



impacts of: (1) an Alternative Capacity Price Rule (“APR”) that has been ineffective in mitigating price-suppressing effects of out-of-market (“OOM”) resources; (2) an insufficient Cost Of New Entry (“CONE”) value; and, (3) the lack of zonal formation on ensuring sustainable prices and efficient participation in the forward capacity auctions (“FCAs”). EPSA notes that certain individual changes represent incremental improvements, but taken as a whole, the package of proposed changes is wholly inadequate to address fundamental market flaws as necessary to ensure the FCM achieves overall just and reasonable results. Furthermore, the negative implications for continued operation of a flawed capacity market are significant and extend beyond ISO-NE – from both a policy and operational standpoint.

Based on the concerns stated herein, EPSA believes these three issues are of sufficient weight and importance to warrant the following action by FERC in exercising its responsibility to ensure just and reasonable rules in the FCM:

- 1) **APR and OOM Issues:** Rather than allowing another lengthy stakeholder process as proposed by ISO-NE, EPSA respectfully requests that the Commission reject the proposed APR revisions as unjust and unreasonable and direct a compliance filing on an expedited basis to be implemented prior to the Fourth FCA (“FCA-4”) to address the concerns raised herein by EPSA. If the Commission declines to require such a filing, resolution of what APR should be applied to OOM supply should be established through either an expedited hearing or Settlement Judge process to be concluded within 90 days. While not

an optimal solution given the extensive stakeholder consideration that has already occurred to date, this accelerated timeframe is both appropriate and achievable as these issues were well-identified going into the stakeholder process that resulted in the instant filing. EPSA further requests that the Commission provide specific guidance and require that the APR must mitigate the price-suppressing effects of OOM supply as fully as possible, consistent with the core FCM design principles articulated in the FCM Settlement that clearing prices should, over time, average the actual cost of new entry.<sup>2</sup> Specifically, the Commission guidance should require that all offers at prices below a resource's long-term average costs net of non-FCA market revenues should be mitigated (upward) to the actual long-term average costs of a peaker. EPSA is concerned that without the Commission's guidance, stakeholders will be unable to resolve these important differences given the broad gulf that remains between load and supplier interests. If the Commission allows these issues to go back – again – to a lengthy stakeholder process (an exercise that is unlikely to adequately address the deficiencies given the clear and unwavering positions between the sectors), EPSA requests that the Commission provide specific guidance as proposed above and a firm deadline for concluding this process.

- 2) CONE Issues:** EPSA requests that the Commission direct ISO-NE to make a compliance filing resetting CONE to levels that more accurately

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<sup>2</sup> *Devon Power LLC, et al.*, Docket Nos. ER03-563-000, et al. (filed March 6, 2006).

reflect a true cost of entry for a peaking unit. Failing that, the Commission should accept the proposal to decouple CONE from the auction starting price<sup>3</sup> and direct that the starting price should be the higher of \$15 kW-month or twice CONE to be implemented as soon as possible and no later than the Fifth FCA (“FCA-5”). The Commission should also accept the proposed inflation adjustment to CONE, but eliminate the one-year lag in implementation. Additionally, if the CONE is not required to be reset at a level consistent with the real cost of new entry of a peaker, the Commission should decouple other FCM mechanisms intended to be indexed to the true cost of new entry from the much lower CONE. Examples of these are the Quantity Rule which decreases Forward Capacity Auction purchases arising from exit of existing capacity through Permanent De-List Bids or Statics De-List Bids, payment of existing units under conditions of Insufficient Supply, Inadequate Competition and the APR.

