resource in future FCAs. Instead, the load parties argue that once operational, the resource's entry costs are sunk and it will only need to cover its going-forward costs. By contrast, the generator parties are generally supportive of benchmark pricing but (as addressed elsewhere in this order) raise a concern whether the IMM's current OOM evaluations for demand resources are comparable with those for generators. While we are not accepting ISO-NE's two-tiered pricing proposal, we note that offer floor price mitigation raises essentially the same concerns as benchmark pricing since both involve the determination of a resource's true competitive price. As such, we will address the general objections to benchmark pricing raised in the paper hearing.[120]

173. As noted in the IMM's September 29, 2010 brief, this Commission has previously approved the use of benchmark pricing in the context of PJM's capacity market to address buyer and seller market power, providing PJM's IMM with the ability to mitigate non-competitive bids.[121] In fact, ISO-NE states that it might develop the benchmark offers "in conjunction with Monitoring Analytics, PJM's Independent Market Monitor," since these values will be recalculated soon for PJM's RPM, which employs an offer price floor.[122] In any case, the IMM has committed to developing the benchmarking methodology "in consultation with stakeholders" and to include the resulting values in a

[119] JFS Second Brief at 33.

[120] Because we are not approving ISO-NE's two-tiered pricing proposal, we will not address benchmarking comments that are specific to ISO-NE's July 1 Proposal, including concerns over the manipulation of two-tiered pricing, the sunsetting of the Alternative Capacity Price, etc.

[121] *See PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,331.

[122] ISO-NE First Brief at 30.

Tariff filing with the Commission.[123] In addition, the IMM states that it will post and periodically update these values on ISO-NE's website.[124] While we are requiring the implementation of offer-floor mitigation rather than benchmarking, we find that these analogous commitments should be implemented and should address the transparency concerns raised by those parties that argue that this process remains largely undefined.[125]

174. Addressing the concerns raised by the load parties about the IMM's ability to calculate a proper benchmark price (or an offer-floor price as required by this order) due to "myriad assumptions that are highly subjective,"[126] we first reiterate that this methodology will be developed in consultation with stakeholders as noted above. As such, we find these concerns to be premature at this point. Further, we note that the IMM presently reviews offers from "new" resources below 0.75 * CONE for buyer market power and various de-list bids of existing resources above their respective thresholds to assess seller market power. Included in that review process is the ability for the IMM to reset non-competitive seller offers, subject to Commission review. In making its argument that this proposed benchmarking mechanism will be "crude" and "error-prone,"[127] JFS fails to distinguish the IMM's role under the proposed benchmarking proposal from the IMM's current responsibilities in this regard..

175. The IMM also proposes a revised benchmarking methodology to address incremental cash flows. Under this methodology, benchmark offers would be calculated for different types of resources, based on the incremental cash flows to the benchmark project as of the date of the auction. The incremental cash flows are those that would be avoided if the benchmark resource does not take on a Capacity Supply Obligation. As we understand the IMM's proposal,[128] incremental cash flows would be calculated assuming

that construction of each benchmark resource would be completed shortly before the beginning of the commitment period. As a result, benchmark resources with lead times less than three years would be assumed not to begin construction until after the conclusion of the applicable FCA. Thus, the benchmark offer (and floor price) for most types of resources would reflect most, if not all, of the resource's construction costs. The exception would be for any project with a very long lead time (e.g., baseload nuclear and coal steam plants), where most construction costs would necessarily be incurred before

permit the exercise of buyer-side market power. As noted earlier, a long-lead-time resource must necessarily begin construction several years before the first FCA into

179. JFS witness Wilson argues that, after the first year in the capacity market, a resource would only need to recover its going-forward costs, and therefore ISO-NE's proposed benchmark prices/floor prices (which for most resources reflect most or all of the resource's long-run levelized costs, net of wholesale revenues) are an improper measure of such offers. But while we agree that a compet

purported problem since the location of a resource physically within the ISO-NE control area does not ensure that the resource contributes to the reliability and market efficiency of New England. Rather, HQUS and BEMI argue that capacity suppliers located both within and outside of the ISO-NE control area may choose where to sell their capacity (existing resources only have a one year capacity obligation), and they may import or export their capacity accordingly.

183. Therefore, HQUS states that, in addition to considering whether an importer has made a "significant investment" in providing capacity in the New England market, ISO-NE should assess the commitment of the importer – i.e., whether the importer is committed to providing capacity to New England on a long-term basis (like HQUS) or simply attempting to leverage positions in multiple markets on a short-term basis. HQUS states that these criteria could include commitments to build transmission lines to deliver capacity to New England, a commitment to build and maintain generation capacity to supply New England markets, a demonstration of a history of capacity sales to the region, or a long-term bilateral contract with a load-serving entity in the ISO-NE region. HQUS states that these commitments would provide ISO-NE with a method to identify and appropriately compensate those capacity sellers that are providing significant long-term benefits to the New England market.

184. ISO-NE argues that the price imports receive should not be based on whether or not they are similar to other classes of resources. Instead, ISO-NE argues that the price should be based on setting the ri

(not on a year to year basis) receive a proper price signal from the Alternative Capacity Price. ISO-NE argues that there is no market design rationale for using the higher Alternative Capacity Price to incent the development of additional resources outside of New England since the capacity price does not generally drive such investments, and paying it would be a waste of consumers' money.

186. Last, ISO-NE refutes HQUS's argument that the new vs. existing framework central to the APR should apply equally to imports. In support, ISO-NE notes that the distinction between new and existing resources is difficult to apply to imported capacity since it raises a fundamental question as to how an importing resource should be defined – as the physical generator providing the capacity or the commitment or contract to provide capacity to New England from external sources. ISO-NE states that it has struggled with related issues such as whether the "long-term" contract can be readily terminated, and what recourse exists if an existing import, backed by a long-term contract, fails to participate in an FCA. ISO-NE disagrees with the arguments of HQUS and BEMI that their historical imports provide a basis for receiving the Alternative Capacity Price; ISO-NE contends that such imports may simply indicate relative pricing and do not indicate whether investments have been made. By contrast, ISO-NE does indicate that it would support development of rules that allow capacity imports utilizing historical investments to be eligible for the Alternative Capacity Price on a case-by-case basis.

187. In response to BEMI's concern about how ISO-NE proposes to treat "in-between" imported resources (i.e., imports whose offer prices are above the Capacity Clearing Price but below the Alternative Capacity Price), ISO-NE clarifies that in-between imports would not clear in the capacity auction nor receive a capacity obligation, except for

in a given zone and in a given auction. Thus, all resources in a given zone, including imports, that are accepted in a given auction would receive the same clearing price.

190. However, we must address the issue of how imports are to be treated with respect to the offer floors that we are requiring. In particular, we must address which (if any) imports are to be subject to the offer floor. In this regard, we agree with ISO-NE that it is generally difficult to determine what resource or set of resources is supporting an import and whether the supporting resource or set of resources is new, existing, or should only be considered in terms of the import cont

entrants will appear since existing suppliers cannot expect to consistently recover even their going-forward costs. Rather, NEPGA contends that New England will be forced to rely on RMR contracts and bilateral agreements and forgo the efficiencies of competitive markets.

195. BG Entities notes that due to the sensitivity of the FCM's vertical demand curve to small changes in capacity, and because the amount of new capacity needed each year is relatively small, the IMM properly emphasized that even a relatively modest amount of out-of-market entry can displace in-market entry and prevent the auction from clearing based on competitively priced offers.[137]

196. In support of "carrying-forward" historical OOM capacity, NEPGA contends that there is "ample evidence" that load parties have sought to artificially suppress capacity prices below competitive levels during the FCAs held to date. For example, as discussed in the April 23 Order, NEPGA states that Connecticut entered into a contracting process with new resources that included specific requirements on how to bid into the FCM (as price-takers under contracts-for-difference), "driven by the objective of obtaining a New England-wide price impact in the FCA" to lower costs for Connecticut ratepayers.[138] BG Entities states that, regardless of whether the participation of state-supported OOM capacity in the first three FCAs is properly characterized as the exercise of buyer market power, it is indisputable that the ability to suppress prices without a proper corrective APR is a fundamental flaw in the design of the FCM. Boston Gen argues that exempting this "egregious" Connecticut historical OOM capacity would reward past exercises of buyer market power and market manipulation - Boston Gen argues that the CT DPUC's conduct in designing the RFPs to reduce the FCM market clearing price constitutes market manipulation within the meaning of section 222 of the FPA and section 1c.2 of the Commission's regulations. Boston Gen argues that what makes CT DPUC's scheme manipulative is not that it sought to increase the amount of installed capacity in Connecticut, but that it evaluated competing projects based on the portfolio-wide

[137] BG Entities Second Brief at 4 (citing Internal Market Monitoring Unit, *Review of the Forward Capacity Market Auction Results and Design Elements*, Docket No. ER09-1282-000, at 5, 43 (June 5, 2009) (IMMU Report).

