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May 31, 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. ER07-546-001

Dear Ms. Bose:

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.

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.) **Docket No. ER07-546-001**

**MOTION FOR LEAVE TO ANSWER
AND ANSWER OF ISO NEW ENGLAND INC.**

Pursuant to Rules 101(e), 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission” or “FERC”),¹ ISO New England Inc. (the “ISO”) hereby submits its *Motion for Leave to Answer and Answer* (“Answer”) to two requests for rehearing filed in the above-captioned proceeding by the Connecticut Department of Public Utility Control (“CT DPUC”), the New England Conference of Public Utility Commissioners² (“NECPUC”), the Vermont Department of Public Service, the Vermont Public Service Board, and the Connecticut Office of Consumer Counsel (collectively, “State Parties”) and Connecticut Jet Power LLC, Devon Power LLC, Middletown Power, LLC, Montville Power LLC, Norwalk Power LLC, NRG Power Marketing, Inc., and Somerset Power LLC (collectively, “NRG Companies”) in response to the Commission’s April 16, 2007 order in this proceeding (“April 16 Order”).³ In that order the Commission conditionally accepted, subject to certain modifications outlined in the order, the ISO’s February 15, 2007 filing (the “February 15 Filing”) in this proceeding, in which it proposed various tariff provisions to implement the

¹ See 18 C.F.R. §§ 385.212, 385.213, and 385.101(e) (2006).

² The Maine Public Utilities Commission does not support the March 6, 2007 Forward Capacity Market (“FCM”) Settlement Agreement (“FCM Settlement” or “Settlement”) and does not join NECPUC in its request for rehearing. The Massachusetts Department of Public Utilities also was not a party to the FCM Settlement but does join NECPUC in its request for rehearing.

³ *ISO New England, Inc.*, 119 FERC ¶ 61,045 (2007) (“April 16 Order”).

Forward Capacity Market⁴ (“FCM”) Settlement Agreement (“FCM Settlement” or “Settlement”)⁵ approved by the Commission.⁶

I. BACKGROUND

In accordance with the FCM Settlement, the ISO was required to file market rules pursuant to Section 205 of the Federal Power Act (“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 NECPUC. In the April 16 Order, the Commission conditionally accepted the market rules and required a compliance filing.

The ISO sought rehearing of a portion of the Commission’s order related to review of de-list bids by the Internal Market Monitoring Unit (“INTMMU”). The State Parties,⁷ NRG Companies,⁸ H.Q. Energy Services (US) Inc., and Brookfield Energy Marketing, Inc. also sought rehearing of the Commission’s April 16 Order.

⁴ 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”).

⁵ 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).

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

⁷ Request for Rehearing and Motion for Clarification by the New England Conference of Public Utility Commissioners, the Connecticut Department of Public Utility Control, the Vermont Department of Public Service, the Vermont Public Service Board, and the Connecticut Office of Consumer Counsel, Docket No. ER07-546-000 (May 16, 2007) (“State Parties’ Pleading”).

⁸ Request for Rehearing of NRG Companies, Docket No. ER07-546-000 (May 16, 2007) (“NRG Companies Pleading”).

II. INTRODUCTION

In this *Answer*, the ISO responds to certain arguments put forth in the requests for rehearing submitted by NRG Companies and the State Parties. The State Parties seek rehearing of the Commission's decision declining to set a date certain for the ISO to complete a re-design of the transmission queue and to take a fresh look at Reliability Agreements. They argue that a date certain is necessary to assure that the ISO moves swiftly to address the queue, and to ensure that a more expensive resource with higher priority in the queue does not set the clearing price in the FCA. They also maintain that reformation of Reliability Agreements should occur in advance of the first FCA. However, the Commission correctly found in the April 16 Order that it is unwise to single out these issues and impose deadlines on the ISO because there are a number of outstanding issues important to the region that require resolution, and the question of prioritization of all of the issues should be addressed in a single compliance filing. In response to that compliance filing, which the ISO anticipates submitting before the end of June, 2007 ("June Filing"), parties will be free to urge a different timing or sequence of resolution.⁹ The Commission should decline to grant rehearing on this point and should not impose deadlines on the ISO that the ISO cannot realistically meet.

The ISO agrees with the State Parties that re-design of the queue should be a high priority, but does not agree that there is a high risk that failure to re-design the queue within the time frame urged by the State Parties may increase the clearing price in the first several auctions. By way of example, the projected need for new capacity in the first auction is likely to be relatively small, and over 17,200 MW of new generation and demand resources have submitted

⁹ In the June Filing, the ISO intends to request a technical conference during the week of July 23, 2007.

