



Sherry A. Quirk
202/778-6475
squirk@schiffhardin.com

1666 K STREET N.W., SUITE 300
WASHINGTON, DC 20006

t 202.778.6400
f 202.778.6460

www.schiffhardin.com

March 30, 2007

VIA ELECTRONIC FILING

The Honorable Philis Posey
Acting Secretary
Federal Energy Regulatory Commission
Room 1A-East, First Floor
888 First Street, N.E.
Washington, D.C. 20426

Re: ISO New England Inc., Docket No. ER07-547-000

Dear Ms. Posey:

Attached for electronic filing in the above-referenced docket is the *Motion for Leave to Answer and Answer of ISO New England Inc.* A copy of the foregoing has been served upon all parties included in the Commission's service list.

If you have any questions or concerns regarding this filing, please feel free to contact me. Thank you for your assistance in this matter.

Respectfully submitted,

/s/ Sherry A. Quirk
Sherry A. Quirk, Esq.
Robin E. Remis, Esq.

Counsel for ISO New England Inc.

Attachment
cc: Official Service List

Installed Capacity Requirements (“ICR”) market rules; and market rules governing the Forward Capacity Auction (“FCA”) (Section III.13.2). In that notice, the Commission established a due date of March 8, 2007, for comments, protests, and interventions. A number of persons filed various protests and comments in response to the Commission’s notice, and on March 23, 2007, the ISO filed its *Motion for Leave to Answer and Answer of ISO New England Inc.* to those pleadings (“March 23 Answer”).

The remainder of the tariff provisions proposed by the ISO in the February 15 Filing have been docketed as Docket No. ER07-547-000 in the second notice of that filing issued by the Commission on February 20, 2007. The due date for comments, protests, and interventions in that docket established in that notice was March 15, 2007. The following answer addresses those filings made in Docket No. ER07-547-000 pursuant to that notice.

Various parties have filed comments in Docket No. ER07-547-000 in support of the February 15 Filing. The New England Conference of Public Utilities Commissioners (“NECPUC”) filed comments in support of the filing, stating that the proposed FCM market rules generally conform with the FCM Settlement and should be approved without modification.⁵ The Connecticut Department of Public Utility Control filed comments in support asserting that (1) the Commission should approve the proposed rules that permit rationing below a unit’s Economic Minimum Limit in reconfiguration auctions because those rules are required by the FCM Settlement; and (2) the Commission should approve the proposed rule for payment of Real-Time Emergency Generation Resources. In addition, the New England Power Pool (“NEPOOL”) Participants Committee has indicated in its comments in support that the issue

⁵ Motion to Intervene of the New England Conference of Public Utilities Commissioners Regarding Revisions to Market Rule 1 Relating to the Forward Capacity Market, Docket No. ER07-547-000 (filed March 15, 2007) at 4.

before the Commission in this proceeding is whether the FCM rules are just and reasonable as well as consistent with, and in furtherance of, the FCM Settlement (and the NEPOOL Participants Committee maintains that the proposed rules are indeed just and reasonable and in furtherance of the FCM Settlement); and that significant efforts to fully implement the FCM are still necessary in New England and remaining issues should continue to be addressed in the NEPOOL stakeholder process.

II. INTRODUCTION

In this *Answer*, the ISO responds to certain arguments put forth in the comments and protests filed by various parties in the instant docket, Docket No. ER07-547-000. To the extent that certain arguments have already been raised and addressed in the March 23 Answer, the ISO, in this *Answer*, incorporates by reference its responses therein and does not elaborate on them here.

NRG Power Marketing Inc. (“NRG PMI”), Connecticut Jet Power LLC, Devon Power LLC, Middletown Power LLC, Montville Power LLC, Norwalk Power LLC, and Somerset Power LLC (collectively “NRG”) object generally to the market rules concerning bilateral contracts.⁶ NRG argues that the FCM Settlement permits absolutely free substitution of one qualified capacity resource for another and that the FCM is a commodity market. Thus, NRG asserts that resources must have the complete ability to transfer a capacity obligation between two qualified suppliers within a zone without any ISO oversight or approval. NRG concludes that if as the ISO has stated, free substitution cannot be permitted, this fact could point to certain

⁶ Motion to Intervene and Protest of NRG Companies (“NRG Pleading”), Docket No. ER07-547-000 (filed March 15, 2007) at 2.

market flaws or the need for additional compensation.⁷ NRG's arguments must be rejected for several reasons. First, the Settlement Agreement does not contemplate absolutely free substitution but, instead, provides the ISO with specific authority to accept or reject a bilateral agreement. Second, this is not a commodity market; it is a forward market for physical resources, with an ability for bilateral contracting that does not undermine reliability. NRG's proposed approach to bilateral contracting, if adopted, will undermine the ISO's ability to achieve reliability. Once a resource is committed to the market, the FCM market design requires that the ISO perform a reliability review before another resource is substituted.

