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May 16, 2007

**VIA ELECTRONIC FILING**

The Honorable Kimberly D. Bose  
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. ER07-546-000**

Dear Ms. Bose:

Attached for electronic filing in the above-referenced docket is the *Request for Rehearing and Request for Expedited Consideration 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.

Counsel for ISO New England Inc.

Attachment

cc: Official Service List

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**ISO New England Inc.**

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**Docket No. ER07-546-000**

**REQUEST FOR REHEARING AND  
REQUEST FOR EXPEDITED CONSIDERATION  
OF ISO NEW ENGLAND INC.**

Pursuant to Section 313(a) of the Federal Power Act (“FPA”)<sup>1</sup> and Rules 212 and 713 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission” or “FERC”),<sup>2</sup> ISO New England Inc. (the “ISO”) hereby requests rehearing of the Commission’s April 16, 2007 “Order Conditionally Accepting Market Rules and Requiring Compliance Filing” (“April 16 Order”)<sup>3</sup> issued in the above-captioned proceeding. In that order, the Commission conditionally accepted the ISO’s February 15 filing (“February 15 Filing”) in which the ISO filed market rules to implement the March 6, 2006 Forward Capacity Market<sup>4</sup> (“FCM”) Settlement Agreement (“FCM Settlement” or “Settlement”)<sup>5</sup> approved by the Commission.<sup>6</sup> In conditionally accepting the proposed market rules and requiring the ISO to

<sup>1</sup> See 16 U.S.C. §8251(a) (2000).

<sup>2</sup> See 18 C.F.R. §§ 385.212, 385.713 (2006).

<sup>3</sup> *ISO New England, Inc.*, 119 FERC ¶ 61,045 (2007).

<sup>4</sup> Capitalized terms used but not defined in this filing are intended to have the meanings given to such terms in the February 15 Filing, the Second Restated New England Power Pool Agreement (the “Second Restated NEPOOL Agreement”), the Participants Agreement, or the ISO New England Inc. Transmission, Markets and Services Tariff (“ISO Tariff”).

<sup>5</sup> Explanatory Statement in Support of Settlement Agreement of the Settling Parties and Request for Expedited Consideration and Settlement Agreement Resolving All Issues, *Devon Power LLC, et al.*, Docket Nos. ER03-563-000, *et al.* (March 6, 2006).

<sup>6</sup> *Devon Power LLC*, 115 FERC ¶ 61,340 (2006), *reh’g denied*, 117 FERC ¶ 61,133 (2006).

make certain filings, the Commission, *inter alia*, addressed issues related to rejection of de-list bids by the Internal Market Monitoring Unit (“INTMMU”). The ISO seeks rehearing on one generalized holding in the Order – requiring the INTMMU to “determine an accurate and appropriate bid level for an Existing Generating Capacity Resource consistent with its net risk-adjusted going forward and opportunity costs.”<sup>7</sup> The ISO requests expedited consideration in order to prevent disruption or delay of the process for reviewing de-list bids. Accordingly, the ISO asks the Commission to issue an order no later than July 15, 2007.

## **I. BACKGROUND**

In accordance with the Settlement establishing the FCM, the ISO was required to file market rules pursuant to Section 205 of the FPA on or before February 15, 2007. This schedule was intended to allow the ISO to conduct the first Forward Capacity Auction (“FCA”) in early 2008 as contemplated by the FCM Settlement.

The package of market rules was developed by the ISO, New England Power Pool (“NEPOOL”) stakeholders, and the New England Conference of Public Utility Commissioners (“NECPUC”). Generally, the market rules implement the FCM by setting forth the framework by which resources shall be eligible to qualify as capacity resources and participate in or de-list from the FCM. The rules also contain provisions delineating the reporting requirements of the ISO to the Commission and challenges to certain ISO determinations. On April 16, 2007, the Commission issued an Order Conditionally Accepting Market Rules and Requiring Compliance Filing. The ISO seeks rehearing of only that portion of the Commission’s order related to review of de-list bids by the INTMMU.

<sup>7</sup> April 16 Order at P 120.

## II. INTRODUCTION

The ISO seeks rehearing of the Commission's ruling requiring the INTMMU to determine an appropriate de-list bid in the event that the ISO finds a generator's de-list bid unjustified. This ruling is inconsistent with the Settlement, erroneously shifts the burden of proving the appropriate bid level from the generator submitting the bid to the INTMMU, and greatly expands the role of the INTMMU by requiring the INTMMU to establish a rate for the generator rather than referring the issue to the Commission for resolution. Furthermore, by providing a generator with multiple opportunities to refine its bid, the Commission may inadvertently invite price searching. This result is contrary to the Settlement's plain language and the interpretation of the Settlement provided in the Explanatory Statement,<sup>8</sup> as well as contrary to law and Commission policy. Given the vulnerability of capacity markets to price manipulation and market power abuse, including anti-competitive behavior by existing generators, the ruling could pose a material risk that prices might be raised to levels higher than those in a fully competitive market.

The Settling Parties agreed to a number of provisions which are intended to address potential price manipulation and market power abuse. In this regard, there are several fundamental concepts embedded in the Settlement and the market rules implementing the Settlement submitted in the February 15 Filing.