[138] NEPGA First Brief at 28-29 (citing *DPUC Investigation of Measures to Reduce*

was a product of OOM payments. In addition, NEPGA also notes that all of this new OOM entry occurred without the APR ever having triggered.

199.

201. Boston Gen avers that market participants have no entitlement to the continued availability of exemptions from mitigation, particularly where the exemption has been shown to have facilitated the exercise of market power. BG Entities similarly contends that that carryover of excess OOM from the first three auctions would not adversely affect participants who built generation based on market rules without an OOM capacity "carry forward" provision, since those participants would still receive a capacity obligation and the related capacity payments if their offers are carried forward into future auctions. Further, BG Entities notes that these OOM resources would continue to receive the same clearing price (the Capacity Clearing Price) that they would have received absent the changes proposed herein, which is the price anticipated at the time they bid the OOM resources into any of the first three FCAs. By contrast, BG Entities argues that not carrying forward the historical OOM capacity would prevent other market participants from receiving just and reasonable rates. Boston Gen argues that CT DPUC's request that the Commission accept the proposed exemption based on its purported detrimental reliance on the existing APR is barred by the doctrine of "unclean hands," which "closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief"[145] (since Boston Gen views the CT DPUC's procurements of additional capacity as a deliberate attempt to manipulate the capacity price). Boston Gen argues that the Commission must reject CT DPUC's claim, both to maintain the credibility of its policy to prevent the exercise of buyer market power and to ensure the long-term viability of the FCM.

202. Addressing load's concerns that mitigating historical OOM would be retroactive ratemaking, NEPGA, BG Entities, and Boston Gen state that they do not seek retroactive changes to prior auction results, nor to change what resources bid in past auctions. Instead, they state that they are concerned only with how the OOM supply that entered in the first three FCAs will be treated in future auctions and that treating this capacity as "carry-forward" OOM capacity is not retroactive ratemaking. In addition, addressing ISO-Ny teTd on 4.93rO8o goactive

203. NEPGA witness Milgrom similarly contends that, in order to promote competitive markets, mitigation should seek to quickly restore future market prices to competitive levels – ones unaffected by any attempt to exercise market power. Milgrom contends that a predictable policy of mitigating market power can achieve two kinds of benefits. First, it both corrects the market prices today to competitive levels and promotes a belief among market participants that future prices will be free from manipulations. Second, Milgrom states that such a policy will promote the expectation that "ill-gotten" gains from market manipulations will be small, because the benefits of long-term market manipulations will be cut short. NEPGA witness Kalt similarly notes that nothing will change the fact that state authorities control large blocks of load, allowing the underlying source of buyer market power to remain intact. However, he argues that addressing monopsonistic manipulation without addressing "benefits" attributable to prior "manipulative conduct" would inappropriately incentivize large buyers to look for other approaches to depress FCM prices.

204. NEPGA argues that, in this case, being subjected to mitigation is either a neutral or a positive thing since it will only increase the bid levels of OOM offers that clear anyway in this market design. As such, NEPGA states that mitigation would increase the capacity revenues paid to these resources. NEPGA argues that the only reason for historical OOM to oppose this outcome is if these resources are intentionally seeking to artificially distort auction clearing prices downward.

205. Addressing the NYISO precedent discussed in the April 23 Order and cited as support in the briefs of JFS,[146]

Gen's accusations regarding the propriety of the CT DPUC procurements to be "baseless" as they ignore that: (1) CT DPUC undertook these procurements pursuant to the Connecticut General Assembly's directive; (2) the procurements address the Commission's and ISO-NE's concerns about resource adequacy in Connecticut; and (3) they relied on the terms of the FCM Settlement. JFS states that inefficient existing generators that accepted the floor price without de-listing should not be allowed to argue that the price they voluntarily accepted was inadequate.

209. Addressing Boston Gen's accusations that the CT DPUC procurements constitute a fraud in violation of section 222 of the FPA, JFS argues that section 201(b) of the FPA and precedent fully protect states' authority to award bilateral contracts to address their identified needs and to further state policy objectives. Further, JFS contends that states are protected by the state action doctrine from allegations that their official conduct constitutes an unlawful exercise of buyer monopsony power. JFS states that both the 2005 Connecticut Energy Independence Act and 2007 Act Concerning Electricity and Energy Efficiency responded to Commission guidance and addressed legitimate state objectives and provided significant social value. Addressing the allegations concerning CT DPUC's decision to employ a contract for difference (CFD) construct to pay these resources, JFS maintains that CT DPUC adopted the CFD provisions so that projects would recover their expected costs but would not set price and earn "excess profits" in the ISO-NE markets. Further, JFS states that it chose this approach because the FCM settlement provided a one-time allowance for new resources to participate as an existing resource during the first FCA to avoid triggering the APR. JFS contends that its procurements relied on the market rules that were in place and there is no basis for retroactively changing that construct to create a carry-forward for OOM capacity. Last, JFS contends that generator proposals that require the IMM to revisit prior OOM determinations are outside the scope of this proceeding and collaterally attack the

FPA, which preempts state laws and regulations that mandate or authorize conduct prohibited by the FPA. Boston Gen states that jurisdictional sellers have a constitutional right under the Fifth Amendment of the U.S. Constitution and a statutory right under the FPA to receive compensatory compensation.

211. Similarly, NEPGA contends that the state action doctrine does not apply for several reasons. First, NEPGA argues that the state action doctrine is not a general ban on accusations that states may have exercised market power. In support, NEPGA argues that JFS fails to cite a single case where a court has found the state action doctrine to be applicable to the FPA. Further, NEPGA argues that the Commission has already rejected the state action doctrine in the wholesale rate context.[149] Last, NEPGA avers that even if the state action doctrine was applicable to the FPA, it would not further JFS's position. NEPGA states that the state action doctrine confers immunity against suit under the Sherman Act to states, but this case does not involve a suit under the Sherman Act against any state and any immunity that states may have in other contexts is irrelevant to this proceeding.

212. JFS notes that all of the proposals offered in the paper hearing include provisions that are implicitly or explicitly intended to set a price floor. By contrast, JFS states that the Joint Filing proposed an explicit temporary fixed floor. JFS states that the fixed floor from the Joint Filing is preferable to the implicit alternatives since, among other things, it is transparent and predictable. As such, JFS urges the Commission to consider whether the Joint Filing's proposed capacity floor through the sixth FCA may provide the best short-term solution to the historical OOM issue. In support, JFS notes that no party opposes a continuation of the price floor. JFS states that the stakeholders and the Commission can then address any additional need for a floor beginning with the seventh FCA.

c. Commission Determination

213. As noted previously, we accept the Joint Filing's proposal regarding the treatment of historical OOM. Specifically, we agree that historical OOM resources should not be subject to mitigation; however, as we have also stated, we agree that the price floor should remain in place until revisions to the current APR are implemented, after which the price floor should expire.[150]

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[149] NEPGA cites *S. Cal. Edison Co.*, 51 FERC ¶ 61,284, at 61,892 (1990).

[150] As stated previously, we note that this may require ISO-NE to make a subsequent filing to extend the price floor beyond the sixth FCA (depending on the

(continued…)

eliminate any reference to the CONE parameter (as discussed later in this order). Therefore, we will require ISO-NE to retain only this function of the CONE parameter until the price floor is eliminated, and this requirement should be incorporated into the subsequent development of market rules stemming from this order; this does not otherwise affect our decision to approve ISO-NE's July 1 Proposal to eliminate all other functions of the CONE parameter on a prospective basis. Further, we find that the subsequent market rules should incorporate the elimination of this sole function for the CONE parameter upon our appr

of the APR is an integral part of its regulation of capacity costs, which, as discussed, are a large component of wholesale rates. Although this proposal by definition results in the "regulation of matters relating to generation," such regulation is a byproduct of a legitimate exercise of the Commission's power to regulate wholesale rates under the FPA.

5. Self-Supply/Hedging

a. July 1 Proposal

221. In its revised APR proposal, ISO-NE proposes to continue to treat new self-supply as OOM capacity, consistent with its current Tariff.

b. Comments and Responses

222. Addressing the self-supply issue as it relates to the APR, EMCOS witness Wilson contends that the current market rules (specifically, section III.13.1.6 of Market Rule 1) preclude any possibility of price suppression by the simple means of concurrently removing both the self-supplied capacity and the load it is obligated to serve from the FCA. As a result, EMCOS argues that there is no price suppression resulting from self-supply that could require mitigation. Further, EMCOS states that because self-supply is capped at the relevant LSE's share of the ICR, self-supply cannot contribute to a surplus of capacity that suppresses future prices. Therefore, EMCOS argues that there is no justification for ISO-NE's proposal to re-price self-supplied capacity in accordance with a "silly" benchmarking pricing mechanism. Further, EMCOS contends that buyer-side market power is a "chimerical construct" that has no application to municipal self-supply.