- 3) Locational Issues:** The Commission should accept the proposed rule to set the auction purchase requirements based on the higher of the local resource adequacy requirement or the transmission security analysis. Additionally, the Commission should require revisions so that all potential zones are modeled for all auctions. The Commission should reject the proposed FCM Pivotal Supplier Test as unnecessary

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<sup>3</sup> The February 22 Filing at 22 states “Under the Rule Changes, the Forward Capacity Auction Starting Price for the Capacity Commitment Periods beginning on June 1, 2013, June 1, 2014, and June 1, 2015 will continue to be two times the CONE applicable to each Capacity Zone. The Starting Price for the FCA for the Capacity Commitment Period beginning on June 1, 2016 will be \$15/kW-month, which is a fixed amount not based on CONE. “

to protect against bids that have already been reviewed by the ISO-NE Internal Market Monitor (INTMMU).

## **II. BACKGROUND**

The February 22 Filing purports to address certain issues identified with the FCM design that required further attention based on experience gained in the first three forward capacity auctions (“FCAs”). These issues were considered in an extensive, almost year-long stakeholder process that commenced in early 2009. Among other things, the stakeholder process considered INTMMU recommendations on possible refinements to the FCM, based on a recent report examining the results of the first two FCAs.<sup>4</sup> The proposed changes include: (1) Revisions to the APR to include two new APR mechanisms and certain adjustments to the existing APR; (2) Increased transparency in the review of offers (from New Generating Capacity Resources and New Demand Resources) below 0.75 times CONE; (3) Extension of the Floor Price for an additional three FCAs using the current floor price formula of 0.6 times CONE; (4) Compensation where a Resource's pro-rationing election is rejected for reliability reasons; (5) Decoupling the FCA Starting Price from CONE; (6) Certain adjustments to the determination of CONE; (7) Clarifications regarding ISO requests for Energy from resources without capacity obligations; (8) Calculation of Zonal Requirements; and, (9) Improved modeling of Capacity Zones.<sup>5</sup>

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<sup>4</sup> See Internal Market Monitoring Unit Review of the Forward Capacity Market Auction Results and Design Elements (issued June 8, 2009) (“INTMMU FCA Report”).

<sup>5</sup> February 22 Filing, Overview of the Rule Changes at 3-10.

However, the Filing Parties acknowledge that the February 22 Filing fails to address all the major issues identified regarding the FCM design and it is noted that "...a number of participants have sought input from the External Market Monitor on the APR, and zonal formation, and other parties seek further discussion on APR pricing and the definition of out-of-market capacity."<sup>6</sup> In response, ISO-NE plans to undertake a further stakeholder process that may take 18 months or even longer (before additional necessary changes are even filed), which will be commenced soon to examine these issues.<sup>7</sup>

The Filing Parties request an effective date of April 23, 2010, for the proposed rule changes, to allow them to be in effect for FCA-4, scheduled to begin on August 2, 2010. The filing includes ISO-NE sponsored testimony from ISO-NE's Robert Ethier, Vice President of Market Development; Mark Karl, Senior Director of Resource Adequacy; and, David LaPlante, Vice President of Market Monitoring.

### **III. PROTEST**

As an initial matter, EPSA notes its strong support for FCM and appreciation for ISO-NE's continued efforts to refine the market construct. ISO-NE has determined that the first three FCAs were successful in retaining existing resources and attracting new resources needed to maintain reliability in New England. However, these auctions also identified significant issues affecting the long-term sustainability of the FCM construct, primarily around auction elements that underpin competitive, market-based pricing.

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<sup>6</sup> *Id.* at 3.

<sup>7</sup> *Id.* at 3 and 10-11.

As these pricing elements are currently structured – which EPSA does not believe is sufficiently remedied by the proposed changes in the February 22 Filing – the FCM is hindered in fully realizing its goal of promoting new generation build, or retaining existing generation that may be needed for reliability. This result is problematic as there are known constraints in the region, and it is completely at odds with a fundamental purpose of establishing the FCM. To wit, at the initiation of the series of proceedings that resulted in the FCM Settlement, the Commission’s objectives for a well-functioning capacity market included sending proper locational price signals, encouraging new generation where needed, obviating the need for Reliability Agreements, and generally ensuring just and reasonable pricing.<sup>8</sup> It is clear that the original FCM rules have not fully achieved those objectives, since there has been no locational indication of relative value even where specific zonal constraints were identified, necessitating several Reliability-Must-Run (“RMR”) Agreements, and the overall pricing has been below a just and reasonable level.