NRG further objects to the alleged absence of both a timetable for completion of review of bilateral contracts and a mechanism for review of an adverse decision by the ISO.⁸ However, NRG's complaints on the first point are premature because the timing and details of the process for submission and review of bilateral contracts will be fleshed out in the manuals that remain to be developed to implement these provisions. With respect to a mechanism for contesting ISO reliability rejections of bilateral contracts, the allegedly aggrieved party has the right to file a Section 206 complaint to overturn the ISO's determination.

EnerNOC, Inc. ("EnerNOC") is concerned that under the proposed FCM rules, Demand Resources will no longer be able to participate in the energy markets and that the energy payments that are currently part of the ISO's 30-minute Real-Time Demand Response Program will be eliminated.⁹ As explained further below, the proposed FCM rules do not eliminate the ability of Demand Resources to participate in the energy

⁷ *Id.* at 5.

⁸ *Id.* at 3-4.

⁹ Motion to Intervene and Comment of EnerNOC, Inc. ("EnerNOC Pleading"), Docket Nos. ER07-546-000 and ER07-547-000 (filed March 8, 2007) at 3-4.

market. Moreover, while the proposed FCM rules would authorize payments to Demand Resources for the Capacity Value that they provide to the electric system, the rules do not authorize explicit payments for reductions in energy usage, as doing so would result in double payment to Demand Resources.

The Capacity Suppliers¹⁰ renew in this docket issues raised in their protest filed in Docket No. ER07-546-000. In particular, they raise various issues concerning the proposed rules addressing offers or bids rejected for reliability reasons, and recommend certain reporting requirements to increase the transparency of the ISO's use of its authority to reject offers or bids for reliability reasons.¹¹ As the ISO has stated more fully in its March 23 Answer, the Capacity Suppliers' proposed revisions are unnecessary because the rules already require the ISO to provide the information they request.¹²

NSTAR Electric & Gas Corporation ("NSTAR") argues that the FCM market rules must address the issue of reliance on generation availability through the forgiveness of gas pipeline penalties.¹³ According to NSTAR, by allowing gas generators to rely on recovery of gas penalties to pay for supply when the gas system is at its most stressed, the proposed market rules would provide *carte blanche* to generators to rely upon gas taken from firm customers, thereby destroying the reliability of the gas system in order to preserve the reliability of the electric

¹⁰ The Capacity Suppliers are Boston Generating, LLC ("Boston Generating"), FPL Energy, LLC ("FPLE"), and the Mirant Parties (Mirant Energy Trading, LLC ("MET"), Mirant Canal, LLC ("Mirant Canal"), and Mirant Kendall, LLC ("Mirant Kendall")).

¹¹ Motion to Intervene and Limited Protest of Capacity Suppliers ("Capacity Suppliers Pleading"), Docket No. ER07-547-000 (filed March 15, 2007) at Appendix A.

¹² March 23 Answer at 19-20; 54-56.

¹³ Intervention and Protest of NSTAR Electric & Gas Corporation ("NSTAR Pleading"), Docket Nos. ER07-546-000 and ER07-547-000 (not consolidated)(filed March 8, 2007) at 12.

system.¹⁴ NSTAR's protest should be rejected because the issue it has raised will be addressed when the ISO submits a further filing on gas-electric market coordination pursuant to Section VII of the FCM Settlement.

Brookfield Energy Marketing Inc. ("Brookfield Energy") reiterates the argument it raised in Docket No. ER07-546-000 regarding the prohibition on capacity exports by Intermittent Power Resources and requests that the restriction on Intermittent Power Resources from backing capacity exports into neighboring control areas be eliminated.¹⁵ For the reasons set forth in the ISO's March 23 Answer, it would be inappropriate to permit Intermittent Power Resources to back capacity exports into neighboring control areas and, thus, the proposed revisions requested by Brookfield Energy should be rejected.¹⁶

Casco Bay Energy LLC ("Casco Bay") argues that holders of Capacity Transfer Rights ("CTRs") should continue to recover their investment in the upgrades that resulted in the award of CTRs even after a constraint ceases to exist and there is no longer price separation.¹⁷ However, Casco Bay misinterprets the CTR mechanism. As explained further below, once a constraint ceases to exist and there is no longer price separation, there is no entitlement to receive an alternative form of compensation. Thus, Casco Bay's proposal should be rejected.