223. EMCOS further contends that self-supply was never intended to be subject to price mitigation in the FCM, and therefore self-supply should remain outside of the scope of any APR developed in these proceedings. Rather, EMCOS argues that under the original APR, new self-supplied FCA resources were only "lumped" with OOM resources to "simplify the representation of those resources as price takers in the Forward Capacity Auction."[160] EMCOS contends that this "did not pose a problem" since any re-pricing under the original APR would reset to the lower of (i) $0.01 below the price at which the last bidder withdrew from the auction or (ii) CONE. EMCOS states that it takes no position on whether resetting FCM prices for OOM capacity that clears the FCA may be

appropriate in contexts other than self-supply. EMCOS argues that the various proposals to re-price capacity from this proceeding would have three undesirable effects on self-supplied resources: (1) the ability of load-serving entities to hedge their ICR obligations through self-supply (either owned generation or purchased power) would be impaired or eliminated; (2) prices resulting from the FCA would be artificially increased over prices that would prevail if self-supply were allowed to operate as intended with no gain in efficiency or consumer welfare; and (3) increased reliance on administered pricing would promote inefficient entry at high prices, resulting in excessive costs to load. In order to avoid this scenario, EMCOS contends that any set of FCM revisions that may derive from this proceeding should specify that there should be no re-pricing of self-supplied FCA resources.

224. Public Systems contend that ISO-NE

228. NEPGA witness Shanker states that Wilson's argument suggests that as long as any procured self-supply equals or is less than demand, the fact that new resources can be used, even when there is a surplus, is irrelevant and does not impact the market. Shanker states that this argument is false since, if the decision were to procure *new* uneconomic supplies bilaterally when cheaper existing resources were available, the overall level of supply would be expanded, and prices, but for mitigation such as the proposed APR, would be artificially depressed. Shanker states that this is why the cited Tariff provision appropriately recognizes that new self-supply is OOM.

229. NEPGA contends that contrary to the arguments offered by load parties, an OOM designation does not lock a self-supplied resource out of the market. Instead, NEPGA states, the principal effect of an OOM designation is that, for purposes of setting the APR price, its offer is mitigated to a price reflecting its levelized cost of new entry while its offer in the FCA auction remains unaffected. NEPGA states that, for an efficient resource (with costs below the APR clearing price), this change has no effect. It clears, regardless of its offer, and the APR clearing price is the same as if the resource had not been designated as OOM. NEPGA notes that only inefficient new self-supply (self-supply with costs above the APR clearing price) would be affected by OOM designation, but it is unclear why load would be eager to protect inefficient new self-supply, which, by definition, costs more than the APR price.

c. Commission Determination

230. Although we are not approving ISO-NE's two-tiered pricing proposal, we disagree with EMCOS' contention that self-supply would not result in price suppression, and agree with ISO-NE that it is reasonable to continue to treat new self-supply as OOM capacity, consistent with the current Tariff.. We agree with ISO-NE that, compared to the capacity price that would exist in a base case where a new resource offered into the capacity market competitively at its full net entry cost, the effect of self-supplying the resource without buyer-side mitigation would be the same as if the resource were allowed to bid zero into the auction.

231. For example, suppose that a new 200 MW resource would not clear if offered at its full net entry cost and, thus, that its full net entry cost was above the Capacity Clearing Price. Compared to this base case, self-supplying the resource would remove 200 MW of load from the auction without changing the amohTw(c.auction without ch 0 TD0h am)]189 0 t chabe a6

demand in the self-supply case would have the same price effect as a 200 MW increase in supply when the resource offers a zero price.

232. Since new self-supply has the same price effect as offering the new resource at a price of zero, it is reasonable to treat the resource as OOM in both circumstances. Failure to classify new self-supply as OOM would allow the mitigation mechanism to be circumvented. Importantly (as noted by load parties), while the April 23 Order states that the briefs in this proceeding "should include a discussion of how APR mitigation can be constructed so that load is able to hedge its capacity obligation outside of ISO-NE's capacity market with bilateral contracting," it also states that "such bilateral contracting [should] not distort the capacity market clearing price."[162] As indicated in the prior example, we find that any new self-supplied capacity that clears (through a zero-price offer rather than at full net entry cost) would distort the market clearing price. Therefore, we find that new self-supply offers should be subject to offer-floor mitigation.

6. Demand Curve

a. Comments and Responses

233. ISO-NE contends that if the Commission rejects two-tiered pricing and instead directs that all resources clearing in the FCA receive payments based on the relatively higher Alternative Capacity Price, it would then be appropriate to consider including an administrative demand curve in the FCM design. ISO-NE states that it did not consider such a proposal since it would completely abandon one of the core FCM design elements – purchasing only the ICR in the FCA.[163] ISO-NE argues that if the ICR limit on capacity purchases were abandoned, then a demand curve would impose some "rationality" on the procurement process, reducing the cost to consumers of purchasing additional capacity.

234. While acknowledging that it would be controversial, NEPGA similarly requests that if the Commission does not fully reform the APR, it should adopt a sloped demand curve. Boston Gen states that the Commission should explore alternatives like a demand curve if it is not prepared to mitigate all OOM entry. NEPGA notes that such a design has been adopted by NYISO and PJM in order to avoid some of the problems at issue in this hearing. NEPGA states that the adoption of a demand curve need not interfere with the descending clock auction of the FCM design. Rather, NEPGA proposes that the

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[162] April 23 Order, 133 FERC ¶ 61,065 at P 77.

[163] ISO-NE notes that, by contrast, the two-tiered pricing mechanism seeks to keep the overpurchase to a minimum.

auction should open at the ceiling price for capacity and the minimum quantity required. NEPGA states that as the auction continues the price would gradually decrease and the quantity would gradually increase with the auction stopping when the amount of resources offered matches the current quantity.

235. Further, NEPGA states that the "sole argument" in favor of a vertical demand curve – that it assures that the amount of capacity procured exactly matches the ICR –

demand curve could work. JFS states that Bidwell argued there that an administratively determined demand curve will rely on non-market inputs that are arbitrary in nature. JFS contends that in consideration of his prior LICAP testimony, the Commission should not credit Bidwell's position here. Further, JFS contends that Bidwell's proposed elastic curve would be unjust and unreasonable as it would be relatively flatter than previous curves considered for New England. As such, JFS avers that this demand curve would improperly require payment to virtually all existing resources with no price signal to retire when there is a capacity surplus.

b. Commission Determination

239. As we are requiring ISO-NE to implement offer-floor mitigation, we find the arguments addressing the pros and cons of a potential demand curve to be moot. To the extent that generator parties request a downward sloping demand curve to address other issues in this proceeding (including the revised dynamic de-list bid threshold under the July 1 Proposal), we note that our approval of the general framework of ISO-NE's July 1 Proposal on zones and market power mitigation also moots these additional rationales.

7. Demand Response Comparability in OOM Determination

a. Comments and Responses

240. Boston Gen argues that the FCM rules should be revised to treat demand response resources and generation resources comparably for the purposes of assessing whether capacity is OOM. Boston Gen asserts that the current rules understate demand response resources' costs by failing to account for their opportunity costs and subsidies paid to consumers. Boston Gen and NEPGA claim that, as a result, a substantial amount of these resources have entered in the market as unaccounted-for OOM capacity. Boston Gen contends that the subsidies provided to such resources have and will continue to affect the FCA price. In addition, Boston Gen states that the Tariff "appears" to require the IMM to calculate demand response resources' long-run average costs for OOM purposes in a manner that ensures that these costs will be less than or equal to zero, meaning that a demand response resource would not be considered OOM until the FCA clearing price drops to zero.