Some of the individual revisions in the February 22 Filing represent an incremental improvement to certain concerns that the Generator and Supplier Sectors have raised in past FCM-related dockets at the Commission and/or within the stakeholder process and should be approved as requested herein. However, the package of revisions in its totality simply does not go far enough in addressing pricing-related issues that were well-identified going into the stakeholder process that culminated with the February 22 Filing.

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<sup>8</sup> *Devon Power LLC*, 113 FERC ¶ 61,075 (2005).

EPSA is very concerned regarding the stakeholder voting structure in ISO-NE, in particular, with respect to the dominance of load interests, and the skewed results it is producing as reflected in the instant proceeding. In order to bring resolution and ensure the viability of the FCM, EPSA urges the Commission to require the APR and CONE compliance filings and take the other actions requested herein to address the adequacy of the APR, ensure a sufficient CONE value and improve locational price signals.

**A. The Stakeholder Process Produced A Skewed Outcome**

The February 22 Filing reflects that NEPOOL supports the proposed market rule changes with 70.1% and 71.69% in favor of Section 12 and Section 13 changes, respectively.<sup>9</sup> Additionally, the New England Conference of Public Utility Commissioners (“NECPUC”) was an active participant in the process and has indicated its support for the market rule changes as approved by the NEPOOL Participants Committee.<sup>10</sup>

However and importantly, the changes were opposed by the entire Generation Sector with further opposition or abstention in the Supplier Sector.<sup>11</sup> The changes were approved with support generally from those representing transmission, load serving entities, publicly-owned entities, alternative resources and end users. As reflected in the voting records submitted as Attachment 6, the Generation Sector also proposed a total of eight amendments that were not

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<sup>9</sup> February 22 Filing at 3.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 35 and Attachment 6 (Tabulations of NEPOOL Participants Committee votes).

supported by other voting sectors as discussed in the February 22 Filing: “While all Participants may agree that the Rule Changes represent an improvement to the status quo, some Participants with generating capacity to serve the region sought additional changes. All of the amendments were opposed by ISO and none of them received sufficient support to be approved by NEPOOL.”<sup>12</sup> Of note, “some Participants with generating capacity” is in fact the entirety of the Generation sector in New England and a majority of the Supplier sector.

EPISA has been and remains in support of well-structured stakeholder and ISO/RTO governance processes. However, the current ISO-NE voting structure appears not to have sufficient balance to enable the region to reach consensus positions, as reflected in the voting results on the FCM market rule changes. This produces unsustainable results from the standpoint that the business concerns and market design proposals of entities who have made significant investments in energy infrastructure to ensure the region’s reliability on the basis of market expectations, and who apparently are expected to make such investments in the future, are not being given due consideration in the proposed solutions adopted. On an issue as fundamental as the design of the capacity market, it is incumbent on the ISO and the stakeholders to find a consensus that satisfies at least a substantial portion of both buyers and sellers in the market.

Further, the fact that a voting majority supports or opposes any particular proposal(s) does not necessarily mean it is the best proposal, most responsive in addressing a particular issue, or just and reasonable. The Commission itself

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<sup>12</sup> *Id.*

has noted this in a recent order accepting the ISO-NE's installed capacity requirement ("ICR") for the final 2010-2011 reconfiguration auction.<sup>13</sup>

Essentially, ISO-NE and NEPOOL submitted differing ICR proposals based on their respective methodologies for calculating regional tie benefits. The Commission ruled in support of ISO-NE's proposal rather than NEPOOL's alternative proposal and rejected the claim from the Massachusetts Attorney General that a showing of support by end-users is enough to justify their preferred outcome:

The application of section 11.1.5 of the Participants Agreement, the jump ball provision, demonstrates that the stakeholder process did not ultimately support the ISO-sponsored proposal. In fact, the joint filing provides that the majority of the Participants Committee (66.61 percent) voted in favor of NEPOOL's alternative proposal, adopted from Mass AG's proposal. NEPOOL's proposal may strike a "reasonable balance" between reliability and costs to consumers. However, a proposed tie benefits value, and consequently, the Installed Capacity Requirement and related values, cannot be based on such support alone. We find no merit in Mass AG's argument that "it is telling that the entire End User Sector, the interested parties that ultimately pay more for the cost of additional capacity" voted unanimously to support the NEPOOL proposal. The NEPOOL Amendment supports a relatively higher tie benefits value, reducing the Installed Capacity Requirement and therefore the amount of capacity that is ultimately purchased for the commitment year. Given their obligation to purchase any additional capacity, end-users would not have an incentive to vote against the lower Installed Capacity Requirement established by the NEPOOL proposal.... [<sup>14</sup>]

With regard to the subsequent stakeholder process that ISO-NE proposes to consider APR pricing and zonal formation issues, among other things, EPSA is very concerned regarding the ramifications of further delaying resolution on these

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<sup>13</sup> See Order Accepting ISO New England's Proposed Installed Capacity Requirement, Hydro Quebec Interconnection Capability Credits, Related Values and Tariff Changes, Subject to Condition, ISO New England Inc. and New England Power Pool, Docket No. ER10-438-000 (issued February 12, 2010).

<sup>14</sup> *Id.* at P 87.

important matters. As described in the February 22 Filing, the process appears very open-ended and not well-defined as ISO-NE commits that “[w]ithin 18 months of this filing, the ISO will make a filing with the Commission, either proposing rules which have been developed or reporting on the status of discussions and progress on these matters.”<sup>15</sup> The stakeholder process that just ended allowed for sufficient time to address these issues as they have been identified since the early stages of FCM implementation and well in advance of this FCM review. Thus, the obligation to go through a stakeholder process has been fully met and another process on the very same issues that were just considered is unlikely to yield any different results.

Instead, EPSA requests that the Commission decline this additional unnecessary process, reject or modify elements of the February 22 Filing as requested herein, and require compliance filings on APR and CONE to be submitted and reviewed on an expedited basis. The prior FERC Order noted above also reaffirms that, at the end of the day, the Commission is and must be the ultimate arbiter in examining the record and rendering decisions that ensure the best outcome for the market as a whole. The Commission must not allow interests who simply have greater strength in numbers in a voting process to push the market away from its core competitive principles and unfortunately, in a direction that is yielding unjust and unreasonable results.

**B. Alternative Capacity Price Rule Revisions Do Not Resolve Price-Suppression Problems Caused by Out Of Market Resources**

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<sup>15</sup> February 22 Filing at 10.

As previously expressed, the proposed revisions to the APR mechanism do not adequately resolve the price-suppression problem created by the participation in the FCM of OOM resources. The APR was included in the FCM design as a post-auction price adjustment mechanism to correct for artificially low clearing prices that may be caused by new entry from OOM resources (i.e., when the capacity clearing price falls below the competitive CONE). These OOM resources are indifferent to the level of the FCM prices due to contractual commitments that cover some or all of their costs. Although close to 3,000 MW of OOM capacity has cleared in the first three FCAs, the APR has never been triggered.<sup>16</sup> As noted in the INTMMU FCA Report, “[t]he tension between the OOM capacity and the need to have the FCA price set by market-based new capacity is one of the FCM’s greatest challenges.”<sup>17</sup> This ability to significantly undermine the market is further recognized in the INTMMU FCA report as follows:

Because the annual new capacity requirement is small relative to the size of existing generation capacity, buyers may have the ability and incentive to exploit the market’s price sensitivity by building or contracting for a large amount of new capacity bilaterally and then offering such capacity into the FCA at an uncompetitively low price. This could depress the capacity clearing price in the FCAs, depending on the size of the capacity addition. This is a concern because depressed prices, or even the prospect of depressed prices, could prevent the FCM from attracting or retaining competitive, market-based resources.<sup>[18]</sup>

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<sup>16</sup> The ISO has acknowledged OOM of 2,345 MW, but independent experts assert that some additional quantity should have been categorized as OOM.