Show of Interest Forms. Given the large volume of interest in providing the relatively small amount of new capacity needed, it is unlikely that the clearing price will be affected by reliance on the queue to resolve overlapping impacts.

The ISO also agrees with the State Parties that the development of new market rules for Reliability Agreements is important; however, these rules should properly be developed through a stakeholder process, so that the Commission has before it a concrete proposal on which to rule. The timing of this process will be addressed in the prioritization filing.

The Commission should also deny rehearing of the portion of its April 16 Order ruling on the provision of the market rules that requires the ISO to consider expanding the Alternative Capacity Price Rule to de-list bids rejected for reliability reasons and to make a compliance filing by June 30, 2007.¹⁰ The State Parties' argument -- that the Settlement does not permit such expansion -- is not ripe because the ISO has not proposed any modification to the Alternative Capacity Price Rule. Until and unless the ISO so proposes, a ruling is premature.

Regarding the timing of notification to de-list bidders of whether a unit is required for reliability reasons, as argued by the State Parties and NRG Companies, the Commission should deny rehearing because notifying generators prior to the end of the auction could facilitate the exercise of market power and threaten the viability of a competitive capacity market. The timing of the notification to generators of de-list bids rejected for reliability reasons, as reflected in the market rules, is critical to the proper functioning of the FCM. Providing notification at the end of the auction is intended to, and will, effectively address market power by reducing the incentive of generators to seek to de-list capacity essential for reliability from the market. It is

¹⁰ April 16 Order at P 88.

well established that capacity markets are vulnerable to the exercise of market power.¹¹ The changes sought by the State Parties and NRG Companies could undermine the integrity of the market by increasing its vulnerability to the exercise of market power by existing generators.

The Commission should also deny rehearing of NRG Companies' request to modify Section III.13.2.5.2.5 of the FCM rules and require the ISO to immediately notify a generator whose de-list bid clears in an auction round, and would otherwise be accepted, that it will not be allowed to de-list for reliability reasons whenever the ISO knows at the conclusion of the auction round that the de-list bid must be rejected for reliability reasons.¹² However, as stated above, providing notification during the FCA to a generator that a resource it seeks to de-list is needed for reliability reasons would likely facilitate the exercise of market power and threaten the viability of a competitive capacity market. Such market manipulation could have an even greater impact when a generator owns multiple resources at a single site. The need to thwart the exercise of market power greatly outweighs any benefit of providing notification to a generator during an auction that its unit is needed for reliability.

The State Parties request clarification that a resource seeking to retire permanently must first comply with the FCM market rules related to permanently de-listing from the capacity market and may not evade the de-list bidding requirements and its Capacity Supply Obligation. The State Parties correctly note that a resource seeking to retire may not simply provide the ISO with a retirement notice pursuant to Section I.3.9 of the Tariff. Because of the interrelationship

¹¹ See *The New Power Company v. PJM Interconnection, Inc.*, 98 FERC ¶ 61,208 at 61,752 (2002) (“Allegations of market power problems have plagued the capacity markets within PJM.”). See also Working Paper on Standardized Transmission Service and Wholesale Electric Market Design, at 2, Docket No. RM01-12-000 (March 15, 2002) (The Commission, in identifying prevailing market design flaws noted that in some regions “high fees are being collected for the value of generation capacity that do not clearly incent the construction of new capacity.”).

¹² NRG Companies Pleading at 1.

between unit retirement, Reliability Agreements and the FCM, the rules associated with unit retirement currently residing in Section I.3.9 of the Tariff will be revised. However, it should be clear that under no circumstance may a resource with a Capacity Supply Obligation exit the market without covering its supply obligation either in a reconfiguration auction or by entering into a bilateral contract.

III. MOTION FOR LEAVE TO ANSWER

In this *Answer*, the ISO responds to certain arguments put forth in the requests for rehearing filed by various parties to this proceeding. While the Commission's Rules of Practice and Procedure allow parties to respond to comments,¹³ as a general matter, the Commission's rules prohibit responses to requests for rehearing.¹⁴ The Commission has the authority, however, to waive this prohibition for good cause.¹⁵ 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,¹⁶ provide information helpful to the disposition of an issue,¹⁷ or aid the Commission in understanding and resolving issues.¹⁸ 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 resolving the issues raised in the requests for rehearing. For these reasons, the ISO respectfully requests that the Commission grant the ISO's motion to provide the following *Answer*.

¹³ See 18 C.F.R. § 385.213(a)(3) (2006).

¹⁴ *Id.* at § 385.213(a)(2) (2006).

¹⁵ *Id.* at § 385.101(e) (2006).