241. In response, the IMM reiterates that the relevant Tariff provisions approved in the April 23 Order were clarifying in nature and did not change the basic principle that differentiates OOM capacity from in-market capacity.[164] Further, the IMM notes that,

[164] The IMM states that the current rule applies standard accounting and valuation techniques to determine whether an offer below 0.75 * CONE is consistent with the

(continued…)

while the methodology is the same for demand resources and generating resources, the implementation (principally the input data) of the analytical framework differs for demand resources and generation, respecting the differences between the resources types. At a high level, the IMM states, the analysis of what determines whether an offer from a demand resource should be found to be OOM involves the following steps: (1) measure the total costs of the demand resource regardless of who incurs the costs;[165]

243. Further, the IMM addresses Boston Gen's argument that, under the current Tariff, a demand resource could not be considered OOM until the FCA clearing price drops to zero or to negative prices, if possible. The IMM notes that the analysis and example supporting Boston Gen's conclusions are incorrect; the IMM states that Boston Gen's cited example does not include any opportunity cost for the reduction in consumption. The IMM notes that the "appropriate standard" for the review of offers is a comparison of the offer to the present value of the net cash flows to the project, regardless of the allocation of project costs and benefits among the different parties.

b. Commission Determination

244. Boston Gen and NEPGA continue to assert (consistent with their positions reflected in the April 23 Order and the August 12 Order) that (1) subsidized demand response is largely responsible for the FCM clearing at the price floor in all four auctions held to date and that (2) the IMM's analysis inappropriately ignores opportunity costs for demand resources when assessing whether their offers are OOM. We have previously noted that the IMM has stated that the first three FCAs would have reached the administrative price floor even absent the OOM capacity.[167] In addition, we also considered these arguments in our August 12 Order where we denied NEPGA's motion for disclosure of information considered by the IMM as it determined whether it considered resources to be OOM for prior FCAs. Our basis for denial was that "NEPGA has not provided any basis for the Commission to reexamine the IMM's OOM determinations from the first three FCAs."[168] The Commission noted that NEPGA failed to acknowledge the "uncontradicted representation" that the relevant rule clarifications "do not change the current Tariff's basic principle that differentiates out-of-market capacity from in-market capacity."[169] Last, we stated that "we will not permit NEPGA to expand the scope of the paper hearing in this case" to revisit the IMM's historical OOM determinations.[170]

245. In the paper hearing, the generator parties continue to assert that the IMM has not properly assessed OOM capacity to date, with Boston Gen and NEPGA arguing that demand resources have improperly entered this market in significant quantities without being determined to be OOM. For example, NEPGA witness Stoddard argues that,

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[167] April 23 Order, 131 FERC ¶ 61,065 at P 150.

[168] August 12 Order, 132 FERC ¶ 61,122 at P 56.

[169] *Id*. P 56 (citing Joint Filing, Transmittal Letter at 20).

[170] *Id*. P 58.

Boston Gen and NEPGA seek to update the historical OOM quantity, such analysis would be moot.

8. Joint Complainants' Takings Argument

a. Joint Complainants' Argument

248. Joint Complainants assert that "[t]he Commission has an obligation to ensure that capacity suppliers are afforded the opportunity to receive compensatory rates, which in this case means providing capacity suppliers a reasonable opportunity to recover their fixed and variable costs, plus a profit."[175] They state that this obligation is grounded in the prohibition against takings of private property for public use without just compensation, found in the Fifth and 14th Amendments to the U.S. Constitution. Joint Complainants cite to *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*,[176] which states that "[r]ates which are not sufficient to yield a reasonable return on the value of property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."

249. Joint Complainants state that the courts look to three factors in determining if an action constitutes a compensable regulatory taking: (1) the economic impact of the regulation on the seller; (2) the extent to which the regulation interferes with the seller's investment-backed expectations; and (3) the character of the governmental action. Applying these rules, Joint Complainants assert that the impact of dysfunctional FCM rules on the fair market value of generating resources in New England is substantial, with many units anticipated not to make a profit, even over the long run; it also states that many market participants, including NRG and PSEG, entered into the market in reliance on the Commission's assurance that the New England markets would permit units to have a reasonable chance of recovering their fixed costs of new entry, plus a profit, over a reasonable long-run horizon. Joint Complainants acknowledge that the Commission's stated goal has always been to ensure that capacity suppliers receive just and reasonable compensation, but assert that unless the Commission addresses the flaws in the FCM

[175] Joint Complainants First Brief at 26.

[176] 262 U.S. 679, 690 (1923) (*Bluefield*). Joint Complainants also cites to *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (*Hope*) (stating that "just and reasonable" rates must provide "enough revenue not only for operating expenses but also for the capital costs of the business" and be sufficient for the utility to "maintain its credit and attract capital").

construct, the operation of the market rules in New England in their current form will have the effect of depriving capacity suppliers of the value of their private property.[177]

250. Joint Complainants further state that the Commission has recognized this principle in recent cases, citing to a case in which the Commission addressed concerns that "ISO-

Docket No. ER10-787-000,

costs.[182] The Commission has made clear that "'in a competitive market, the Commission is responsible only for assuring that [a resource] is provided the *opportunity* to recover its costs,' not a guarantee of cost recovery."[183]

255. Moreover, resources are not compelled to participate in the FCM; the FCM market design provides each resource with the ability to choose whether or not to remain in the FCM. Each existing capacity resource chooses each year what kind of de-list bid to submit, and, if it anticipates that the capacity price may not meet its needs, may choose a type of bid that will permit it to retire its resource if it does not receive an acceptable price. If, however, a resource chooses not to do so, then it must accept the price at which the market ultimately clears. The Commission made clear in a recent case that resources should choose their capacity bids carefully, with attention to the consequences, recognizing that, if a resource so wished, it could select a de-list bid that would not require it to provide capacity at what it might consider to be an unacceptable price.[184]

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[182] If we were to allow a rate that recovered more than a traditional cost-based rate when the market rate exceeded that traditional cost-based rate, but then allowed a traditional cost-based rate when the market rate dropped below that traditional cost-based rate, such a "higher of cost or market" regime would inevitably produce a rate that not only would guarantee cost recovery (not just the opportunity for cost recovery), but likely would guarantee more than cost recovery. Such a rate would be unjust and unreasonable.

[183]

Thus, there can be no question of confiscation of a resource's property by compelling it to continue providing service.

256. The two cases Joint Complainants cite are not on point. In the 2007 ISO-NE case where the Commission addressed the possibility that "ISO-NE's market rules, as proposed, could result in compelling an existing generating resource being required to offer capacity at a price less than its net risk-adjusted going forward and opportunity costs," so that "confiscatory ratemaking" might result,[185] the Commission was addressing a situation in which a generator had already chosen to submit a de-list bid that would require it to stay in the market, and that required discussions with the IMM before the de-list bid could be entered in the auction. The Commission's concern was to ensure sufficient fairness to the resource during discussions with the IMM, and ISO-NE submitted a compliance filing resolving the Commission's concerns which the Commission subsequently accepted.[186] Similarly in *PJM*, the Commission was considering a different kind of problem – namely, whether existing capacity resources could be required to continue providing capacity to PJM for longer than a specified brief period, once they indicated their intent to retire – and it was in response to this question that the Commission stated that "[i]t is questionable whether . . . the Commission could enforce[] a requirement that generators continue to operate at a loss."[187] We emphasize that we have thoroughly reviewed all the various proposals and comments submitted in these consolidated proceedings and considered the various parties' concerns and positions. Given this, we reject the claim that our actions in approving any specific modifications to the FCM rules amount to a "taking" without due compensation.

257. It is, therefore, inaccurate for Joint Complainants to suggest that as a general matter, they are being compelled to provide capacity to ISO-NE at a confiscatory price. As shown above, each capacity resource in ISO-NE is provided with a choice. If a resource decides, after assessing its own business plan and needs, that participation in the FCM is right for it, it must accept the capacity price that results from the operation of the FCM auction, which may or may not be a price that enables a resource to cover its costs and earn a satisfactory profit. But if a resource does not wish to take that risk, nothing

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> costs at issue here, for the period when its resource was needed for reliability, while giving up the opportunity to receive revenues in excess of its costs in future years.

[185] *ISO New England Inc.*, 120 FERC ¶ 61,087 at P 52.

[186] *ISO New England Inc.*, 121 FERC ¶ 61,070 (2007).

[187] *PJM*, 115 FERC ¶ 61,079 at P 36 (footnote omitted).

compels it to do so. Thus, there can be no question of confiscation under the Fifth Amendment.

C. Zones and Market Power Mitigation

1. April 23 Order

258. While accepting certain revisions related to the modeling of zones outright,[188] in the April 23 Order establishing this paper hearing, the Commission directed parties to comment on the following: whether zones should always be modeled, whether all de-list bids should be considered in the modeling of zones, whether a pivotal supplier test is needed, and whether market power mitigation should be revised if zones were always modeled. Importantly, while the April 23 Order approved certain rule revisions that made it more likely that certain de-list bids would trigger the formation of additional zones (pending the outcome of this paper hearing), that zonal determination still was performed before the auction.[189]

2. The July 1 Proposal

259. In response to the April 23 Order, ISO-NE proposes to model all zones all the time in order to allow for a greater possibility of price separation during an auction.[190] Key elements of the zonal proposal are: (1) the use of eight energy load zones as initial capacity zones; (2) the use of a stakeholder process for vetting future zonal designations; (3) the expanded use of de-list bids to trigger zone formation; and (4) revisions to the descending clock auction. However, because smaller zones are more vulnerable to the exercise of market power, ISO-NE also proposes corresponding revisions to the market power mitigation measures. Key elements of the proposed market power mitigation rules are: (1) revisions to the dynamic de-list bid threshold; (2) revisions to the calculation of

[188] For example, the Commission approved setting the LSR for an import-constrained zone equal to the capacity needed to satisfy the higher of (i) the LRA or (ii) the TSA.