FirstLight Power Resources Management LLC, FirstLight Hydro Generating Company and Mt. Tom Generating Company LLC (collectively "FirstLight Parties") seek clarification that the FCM market rules require listed capacity resources participating in the FCM to offer into the

¹⁴ *Id.* at 15.

¹⁵ Motion to Intervene and Protest of Brookfield Energy Marketing Inc. ("Brookfield Energy Pleading"), Docket No. ER07-547-000 (filed March 12, 2007) at 4-6.

¹⁶ March 23 Answer at 56-57.

¹⁷ Motion to Intervene and Comments of Casco Bay Energy Company LLC ("Casco Bay Pleading"), Docket No. ER07-547-000 (filed March 15, 2007) at 5-6.

Day-Ahead and Real-Time Energy Markets the resources' physical operating characteristics but do not impose any additional obligations on such resources, *e.g.*, requiring such resources to provide ancillary services.¹⁸ As explained further below, the Commission should deny the requested clarification which is unnecessary based on the unambiguous plain language of the market rules and the intent of the FCM Settlement.

III. MOTION FOR LEAVE TO ANSWER

In this *Answer*, the ISO responds to certain arguments put forth in the comments and protests filed by various parties to this proceeding. While the Commission's Rules of Practice and Procedure allow parties to respond to comments,¹⁹ as a general matter, the Commission's rules prohibit responses to protests.²⁰ The Commission has the authority, however, to waive this prohibition for good cause.²¹ The Commission has found good cause to permit replies where they are otherwise prohibited in various circumstances, including where the answer would assure a complete record in the proceeding,²² provide information helpful to the disposition of an issue,²³ permit the issues to be narrowed or clarified,²⁴ or aid the Commission in understanding and resolving issues.²⁵ The ISO believes that this *Answer* will clarify the issues, assure a more complete record in this proceeding, and otherwise assist the Commission in understanding and

¹⁸ Motion to Intervene and Comments of the FirstLight Parties ("FirstLight Pleading"), Docket No. ER07-547-000 (filed March 15, 2007), at 4-6.

¹⁹ See 18 C.F.R. § 385.213(a)(3) (2006).

²⁰ See 18 C.F.R. § 385.213(a)(2) (2006).

²¹ See 18 C.F.R. § 385.101(e) (2006).

²² See, *e.g.*, *Pacific Interstate Transmission Co.*, 85 FERC ¶ 61,378 at 62,444 (1998), *reh'g denied*, 89 FERC ¶ 61,246 (1999).

²³ See, *e.g.*, *CNG Transmission Corp.*, 89 FERC ¶ 61,100 at 61,287 n.11 (1999).

²⁴ See, *e.g.*, *PJM Interconnection, L.L.C.*, 84 FERC ¶ 61,224 at 62,078 (1998); *New Energy Ventures, Inc. v. Southern California Edison Co.*, 82 FERC ¶ 61,335 at 62,323 n.1 (1998).

²⁵ See, *e.g.*, *Tennessee Gas Pipeline Co.*, 92 FERC ¶ 61,009 at 61,016 (2000).

resolving the issues raised in response to the February 15 Filing. For these reasons, the ISO respectfully requests that the Commission grant the ISO's motion to provide the following *Answer*.

IV. ANSWER

A. The ISO Must Have the Ability to Review Bilateral Contracts for Impacts on Reliability

1. NRG Arguments

NRG objects generally to Section III.13.5 of the proposed market rules, the entire 7-page section concerning bilateral contracts.²⁶ According to NRG, the ISO's review of the transfer of FCM obligations directly contradicts the FCM Settlement, affords the ISO significant discretion in the review of such transfers, and impinges upon the Commission's exclusive jurisdiction under Section 203 of the FPA.²⁷ NRG's entire argument is premised on the assertion that "the FCM Settlement provides for a market solution, premised upon a fungible commodity product -- installed capacity -- that can be commercially exchanged."²⁸

NRG states that there is no clear time frame for the ISO to complete its review of the transfers of obligations, and that the proposed rules set forth a burdensome process that will restrict the liquidity in the market, and perhaps eliminate the secondary capacity market altogether.²⁹ Further, NRG states that there is no clear or timely review process from an adverse ISO determination and that the ISO can deny a transfer request and effectively hold a specific resource captive for "reliability issues."³⁰ NRG believes that the ISO can use these provisions to

²⁶ NRG Pleading at 2-4.