First, the Settling Parties agreed that if new capacity is needed, the clearing price should be set by new generating resources, not existing generation. As stated in the Explanatory Statement to the Settlement, "A key element of the auction design is the competitive bidding

<sup>8</sup> Explanatory Statement at 32; FCA Settlement at § 11, Part III.E.

process that will price all capacity from bids made by new capacity.”<sup>9</sup> To achieve this goal, the Settlement provided that new generating resources have the opportunity to bid into the market with few restrictions, but as a general rule, existing generators would enter the market as price takers, with a bid of zero.<sup>10</sup>

Second, the Settling Parties recognized that resources could not be forced to participate in the market and, therefore, must have the right to de-list; but that existing generators could exercise market power through the submission of de-list bids. As explained in the February 15 Filing, a generator owning a number of resources in New England has the incentive to submit a high de-list bid in order to remove capacity from the market to achieve the result of a higher clearing price for the benefit of its remaining resources participating in the auction.<sup>11</sup> Thus, the Settlement provided that:

In reviewing bids from Existing Capacity that are subject to review as set forth in Part III.D above, *the Market Monitor shall review that the proposed bid is consistent with the Resource’s net risk-adjusted going forward and opportunity costs*, recognizing, among other things, infra-marginal rents, availability adjustments, and PER deductions.

The Explanatory Statement, which described the purposes of the Settlement and was reviewed and endorsed by all of the Settling Parties, explained that the INTMMU was only to have “specifically delineated authority to *review and reject* bids that are concluded to be improper...”<sup>12</sup>

In light of this plain language, the ISO acted on its authority in Section 3.B of the Settlement, and filed pursuant to Section 205 of the FPA, market rules that are “consistent with,

<sup>9</sup> Explanatory Statement at 9.

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

<sup>11</sup> February 15 Filing at 38-39, 42-43.

<sup>12</sup> Explanatory Statement at 11 (emphasis added).

and in furtherance of, all terms contained in the Settlement.” Thus, the proposed market rules require an existing generator to submit support for the cost components of its de-list bid,<sup>13</sup> subject to review by the INTMMU,<sup>14</sup> and provide that the bid is subject to rejection by the INTMMU if the bid is not consistent with the resource’s going forward or opportunity costs. Under Section 205, the Commission’s inquiry is limited to “whether the rates proposed by a utility are reasonable – and [this inquiry does not] extend to determining whether a proposed rate schedule is more or less reasonable than alternative rate designs.”<sup>15</sup> The changes proposed herein “need not be the only reasonable methodology, or even the most accurate.”<sup>16</sup> Despite certain protests to the contrary, the filed rule on de-listing meets this standard, and the Commission’s ruling to the contrary is in error.

Even if the Settlement did not clearly limit the role of the INTMMU, as the ISO believes that it does, the Commission’s ruling would be in error as a matter of law and policy in that it improperly shifts the burden of proof with respect to the appropriate level of a de-list bid from the generator to the ISO. The INTMMU will not have an adequate basis of information to assess the accuracy of the de-list bid, other than through the generator’s own submission, and the knowledge and experience of the INTMMU and its consultants of the range of costs for similar plants. The INTMMU’s role was aptly intended to be one of an auditor, probing the validity of various cost items based on the resource’s current costs and comparing them to costs for similar plants. If the INTMMU identifies a cost that appears to be inconsistent with the resource’s going forward and opportunity costs or the usual range of such costs, the INTMMU will seek

<sup>13</sup> February 15 Filing at 28, 75-76; Market Rules, Section III.13.1.2.3.2.1.

<sup>14</sup> *Id.*

<sup>15</sup> *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984).

<sup>16</sup> *Oxy USA, Inc. v. FERC*, 64 F.3d 679, 692 (D.C. Cir. 1995).

verification through the consultation process.<sup>17</sup> If the generator is unable to justify the cost through the consultation process, the INTMMU will inform the generator of its intent to reject the de-list bid no later than thirty days before its filing with the Commission.<sup>18</sup> The ISO, in its filing pursuant to Section III.13.8.1 of the rules to be made no later than 90 days prior to the first day of the auction, will set forth its findings on each cost component, including the basis for its intent to reject the de-list bid, with the reasons for such rejection.

The Commission's concern that a generator whose de-list bid is rejected and whose going forward or opportunity costs, while not as stated in its de-list bid, nevertheless are higher than the price where dynamic de-listing can be elected, is addressed in the filed rules, which provide for the ISO to submit a record that presents the Commission with the narrow basis on which a dispute exists in its November 1 informational filing. The generator may submit justification for its de-list bid in response to this filing. On the basis of this record, the Commission may rule, and the bid found appropriate by the Commission will be entered into the FCA. The generator will already have had the INTMMU's determination for at least thirty days, and the Commission can reasonably set a relatively short time period for response to the ISO's filing. Given that the relevant cost information is in its hands, the generator should be in a position to rapidly file an answer to the ISO's submission, and the Commission will have a period of 75 days to resolve any issues. All of this can reasonably be accomplished before the FCA.

The process envisioned by the Settlement and embodied in the rules serves an important function. If a generator has the discretion to substitute the INTMMU's determination of an appropriate bid level for the generator's original bid, subject to review by the Commission, a

<sup>17</sup> February 15 Filing at 41, Market Rules, Section III.13.1.2.3.2.1.1.

<sup>18</sup> Market Rules, Section III.13.1.2.4.

generator will know that it has multiple opportunities to revise its bid and avoid rejection. Its first bid may, without consequence, include cost components that the generator may know cannot be justified, and that the INTMMU must then discover and revise. If the INTMMU does not have complete information relevant to the bid, the generator may then question the INTMMU's revised bid when the ISO submits its informational filing with the Commission. In essence, a generator will have multiple chances to refine its bid, perhaps ultimately arriving at a lower de-list bid than submitted, but still higher than the true cost. Such a process will not lead to submission of competitive de-list bids at the bid submittal deadline, but is likely to instead promote gaming of the bidding process. The ISO urges the Commission to grant rehearing and modify its April 16 Order on this point.