[189] Capacity zones would be established only when the existing internal resources for an import-constrained zone could not satisfy the LSR.

[190] In other words, ISO-NE will model zones regardless of whether the projected installed capacity in the import-constrained load zone is less than the load zone's LSR.

static and permanent de-list bids;[191] and (3) elimination of the pivotal supplier test. Additionally, ISO-NE proposes to eliminate the quantity rule.

3. Model All Zones All the Time

260. In its July 1 Proposal, ISO-NE emphasizes that its current use of large zones makes it difficult to properly reflect electrical constraints, resulting in the need to reject de-list bids and to pay these resources an out-of-market price. ISO-NE states that this scenario happened during the first and third FCAs. Under the current rules, the rejection of a de-list bid results in a resource being compensated at its offer price while the other resources in the zone receive the pool-wide price. If capacity zones are modeled all of the time, ISO-NE argues that a local reliability need would have a greater chance of being met with resources clearing in the market rather than rejected de-list bids. However, ISO-NE notes that modeling all zones all the time does not necessarily mean that price separation will occur. Rather, explicitly modeling all zones only allows for the possibility of zonal price separation during the auction.

a. Eight Energy Load Zones as Initial Capacity Zones

261. ISO-NE proposes to use the eight energy load zones as capacity zones for the sixth FCA.[192] ISO-NE asserts that the existing energy load zones capture most, but not all, of the relevant electrical constraints in the transmission system. ISO-NE states that the capacity zones modeled in each FCA will be used for subsequent annual reconfiguration auctions associated with the same capacity commitment period.[193]

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[191] Permanent de-list bids enable a resource to leave the FCM permanently, and they must be reviewed by the IMM if they exceed 1.25 * CONE.

[192] The eight load zones are Connecticut, Maine, New Hampshire, Rhode Island, Vermont, Northeastern Massachusetts/Boston, Southeastern Massachusetts, and Western/Central Massachusetts.

[193] ISO-NE's proposal to use the eight existing energy load zones as capacity zones and to model those zones in subsequent annual reconfiguration auctions was also proposed in the Joint Filing. However, since we find the Joint Filing zonal modeling proposal to be unjust and unreasonable, we must reassess ISO-NE's proposal to use the eight existing energy load zones as capacity zones in the context of ISO-NE's expanded zonal modeling proposal.

i. Comments and Responses

262. Load parties favor retention of the status quo and do not generally support ISO-NE's proposal to use the eight energy load zones as capacity zones for the sixth FCA. As stated previously, JFS and Mass DPU are satisfied that the zonal proposal accepted in the April 23 Order is a just and reasonable approach to balancing the need to set appropriate locational rates and prevent existing generators from creating a separate zone through the exercise of market power. In their view, ISO-NE's current zonal modeling that uses the higher of the TSA or the LRA to determine the LSR will virtually eliminate the need for ISO-NE to reject de-list bids for reliability reasons.

263. JFS argues that ISO-NE has not adequately justified the use of the eight energy load zones. For example, they claim that ISO-NE has not adequately addressed what relevant electrical constraints were not captured by the current zonal methodology or how market power concerns raised by these new potential zones might be mitigated. In fact, JFS is not confident that any revisions to market power mitigation can satisfactorily address market power concerns that would be raised by ISO-NE's proposal to model all zones. Mass DPU questions whether new generation could effectively respond to any additional zonal price signals because siting new generation in small zones in congested urban and suburban areas is difficult. However, if the Commission agrees that zones should be modeled all the time, Mass DPU asks that the Commission revisit whether using the higher of the TSA and LRA to set the LSR continues to be appropriate.

264. JFS and National Grid raise the concern that ISO-NE's proposal will result in the balkanization of markets. According to JFS, it would be unjust and unreasonable for the

separate and discrete issues in a manner that reduces the probability that locational value will be reflected in market outcomes.

269. ISO-NE also contends that it is not seeking to set a zonal modeling standard that "captures every possible combination of constraints that may arise."[199] Rather, ISO-NE agrees that the LSR should be set "at a level sufficient to cover most reasonably anticipated events, [but] it will not be set at a level high enough to guarantee that every combination of obligated resources within the zone will meet system needs."[200]

270. Moreover, ISO-NE asserts that JFS's statements regarding PJM's RPM represent an attack on locational capacity markets – an issue long ago addressed by the Commission. Further, ISO-NE argues that the other RTO capacity markets (including PJM's) are different in many respects and thus are not directly comparable to New England. Similarly, NEPGA asserts that JFS's claim that locational pricing in RPM has not attracted new entry ignores whether it would have been profitable for a new entrant to build in a constrained zone in PJM, RPM's bias in favor of transmission solutions when constraints are binding, and the effect of state-sponsored OOM entry in PJM.

271. In response to the generator parties, ISO-NE contends that the existing energy zones captures most of the relevant electrical constraints in the transmission system and are therefore an appropriate starting point for determining which capacity zones to model. While ISO-NE examined different options for modeling capacity zones, ISO-NE states that, due to the complexity of implementation of some of the options presented, known auction and settlement software limitations, and the benefits of using existing energy load zones, it was decided that energy load zones and/or their subdivision(s) would be used as potential capacity zones in the FCA.

ii. Commission Determination

272. We accept ISO-NE's proposal to use the eight energy load zones as initial capacity zones.[201] More comprehensive zonal modeling permits greater market transparency

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[199] ISO-NE Third Brief at 68-69 (citing Joint Filing Supporters Second Brief at 32).

[200] *Id.* at 69 (citing FCM Redesign Filing, Transmittal Letter at 25).

[201] While ISO-NE states that it will commit to such a change in time for the sixth FCA, as stated elsewhere in this order, we will require ISO-NE to file a proposed schedule for filing market rules in accordance with this order on paper hearing (including on this issue) within 30 days of its issuance.

because it reduces the likelihood of rejecting de-list bids and relying on out-of-market solutions. While this greater transparency is preferable, load parties have noted that the Commission has previously not required ISO-NE to model all zones all the time because smaller zones enhance market power concerns.[202] As discussed further below, ISO-NE and its IMM have proposed revised market power mitigation provisions to address this concern. Therefore, we see no reason to further delay the modeling of all zones all the time.

273. Both load parties and generator parties agree that locational pricing is appropriate; however, these parties disagree as to what extent revisions are necessary. As noted previously, load parties believe that ISO-NE's current Tariff provisions regarding zonal modeling are sufficient. By contrast, generator parties support the revisions proposed in the July 1 Brief but suggest that even more zones may need to be modeled (including whenever de-list bids are rejected for reliability). As discussed further below, we reject both parties' arguments, and we accept ISO-NE's July 1 Proposal.

274. As discussed previously, we find the Joint Filing zonal modeling proposal unjust and unreasonable because it continued to rely on the rejection of de-list bids to support local reliability. We find that the July 1 Proposal addresses many of the deficiencies in the Joint Filing with respect to zones. Instead of modeling a separate zone only when the projected installed capacity in the import-constrained load zone is less than the load zone's LSR, ISO-NE proposes to determine the appropriate capacity zones in advance of the auction and then to continue to model those specific capacity zones for that capacity commitment period. Therefore, a zone could be modeled, even if projected installed capacity in the zone was slightly higher than the LSR or if a localized need develops in a reconfiguration auction. This creates a greater likelihood that zonal price separation will be allowed to reflect actual locational needs. We also note that, contrary to concerns

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[202] *See* Joint Filing Supporters First Brief at 39 (citing FCM Settlement Order, 115 FERC ¶ 61,340 at P 123):

> [I]f auction results were used to force local capacity zones/local auctions, …sellers of capacity would have the incentive to withhold capacity to create price separation and separate capacity zones where they are not necessary. These constraints would bind only because of the exercise of market power, and not because of actual physical limitations arising from competitive market conditions. The locational feature of the [FCM] Settlement Agreement, in contrast, will be based on an objective analysis of actual transmission system constraints.

expressed by load parties, this does not mean that price separation will result; prices will only separate if constraints bind. Further, as discussed below, ISO-NE's revised proposal to always model zones also includes revised mitigation rules.

275. We dismiss arguments by both load and generator parties that basing potential capacity zones on the existing energy load zones might not be appropriate. Specifically, load parties argue that ISO-NE has not sufficiently justified the need for the proposed eight capacity zones, while generator parties question whether the proposed eight capacity zones reflect the physical realities of the system. ISO-NE has explained the benefits of using the existing energy load zones as the basis for potential capacity zones, including: (1) avoiding the creation of another zonal system in the ISO markets; (2) conforming to existing ISO settlement systems and market trading patterns; (3) ensuring that capacity zones will not cross state or utility boundaries; and (4) partially coinciding with the electrical boundaries of what could be considered "pure" capacity zones.[203] We recognize that the development of zones is not a simple task, and we therefore find it reasonable that ISO-NE use the existing energy load zones as the basis for potential capacity zones.