¹⁶ See, e.g., *Islander East Pipeline Co.*, 102 FERC ¶ 61,054 at P 9 (2003).

¹⁷ See, e.g., *CNG Transmission Corp.*, 89 FERC ¶ 61,100 at 61,287 n.11 (1999).

¹⁸ See, e.g., *Tennessee Gas Pipeline Co.*, 92 FERC ¶ 61,009 at 61,016 (2000).

IV. ANSWER

A. **The Commission Did Not Err In Declining To Set A Timeline For The Redesign Of The Interconnection Queue And In Not Requiring That Rules For Reliability Agreements Be In Place Before The First FCA.**

1. **State Parties' Arguments**

The State Parties challenge the aspect of the April 16 Order that allows the ISO to disqualify new capacity resources from the FCA based on their interconnection queue positions. They argue that the interconnection queue rule is unjust and unreasonable and that the Commission erred by “approving an undeniably anti-competitive rule that it agrees should be used only ‘at the outset’ of the FCM but nevertheless refusing to fix a date when this insupportable rule must be replaced.”¹⁹ According to the State Parties, the Commission gives “too little weight to the consequences of delay and, therefore, puts no teeth in its admonition for stakeholders to give this relationship serious consideration.”²⁰ Moreover, the State Parties contend that the longer the ISO denies capacity market access to the lowest-cost new generation, “the more it will erode confidence in the FCM.”²¹

The State Parties request that the Commission require the ISO to file, no later than February 1, 2008, rules that will permit new generation resources to compete in the FCA on the basis of price, not interconnection queue position.²² They claim that without such a firm deadline, neither the ISO nor stakeholders are likely to “focus the attention necessary to solve

¹⁹ State Parties' Pleading at 7.

²⁰ *Id.*

²¹ *Id.* at 8.

²² *Id.*

this difficult issue.”²³ Thus, they argue that resolution of this issue should be the Commission’s “top priority,” regardless of where it ranks among the ISO’s or stakeholders’ priorities.²⁴

The State Parties also argue that while the Commission “correctly found that it would be desirable to have [ISO-NE’s] Reliability Agreement process redesign in place before the first Forward Capacity Auction to provide a more transparent rate structure for compensation of units under any potential Reliability Agreements,”²⁵ the April 16 Order erroneously deferred the issue of just and reasonable compensation for units whose de-list bids are rejected for reliability reasons until it is presented with a specific case in the future. The State Parties point out that because no de-list bids will have been rejected in advance, there can be no “specific case” decided before the first FCA.²⁶ Thus, the State Parties seek clarification that in determining its priorities, the ISO must consider the Commission’s desire “to complete the necessary process redesign for Reliability Agreements prior to the first FCA.”²⁷

2. ISO Response

The Commission should deny rehearing of the abovementioned aspects of the April 16 Order. First, the Commission has specifically ordered the ISO to make a compliance filing setting forth a prioritization and a schedule for resolving the major issues relating to FCM that must be addressed. These issues include re-design of the queue and a review of the terms of, and rates for, Reliability Agreements. The ISO, in its February 15 Filing, committed to make such a filing on the earlier of September 1, 2007, or thirty days after a joint NECPUC/NEPOOL

²³ *Id.*

²⁴ *Id.* at 9.

²⁵ *Id.* at 20.

²⁶ *Id.*

²⁷ *Id.* at 21.

meeting where such prioritization is a major topic.²⁸ The ISO has been working with NEPOOL and NECPUC over the last month on this issue, and anticipates making the compliance filing ordered by the Commission by the end of June, 2007, and possibly as soon as the week of June 11, 2007, after a scheduled NEPOOL Participants Committee meeting on June 8, 2007, where prioritization will be discussed.²⁹ Thus, the States Parties will shortly have the opportunity to weigh in with their views on the appropriate timing for resolution of these issues. It is appropriate for the Commission to deny rehearing on this point and to resolve these issues in the prioritization filing because the only way to satisfactorily resolve all of these difficult issues is to develop a comprehensive schedule that recognizes the limited resources of the ISO and the stakeholders. Addressing the issues piecemeal, as advocated by the State Parties, will result in misallocation of resources and failure to address other important issues.

With regard to the State Parties' assertion that the Commission "puts no teeth" in its admonition for stakeholders to give the interconnection queue redesign serious consideration, the ISO has clearly indicated that the issue will be high on its list of priorities. In the February 15 Filing, the ISO stated that sole reliance on the queue is not an ideal solution. But before the details of the queue process can be integrated with the FCM, a number of policy decisions must first be considered and resolved.³⁰ The ISO, in its February 15 Filing, identified several issues that need to be considered as the FCM is implemented, and certain tasks that remain to be done by both the ISO and the region's stakeholders separate and apart from the FCM.³¹ The ISO

²⁸ February 15 Filing at 22.