²⁷ *Id.* at 3.

²⁸ *Id.* at 2.

²⁹ *Id.* at 3-4.

³⁰ *Id.* at 4.

backstop its determinations of the proper level of capacity, thus allowing it to lower its determination of ICR.³¹ NRG claims that the restrictions are discriminatory as some resources will be allowed to enter bilateral arrangements while others will be denied the ability to do so, although the compensation in the FCM is identical for all units.³²

NRG further argues that an efficiently designed capacity market should embrace the free substitution of one qualified service provider with another, and that the inability to transfer a capacity obligation between two qualified suppliers within a zone could indicate (i) a significant deficiency (of either capacity or transmission) for which an appropriate market signal has not been sent to the entity best capable of resolving the issue; (ii) the understating of the amount of capacity within the Capacity Zone required to ensure reliability within the zone; or (iii) the improper sizing of the Capacity Zone.³³

NRG believes that the only obligation that should be placed on a supplier seeking to execute a bilateral contract is that the supplier should be required to provide notice to the ISO thus affording the ISO an opportunity to review any such transfer.³⁴ If the ISO seeks to prohibit a transfer due to reliability concerns, according to NRG, the ISO should be required to make a Section 205 filing with the Commission explaining in detail its reasons for seeking to prohibit the transfer, and explaining whether the prohibition would result in undue discrimination as applied to the specific facts at hand. Finally, NRG requests the Commission to direct the ISO to develop pricing rules that would both compensate a resource that was denied the right to transfer

³¹ *Id.*

³² *Id.*

³³ *Id.* at 5-6.

³⁴ *Id.* at 6.

its obligation, and send signals to the market and transmission owners as to the need for additional capacity and/or transmission necessary to resolve the problem.³⁵

2. ISO Response

NRG's protest raises both substantive and procedural issues. Substantively, NRG's proposed approach to bilateral contracting, if adopted, will undermine the basic objectives of the FCM market design. The essence of NRG's argument is that the FCM Settlement provides that entities shall be free to transact in the bilateral market, with an unlimited ability to substitute an alternative supplier in the same Capacity Zone. NRG argues that the ability to commercially exchange a fungible product is one of the fundamental underlying premises of the FCM Settlement.

NRG's reading would overturn the fundamental market design approved by the Commission in the FCM Settlement. At the most basic level, NRG misperceives this market as a commodity market – like sugar or corn – when, in fact, it is a physical market for a set of generating and demand resources that can provide reliable electric service to New England's customers. The FCM Settlement contemplates that the FCA would purchase sufficient capacity to assure reliability as measured by ICR.³⁶ The FCA will also purchase sufficient capacity in each sub-region of New England to assure enough capacity in each of those regions.³⁷ The Settlement provides the ISO the ability to reject units that wish to leave but cannot because they are needed for reliability reasons, as noted above.³⁸ Thus, the outcome of the FCA is a set of resources that will assure resource adequacy for the entire region and each sub-region, as well as

³⁵ *Id.* at 7.

³⁶ FCM Settlement, Transmittal Letter at 23, n.41 and FCM Settlement at Section 11, Part III.C.

³⁷ FCM Settlement at Section 11, Part IV.B.2.

³⁸ FCM Settlement at Section 11, Part III.K.

meet any other relevant reliability concerns. Once a resource is accepted in a primary FCA, that resource is committed to provide its capacity during the Capacity Commitment Period. Each of the resources that clear in the FCA play an important role maintaining reliability. Therefore, it is essential that the ISO have the right to review resources that wish to exit the market for reliability concerns after they clear in the FCA and acquire a Capacity Supply Obligation. As discussed more fully below, that obligation can be relieved through bilateral contracting, but only if the reliability of the system is not jeopardized.

Recognizing that bilateral contracts are an important component of a well functioning market, the Settlement provides for them; however, NRG's argument reads much too much permissiveness into the FCM Settlement regarding bilateral contracts. The Settlement states that bilaterals "shall be allowed,"³⁹ but, importantly, the Settlement also specifically provides the ISO with the right to "accept" such transactions.⁴⁰ "Accept" cannot be read to mean "must allow" and, critically, nowhere else in the FCM Settlement is there an explicit and absolute right to bilaterally contract out of obligations.