### **III. STATEMENT OF ISSUES**

Pursuant to Rule 713(c)(2) of the Commission's Rules of Practice and Procedure, the ISO hereby lists each issue on which it seeks rehearing of the Commission's April 16 Order and provides representative precedent in support thereof:

1. The Commission's ruling requiring the INTMMU to determine a de-list bid level for an Existing Generating Capacity Resource consistent with its net risk-adjusted going forward and opportunity costs is inconsistent with the Settlement's plain language that specifies that the INTMMU will review a de-list bid, and significantly broadens the role of the INTMMU beyond that contemplated by the Settlement. FCA Settlement at § 11, Part III.E.

2. The Commission's ruling improperly shifts the burden of proof from the proponent of the rate to the ISO, in violation of well-settled principles of law. *See e.g., Alabama Power Co. v. FERC*, 993 F.2d 1557 at 1571 (D.C. Cir. 1993) (*citing Winnfield*

v. *FERC*, 744 F.2d 871, 877 (D.C. Cir. 1984)); *ISO New England Inc.*, 113 FERC ¶ 61,055 at P 22 (2005).

3. The Commission’s ruling requiring ISO New England to include in the informational filing with the Commission a de-list bid level for certain Existing Generating Capacity Resources is contrary to law and FERC policy because it relieves a generator of the obligation to prove that its de-list bid is consistent with going forward and opportunity costs and instead imposes an obligation on the INTMMU to set an appropriate rate. This result requires the INTMMU to establish a remedy for potential price manipulation rather than referring unacceptable bids to the Commission for appropriate action. *See Market Monitoring Units in Regional Transmission Organizations and Independent System Operators*, “Policy Statement on Market Monitoring Units,” 111 FERC ¶ 61,267 (2005).

4. The Commission’s ruling permits generating resources to inflate their submitted de-list bids and offer to de-list at a level exceeding their net risk-adjusted going forward and opportunity costs. This could result in market manipulation and unjust and unreasonable rates. *See* 16 U.S.C. § 824d (2006).

#### **IV. BASIS FOR REHEARING**

##### **A. The ISO’s Proposal for Review of De-List Bids**

As explained above, Section III.13.1.2.3.2 of the proposed rules provides for review by the INTMMU of de-list bids from Existing Generating Capacity Resources. Under proposed Section III.13.1.2.3.2.1, the ISO’s INTMMU will review each Static De-List Bid and Export Bid above 0.8 times the Cost of New Entry (“CONE”), and each Permanent De-List Bid above 1.25

times CONE, submitted by Existing Generating Capacity Resources.<sup>19</sup> The INTMMU will review such bids to determine whether the bid is consistent with the resource's net risk-adjusted going forward costs and opportunity costs.<sup>20</sup> The rules require submission of sufficient documentation and information in the Existing Capacity Qualification Package to allow the INTMMU to make such determinations.<sup>21</sup> The INTMMU may also seek additional information<sup>22</sup> and consult with the generator.<sup>23</sup>

The proposed rules state that where the INTMMU determines that the bid is inconsistent with the resource's costs, that de-list bid will be rejected and the resource will be entered into the FCA as a price taker.<sup>24</sup> In such case, an explanation of the reasons for rejecting any de-list bid based on the INTMMU's review will be made to the Lead Market Participant and will also be included in the informational filing made to the Commission no less than 90 days before the first day of the FCA.<sup>25</sup> This process was developed to allow a resource whose de-list bid has been rejected to analyze the reasons for the rejection and, if it disagrees with the rejection, ask the Commission for a remedy.<sup>26</sup>

<sup>19</sup> February 15 Filing at 75-76; Market Rules, Section III.13.1.2.3.2.1.

<sup>20</sup> February 15 Filing at 75-76; Market Rules, Section III.13.1.2.3.2.1.2 and Section III.13.1.2.3.2.1.3.

<sup>21</sup> Market Rules, Section III.13.1.2.3.2.1.

<sup>22</sup> Market Rules, Section III.13.1.2.3.2.1.1.

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

<sup>24</sup> Market Rules, Section III.13.1.2.3.2.1.1. and Section III.13.2.3.2(c).

<sup>25</sup> February 15 Filing at 42; Market Rules, Section III.13.8.1.

<sup>26</sup> February 15 Filing at 42.

## **B. Objections by Parties**

Milford and NRG protested the filed rules and argued that the ISO's proposal would mitigate bids below existing resources' costs, so that the resource would be forced to offer capacity at a loss. Capacity Suppliers maintain that if the INTMMU disputes any portion of the de-list bidder's bid, then the entire bid will be rejected, even if there is agreement between the INTMMU and the de-list bidder regarding the majority of the cost components of the bid. They further argue that although a generator may seek relief from the Commission, due to the timing of the ISO's required informational filing, the Existing Generating Capacity Resource would be forced to participate in the FCA as a price taker. Capacity Suppliers further argue that it is unlikely that the record of an informational filing and an intervening protest will be sufficient for the Commission to render a decision within the 90 days allotted. Therefore, they assert, there is a strong probability that a rejected bid will result in the Existing Generating Capacity Resource being forced to participate in the FCA at a price level that may be insufficient to cover the resource's costs.

Milford and NRG suggest an alternative that would require the INTMMU to disclose its cost component-by-cost component review of an Existing Generating Capacity Resource's bid. They state that if a bid is then rejected, the affected resource could then submit an acceptable bid rather than be entered as a price taker. Capacity Suppliers propose to allow the generator to submit a de-list bid consistent with the INTMMU's determination of justified bid components.