²⁹ The ISO intends to request a technical conference on its compliance filing during the week of July 23, 2007.

³⁰ February 15 Filing at 17.

³¹ *Id.* 20-22.

stated that the issues are complex, and to assure that its efforts are efficient, it underscored the need to prioritize them.³² Rather than pre-judge the prioritization process, the Commission, in its April 16 Order, properly and judiciously allowed New England stakeholders to develop a prioritization list as part of the ISO's efforts to address the many issues facing the region, as described in the February 15 Filing³³

The State Parties allege that without a firm deadline, “neither the ISO nor stakeholders are likely to focus the attention that will be required to solve this difficult question.”³⁴ However, such allegation is false and, in fact, the Commission underscored the importance of prioritizing the interconnection queue issue:

[T]he Commission considers the interconnection issue important and worthy of speedy resolution. ISO-NE's reaction to the protests indicates that this appears to be the most important issues to address. We agree. While we will not prioritize among the listed issues for the region, we believe that the interconnection queue issue is of sufficient importance to merit, at the very least, a position near to the top of any list of priority.³⁵

Thus, the interconnection queue was identified by the ISO, stakeholders, and the Commission as a matter of significantly high importance, and this will be reflected in the timeline prioritizing issues in the June Filing. If the State Parties are dissatisfied with the proposed timeline for interconnection queue redesign as set forth in the June Filing, they may lodge an objection to that filing; however, their arguments here are premature.

³² *Id.* 20-22.

³³ April 16 Order at PP 60, 68.

³⁴ State Parties' Pleading at 8.

³⁵ April 16 Order at P 69.

In the April 16 Order, the Commission likewise explicitly declined to set a firm date by which the ISO should complete a redesign of the Reliability Agreement process.³⁶ The Commission found reasonable the ISO's proposal for resolving the problem regarding compensating units needed for reliability through a stakeholder process that will develop a proposal for filing with the Commission. Furthermore, the Commission agreed with the ISO that "it would be **desirable** to have its Reliability Agreement process redesign in place before the first Forward Capacity Auction. . . ."³⁷ However, the Commission did not mandate this timeline. In its February 15 Filing, the ISO noted that it anticipated revising the Tariff³⁸ and the existing market rules to resolve how a just and reasonable rate for Reliability Agreements will be determined, the form of the Reliability Agreement and the process for obtaining a Reliability Agreement. The ISO underscored that "[t]his major effort will. . . require significant stakeholder review, ISO resources and Commission approval."³⁹ The prioritization of the Reliability Agreement process will be reflected in the June Filing. Accordingly, the State Parties' argument here is premature.

Furthermore, the firm February 1, 2008 deadline proposed by the State Parties for filing rules related to interconnection queue redesign, and the request to clarify that the ISO complete the necessary redesign of the Reliability Agreements process prior to the first FCA, are not attainable if the schedule for implementation of the FCM is to be met. The ISO explained in its

³⁶ *Id.* at P 85 ("While we will not order a date by which this filing should be made, we agree with ISO-NE that it would be desirable to have its Reliability Agreement process redesign in place before the first Forward Capacity Auction. . . .").

³⁷ *Id.* (emphasis added).

³⁸ The ISO anticipates revising Sections I.3.9 and I.3.10 of the Tariff and the existing market rules (many of which are in Appendix A of Market Rule 1) dealing with Reliability Agreements and compensation thereunder.

³⁹ February 15 Filing at 18.

February 15 Filing that a rapid resolution of these issues is not possible given the competing tasks related to implementing the FCM and successfully operating the first auction early next year, which must have absolute priority. The ISO underscored that: “If any of these key steps [to implement the FCM] are ignored or given short shrift, resolutions of the issues described above will be of no moment since the FCM itself might well fail.”⁴⁰

Given the ISO’s limited resources, and the limited resources of the states and NEPOOL participants, it is simply not possible to take the necessary steps to implement the FCM and simultaneously redesign the Reliability Agreement and interconnection queue processes under the timelines proposed by the State Parties. In fact, a core group of ISO staff and consultants are currently working overtime on resource qualification, preparing for the auction, and developing the related market rules and manuals. These same staff and consultants would be part of the team required to work on interconnection queue redesign and Reliability Agreement reformation.