<sup>17</sup> INTMMU FCA Report at 6.

<sup>18</sup> *Id.* at 43.

Based on the INTMMU recommendations and stakeholder considerations, the February 22 Filing proposes several revisions to the APR mechanism, although there are no adjustments to pricing (which remains the lesser of CONE or \$0.01 below the price at which the last new non-OOM resource withdrew from the FCA).

Among the revisions, the current APR is retained (as “APR-1”) with certain modifications, which includes cleared permanent de-list bids in the trigger conditions. The new APR-2 provision is triggered when no new capacity is required, but where OOM capacity from previous FCAs affects the current FCA (and includes a six-year carry forward provision). The new APR-3 is designed to account for rejected de-list bids, an issue identified during development of the original FCM rules, and which the Commission has required in a prior Order to be addressed by ISO-NE (by May 17, 2010).<sup>19</sup>

EPSA’s opposition to the proposed APR is two-fold: (1) the revisions still result in an incomplete trigger that leaves a loophole in particular with the 6-year carry forward mechanism for OOM surplus capacity in APR-2, which leaves the market exposed to the inefficient price impacts of buyer market power or other OOM entry; and, (2) the proposal retains an inadequate price when triggered, particularly when the current CONE is insufficient to cover the actual cost of new entry.

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<sup>19</sup> See ISO New England Inc. and New England Power Pool, Limited Revision to FCM Rules to Extend Date for Filing Regarding Treatment of De-list Bids Rejected for Reliability Reasons, Docket No. ER08-952-000 (filed May 14, 2008) (“FCM Rules Date Extension Filing”); Letter Order re: Limited Revision to FCM Rules, Docket No. ER08-952-00 (June 10, 2008) (“Letter Order re: FCM Rules Date Extension Filing”)

In plain terms, the OOM capacity has tainted the FCA auctions held to date. EPISA believes there is a simple answer here: Competitive market participants' capacity needs to clear in the FCAs without the distorting effects of inordinately low bids. There are stringent market mitigation provisions in place to protect against high-priced bidding and ensuring that such bids do not influence market clearing prices; likewise, more stringent protections are also needed to guard against uneconomically low bids and their potential to produce FCA prices that are below competitive levels.

Rather than allowing another lengthy stakeholder process, EPISA respectfully requests that the Commission reject both the existing and the proposed APR changes as unjust and unreasonable and direct a compliance filing revising the APR to be implemented prior to FCA-4. The Commission should determine that submitting offers into the FCA at prices below a resource's long-term average cost net of non-FCA market revenues is unjust and unreasonable, unless the below-costs bid is fully reviewed and justified by the INTMMU. The Commission should require that the revised APR must mitigate OOM as fully as possible, consistent with the underlying principles of the FCM market design. Further, the Commission should determine that all offers at prices below a resource's long-term average costs net of non-FCA market revenues should be mitigated (upward) to the actual long-term average costs of a peaker. The object should be "to reset the clearing price to a level that would be expected in a competitive market," consistent with the core design principle of

FCM: that clearing prices should, over time, average the actual cost of new entry.<sup>20</sup>

If the Commission declines to require such a filing, resolution of what APR should be applied to OOM supply should be established through either an expedited hearing or Settlement Judge process to be concluded within 90 days. While not an optimal solution given the extensive stakeholder consideration that has already occurred to date, this accelerated timeframe is both appropriate and achievable as these issues were well-identified going into the stakeholder process that resulted in the instant filing. Such a process should include specific guidance as articulated above. EPSA is concerned that without the Commission's guidance, stakeholders will be unable to resolve these important differences given the broad gulf that remains between load and supplier interests.