## **C. April 16 Order**

Without addressing the provisions of the ISO's filed rules that permit a generator the time and opportunity to make a submission supporting its requested de-list bid level, the Commission found that the ISO's proposal could result in an existing generating resource being forced to

offer capacity at a price less than its net risk-adjusted going forward and opportunity costs.<sup>27</sup> It required the INTMMU to determine an accurate and appropriate bid level for an existing generating capacity resource consistent with its net risk-adjusted going forward and opportunity costs, and to disclose the results of its review, including all cost components and appropriate input levels used in its mitigation formula.<sup>28</sup> The Commission further required the ISO to amend the market rules to allow existing generating capacity resources whose Permanent De-List, Static De-List, Export, or Administrative Export bids are determined to be inconsistent with their net risk-adjusted going forward and opportunity costs be allowed to submit revised de-list bids consistent with the price level determined by the INTMMU.<sup>29</sup>

#### **D. Argument**

##### **1. The Commission’s Ruling Contravenes the Settlement Agreement and Commission Policy and is Contrary to Law.**

The Commission, in the April 16 Order, erroneously found that the proposed market rules “could result in an existing generating resource being forced to offer capacity at a price less than its net risk-adjusted going forward and opportunity costs.”<sup>30</sup> Thus, the Commission ordered the ISO to amend the proposed rules to require the INTMMU to determine an “accurate and appropriate bid level” and allow generators whose de-list bids were rejected by the INTMMU as inconsistent with the resources’ costs to submit revised de-list bids. The Commission’s order improperly broadens the role of the INTMMU, is contrary to the Settlement and Commission policy, and shifts the burden of proof of the appropriateness of the de-list bid level to the

<sup>27</sup> April 16 Order at P 117.

<sup>28</sup> *Id.* at P 120.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at P 117.

INTMMU. As explained *infra*, consistent with the Settlement and Commission policy, the rules, as proposed, provide for adequate measures to safeguard against the inability of existing generators to recover their going forward or opportunity costs while simultaneously providing reasonable safeguards to minimize the exercise of market power by generators seeking to de-list.

**a. The Commission's Ruling is Contrary to the Settlement Agreement and Law.**

The April 16 Order is contrary to the terms agreed upon by the Settling Parties and constitutes an unlawful departure from the Settlement. The Settlement expressly provides for *review* by the INTMMU of FCA bids but nowhere in the Settlement is it contemplated or did the Settling Parties agree that, in the event it is determined by the INTMMU that a bid is inconsistent with a resource's net risk-adjusted going forward or opportunity costs, the ISO may adjust or require adjustment of such bid. Namely, Section III.E of the Settlement expressly provides:

**Review by Market Monitor.** In reviewing bids from Existing Capacity that are subject to review as set forth in Part III.D above, *the Market Monitor shall review that the proposed bid is consistent with the Resource's net risk-adjusted going forward and opportunity costs*, recognizing, among other things, infra-marginal rents, availability adjustments, and PER deductions.... The details of this review shall be developed in the Market Rules.<sup>31</sup>

The Explanatory Statement drafted and endorsed by the Settling Parties further amplifies the intent of this provision, specifying as follows:<sup>32</sup>

The Market Monitoring Unit will have *specifically delineated authority to review and reject bids that are concluded to be improper*, subject to appropriate Commission involvement. This review is intended to ensure that neither monopoly nor monopsony market power are inappropriately exercised.

<sup>31</sup> FCA Settlement at § 11, Part III.E.

<sup>32</sup> Explanatory Statement at 11 (emphasis added).

Given this plain language, the ISO acted in accordance with Section 3.B. of the Settlement, which authorized the ISO to file market rules under Section 205 of the FPA implementing the FCM that are “consistent with, and in furtherance of, all the terms contained in this Settlement Agreement . . .” Under Section 205, the Commission “plays ‘an essentially passive and reactive’ role”<sup>33</sup> whereby it “can reject [a filing] only if it finds that the changes proposed by the public utility are not ‘just and reasonable.’”<sup>34</sup> The Commission limits this inquiry “into whether the rates proposed by a utility are reasonable – and [this inquiry does not] extend to determining whether a proposed rate schedule is more or less reasonable than alternative rate designs.”<sup>35</sup> The changes proposed herein “need not be the only reasonable methodology, or even the most accurate.”<sup>36</sup> As a result, the Commission is obliged to accept the ISO’s Section 205 filing if it is just and reasonable, regardless of whether an alternative approach is advanced by an intervenor or the Commission.<sup>37</sup> The ISO submits that the proposed market rules meet this standard.

Consistent with the Settlement, the proposed rules provide for the INTMMU to monitor the potential for the exercise of monopoly or monopsony power by reviewing the de-list bid, *i.e.*, acting in a manner analogous to that of an auditor in reviewing the legitimacy of the cost components reported by existing generators in their de-list bids. In this capacity, the INTMMU

<sup>33</sup> *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002) (quoting *City of Winnfield v. FERC*, 744 F.2d 871, 876 (D.C. Cir. 1984)).

<sup>34</sup> *Id.*

<sup>35</sup> *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984).

<sup>36</sup> *Oxy USA, Inc. v. FERC*, 64 F.3d 679, 692 (D.C. Cir. 1995).

<sup>37</sup> *Cf. Southern California Edison Co., et al.*, 73 FERC ¶ 61,219 at 61,608 n.73 (1995) (“Having found the Plan to be just and reasonable, there is no need to consider in any detail the alternative plans proposed by the Joint Protesters.”) (citing *City of Bethany*, 727 F.2d at 1136).

will check the validity and accuracy of claimed costs. In contrast, the April 16 Order significantly transforms the role of the INTMMU into an entity charged with setting the permitted cost-of-service type rate (*i.e.*, the INTMMU “will be required to determine an accurate and appropriate bid level for an existing generating capacity resource consistent with its net risk-adjusted going forward and opportunity costs”),<sup>38</sup> thereby greatly expanding the INTMMU’s role. Nowhere in the Settlement is such an expansive role described or envisioned. By requiring the INTMMU to set rates, the Commission has increased the command of the INTMMU over generation owners in contravention of the terms of the Settlement.