Moreover, the State Parties incorrectly argue that the current queue is unjust and unreasonable.⁴¹ The interconnection queue methodology underlies FERC’s well-established and broadly applied interconnection rulemaking policy. The queue was developed as part of the Commission’s open access policy in Order No. 888. Its application in New England was hotly contested and, among other major issues, the *Bucksport* decision established the Minimum Interconnection Standard for New England.⁴² The Commission has often noted that changing the *pro forma* Tariff has to have extremely strong support.⁴³ As the ISO has previously noted in this

⁴⁰ *Id.* at 22.

⁴¹ State Parties’ Pleading at 7-8.

⁴² *Champion International Corporation and Bucksport Energy, L.L.C. v. ISO New England Inc. et al.*, 85 FERC ¶ 61142 (1998).

⁴³ In addition, the Commission will review proposed variations to the ISO’s *pro forma* interconnection procedures to ensure that they do not provide an unwarranted opportunity for undue

proceeding, to achieve the results that the states seek will require full re-examination and consideration of interconnection standards, grandfathering, prioritization, deliverability, cost responsibility for system upgrades and numerous other issues.⁴⁴ Issues related to the queue arose with respect to the generation interconnection process, which began with a Commission Advanced Notice of Proposed Rulemaking in 2001⁴⁵ and concluded with a Final Rule on Generator Interconnection Agreements and Procedures in July of 2003.⁴⁶ The ISO and NEPOOL filed in response to the Commission's directive in January of 2004,⁴⁷ and FERC ruled in November of 2004.⁴⁸ In the November order, the Commission, in response to proposed variations to the definition of the term "queue," underscored that "[t]he System Operator's obligations with respect to maintaining the queue are unambiguous under our *pro forma* requirements."⁴⁹

Finally, the consequences of permitting new generation resources to compete in the FCA on the basis of their interconnection queue position for a brief period should be minimal. Taking into account the current estimate of Installed Capacity Requirements for 2010/11 pursuant to the Regional System Plan ("RSP") 2006, less existing qualified capacity, the need for new capacity discrimination or produce an interconnection process that is unjust and unreasonable. *ISO New England Inc., et al.*, Order On Small Generator Interconnection Compliance Filing And Modifications To Large Generator Interconnection Procedures And Agreement, 115 FERC ¶ 61,050 at P 12 (2006).

⁴⁴ Motion for Leave to Answer and Answer of ISO New England Inc., Docket No. ER07-546-000 (March 23, 2007).

⁴⁵ Advance Notice of Proposed Rulemaking on Standardizing Generator Interconnection Agreements and Procedures, Docket No. RM02-1-000 (October 25, 2001).

⁴⁶ Standardization of Generator Interconnection Agreements and Procedures, 104 FERC ¶ 61,103 (July 24, 2003).

⁴⁷ New England Power Pool Participants Committee's Proposed Amendments to NEPOOL Tariff that comply with the Commission's Final Rule on the Standardization of Interconnection Agreements and Procedures, Docket No. ER04-433-000 (January 20, 2004).

⁴⁸ *New England Power Pool*, 109 FERC ¶ 61,155 (2004).

⁴⁹ *Id.* at P 32.

in the first FCA is expected to be relatively small. As the ISO announced in a press release on March 16, 2007, Show of Interest Forms representing more than 17,200 MW of new capacity have been filed, comprised of more than 15,000 MW of generation projects and over 2,200 MW of demand resources.⁵⁰ The amount of new capacity submitting Show of Interest Forms, especially in the form of demand response, and the amount of capacity likely to be needed indicate that ample capacity will be available at competitive prices. Thus, the minimal impact of relying on an orderly and deliberate stakeholder process to address the interconnection queue issue does not justify jeopardizing the immediate steps necessary to implement the FCM and successfully conduct the first auction.

Accordingly, for the foregoing reasons, the State Parties' request for rehearing on the interconnection queue issue and request for clarification concerning the Reliability Agreement process should be denied.

B. The Commission Did Not Err In Accepting A Rule Creating A Stakeholder Process To Consider Expanded Criteria For Invoking The Alternative Capacity Price Rule.

1. State Parties' Arguments

The State Parties argue that the Commission should grant rehearing and reject the proposed rule creating a stakeholder process to consider expanded criteria for invoking the Alternative Capacity Price Rule.⁵¹ Citing Section 4.A of the Settlement, they claim that the ISO "may not seek *any* modification to the fixed terms of the Settlement"⁵² until September 1, 2008,

⁵⁰ Competitive Wholesale Markets Prove an Effective Tool for Fulfilling Regional Electricity Needs, ISO New England Reports Strong Initial Response to New Forward Capacity Market, press release (March 16, 2007), available at <http://www.iso-ne.com/nwsiss/pr/2007/fcm_so_i_results_03-16-2007.pdf>.

⁵¹ State Parties' Pleading at 9-13.