If the Commission allows these issues to go back – again – to a lengthy stakeholder process (an exercise that is unlikely to adequately address the deficiencies given the clear and unwavering positions between the sectors), EPSA requests that the Commission provide specific guidance as proposed above and a firm deadline for concluding this process.

### **C. The Cost Of New Entry (CONE) In ISO-NE Remains Dramatically Understated**

The centerpiece of FCM is the CONE parameter. It is used for over fifteen distinct applications within FCM. Consequently, CONE must be set at a level

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<sup>20</sup> *Devon Power LLC, et al.*, Docket Nos. ER03-563-000, et al. (filed March 6, 2006).

and updated on a periodic basis to ensure that this central parameter reflects prevailing market conditions and economic realities. EPSA has previously commented on the need for adequate CONE values to promote efficient pricing in capacity markets.<sup>21</sup> In the FCM, EPSA is very concerned regarding the dramatically understated current CONE level (set at \$4.918 kW-month), which is set too low both from the standpoint of real peaking generator costs, as well as the CONE established in neighboring regions' capacity markets.

### CONE Values for RTOs

	<b>ISO-NE</b>	<b>PJM – Zone 4</b> (PPL/MetEd/Penelec)	<b>NYISO</b> (Rest of State)
CONE (\$/kW-Month)	4.918	6.70	8.92

Note: The representative CONE values reflected above for PJM (Zone 4) and NYISO (Rest of State) are converted from the measurements used in the respective RTOs to allow for comparison with ISO-NE, i.e., CONE for PJM Zone 4 is \$220.33/MW-day and CONE for NYISO Rest of State is \$107.04/kW-year.

As reflected in the chart above, CONE in FCM is set significantly lower relative to the New York ISO and PJM Interconnection markets – as much as 40 percent - while the true cost of new entry has increased. In discussing the appropriate starting price for FCAs to incent robust participation and ensure a competitive market, the recent INTMMU FCA Report noted that the current CONE level "...is significantly below most estimates of the cost of new entry for

<sup>21</sup> See Comments of the Electric Power Supply Association, PJM Interconnection, LLC, ER05-1410-010, et al. (filed January 9, 2009) and Motion To Intervene and Comments in Support of the Electric Power Supply Association, PJM Interconnection, LLC, Docket No. ER08-516-000 (filed February 21, 2008). The filings may be accessed at: [www.epsa.org](http://www.epsa.org).

generating resources.”<sup>22</sup> While several changes are proposed in the February 22 Filing related to CONE application, under the FCA rules, there are numerous remaining functions relating to or based off of the CONE value, including determining CONE for the next FCA auction, setting the floor price for the APR, offer thresholds for market monitoring reviews, the quantity for replacing de-listed capacity, and credit requirements, among other things.<sup>23</sup>

In other words, CONE is the foundation for establishing a competitive price signal; therefore, it is essential for this value to be set at a level sufficient to incent necessary investment in new and retain existing infrastructure, incent demand response participation, assure the FCM price over the long term reflects the entry costs of a peaking generator, and to maintain the viability of the FCM construct. A critical concern with regard to CONE is that under the existing market rules, CONE only moves upwards when there is an actual capacity shortage – and given the significant OOM over-hang, this adjustment is not likely to happen. Further, when capacity attempts to exit in response to such conditions, exit may be blocked by reliability rejection of de-list bids triggering an inadequate APR-2 adjustment based on a deflated CONE. Alternatively, exit via successful Permanent De-List Bids or Static De-List Bids may artificially decrease the Forward Capacity Auction demand (and associated prices) at price levels below the intended function of the Quantity Rule.<sup>24</sup> EPISA asserts not

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<sup>22</sup> INTMMU FCA Report at 8.

<sup>23</sup> *Id.* at 7.

<sup>24</sup> While the Quantity Rule was intended to defer all replacement capacity purchases for Permanent De-List Bids above 150% of the true cost of new entry (Section III.13.2.5.2.1(a)) and

enough was done in the stakeholder process to make the necessary adjustments to the actual CONE level. Generators should be assured a reasonable opportunity to receive a return on and of investment and the current CONE, along with other flaws, does not allow such recovery.