276. We also disagree with load party arguments that zonal pricing in PJM has failed to achieve the objectives of attracting and retaining capacity in constrained zones; RPM has consistently acquired sufficient resources to meet capacity needs. Further, JFS's arguments concerning RPM fail to establish that ISO-NE's proposal to always model capacity zones is an unjust and unreasonable approach to addressing local reliability concerns. As ISO-NE notes, there are important differences between the two markets. Moreover, we note that capacity markets, such as RPM and FCM, provide only one source of market-based revenue for capacity resources. Other factors that influence investment decisions included expected energy and ancillary service revenues, the estimated cost of transmission expansions and upgrades, and risks created by an uncertain economic climate and regulatory actions that could affect long-term profitability. Accordingly, decisions by a resource to enter the market cannot be attributed solely to an increase in a capacity market price for a particular future one-year period.

277. We also dismiss Mass DPU's request that the Commission revisit the use of the higher of the TSA or LRA to set LSR. The Commission approved the use of the "higher of" method in the April 23 Order; therefore, this issue is not properly within the scope of the paper hearing.[204]

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[203] ISO-NE Second Brief at 31 (citing Joint Filing, Karl Testimony at 5).

[204] April 23 Order, 131 FERC ¶ 61,065 at P 108.

Docket No. ER10-787-000,

Docket No. ER10-787-000,

Specifically, Stoddard suggests that, in subsequent auctions, the constraint leading to the rejected de-list bid should be expressly modeled to avoid additional payments outside of the market and to permit locational pricing. Alternatively, Shanker suggests that, when such de-list bids are rejected, the auction process should be modified to incorporate the constraint and the auction should be re-run.

288. Responding to NEPGA's concerns, ISO-NE states that modeling all constraints under all circumstances is not a desirable goal given the existence of local needs, which may only be capable of being met by a single particular resource. Instead, ISO-NE notes that as many constraints should be modeled as "reasonably" possible in establishing zones, since the objective of establishing zones should not be to model every possible constraint in order to eliminate the need to ever reject a de-list bid. Essentially, ISO-NE contends that given the zonal market design (and given the fact that not all de-list bids are submitted in advance of the auction), it may be impossible to develop a configuration that captures every possible combination of constraints that may arise.

289. However, ISO-NE states that it is amenable to Stoddard's proposal of examining whether it would be appropriate following the rejection of a de-list bid to model the revealed constraint within the zonal configuration used in the subsequent auction. ISO-NE states that no change to the current market rules is necessary to reach this outcome; if a constraint indicates a broader adequacy or security issue, that issue would be reviewed in the zonal development process for the subsequent FCA and the zone might be modeled for that auction. Regarding Shanker's proposal, ISO-NE states that stopping the auction, reconfiguring zones, and re-running the auction would cause substantial disruption to the market. Therefore, ISO-NE contends that Shanker's proposal should be summarily rejected.

ii. Commission Determination

290. We approve ISO-NE's proposal to allow static and dynamic de-list bids from all resources to establish zonal prices. As discussed further below, by definition static de-list bids have already been screened by the IMM. Under ISO-NE's July 1 Proposal (and as discussed below), dynamic de-list bids must now be below a relatively stricter $1.00/kW-month threshold, a threshold that we agree is competitive. Under such a construct, we agree that it is likely that any "higher" zonal price would be justified by market conditions and would not reflect an exercise of market power.

291. Regarding ISO-NE's statement that "[t]here may be unique, unit-specific constraints that lead to the rejection of de-list bids even under the new proposed design," we agree with ISO-NE that that it would not be practicable to develop a zonal configuration that captures every possible combination of constraints that may arise. Addressing Mass DPU's concern over which criteria will be employed to determine that certain units should not set a zonal price, ISO-NE explains that situations in which it may be necessary to reject a de-list bid could occur when a single resource causes the

welfare while recognizing bi-directional and mesh network constraints" and that it "is likely to result in an optimization problem that requires extensive use of heuristic solution methods and is likely to produce multiple locally optimal solutions that the solution software would not be able to consistently identify."[208] Specifically, Maine PUC states that these comments suggest a certain level of subjectivity in the determination of how zones will clear. According to Maine PUC, this subjectivity may result in significant litigation. Therefore, Maine PUC states that ISO-NE should be required to provide more information about its proposed mechanism before the Commission rules on whether or not it is workable.

296. In response, ISO-NE notes that its proposed LMP optimization model is essentially the same proceod4378( )Tj/TT2 1 Tf1.0184 0 TD TD-0.0 in capac0008 Tmket.-0.0007 Tc-0.

speak to the complexity of modeling zones all of the time; however, ISO-NE's subsequent response provides a fairly clear, high-level explanation of how such a market design would clear. It is not obvious based on the relatively condensed timeframe of the paper hearing that significant implementation details of such a design could be provided at this point, nor do we find ISO-NE's July 1 Proposal to be unjust and unreasonable on this issue. We note that stakeholders will have the opportunity to offer their input/critiques of the auction clearing mechanism during the subsequent development of market rules stemming from the instant order.

e. Additional Issues

i. Comments and Responses

299. Load parties express concerns that modeling all zones all the time will interfere with ISO-NE's regional system planning process. Specifically, National Grid states that, because transmission does not respond to the market price signals sent by modeling zones but is developed through a central planning function carried out by ISO-NE and NEPOOL, under the July 1 Proposal, generation solutions may be selected even when transmission solutions would be more cost effective. According to National Grid, this situation occurred in PJM; PJM's planning process failed to recognize and eliminate transmission constraints until consumers were forced to endure high capacity charges. National Grid requests that a process requiring modeling all zones all the time not be approved until ISO-NE and the NEPOOL stakeholders review the regional system planning process Tariff provisions to ensure that alternative solutions to zonal capacity requirements are considered.

300. Other load parties question whether ISO-NE's proposed revisions to the FCM market rules are necessary, given significant investments in New England's transmission system. For example, EMCOS notes that the investments in the transmission system will cause ISO-NE's Regional Network Service rate to increase to approximately $115/kW-month by 2013 (greater than a sevenfold increase since 1997). Mass DPU requests that, if the Commission approves ISO-NE's proposal to model all zones all the time, the Commission require ISO-NE to provide greater transparency in the regional system planning process so that market participants can address any potential constraints in the most cost-effective manner.

301. Regarding National Grid's request that ISO-NE's proposal to always model zones not be approved until the regional system planning process is reviewed, ISO-NE contends that this argument should be rejected as a collateral attack on the concept of locational pricing, asserting that National Grid is requesting to delay zonal modeling until locational

pricing differences no longer exist.[210] Further, ISO-NE argues that the implementation of the July 1 Proposal should not be dependent upon the regional system planning process because the transmission planning process does not neatly coincide with the operation and schedule of the FCM. ISO-NE states that the transmission planning process is an ongoing, forward looking process with a ten

stakeholders to increase transparency in the planning process, as well as to ways to more effectively assess non-transmission alternatives.[212]

4. Revised Mitigation Rules

304. As mentioned previously, in order to permit modeling all zones all the time, ISO-NE proposes to adopt new market power mitigation rules.

a. Revisions to the Dynamic De-List Bid Threshold

305. ISO-NE proposes a reduced threshold for dynamic de-list offers, i.e., those requiring no IMM review, of $1.00/kW-month instead of the current value of 0.8 * CONE. ISO-NE notes that the current threshold of 0.8 * CONE bears no particular relationship to a resource's opportunity or going forward costs and is a reasonable threshold only under the former approach to determining zones (where zones are only determined before the auction; i.e., dynamic de-list bids can not trigger zonal separation). ISO-NE states that the $1.00/kW-month level is based on the lowest market clearing price achieved in the three annual reconfiguration auctions held to date – auctions that (unlike the FCAs that have occurred) are not subject to a price floor. Because the market clearing prices determined in these auctions actually represent prices that suppliers were

307. For example, Joint Complainants' witness Bidwell asserts that without the 0.8 * CONE threshold, annual prices will fall so far below CONE that it will be effectively impossible for a capacity supplier to recover its fixed operating costs over the expected life of the facility, after only a few annual FCAs. Joint Complainants states that, without the 0.8 * CONE threshold, consumers will end up paying more in the long run since rational suppliers will not enter and stay in a market that does not provide even the opportunity to earn a return on their investment. Similarly, NEPGA notes the price stabilizing role of the 0.8 * CONE threshold and suggests that if dynamic de-list bids are no longer permitted at this threshold, the Commission should implement a demand curve.

308. According to Joint Complainants, there are already extensive mitigation measures in place to protect against market power abuse by capacity sellers. These measures include: (1) a 0.8 * CONE threshold, which will mitigate bids to below the year-over-year rate necessary for suppliers to receive just and reasonable compensation; (2) the ability of new participants to enter the market if an incumbent raises its price above the actual levelized cost of new entry; and (3) the substantial capacity surplus that exists in FCM.