⁵² *Id.* at 9 (emphasis in original).

the specified end of an agreed upon Waiver Period. They assert that the Alternative Capacity Price Rule in the Settlement (Section 11.III.I) is “controversial,”⁵³ and that any changes to the criteria for applying the Alternative Capacity Price Rule “would have required commensurate compromises in other areas in order to achieve broad support.”⁵⁴ They also assert that the Settlement distinguishes between the Settlement itself, which cannot be modified during the Waiver Period other than through certain very limited procedures, and market rules, which are subject to change if necessary to protect system reliability, competitiveness, or efficiency.

The State Parties also assert that by opening the door to Settlement changes, the Commission “will strengthen the position of change advocates and make the outcome a virtual *fait accompli*.”⁵⁵ Further, the State Parties maintain that even if the proposed modifications to the FCM Settlement were permissible, the ISO “has not justified an expedited process”⁵⁶ to consider expanding the scope of the Alternative Capacity Price Rule. Citing the ISO’s recent release of de-list bid data relating to the first FCA, they allege that it is “impossible”⁵⁷ for the ISO to show that any rule modification will be necessary until at least the second FCA.

2. ISO Response

As an initial matter, the State Parties mischaracterize Section 4.A of the Settlement Agreement. In relevant part, that Section provides:

Except as provided in Section 4.C, during the Waiver Period, the ISO shall retain its authority under Section 205 of the FPA to file modifications of the Market Rules that address the terms of the Settlement Agreement; where the ISO makes such a filing, the ISO must demonstrate to the FERC that failure to implement the

⁵³ *Id.* at 10.

⁵⁴ *Id.*

⁵⁵ *Id.* at 12.

⁵⁶ *Id.*

⁵⁷ *Id.* at 13.

proposed change in the Market Rule would have a negative effect on (1) system reliability or security, or (2) the competitiveness or efficiency of the Forward Capacity Market or forward reserve market.

The State Parties characterize this provision as an “absolute prohibition on changes to the firm Settlement terms” and contend that “ISO-NE may not seek any modification to the fixed terms of the FCM Settlement Agreement until September 1, 2008, the specified end of an agreed upon Waiver Period.”⁵⁸ This interpretation of the Settlement Agreement is completely at odds with the plain language of the Agreement and its intent. The provision clearly allows the ISO to file for changes, provided certain conditions are met. Indeed, it is critical for the ISO to retain its FPA Section 205 rights in case there are fundamental problems with the design of the FCM that must be cured. Thus, the Commission’s holding in paragraph 91 of the April 16 Order is correct and the State Parties’ request for rehearing should be denied. This being said, however, the Commission should not address the appropriate standards or burdens of proof with regard to changes in the Settlement or the rules thereunder on rehearing. Instead, the Commission should await an actual filing that presents a proposed change to the Settlement or the applicable market rules to apply the terms of Section 4.A. By postponing this potential controversy (and a controversy that is only theoretical at this point), the Commission, like a court, will only be deciding a true case in controversy, rather than rendering an essentially advisory opinion.

The Commission should deny rehearing on whether changes can or should be made to the Alternative Capacity Price Rule because a ruling on whether such changes are appropriate is not ripe. It is not certain what if any changes the stakeholders will recommend and what course of action the ISO will ultimately propose regarding whether any revised rules are necessary. As required by Section III.13.2.5.2.5(f), “[t]he ISO will file with FERC on or before June 30, 2007

⁵⁸ State Parties’ Pleading at 9-10.

either: (i) any potential rule changes relating to the treatment of de-list bids rejected for reliability reasons or (ii) its recommendation not to institute any rule changes and to delete this subsection (f).”⁵⁹ If a change is proposed, the ISO will demonstrate that the change meets the applicable standards for making such a filing. All parties retain their complete rights to make whatever challenges they deem fit concerning that filing, and considerations of administrative efficiency require that the Commission not address arguments concerning the propriety of a filing proposing revised rules until the time that such a filing actually is made.

The State Parties’ argument that no harm will result from delaying any proposed modification of the Alternative Capacity Price Rule because it is not likely to have any effect until at least the second FCA⁶⁰ misses the mark. As the ISO noted in its February 15 Filing,⁶¹ the ISO’s willingness to agree to a rule requiring a filing by June 30 with respect to the applicability of the Alternative Capacity Price Rule to de-list bids was grounded in the conclusion that such a filing would not require the degree and intensity of effort that queue re-design and reliability agreement review requires. If and to the extent that the ISO proposes to change the Alternative Capacity Price Rule and the State Parties object on the basis that such a change need not be made in the immediate future, they may make this argument in response to the June 30 filing.