To remedy this, EPSA requests that the Commission direct ISO-NE to make a compliance filing resetting CONE to more reasonable levels, as in PJM and NYISO, that more accurately reflect a true cost of entry for a peaking unit. Failing that, FERC should accept the proposal to decouple CONE from the auction starting price, modify it to require that the starting price is the higher of \$15 kW-month or twice CONE, and direct that ISO-NE implement this change as soon as possible and in no event later than to apply in FCA-5.

Additionally, the Filing Parties propose to partially address the understatement of CONE and the potential for the value to get 'stale' by adjusting the value according to a Handy-Whitman index of utility construction costs in years when the value is not otherwise updated, but to apply that adjustment for the first time in the fifth FCA ("FCA-5") for the Capacity Commitment Period 2014-15. If CONE is not comprehensively updated as EPSA recommends, there is no reason to delay this small but important improvement in FCM, to reflect inflation, and it should be approved and implemented for the FCA-4 cycle.

Additionally, if the CONE is not required to be reset at a level consistent with the real cost of new entry of a peaking unit, the Commission should decouple other FCM mechanisms intended to be indexed to the true cost of new

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Static De-List Bids above 120% of the true cost of new entry (Section III.13.2.5.2.2(a)), the deflated CONE alters the function of this rule to deliver artificially low prices.

entry from the much lower CONE. Examples of these are the Quantity Rule which decreases Forward Capacity Auction purchases arising from exit of existing capacity through Permanent De-List Bids or Statics De-List Bids, payment of existing units under conditions of Insufficient Supply, Inadequate Competition and the APR.

**D. Further Improvements Are Needed With Respect To Zonal Definition and Price-setting Eligibility**

Another fundamental underpinning in establishing the FCM grew from an identified need for locational capacity pricing due to constraints in New England and concern by the FERC that capacity resources in the region were not adequately compensated in relation to their location and contribution to local and regional system reliability.<sup>25</sup> Although FCM was intended to be a locational market, the results of the three FCAs held to date reflect that the market has not worked in this manner – and the proposed changes in the February 22 Filing are unlikely to result in any material change. Specifically, in the first three auctions, there have been two instances in which ISO-NE has rejected substantial de-list bids for reliability reasons – and yet the market yielded no locational price differentiation that would indicate the relative scarcity of capacity in the affected zones. To address this disconnect, additional refinements are needed beyond the proposed modifications to ensure that locational differences do not continue to be obscured, and that legitimate price differences are revealed in locational FCM clearing prices.

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<sup>25</sup> *Devon Power LLC, et al.*, 103 FERC ¶ 61,082 (2003).

In a positive first step, the February 22 Filing revises the methodology for calculating the Local Sourcing Requirements (“LSR”) for import-constrained Capacity Zones. Specifically, under this measure, the ISO will model the higher of the local resource adequacy criterion and the transmission security criterion that the ISO uses to evaluate system operational reliability when reviewing de-list bids for the FCA to be used to determine the LSR for Capacity Zones.<sup>26</sup> This proposed adjustment should be approved, but this alone does not address the structural barriers that prevent proper locational price signals from being formed to reflect the value of capacity in a constrained location.

The February 22 Filing also proposes several revisions intended to allow for improved modeling of Capacity Zones. First, to improve zonal definition, modifications are proposed that would provide that the existing energy market Load Zones (and/or their subdivision) be used as the basis for modeling potential Capacity Zones in the FCAs.<sup>27</sup> Second, the rule changes propose that additional types of bids – i.e., non-price retirement requests, permanent de-list bids, static de-list bids from non-pivotal suppliers, export bids from non-pivotal suppliers, and administrative export de-list bids from non-pivotal suppliers – would be considered in the modeling and pricing of Capacity Zones in an FCA.<sup>28</sup> Third, a new FCM Pivotal Supplier test is proposed for de-list bids that “acts as a

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<sup>26</sup> INTMMU FCA Report at 8.