NRG's argues that the market design should treat resources that qualify for the FCA as equally deliverable and interchangeable both within a zone modeled in the FCA, and also within any larger consolidated zone resulting from the lack of price separation in the auction. This argument ignores the crucial fact that the procurement of a resource in the FCA is the reason that there was no price separation in the auction. As explained in the February 15 Filing (in the context of reconfiguration auctions, which are a proper analogy for bilateral contracts) the absence of price separation in the FCA does not mean that there is no specific need for capacity

³⁹ FCM Settlement at Section 11, Part III.P.

⁴⁰ *Id.* at Section 11, Part IV.B.2.

in local potentially import-constrained zones.⁴¹ Rather, it means that there was sufficient capacity (both existing and new) in the import-constrained zone that was willing to remain in the auction at the region-wide clearing price. Allowing resources to leave without a reliability review could result in too little capacity in that reliability region. For example, a plausible scenario is that all of NRG's units in Connecticut could clear in the FCA and additionally, sufficient additional units in Connecticut could stay in the auction so that there was not price separation in Connecticut. Under NRG's proposal, NRG could simply sign a bilateral contract with units in western Massachusetts or Maine to replace their Connecticut capacity because there was only one zone. Permitting this would obviously result in too little capacity in Connecticut and undermine the integrity of the FCA. The lack of capacity in Connecticut cannot be remedied in the reconfiguration auctions because the Settlement does not permit auctions for local zones when there is no price separation in the auction. NRG's proposal would result in a failed market.

In the FCM Settlement, consumers agreed to commit to pay generators three years in advance in exchange for assuming a resource specific obligation to be there to assure reliability. Indeed, by participating in the FCA and clearing in that auction at a price accepted by the resource, each resource is accepting the obligation to provide capacity at a just and reasonable, market determined rate. If there is an unfettered right to exit the market and renege on an obligation, then the basic bargain of the FCM Settlement has been broken. This would set up a game where units who think they might be needed for reliability would simply leave the market and wait for some form of reliability agreement at a higher price. Setting up a structure that encourages shopping for the higher of cost or market is bad market design and is bad for reliability.

⁴¹ February 15 Filing at 141.

Additionally, a key component of the bargain struck in the FCM Settlement was to eliminate the requirement that de-listed resources offer into the real-time market.⁴² The *quid pro quo* for this change from the existing market was to provide the ISO with the ability to review bilateral contracts and reconfiguration auction participation to assure that reliability was not harmed by the de-listing of resources. Generators gained the flexibility to avoid offer requirements for de-listed resources, and the trade-off contemplated in the Settlement was a restriction on shedding obligations through bilaterals or reconfiguration auctions. NRG's arguments would overturn this balance, leaving generators with flexibility but the ISO with no ability to maintain reliability.

NRG's further contention that suppliers fulfilling local reliability needs should be paid additional compensation for this service should be rejected.⁴³ As explained in the February 15 Filing, in the context of reconfiguration auctions:⁴⁴

Resources may also be prevented from shedding obligations for local reliability reasons, such as providing VAR support. The rejection of these resources for reliability does not imply that these resources should be entitled to additional compensation. They are simply being held to the obligation they undertook in the FCA. If they are asked to provide additional services, *e.g.* VAR support or regulation, they will be compensated for those services through the appropriate ISO tariff or markets.

Similarly, NRG's argument that the Commission should require the ISO to make a filing with the Commission to prevent a bilateral contract that threatens reliability from

⁴² FCM Settlement at 42.

⁴³ NRG also takes issue with the ISO's guidance that suppliers should price into their offers the obligation they will assume to fulfill a Capacity Supply Obligation, and the possibility that they may not be able to transfer or shed this obligation. According to NRG, it is unfair for the ISO to provide this guidance when in its regulations related to review of de-list bids, such risk premiums are not permitted. NRG mixes apples and oranges with this argument, as the proper cost components of a de-list bid are different from an offer into the FCA. A risk premium associated with assuming a Capacity Supply Obligation is not properly includable in a de-list bid because it is not a going forward cost.

⁴⁴ February 15 Filing at 142.

going forward should be dismissed. As explained above, the FCM market design depends upon physical assets assuming commitments several years in advance of the Capacity Commitment Period and upon the committed capacity itself being in place to serve load. The free substitution of resources urged by NRG is incompatible with this design, for the reasons explained above. To the extent that a market participant disagrees with the ISO's reliability determination, that market participant should bear the burden of demonstrating that the ISO is in error, and exercise its rights before the Commission under Section 206 of the Federal Power Act.

NRG is correct that the ISO must provide written notice and explanation to a resource already committed through the FCA explaining the rationale for refusing to accept a bilateral agreement, and the process for so doing will be laid out in the Manuals, as described below. The ISO makes many reliability determinations regarding operations of the bulk power system every day and, carrying NRG's argument to its logical end, each of those determinations would be the subject of a 205 filing. This would turn on its head the long accepted FERC practice under Sections 205 and 206 of the FPA.