**b. The Commission’s Ruling Greatly Expands the Role of the INTMMU in Contravention of Commission Policy.**

Assuming, *arguendo*, that the language of the Settlement is not controlling regarding the intended role of the INTMMU, which the ISO believes that it does, the Commission’s ruling is in error. It expands the relatively circumscribed role that market monitors are intended to play in organized markets, by placing the INTMMU in the position of performing a partial cost-of-service analysis of a de-list bid, concluding that the bid is excessive, and fashioning a remedy for the bid. Execution of this extensive ratemaking function is not analogous to the fairly mechanical process that the INTMMU performs in energy market mitigation. In addition, the ruling shifts the burden of proposing a substitute bid to the INTMMU, in violation of the settled principle that the proponent of a rate or charge bears the burden of proving its justness and reasonableness.<sup>39</sup> In contrast, the ISO’s filed market rules recognize the limits in time, resources,

<sup>38</sup> April 16 Order at P 120.

<sup>39</sup> See *e.g.*, *Alabama Power Co. v. FERC*, 993 F.2d 1557 at 1571 (D.C. Cir. 1993) (*citing Winnfield v. FERC*, 744 F.2d 871, 877 (D.C. Cir. 1984)); *ISO New England Inc.*, 113 FERC ¶ 61,055 at P 22 (2005).

and expertise resident in the INTMMU, and preserve for the Commission the ultimate decision on an appropriate remedy for an excessive bid.

**(i) The Commission’s Ruling Improperly Shifts the Burden of Proof to the ISO.**

The intent of the ISO’s proposed market rules on de-listing is that a de-list bid represents the lowest cost at which a generator is indifferent to whether it acquires a capacity obligation or exits the market. The generator has possession of all relevant information to prove what this cost level is, and is charged with providing necessary cost data to support its de-list bid.<sup>40</sup> In submitting cost data associated with de-list bids, the market rules require that “[t]he entire de-list submittal shall be accompanied by an affidavit executed by a corporate officer attesting to the accuracy of the reported costs and the reasonableness of the estimates and adjustments of costs that would otherwise be avoided if the resource were not required to meet the obligations of a listed resource.”<sup>41</sup> The proposed market rules thus place the burden of justifying the de-list bid on the generator. This is consistent with the well settled principle that a proponent of a rate or charge bears the burden of proof as to its justness and reasonableness.<sup>42</sup>

This allocation of burden of proof is appropriate because, practically, the INTMMU’s review will not result in a substitute number for each cost component of the de-list bid, which can be then presented as the correct number to the Commission. Rather, the INTMMU will review and estimate each of the cost components based upon the knowledge and experience of the INTMMU and its consultants, and the information submitted by generators seeking to de-list.

<sup>40</sup> Market Rules, Section III.13.1.2.3.2.1.

<sup>41</sup> *Id.*

<sup>42</sup> See e.g., *Alabama Power Co. v. FERC*, 993 F.2d 1557 at 1571 (D.C. Cir. 1993) (citing *Winnfield v. FERC*, 744 F.2d 871, 877 (D.C. Cir. 1984)); *ISO New England Inc.*, 113 FERC ¶ 61,055 at P 22 (2005).

Like an auditor, the INTMMU will review whether each cost component submitted by the generator is based upon the actual costs of the resource, and whether those costs fall within a range that is typical of similar costs for similar plants. From this review, the INTMMU will assess whether each specific cost element is within a range of reasonableness, and if, the cost components included in the de-list bid fit within their respective range of reasonableness, the INTMMU will find the bid acceptable. If any component does not, the INTMMU will inquire further with the generator. If inadequate justification is offered for a cost that falls beyond the range of reasonableness, the INTMMU will document the basis for its finding that that cost component is unacceptable, detail its finding to the generator and in the ISO's filing with the Commission, along with its finding that the de-list bid should be rejected. The INTMMU cannot reasonably examine all potential theoretical alternatives associated with each cost component and specify a precise cost level. Thus, the Commission will receive a record on the INTMMU's findings for each cost component.

By contrast, the April 16 Order would require the INTMMU to actually derive costs in a much greater level of detail that is contrary to the provisions of the Settlement and rules. For example, in submitting a bid based on going forward costs, an oil resource may, as part of its justification, provide an estimate of the staffing costs avoided by shutting down as part of the going forward cost calculation specified in the rules.<sup>43</sup> The owner may estimate 40 full-time employees at various pay-grades and benefit levels will not be required to maintain its mothballed status. Under the filed rules, the INTMMU would evaluate the documentation of the costs and determine whether such costs are in line with the plant's current costs and within a typical distribution of staffing costs for similar plants. The INTMMU would not substitute its

<sup>43</sup> See Market Rules, Section III.13.1.2.3.2.1.2.

business judgment for the plant operator's and determine the correct number of employees, but would identify a range. However, pursuant to the April 16 Order, the INTMMU may be required to determine whether there may be a more accurate estimate, *e.g.*, 35 full-time employee costs can be avoided. Such a determination would be necessary because the April 16 Order requires the ISO to estimate an exact dollar figure -- a precise expenditure level -- for a replacement bid rather than simply to determine whether the costs fall into a typical distribution of costs for similar plants. Not only does the ISO lack resources to make such determinations but, more importantly, it is inappropriate to require the ISO to determine costs at this level of detail, which is more suitable for a traditional cost-of-service rate case.