<sup>27</sup> February 22 Filing at 26-28.

<sup>28</sup> *Id.* at 28-29.

safeguard against the exercise of market power by identifying which suppliers are non-pivotal and therefore likely to offer competitively.”<sup>29</sup>

The first change above is not unreasonable and should be approved. However, the other changes are unnecessary due to the INTMMU review and limitations that already exist for mitigating de-list bids. More precisely, the second change is unnecessary because zones should be modeled regardless of the supply/demand balance in the zone. *Specifically, zones should be modeled all the time and FERC should require this change instead.* If the constraint binds, the zone will have a separate price; if not, it will clear at the same price as the rest of pool. It is inefficient to require new entry, even taking into account retirements and de-listings submitted prior to the auction, before allowing a zonal price to be established.

The third change, with regard to the proposed FCM Pivotal Supplier test, should be rejected. EPSCA reiterates that there is already appropriate mitigation in place to guard against potential exercise of seller market power, in the form of INTMMU and Commission review of de-list bids above 0.8 CONE and a prohibition on dynamic de-list bids above 0.8 CONE. There is no need to impose yet another layer of mitigation – resulting in a “belts and suspenders” approach – and further masking true pricing signals necessary to reflect the marginal cost of capacity, incent investment and ensure market efficiency. As the INTMMU notes:<sup>30</sup>

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<sup>29</sup> *Id.* at 29-31.

<sup>30</sup> INTMMU FCA Report at 21.

The current design addresses physical and economic withholding (at the system-wide level or within any defined capacity zones) through the following measures:

- Competition with potential new capacity by lowering barriers to entry for various types of resources, with the three-year forward period, limited penalties, and the option to lock in first-year revenues for up to five years
- INTMMU review of all static and permanent de-list bids above 0.8 x the CONE
- Prohibition of dynamic de-list bids above 0.8 x the CONE.

If allowed, the proposed modifications for modeling of Capacity Zones will still likely necessitate Reliability Agreements and do not adequately address the need to improve zonal definition and price-setting eligibility. FERC has previously been explicit in voicing concern regarding use of such agreements and the ability to undermine efficient market performance.<sup>31</sup>

Of note, the INTMMU FCA Report that initiated the stakeholder process recognized the need for improved modeling of Capacity Zones, but expressed concern regarding the potential for seller market power abuse.<sup>32</sup> Such concerns are unfounded since, as the INTMMU FCA Report clearly describes, there is currently ample and sufficient mitigation in Capacity Zones.

#### **IV. MOTION TO INTERVENE**

EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide

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<sup>31</sup> *Devon Power LLC, et al.*, 103 FERC ¶ 61,082 (2003).

<sup>32</sup> INTMMU FCA Report at 4-5.

reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers.

Many of EPSA's member companies have made significant investments in generation assets in New England and/or are market participants in the ISO-NE electricity markets, including the FCM. Further, many EPSA members are active participants in the ISO-NE stakeholder process. EPSA and/or its members have also been and continue to be active in many of the Commission's ongoing proceedings on ISO-NE matters. Accordingly, EPSA has a direct and substantial interest in the outcome of this proceeding that cannot be adequately represented by any other party and allowing EPSA to participate in this proceeding would be in the public interest.

All pleadings, correspondence and other communications concerning this proceeding should be directed to:

Nancy Bagot, Vice President of Regulatory Affairs  
Electric Power Supply Association  
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## **V. CONCLUSION**

WHEREFORE, EPSA respectfully requests that the Commission grant its motion for leave to intervene and consider its Protest and requested relief as set forth above in rendering its decision on revisions to the ISO-NE's FCM market rules.

Respectfully submitted,



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March 15, 2010

**CERTIFICATE OF SERVICE**

I hereby certify that I have served a copy of the comments via email, upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., March 15, 2010.



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Nancy Bagot, VP Regulatory Affairs