309. Generator parties also disagree that the lowest market clearing price in the reconfiguration auctions held to date is a competitive proxy for determining the threshold for dynamic de-list bids. For example, NEPGA witness Stoddard concludes that, because Tjent 5aisestediosuggesent 5a(rve.4(u)-(hrve.4(izeddatrao Joi17.6682 -54D-5 TD-0.0007 Tc0.00035 Tw

likelihood of a significant price effect below $1.00/kW-month is limited and does not warrant review of every de-list bid. The $1.00/kW-month threshold is based on the lowest price submitted in a reconfiguration auction to date and represents a reasonable estimate of the cost of providing capacity. Moreover, the IMM agrees that reconfiguration auctions should be monitored and reviewed to assess whether their market clearing prices remain a reasonable basis on which to base the threshold for the FCAs.

315. Additionally, we disagree with the argument offered by generator parties that the 0.8 * CONE threshold for dynamic de-list bids is necessary to limit the volatility of the market on the downside. A resource's de-list bid is not intended to serve as a price stabilizer; it is intended to represent the offer a competitive supplier would accept voluntarily to commit its resource as a capacity resource. Such capacity revenues would make a contribution to the supplier's fixed costs, as would infra-marginal energy and ancillary services revenues. No assurance for cost recovery is made for participating in competitive markets, only an opportunity to do so.[216]

b. Revisions to the Calculation of Static and Permanent De-List Bids

316. Under the July 1 Proposal, all static and permanent de-list bids must be submitted to the IMM for review.[217] While ISO-NE proposes to continue basing its review of acceptable static and permanent de-list bi

320. The IMM defends the default assumption that a unit submitting a static de-list bid will continue to participate in the energy and ancillary services markets. The IMM asserts that, absent evidence to the contrary, this is a reasonable assumption for a resource that seeks to leave the capacity market for a single year, since a generating resource earns revenue by providing energy and ancillary services. However, the IMM states that, if a resource does intend to leave the energy and reserve markets, the resource's costs will be calculated on that basis. Further, ISO-NE states that there is no requirement that an

324. Finally, we dismiss concerns that the IMM will be overburdened by additional static and permanent de-list bids submitted as a result of the July 1 Proposal. According to the IMM, it does not anticipate being overburdened in meeting its obligations.

c. Elimination of the Pivotal Supplier Test

325. Because all bids above the $1.00/kW-month dynamic de-list bid threshold would be assessed for competitiveness in advance of the FCA, ISO-NE states that the pivotal supplier test that was part of the Joint Filing is no longer necessary and proposes to eliminate it.

i. Comments and Responses

326. JFS states that their sponsored testimony by Blumsack supports the necessity of a pivotal supplier test, a view shared by Mass DPU, National Grid, and EMCOS. JFS is concerned that, without a pivotal supplier test, existing resources may have an incentive and ability to create zonal separation not based on actual physical limitations. JFS is not convinced that proposed lower thresholds alone are adequate to preclude pivotal suppliers from exercising market power. Specifically, Blumsack argues that pivotal suppliers in an import-constrained zone could profit by using a de-list bid to trigger the creation of a capacity zone. In his Supplemental Testimony, in particular, Blumsack emphasizes that dynamic de-list bids should not be considered in the definition of capacity zones and that, even with the proposed $1.00/kW-month threshold, a need for a pivotal supplier test remains.

327. Likewise, Mass DPU cautions against removing the pivotal supplier test because it is concerned that doing so may allow for the exercise of market power in some circumstances. It requests that the Commission require ISO-NE to retain the pivotal supplier test and revisit the issue in five years.

328. National Grid also believes that a pivotal supplier mechanism is necessary on the basis that suppliers often have an incentive to force price separation even if they de-list their entire portfolio/resource. Although such a supplier would fail to receive a Capacity Supply Obligation in the FCA, National Grid raises the concern that such pivotal suppliers might nevertheless benefit from higher prices in future reconfiguration auctions or in bilateral contracts.

329. EMCOS states that, if the Commission proposes to pursue a requirement that ISO-NE expand its modeling of capacity zones, it should both (1) retain structural protection against market power afforded by the pivotal supplier test proposed in ISO-NE's Joint Filing and (2) augment the pivotal supplier test with a concurrent, flat prohibition against zonal pricing in any capacity zone with a Herfindahl-Hirschman Index (HHI) in excess of the 1800 "highly concentrated" threshold.

330. Stoddard agrees with ISO-NE that, under its proposed market power mitigation, a pivotal supplier test is unnecessary.[219] Additionally, in response to EMCOS, NEPGA states that EMCOS misuses and misreads the DOJ/FTC Horizontal Merger Guidelines in supporting a concurrent, flat prohibition against zonal pricing in any capacity zone with an HHI in excess of the 1800 highly concentrated threshold. First, NEPGA argues that

NEPGA suggests that if market participants want to systematically purchase less capacity when prices are higher than some benchmark, then the capacity market should simply include a demand curve.[222]

ii. Commission Determination

335. We accept ISO-NE's proposal to eliminate the quantity rule. We agree with ISO-NE that the quantity rule is no longer necessary, since it was never invoked in any of the FCAs to date and since ISO-NE's revised mitigation rules, which we are accepting, will make it even less likely that the quantity rule would be invoked. Moreover, we note that ISO-NE's proposed mitigation measures are a more efficient way to prevent economic withholding, since the quantity rule may result in certain unintended consequences including the suppression of efficient pricing, and the reduction in lead time to develop new resources.[223]

D. CONE

1. April 23 Order

336. In the April 23 Order, the Commission accepted Filing Parties' proposal to decouple the FCA starting price from CONE as well revisions to CONE's updating mechanism.[224] However, noting that "the proper CONE value is important, since it is tied to numerous aspects of the FCM," the Commission set for hearing "[w]hether the value of CONE should be reset."[225] The Commission agreed with generator parties that, because of the manner in which the review of potential OOM capacity was triggered,[226] at very low levels of CONE, parties seeking to affect the FCM price had the ability to offer

[222] NEPGA First Brief, Ex. 2 at 96-98 (Stoddard Testimony).

[223] As discussed previously, ISO-NE's proposed mitigation measures will: (1) reduce the threshold for dynamic de-list bids to $1.00/kW-month and (2) revise the calculation of net risk-adjusted going forward and opportunity costs for static and permanent de-list bids to assume that sellers continue participating in the energy and ancillary services markets.

[224] April 23 Order, 131 FERC ¶ 61,065 at P 16, 139, 150.

[225] *Id.* P 18, 151.

[226] Under the preexisting and Joint Filing rules, new capacity offers below 0.75 * CONE are reviewed to assess whether they are OOM. Thus, as CONE values decrease, this threshold becomes relatively low.

new capacity at well below their resource costs yet at a level that would avoid review. Because "the CONE value is intrinsically tied to the OOM determinations that are part of the APR Issue," the Commission directed parties to address "the issue of the proper value of CONE."[227]

2. The Proper Value of CONE

a. July 1 Proposal

337. Rather than address the proper value of CONE, ISO-NE's July 1 Proposal eliminates or replaces CONE entirely. For example, the OOM and mitigation rule revisions proposed by ISO-NE result in the elimination of many of the most significant uses of CONE. As discussed above, offer floors will replace CONE as the threshold for IMM review of OOM resources for buyer market power, and $1.00/kW-month will replace 0.8 * CONE as the threshold for dynamic de-list bids, the maximum non-reviewed supplier de-list bid. ISO-NE's proposal to remove the quantity rule will eliminate an additional use of CONE.

338. In its July 1 Proposal, ISO-NE proposes that the remaining uses of CONE be replaced with other indices, such as the FCA starting or clearing price. These remaining uses include the price at which ISO-NE will buy replacement capacity in annual reconfiguration auctions; the price at which resources must submit offers to "cover" Capacity Supply Obligations on which they cannot deliver; the price paid to existing resources when there is inadequate supply or insufficient competition in the FCA; and setting the level of financial assurance required for new capacity clearing the FCA.

b. Comments and Responses

339. Commenters are generally supportive of ISO-NE's proposal to eliminate or replace the uses of CONE. NEPGA opposes two of ISO-NE's proposed alternatives to

insufficient competition should be slightly above the benchmark cost of a peaker. In the context of the revised mitigation regimes proposed by ISO-NE and accepted by the Commission, we find this suggested modification unnecessary.