This problem is exacerbated with regard to the treatment of de-list bids based on opportunity costs under the proposed rules. In contrast to the determination of going forward costs under Section III.13.1.2.3.2.1.2 where a formula sets forth the various cost elements to be considered, the rule that governs opportunity costs, Section III.13.1.2.3.2.1.3, contains no such formula specifying the manner in such costs are to be calculated. This is because opportunity costs are too varied and their treatment is too idiosyncratic to be incorporated into a single equation. For example, a generator may submit a de-list bid based upon the opportunity cost of replacing its generating resource located on the water-front with a condominium development. The INTMMU may be able to retain consultants to provide appraisals of the opportunity costs, but these appraisals will be subjective to some degree and may well differ. Based on the appraisals, the INTMMU is not well positioned to develop a substitute bid; however, if its appraisals are all significantly below the opportunity cost on which the generator's bid was based, the INTMMU would at least be able to conclude that the bid is not consistent with the resource's going forward and opportunity costs.

The April 16 Order errs in implicitly assuming that all costs that may force the basis for a de-list bid are found in a “mitigation formula.”<sup>44</sup> Rather, if the opportunity costs relied upon by the generator were in line with the costs estimated by the INTMMU, it would not provide a basis for rejection. In contrast, the April 16 Order would require the ISO to specify a particular value.

**(ii) The Commission’s Ruling Erroneously Expands the Role of the Market Monitor.**

The breadth of responsibility imposed on the INTMMU by the Commission’s ruling stands in contrast to the circumscribed role the Commission has otherwise prescribed for market monitors. For example, in the April 16 Order, the Commission was careful to provide that in the event the ISO finds potential price manipulation, it must not provide its own remedy but refer the matter to the Commission for an appropriate remedy:

The Market Monitor does not have the authority to make the determination as to whether or not there has been an attempt at manipulation or physical withholding. Therefore, ISO-NE is directed to revise sections III.13.1.2.3.2.3, III.13.1.2.3.2.2, and III.13.1.3.5.6.1, to state that if the Market Monitor determines that a bid or offer may be an attempt at manipulating the auction, the Market Monitor shall not only reject the bid or offer, but also will refer to the Commission the alleged attempt at manipulation, in accordance with the referral protocols set forth in Appendix A to the Policy Statement on Market Monitoring. Similarly, ISO-NE is directed to revise section III.13.1.2.2.5.2 to state that, if in its review of certain bids by existing generation resources, existing demand resources or existing import capacity resources the Market Monitor determines the bid may be an attempt to manipulate the Forward Capacity Auction, the Market Monitor shall refer the alleged attempt to the Commission. Finally, ISO-NE is directed to revise section III.13.1.7 to state that if the Market Monitor finds in its review of a resource’s summer historical values that there may be an attempt to exercise physical withholding, the Market Monitor will refer the alleged physical withholding to the Commission. ISO-NE is directed to make this compliance filing by September 1, as ordered above.<sup>45</sup>

<sup>44</sup> See April 16 Order at P 120 (“The Commission will require the Market Monitor to disclose the results of its review, including all cost components and appropriate input levels used in its mitigation formula.”).

<sup>45</sup> April 16 Order at P 126.

When the ISO finds that a de-list bid is excessive and cannot be justified, despite ample opportunity by the generator to offer supporting data, the ISO believes that the same considerations underlying the Commission's instruction above, limiting the ISO's authority to fashion a remedy should apply. This will properly maintain consistency with regard to the limited role established for market monitors by Commission policy.<sup>46</sup>

**(iii) Energy Market Mitigation Is Not Analogous To Review of De-List Bids.**

Some parties claim that requiring the ISO to adjust or mandate adjustment of bids is appropriate and would be analogous to the process used in the energy market.<sup>47</sup> However, in energy market price mitigation, the INTMMU applies a relatively mechanical formula reflecting fuel costs and heat rates. Heat rates are an engineering number, and fuel costs are available through various published sources. In contrast, determining appropriate cost levels for going forward and opportunity costs is subjective and idiosyncratic, as each plant's circumstances are quite different, and, thus, the energy market example is inapposite.

<sup>46</sup> For example, in the Policy Statement on Market Monitoring Units, the Commission stated that ISOs may administer compliance with tariff provisions "only if they are expressly set forth in the tariff; involve objectively identifiable behavior; and do not subject the seller to sanctions or consequences other than those expressly approved by the Commission and set forth in the tariff, with the right of appeal to the Commission." *Market Monitoring Units in Regional Transmission Organizations and Independent System Operators*, "Policy Statement on Market Monitoring Units," 111 FERC ¶ 61,267 at P 5 and n.3 (2005). Furthermore, the Commission cited to *California Independent System Operator Corporation*, in which it held that "where policy issues are implicated or the question of whether a tariff violation has occurred cannot be determined objectively pursuant to Commission-approved tariff provisions, it is the Commission's statutory responsibility to address the question." *California Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,179 (2004). See also, *New York Independent System Operator, Inc.*, 89 FERC ¶ 61,196, at 61,605 (1999), *reh'g denied*, 90 FERC ¶ 61,317 (2000).

<sup>47</sup> Motion to Intervene and Limited Protest of Capacity Suppliers, Docket No. ER07-546-000 (March 8, 2007) at 11.

**2. The Commission’s Conclusion That The Proposed Rules Could Result In Generators Not Being Allowed To Recover Their Costs Is Erroneous.**

In requiring the INTMMU to determine appropriate de-list bids and give existing generators the option of revising their bids, the Commission erroneously concluded that absent such a requirement, there would be a possibility of confiscatory ratemaking. In accepting the argument raised by certain generators, the Commission overlooked the fact that the proposed rules incorporate numerous measures to ensure that existing generators have the opportunity to furnish the ISO with accurate cost information, provide any necessary explanations associated with such costs, as well as seek Commission review in the event that the ISO rejects such bids. As explained below, the approach set forth in the market rules is reasonable, contains all necessary safeguards and, as a result, the Commission should reverse its order requiring modification of these rules.