⁵⁹ Market Rule 1, Section III.13.2.5.2.5(f).

⁶⁰ State Parties’ Pleading at 12-13.

⁶¹ February 15 Filing at 20.

C. The Commission Did Not Err In Accepting the ISO’s Market Rules Concerning The Timing Of Notification To De-List Bidders Of Whether A Unit Is Required For Reliability Reasons.

1. State Parties’ Arguments

The State Parties and NRG Companies argue that the Commission erroneously concluded that, in all cases, the ISO will be unable to determine whether a unit is required for reliability reasons until the conclusion of the auction. The State Parties argue that this is contrary to the objective of the New England capacity market to minimize the need for Reliability Must Run (“RMR”) agreements by encouraging new entry in locations that would satisfy particular reliability needs. They argue that “parties intended for de-list bids rejected for reliability reasons to be distinctly short term, with alternative arrangements quickly rectifying the reliability need and permitting the resource to de-list.”⁶² Thus, they argue that “the FCM rules should facilitate the earliest possible notification of a reliability need, thereby stimulating prompt market responses.”⁶³

NRG Companies and the State Parties concede that in some instances the ISO will not know until the conclusion of the auction that no new generation will meet the local reliability requirement filled by a unit seeking to de-list. However, in the situation where “no new entrants submit Show of Interest forms for projects that could conceivably satisfy the reliability need being met by a unit seeking to de-list and there are no transmission upgrades that will be in place by the start of the Commitment Period, ISO-NE will know immediately and conclusively that this de-list bid will have to be rejected”⁶⁴ and that waiting until the conclusion of the auction

⁶² State Parties’ Pleading at 14.

⁶³ *Id.*

⁶⁴ *Id.* at 15.

before alerting other potential new entrants that they may have an opportunity to replace a reliability unit is arbitrary and capricious.⁶⁵

Additionally, NRG Companies claim that generators with multiple resources on the same site will suffer financial harm due to the fact that (1) the de-list bids of these generating units are interrelated; (2) a failure to inform the generator that a de-list bid which has cleared will, in fact, be rejected, will distort the de-list bids for the other generating units in subsequent auctions and (3) the distortion will cause substantial economic harm to both the entity and the market.⁶⁶ The State Parties add that, “[b]y withholding that key information for several months, ISO-NE may delay market-driven solutions to reliability concerns that could be met at a lower costs in subsequent reconfiguration auctions.”⁶⁷ Thus, NRG Companies conclude that the Commission erred when it permitted the ISO to defer disclosure in these circumstances until the conclusion of the FCA, and on rehearing, the Commission should require the ISO to advise market participants promptly whenever it becomes apparent that a unit’s de-list bid will be rejected for reliability reasons.

2. ISO Response

The Commission should deny the requests for rehearing regarding the issue of notification prior to the end of an FCA of the rejection of a de-list bid for reliability reasons. The de-list bid process, including the timing of notification to generators seeking to de-list, is fundamental to the success and competitive nature of the FCM. In many cases, the ISO will not know if a unit is needed for reliability until the conclusion of the FCA. In any case, information about units needed for reliability reasons should only be released after the auction, as the need to

⁶⁵ *Id.* at 2, 4-5.

⁶⁶ *Id.* at 2, 5-6.

⁶⁷ State Parties Pleading at 15.

prevent the exercise of market power greatly outweighs the claims raised by the State Parties and NRG Companies.

If a generator is informed prior to the conclusion of the auction that it is needed for reliability, it can submit an inflated de-list bid knowing that it will be paid during the Capacity Commitment Period in any case, thereby attempting to procure the higher of cost or market payments. As explained in the February 15 Filing:

While the ISO may begin its reliability review at the time a generator submits a de-list bid, it is not possible or necessary to inform a generator that it might be needed for reliability prior to determining whether the resource would have cleared the auction. The need for a resource may depend on which other resources clear in the auction. If the resource does not clear in the auction, there is no need to inform it that it might be needed for reliability. The ISO's view in this matter is also informed by a desire to prevent generators from attempting to procure the higher of cost of service rates or market prices. Generators that know they are needed for reliability will have additional incentives to de-list to attempt to earn the higher of cost or market.⁶⁸

At present, there are about 33,000 MW of existing capacity receiving capacity credit. The incremental need for capacity to meet the Installed Capacity Requirement each year is likely to be between 500 and 1000 MW of capacity per year. If the de-list rules 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 MW 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. This rationale applies equally to the issue raised by NRG Companies regarding generators that own a portfolio of resources in the same location. The

⁶⁸ February 15 Filing at 40.

portfolio impact of market power is far more detrimental to the capacity market and greatly outweighs the argument in favor of providing notification to generation owners prior to the conclusion of the FCA.