343. We find all proposals to recalculate CONE to be unnecessary and, in light of our requirement to implement offer-floor mitigation, reject them as moot. In the April 23 Order, the Commission noted the importance of CONE in determining OOM capacity and observed that, at very low levels of CONE, parties seeking to affect the FCM price had the ability to offer new capacity well below their resource costs, yet at a level above the IMM threshold for review. The Commission wrote, "[A]s the CONE value is intrinsically tied to the OOM determinations that are part of the APR Issue, we will require the Filing Parties and others to address . . . the issue of the proper CONE value."[230] In this order the Commission approves and requires changes to the FCM mitigation schemes that remove reliance on CONE. Therefore, the Commission's primary rationale for directing parties to address the proper value of CONE has been obviated, and all proposals to reset CONE have been mooted.

344. We find unconvincing NEPGA's argument that ISO-NE should nevertheless calculate a value called "CONE" that represents the actual cost of new entry. While it is certainly likely that (based on our requirement to employ offer-floor mitigation) ISO-NE will find it necessary to calculate an offer floor for the cost of a new peaking unit, nothing requires that this value be labeled "CONE" nor that it serve any purpose other than as an offer floor for a particular resource. We find equally uncompelling the argument that CONE should be reset to reflect the true cost of new entry of a peaking unit because it is that cost that the FCM must sustain. Whatever the theoretical merits of this proposition, no party demonstrates how calculating the cost of new entry of a peaking unit (which NEPGA asserts will be done anyway) and labeling it "CONE" will have any effect on the market. We decline to order ISO-NE to "reset" a value that will essentially be written out of the market rules. We therefore reject the proposals to reset CONE.

345. Our acceptance of ISO-NE's proposal to eliminate the CONE parameter also moots arguments concerning CONE not addressed here such as, for example, NEPGA's proposal that CONE reflect cost of service values raised in historical New England RMR proceedings.

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[230] April 23 Order, 131 FERC ¶ 61,065 at P 151.

V. Other

A. Complaints from NEPGA and Joint Complainants

346. As mentioned at the opening of this document, prior to the issuance of the April 23 Order, NEPGA and Joint Complainants filed complaints arising out of the Joint Filing. Both sets of parties had already submitted protests of the Joint Filing in the Joint Filing's docket, and stated that they filed the complaints in order to eliminate any argument that the relief they sought could not be granted in response to their protests. In the April 23 Order, the Commission consolidated the dockets of the two complaints with the Joint Filing's docket. The Commission stated that, so as to ensure that NEPGA and Joint Complainants "are able to obt

Docket No. ER10-787-000,

359. While addressing arguments that OOM capacity was responsible for suppressing prices in the FCM, the April 23 Order also clearly specified which issues were set for paper hearing, including, as relevant for this issue: (1) the appropriate APR triggering conditions, if any; (2) the treatment of OOM resources that create capacity surpluses for multiple years; and (3) the appropriate price adjustment under the APR. Contrary to NEPGA's assertion, the Commission did not set for paper hearing either implicitly or explicitly the issue of whether resources were properly determined to be OOM in the first three FCAs. Rather, the Commission stated that, because the IMM notes that OOM entry had no effect on FCA pricing during the first three FCAs, "arguments that OOM entry

found to be in-market or out-of-market."[249] The Commission repeated this point in the August 12 Order, stating that "NEPGA fails to acknowledge the Filing Parties' uncontradicted representation that the relevant rules will not change the determination of whether a specific project is found to be in-market or out-of-market,"[250] a point that NEPGA's own expert witness concedes.[251] As a result, the Commission would have had no basis for setting these historical OOM determinations for hearing, given they have already been approved by this Commission in orders issued prior to each respective FCA.[252] NEPGA also argues that, even if these determinations would have remained unchanged under the clarified OOM rule, "factual errors" may have resulted in the IMM failing to recognize that certain capacity should have been classified as OOM. We find that NEPGA fails to support this argument, misconstruing its allegations concerning subsidized demand response resources (as discussed elsewhere in this order) as support for its position.

362. dwsewhill of

NEPOOL stakeholder process."[255] A few days later, on August 20, 2010, the Mirant Parties[256] filed an *Emergency Request for Clarification Or, In The Alternative, Rehearing* addressing the October 1, 2010 qualification deadline for existing capacity. Specifically, the Mirant Parties sought clarification that either (1) any existing FCM rules applicable to the then-upcoming Existing Capacity Qualification Deadline would also be applied in the corresponding fifth FCA or (2) if new FCM rules emerge from the paper hearing and are made effective for the fifth FCA after market participants have undertaken pre-auction activities required under the Tariff for the fifth FCA, market participants will be given the opportunity to modify such acts or submissions. NRG[257] filed an answer in support of the emergency request for clarification. Although the relevant deadline has passed, we reiterate our earlier statement in the August 12 Order that the rules the Commission approved in the April 23 Order will remain in effect pending any new rules. As discussed below, ISO-NE's compliance filing will address the specific timing of revised market rules stemming from this order.

D. Timing

367. Recognizing that ISO-NE would conduct the fourth FCA in August 2010, and to eliminate the uncertainty that would result from not having Tariff provisions in place to govern that auction, in the April 23 Order the Commission accepted the Tariff provisions that related to the issues set for paper hearing. The Commission noted that it anticipated that, if practicable, it would issue an order accepting revised market rules before March 1, 2011 in time to govern subsequent auctions.

368. In its *Request for Clarification or, in the Alternative, Rehearing* of our April 23 Order, ISO-NE requested that the Commission "order the ISO to work with stakeholders to develop a schedule for filing rules in accordance with the order and file the proposed schedule within 30 days of the Commission's decision on the issues set for paper hearing."[258] We will grant this request and expect ISO-NE to file a proposed schedule for filing market rules in accordance with this order on paper hearing within 30 days of its

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[255] August 12 Order, 132 FERC ¶ 61,122 at P 36.

[256] Mirant Energy Trading, LLC, Mirant Canal, LLC Canal, and Mirant Kendall, LLC.

[257] NRG Power Marketing LLC, Connecticut Jet Power LLC, Devon Power LLC, Middletown Power LLC, Montville Power LLC, Norwalk Power LLC, and Somerset Power LLC.

[258] ISO-NE May 5 Request for Rehearing at 2.

issuance. That filing should also address the timeframe for consideration of the two issues that we are requiring ISO-NE to further examine with stakeholders – the development of market rules to implement an offer-floor mitigation construct, and the proper offer floor price for

2. Commission Determination

372. We dismiss the requests that ISO-NE perform a more detailed analysis of the cost impacts of the July 1 Proposal. Maine PUC appears to be arguing that ISO-NE should complete an accurate prospective analysis of the July 1 Proposal's cost impact despite the fact that the ISO concedes that it has not yet developed benchmarks, a process that it has committed to vet through the stakeholder process. In addition, while the Maine PUC criticizes ISO-NE's decision to examine how its proposal would affect prior FCAs, any analysis ISO-NE would offer at this point would employ a considerable number of assumptions, any one of which can be debated. In addition, given the accelerated nature of this paper hearing, we do not believe it would be reasonable to expect that ISO-NE would have developed the price cost estimate Maine PUC seeks.

The Commission orders:

By the Commission. Commissioner LaFleur and Chairman Wellinghoff are concurring with a separate statement attached. Commissioner Spitzer is dissenting in part with a separate statement to come at a later date.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Potomac Economics (the External Market Monitor, or EMM)

PSEG Energy Resources & Trade LLC; PSEG Power Connecticut LLC; NRG Power Marketing LLC; Connecticut Jet Power LLC; Devon Power LLC; Middletown Power LLC; Montville Power LLC; Norwalk Power LLC; and Somerset Power LLC (Joint Complainants)

Connecticut Municipal Electric Energy Cooperative (CMEEC), Massachusetts Municipal Wholesale Electric Company (MMWEC), and New Hampshire Electric Cooperative, Inc. (NHEC) (Public Systems)

Second Briefs

Brookfield Energy Marketing Inc. (BEMI)

Boston Gen

BG Dighton Power, LLC (BG Dighton), Lake Road Generating, L.P., MASSPOWER and BG Energy Merchants, LLC. (BG Entities)

EMCOS

HQUS

ISO-NE

ISO-NE Internal Market Monitor (IMM)

Joint Complainants

Joint Filing Supporters

Maine PUC

Mass DPU

National Grid

NEPGA

Public Systems

Third Briefs

Boston Gen

BG Entities

EMCOS

HQUS

ISO-NE

ISO-NE IMM

Joint Complainants

Joint Filing Supporters

Maine PUC

National Grid

NEPGA

NEPOOL

Public Systems

Fourth Briefs

HQUS

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ISO New England, Inc. and
New England Power Pool Participants Committee

New England Power Generators Association v.
ISO New England Inc.

PSEG Energy Resources & Trade LLC, PSEG Power
Connecticut LLC, NRG Power Marketing LLC,
Connecticut Jet Power LLC, Devon Power LLC,
Middletown Power LLC, Montville Power LLC,

component of entities' efforts to satisfy their renewable portfolio standard obligations, and that the Commission should be willing to consider such requests.[1]