The market rules provide that existing generators may submit Static or Permanent De-List Bids or Export or Administrative Export De-List Bids, and supply the requisite documentation and information that must be included therewith to allow the INTMMU to review whether such bids are consistent with the resource’s net risk-adjusted going forward and opportunity costs.<sup>48</sup> Moreover, where appropriate, the INTMMU will consult with the generator in the event there is an issue with the consistency of the de-list bid and the associated costs.<sup>49</sup> Thus, a generator seeking to de-list has the opportunity to furnish detailed information regarding its costs as well as to consult with the ISO and provide further explanation of such costs, as necessary.

<sup>48</sup> Market Rules, Section III.13.1.2.3.2.

<sup>49</sup> *Id.* at Section III.13.1.2.3.2.1.1.

Importantly, in the event a de-list bid is rejected, the market rules provide adequate time for challenges to and FERC review of such determinations. During the development of the market rules to implement the market monitoring provisions, a deliberate process was developed so that a generator could request a review of the INTMMU's rejection decision. This process explicitly involved Commission review. Pursuant to the rules, no later than 120 days prior to the FCA, the ISO shall notify the generator whether its de-list bid was accepted or rejected and, in the case of rejection, shall provide an explanation of the reasons why such bid was rejected.<sup>50</sup> Notably, in order for the INTMMU to explain the reasons for the rejection, it will also need to identify the components of the de-list bid that did not cause the INTMMU to reject the bid. Thus, the generator will know what components fell within the range of reasonableness and which components were outside that range. No later than 90 days prior to the FCA, the ISO will make an informational filing with the Commission including, *inter alia*:

an explanation of the reasons for rejecting any de-list bids based on the Internal Market Monitoring Unit review. The filing shall identify to the extent possible the components of the bid which were accepted as justified, and shall also identify to the extent possible the components of the bid which were not justified and which resulted in rejection of the bid.<sup>51</sup>

The rules expressly provide for the ability to comment on or challenge any of the determinations contained in the informational filing and allot 75 days after the date of the informational filing for the Commission to direct the ISO to modify its determinations in conducting the FCA.<sup>52</sup> Thus, prior to the auction, a generator submitting a de-list bid has numerous opportunities to detail and support its claimed costs both before the ISO as well as before the Commission. Because the Commission will review any challenges and presumably rule upon the

<sup>50</sup> Market Rules, Section III.13.1.2.4.

<sup>51</sup> *Id.* at Section III.13.8.1(a).

<sup>52</sup> *Id.* at Section III.13.8.1(b).

appropriateness of the claimed costs associated with a de-list bid in advance of the FCA, a generator will have the opportunity to make its case and thus, confiscatory ratemaking will be avoided. However, the ISO anticipates that, no matter whether the ISO's filed rules or the Commission's ruling ultimately binds generators, the Commission will be called upon to rule on virtually every rejected de-list bid. The Commission will remain as the ultimate decision-maker on the appropriate de-list bid applicable to the generator.

### **3. The Commission's Ruling May Facilitate the Exercise of Market Power.**

The ISO has taken considerable care in proposing rules associated with de-list bids to ensure to the greatest degree practicable that generators submit bids in line with their going forward and opportunity costs because de-list bids can constitute physical withholding of capacity leading to price manipulation and the exercise of market power. Addressing price manipulation and market power is a major challenge in capacity markets, and a previous market failed due to the ISO's concerns with price manipulation.<sup>53</sup> Generators have access to the relevant information and more than adequate opportunity to develop appropriate de-list bids. The ISO is concerned that requiring the INTMMU to develop a substitute bid for a generator's unjustified de-list bid places an inappropriate burden on the INTMMU, and may result in bids that are in excess of going forward or opportunity costs, thus creating the possibility of market prices that will be higher than those in a fully competitive market.

At present, there are about 33,000 megawatts of existing capacity receiving capacity credit. The incremental need for capacity to meet the Installed Capacity Requirement each year

<sup>53</sup> *Central Maine Power Co. v. FERC*, 252 F.3d 34 at 39 (1st Cir. 2001) ("[T]he auction market [for reserve capacity] appears not to have been successful... the prices were thought to have been subject to manipulation."), *order on remand, ISO New England, Inc.* 96 FERC ¶ 61,359 at 62,352 (2001), *reh'g denied*, 97 FERC ¶ 61,341 (2001), *review denied, Sithe New England Holdings, LLC v. FERC*, 308 F.3d 71 (1st Cir. 2002).

is likely to be between 500 to 1000 megawatts of capacity per year. If the de-list rules, as proposed, were not in place, a generating company with a large portfolio would have a strong incentive to withhold a relatively small amount of existing capacity to force the purchase of additional new capacity to increase the price in the FCM. For example, if existing generators are able to de-list as little as 200 megawatts of capacity, the need for new capacity would increase by at least 20 percent. When viewed from this perspective, the importance of controlling de-listing to prevent economic withholding from increasing the price becomes clear. Furthermore, this could result in an artificially higher de-list bid clearing the market and raising the price above competitive levels.

To provide transparency to the capacity market, the FCM Settlement requires that de-list bids and certain associated information be published immediately after the submittal deadline, approximately 10 months in advance of the auction. The general rule is that every de-list bid that is accepted for participation in the FCA is binding. Once accepted for participation, such bids may not be withdrawn or modified and will be entered into the auction at the submitted price, absent rejection by the INTMMU.<sup>54</sup> If the generator believes that the INTMMU erroneously rejected its bid, the generator has the opportunity to prove that its bid was correct as submitted when the Commission reviews the INTMMU's reasons for rejection. In contrast, the April 16 Order provides a generator with several chances to have its de-list bid modified, thus removing all risk of initially overstating its costs and gaming the capacity market, and vitiating the market

<sup>54</sup> There is a limited exception to the general rule that all of the posted information is final, *i.e.*, it is possible that a posted de-list bid may be rejected by the ISO because the unit is needed for reliability. However, this is an exception, not the norm. Those relying on posted de-list bid information will understand that a few bids might be rejected, but otherwise these are the de-list bids that are going into the auction. Furthermore, the clause in the FCM Settlement that 'if approved, full information will be posted' should not be interpreted to mean that the initial submittal is not firm on price. The review process extends well beyond the deadline for new capacity, and therefore such an interpretation would also make meaningless this information as a market signal.

value of publishing de-list bids upon their submittal. The market rules, as proposed, minimize the risk of market manipulation and should be accepted.