Although disclosing information promptly to encourage replacement of RMR units is a commendable goal, that concern is outweighed in this situation by the need to prevent the exercise of market power. As the ISO has noted previously,⁶⁹ if a unit knows that it is needed for reliability and that it has market power, it could attempt to exercise that market power to obtain the higher of cost or market. Providing notification of de-list bids rejected for reliability reasons at the conclusion of the auction is even more vital where a generator has multiple resources in the same area. Thus, the ISO seeks to maintain that information confidential until the last possible time because in many cases, the need for a given unit will be influenced by other units remaining or leaving the market.

D. Whether The Commission Should Clarify That Any Existing Unit Seeking To Retire Permanently Must Comply With The FCM Rules For Permanent De-list Bids.

1. State Parties' Arguments

The State Parties argue that the Commission should clarify that any unit seeking to retire under Section I.3.9 of the Tariff must first submit a Permanent De-list Bid.⁷⁰ They state that the FCM Settlement “is unequivocal -- All Existing Capacity shall be a capacity Resource in the FCA unless its . . . Permanent De-list Bid is accepted,” and that “the FCM Rules reflect the

⁶⁹ *See Id.* at 40.

⁷⁰ State Parties' Pleading at 21-23.

requirement for all existing capacity to submit a de-list or export bid in the qualification process or to become an automatic price taker in the FCA.”⁷¹

However, they point out that:

[i]n rejecting arguments about the timing and binding nature of de-list bids, the Commission quoted the ISO as stating that “a unit may retire prior to the [Forward Capacity Auction] for a given Capacity Commitment Period,” and “[i]f it chooses to do so, the unit will not be entered into the [Forward Capacity Auction] and its capacity will be replaced,’ subject to the timing requirements that ISO-NE notes.” The Commission then observes that “ISO-NE’s proposed FCM Rules do not preclude or revise the current New England market rules for the retirement of resources that allow generating resources to submit notice of retirement *at any time*, given a notice period of sixty days and subject to a reliability review by ISO-NE.”⁷²

The State Parties argue that the Commission should clarify that a unit seeking to retire must fulfill its supply obligations under the FCM.⁷³ The State Parties further argue that it would be misleading to suggest that a unit may submit a notice of retirement and exit the market “at any time” simply by giving 60-days notice, and the Commission “should clarify that a resource may not evade the FCM’s de-list bidding requirements and capacity resource obligations by filing a retirement notice ‘at any time.’”⁷⁴

2. ISO Response

The ISO affirms that a resource seeking to retire must comply with the market rules associated with the FCM and cannot evade its Capacity Supply Obligation. The rules associated with retirement of a resource will be revised to harmonize the interrelated rules regarding Reliability Agreements, retirement and the FCM. In any event, a unit that has undertaken a supply obligation in the FCM cannot retire without first covering its supply obligation.

⁷¹ *Id.* at 21.

⁷² *Id.* at 22.

⁷³ *Id.*

⁷⁴ *Id.* at 23.

A Capacity Supply Obligation is defined as:

an obligation to provide capacity from a resource, or a portion thereof, to satisfy a portion of the Installed Capacity Requirement that is acquired through a Forward Capacity Auction in accordance with Section III.13.2, a reconfiguration auction in accordance with Section III.13.4, or a Capacity Supply Obligation Bilateral in accordance with Section III.13.5 of this Market Rule.⁷⁵

A resource that acquires a Capacity Supply Obligation must fulfill that obligation for the duration of the Capacity Commitment Period by either satisfying that obligation itself or by covering that obligation. Pursuant to the market rules, a resource may cover its supply obligation in a reconfiguration auction or by entering into a Capacity Supply Obligation Bilateral.

In no circumstance may a resource circumvent the requirement to cover a Capacity Supply Obligation by notifying the ISO that the unit is being retired. Because of the interrelationship between Reliability Agreements, unit retirements and the FCM, as well as the need to harmonize the rules associated therewith, the market rules regarding retirement currently residing in Section I.3.9 of the Tariff will be revised. In any case, it should be clear that a resource with a supply obligation in the FCM may not notify the ISO pursuant to the retirement provisions of the Tariff that it seeks to retire without simultaneously complying with the requirements in the FCM market rules regarding Capacity Supply Obligations.

⁷⁵ Market Rule 1, Section III.1.3.2.

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 portions of requests for rehearing discussed herein.

Respectfully submitted,

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Dated: May 31, 2007

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 31st day of May, 2007.

/s/ Sherry A. Quirk
Sherry A. Quirk