Procedurally, NRG complains about the alleged absence of a time table for completion of review of bilateral contracts. NRG's complaint in this regard is premature. As the ISO made clear during the stakeholder process, the timing and the details of the process for submission and review of bilateral contracts will be detailed in the Manuals that remain to be developed to implement these provisions. NRG should await the development of the Manuals, and the

stakeholder process that surrounds such development. There, NRG can actively participate and raise its concerns about timing.⁴⁵

For all of these reasons, NRG's protest should be rejected.

B. Participation of Demand Resources in Energy Markets

1. EnerNOC Argument

EnerNOC is concerned that under the proposed FCM rules, Demand Resources will no longer be able to participate in the energy markets and that the energy payments that are currently part of the ISO's 30-minute Real-Time Demand Response Program will be eliminated. EnerNOC asserts that the proposed exclusion of Demand Resources from the energy markets appears to be based on the assumption that a large majority of customers will be on Time-of-Use or Real-Time Pricing tariffs, (both of which EnerNOC supports), by 2010. EnerNOC questions whether such pricing mechanisms will be widely adopted by 2010. Because of the possibility that such pricing mechanisms may not be widely adopted by that time, EnerNOC believes that it is not appropriate to eliminate the ability of Demand Resources to participate in the energy market.

2. ISO Response

EnerNOC's argument that the proposed FCM rules eliminate the ability of Demand Resources to participate in the energy market is misleading and rests upon a limited view of markets and participation by demand resources in these markets. Demand resources participate in all markets, including the energy markets, by using less when price increases. Nothing in the FCM rules affects this basic right. The February 15 Filing extends the current Load Response

⁴⁵ To the extent that the Manuals include provisions that constitute rates, terms, or conditions of service, the ISO will make appropriate filings with the Commission, and if NRG opposes those provisions in the filing it will have an opportunity to then protest to the Commission.

Program from the current expiration date of February 29, 2008 to May 31, 2010 to permit participants in the demand response program to receive ICAP Transition Payments and continue the price-based programs for approximately an additional two and one half years. There is no need for the capacity-based programs once the FCM commences because the Commission's objective of integrating demand-side into the market will be achieved. It is the ISO's view that because the integration of demand resources into the wholesale markets⁴⁶ is sufficiently complete, there is no need to extend the price-based programs beyond 2010. Notwithstanding, at the request of several stakeholders, the ISO has committed to discuss the termination of the price-based programs in the stakeholder process prior to their termination in June 2010. Thus, EnerNOC's request to continue these programs is premature and should be addressed in the upcoming stakeholder process. For the reasons set forth above, EnerNoc's request should be rejected.

C. Offers or Bids Rejected for Reliability Reasons

1. Capacity Suppliers Arguments

In their protest to the ISO's February 15 Filing in Docket No. ER07-546-000, the Capacity Suppliers raised various issues (at pp 15-22 of that filing, which they attach as Appendix A to their Docket No. ER07-547-000 protest) concerning the rules proposed by the ISO relating to offers or bids rejected for reliability reasons. Capacity Suppliers also renew the comments filed in the companion docket ER07-546-000 and argue that the ISO should increase the transparency of its use of its authority to reject offers or bids for reliability reasons.⁴⁷ The

⁴⁶ Currently, in addition to participation in the capacity market, demand can participate in both the energy market and the ancillary services market by registering as asset-related demand ("ARD") and being dispatched by the ISO. Moreover, a pilot program to allow demand resources as small as 100 kW to participate in the ancillary services market is pending.

⁴⁷ Capacity Suppliers Pleading at Appendix A.

Capacity Suppliers assert that the issues they raised in their Docket No. ER07-546-000 protest span proposed tariff sections docketed in both Docket No. ER07-546-000 and Docket No. ER07-547-000. However, rather than reiterate at length in this Docket No. ER07-547-000 proceeding those arguments and the requests for relief, the Capacity Suppliers request that the arguments and requests contained in their Docket No. ER07-546-000 protest be considered, as appropriate, in this proceeding.

2. ISO Response

The ISO has responded fully to the Capacity Suppliers' concerns and hereby incorporates by reference the relevant portions of its March 23 Answer in the instant proceeding.⁴⁸ For the reasons set forth in its March 23 Answer, the proposed revisions requested by Capacity Suppliers are unnecessary because the rules already require the ISO to provide the information they request. Consequently, the proposal proffered by Capacity Suppliers should be rejected.