The April 16 Order mandates modification of the market rules in a manner which would provide numerous opportunities for the modification of a de-list bid, thus increasing the potential for market manipulation. First, a generator seeking to de-list must submit a bid in its qualification package which will be reviewed by the INTMMU. The INTMMU may lower but not increase such de-list bids. Thus, if a generator wishes to exercise market power, it could inflate its initial bid -- secure in the knowledge that it could not be rejected but could only be decreased. Second, the April 16 Order requires the INTMMU to establish an alternative de-list bid if it is determined that the initial bid exceeds the resource's going forward and opportunity costs. A third opportunity for bid modification arises because a generator would be permitted, after notification of the revised de-list bid, to inform the INTMMU that it has failed to account for some resource or company-specific cost savings that should be factored in to the revised de-list bid.

Given this "three bites at the apple" process, a generator wishing to exercise market power has an incentive to inflate its initial de-list bid with no penalty for doing so. If the INTMMU does not identify the non-compliant behavior, the generator will successfully manipulate the market. If the INTMMU revises the de-list bid down, and the generator accepts the new, lower de-list bid, then the generator is no worse off than in a competitive market. Indeed, the generator's acceptance of a lower INTMMU de-list bid is *prima facie* evidence that the initial bid was inflated and represents an attempt to exercise market power, for which no sanctions have been established.

The ISO submits that a better approach is to require a generator's de-list bid to be binding as filed. To the extent that the INTMMU finds any cost component of the bid unacceptable, it may make its case to the Commission. The Commission then may choose whether to accept the generator's bid or the ISO's rationale for rejecting the bid. Such an approach will prevent price searching behavior and address potential market power concerns.

**4. The Commission's Ruling Contravenes FERC Policy Instructing Market Monitors to Provide Incentives to Generators to Provide Reliable Service at Least Cost.**

Because, under the April 16 Order, the burden falls on the ISO and not the market participant seeking to de-list to determine the appropriate bid level, there is an incentive for generators to inflate their de-list bids and rely on the ISO's bid price as a fall back, knowing that if the above-cost bid is rejected they may revise their bids in accordance with the INTMMU's determination. In this regard, the Commission's April 16 Order is contrary to Commission policy. The Commission's Policy Statement on Market Monitoring Units provides:

Good market rules are essential to efficient wholesale markets in which competing suppliers have incentives to meet the customers' needs for reliable service at the least cost. ISO/RTO markets are operationally complex. MMUs should have access to data and other resources to evaluate participant behavior and responses in these markets. As such, MMUs should evaluate the market-specific responses of individual market participants to existing or proposed market rules and tariff provisions.<sup>55</sup>

Contrary to FERC policy, the April 16 Order minimizes "incentives to meet the customers' needs for reliable service at the least cost." Rather, the process outlined in the April 16 Order may enable generators to inflate costs and influence price.

<sup>55</sup> Policy Statement on Market Monitoring Units, 111 FERC ¶ 61,267 at P 3 (2005).

**5. The ISO Requests an Expedited Ruling on this Issue In Order to Prevent Disruption and Delay With Regard to the Process for Reviewing De-List Bids.**

As contemplated by the FCM Settlement, the ISO is to conduct the first FCA in early 2008. The Settlement reflects a decision that the first FCA should occur “no later than the end of the first quarter of 2008...” This date was selected as the latest that the auction could be feasibly run and procure new capacity that would be able to be available to serve load in June of 2010. The Settlement’s reliance on new capacity to set the Capacity Clearing Price in the FCA underlies this timing decision. Thus, the first auction will be conducted in February, 2008. Under the market rules, the ISO will be required to notify generators of the results of its review by October 1, 2007, thirty days before its informational filing to the Commission on November 1, 2007. However, the ISO is required under the April 16 Order to submit a compliance filing on September 1, 2007 and also determine appropriate de-list bids. In order to adhere to the tight time frame for complying with the schedule contemplated by the Settlement, the ISO requests that the Commission act on an expedited basis with regard to the instant Request for Rehearing. Delay in resolving key issues could likely delay the process for review of de-list bids by the ISO and require the first auction be postponed. Accordingly, the ISO asks the Commission to issue an order no later than July 15, 2007.

**V. CONCLUSION**

For the foregoing reasons, the ISO respectfully requests that the Commission grant its rehearing request and fully consider the reasons stated above in support thereof.

Respectfully submitted,

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Dated: May 16, 2007

## ATTACHMENT A

### TABLE OF ABBREVIATIONS AND ACRONYMS

This table provides definitions for abbreviations and acronyms used throughout this filing.

CONE	Cost of New Entry
FCA	Forward Capacity Auction
FCM	Forward Capacity Market
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
ICR	Installed Capacity Requirements
INTMMU	Internal Market Monitoring Unit
ISO	ISO New England Inc.
kW	Kilowatt
MMU	Market Monitoring Unit
MW	Megawatt
NECPUC	New England Conference of Public Utility Commissioners
NEPOOL	New England Power Pool
RTO	Regional Transmission Organization

## **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 16th day of May, 2007.

/s/ Sherry A. Quirk  
Sherry A. Quirk