D. Provisions Governing Recovery of Extraordinary Fuel Expenses

1. NSTAR Argument

NSTAR argues that the FCM market rules must address the issue of reliance on generation availability through the forgiveness of gas pipeline penalties.⁴⁹ According to NSTAR, the language in the FCM Settlement designed to improve gas-electric coordination during cold weather events is rendered meaningless if gas-fired generators are free to ignore pipeline restrictions.⁵⁰ NSTAR maintains that by allowing gas generators to rely on recovery of gas penalties to pay for supply when the gas system is at its most stressed, the proposed market rules would provide *carte blanche* to generators to rely upon gas taken from firm customers,

⁴⁸ March 23 Answer 54-56.

⁴⁹ NSTAR Pleading at 12.

⁵⁰ *Id.* at 14.

thereby destroying the reliability of the gas system in order to preserve the reliability of the electric system.⁵¹

2. ISO Response

NSTAR's protest should be rejected because the issue it has raised will be addressed when the ISO submits a further filing on gas-electric market coordination pursuant to Section VII of the FCM Settlement. As noted in the February 15 Filing:

One issue raised during stakeholder discussion was that resources using natural gas as their primary fuel source should not be permitted to recover gas pipeline imbalance charges and other penalties applicable to procurement of fuel during times of extraordinary fuel prices. The Settlement permits generators to recover gas pipeline imbalance charges and other penalties incurred during periods of extraordinary fuel costs, and thus does not require that the recovery of such costs should be prevented. However, as the ISO files rules to implement Section VII of the Settlement regarding gas availability, it may seek to clarify the provision to assure that they do not provide improper incentives.⁵²

The ISO requests that the Commission defer a ruling on the issue raised by NSTAR, and permit the ISO to submit a further filing on coordination of the gas and electric markets. In the meantime, the Commission should monitor this issue.

E. Intermittent Power Resources Should not be Permitted to Back a Capacity Export to an External Control Area.

1. Brookfield Argument

Brookfield Energy reiterates the argument that it raised in the companion docket (Docket No. ER07-546-000) regarding the prohibition on capacity exports by Intermittent Power

⁵¹ *Id.* at 15.

⁵² February 15 Filing at 157.

Resources and argues that the restriction on Intermittent Power Resources from backing capacity exports into neighboring control areas should be eliminated.⁵³

2. ISO Response

The ISO has responded fully to Brookfield Energy's concerns and hereby incorporates by reference the relevant portions of its March 23 Answer in the instant pleading.⁵⁴ For the reasons set forth in its March 23 Answer, it would be inappropriate to permit Intermittent Power Resources to back capacity exports into neighboring control areas and, thus, the proposed revisions requested by Brookfield Energy should be rejected.

F. Capacity Transfer Rights are Financial Instruments Intended to Reflect the Costs or Benefits of a Constrained Zonal Requirement and are not a Perpetual Right to Compensation Regardless of the Existence of Congestion.

1. Casco Bay Argument

Referencing the specific CTR allocations set forth in the market rules, Casco Bay seeks assurance that holders of CTRs will continue to recover their investment in the upgrades that resulted in the award of CTRs even after "regionally-funded upgrades reduce or eliminate the capacity price separation that is necessary if CTRs are to provide the intended compensation."⁵⁵

2. ISO Response

As ISO witness, Mr. Mark Karl testified in *Devon Power, LLC*:

A CTR is an allocation of the ability to import capacity over a specific interface in the Locational ICAP market that enables its holder to buy and sell ICAP in neighboring ICAP Regions and be held financially harmless. A CTR acts as a purely financial instrument such that its holder is paid the difference

⁵³ Brookfield Energy Pleading at 4-6.

⁵⁴ March 23 Answer at 56-57.

⁵⁵ Casco Bay Pleading at 1-2.

in Locational ICAP price between two ICAP Regions associated with the CTR.⁵⁶

Contrary to Casco Bay's interpretation, a CTR is a financial, not physical, instrument which enables an entity that funds an upgrade resulting in the increase in transfer capacity across a constrained interface to obtain the financial equivalent, *i.e.*, capacity price, outside of the constrained area.

With regard to CTRs, the FCM market rules "provide that revenues collected from load serving entities in excess of revenues paid to resources will be paid to the holders of CTRs, which are a financial but not a physical right to transfer capacity across an interface. The ISO will create CTRs for each interface associated with a Capacity Zone that has experienced price separation in the FCA. . ."⁵⁷ To the extent a constraint ceases to exist, there is no longer price separation so the need for the CTR and the dollars that pay for the CTR no longer exist.

Casco Bay does not understand the concept of CTRs as shown by its request for alternative compensation in the event that a constraint ceases to exist. Casco Bay states:

If such a PTF-funded upgrade reduced or eliminated price separation across a given interface, the CTRs awarded in recognition of the participant-funded upgrades to that interface would cease to provide the intended compensation to the initial private investors (such as Casco Bay) and, absent some alternative mechanism for compensating CTR holders, the entity that privately-funded the upgrades will receive less and perhaps no value for its investment.⁵⁸

No alternative compensation is warranted in the absence of price separation and Casco Bay's proposal⁵⁹ should be rejected. As explained above, a CTR is a financial mechanism conferring a financial right on the CTR holder that funded an upgrade to source part of its total constrained

⁵⁶ *Devon Power LLC*, Docket No. ER03-563-030, Prepared Direct Testimony of Mark Karl on Behalf of ISO New England Inc. (August 31, 2004), at 3.

⁵⁷ February 15 Filing at 168.

⁵⁸ Casco Bay Pleading at 6.

⁵⁹ *Id.* at 7-8.

zonal requirement outside of a constrained area and receive the equivalent of the capacity price across the constraint. Casco Bay misinterprets a CTR as a guaranteed source of revenue to pay for its investment *ad infinitum*. CTRs simply permit an entity that funded an upgrade, *e.g.*, Casco Bay, to receive the financial equivalent of exporting capacity over the constrained interface. If the value of capacity on both sides of the interface is the same, there is no need for the CTR as the investment has achieved its objective of allowing that entity to sell across the interface. Providing additional compensation in such circumstance would result in double payment. For the reasons set forth above, Casco Bay’s proposal should be rejected.

G. Consistent with the FCM Settlement, Offers from Listed Capacity Resources Must Reflect the Then-Known Unit Specific Operating Characteristics of Such Resources.

1. FirstLight Argument

FirstLight seeks clarification that the FCM market rules require listed capacity resources participating in the FCM to offer into the Day-Ahead and Real-Time Energy Markets the resources’ physical operating characteristics but do not impose any additional obligations on such resources, *e.g.*, requiring such resources to provide ancillary services.

2. ISO Response

The rights and obligations of listed capacity resources are expressly set forth in the FCM market rules. Specifically, Section III.13.6.1 describes the rights and obligations of listed capacity resources. As provided therein, listed capacity generating resources must be offered into both the Day-Ahead and Real-Time Energy Markets and the offers “must reflect the then-known unit-specific operating characteristics (taking into account, among other things, the physical design characteristics of the unit) consistent with good utility practice.”⁶⁰ Thus,

⁶⁰ Proposed FCM Market Rules, Section III.13.6.1.1.2. *See also* Section III.13.6.1.1.1.

pursuant to the FCM market rules, listed capacity generating resources must offer their physical operating characteristics and follow dispatch instructions consistent with such unit characteristics. Aside from the obligations expressly contained in Section III.13.6.1 and the requirement to follow dispatch instructions, the FCM market rules do not mandate participation in other markets. The plain language of the market rules and the intent of the Settlement are unequivocal and, thus, there is no need for clarification. Consequently, FirstLight's request should be denied.

V. CONCLUSION

For the foregoing reasons, the ISO respectfully requests that the Commission: (i) grant the ISO's *Motion for Leave to Answer*; and (ii) reject the protests and comments discussed herein in their entirety.

Respectfully submitted,

/s/ Sherry A. Quirk, Esq.

Sherry A. Quirk, Esq.

Robin E. Remis, Esq.

Schiff Hardin LLP⁶¹

1666 K Street, N.W., Suite 300

Washington, D.C. 20006

(202) 778-6475

/s/ Raymond W. Hepper, Esq.

Raymond W. Hepper, Esq.

Kerim May, Esq.

ISO New England Inc.

One Sullivan Road

Holyoke, MA 01040-2841

(413) 540-4585

Counsel for ISO New England Inc.

Dated: March 30, 2007

⁶¹ Sherry A. Quirk and Robin E. Remis previously were associated with the law firm of Sullivan & Worcester LLP.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (2006), upon each person designated on the official service list in this proceeding as compiled by the Secretary of the Federal Energy Regulatory Commission.

Dated at Washington, D.C., this 30th day of March, 2007.

/s/ Sherry A. Quirk
Sherry A. Quirk

DC\ 7035175.3