

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

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

Docket Nos. ER10-787-000

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

EL10-50-000

**PSEG Energy Resources & Trade LLC, PSEG
Power Connecticut LLC, NRG Power Marketing
LLC, Connecticut Jet Power LLC, Devon Power
LLC, Middletown Power LLC, Montville Power
LLC, Norwalk Power LLC, and Somerset Power
LLC v.
ISO New England Inc.**

EL10-57-000

SECOND BRIEF OF THE MAINE PUBLIC UTILITIES COMMISSION

Pursuant to the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission”) and the Commission’s Order on Capacity Market Revisions and Related Complaints,¹ the Maine Public Utilities Commission hereby respectfully submits its second brief in this paper-hearing proceeding.

ISO New England, Inc.’s (“ISO-NE”) first brief indicates that it has misunderstood the Commission’s requirement in its April 23 Order that ISO-NE must provide additional support for certain aspects of its February 22 filing. Instead of providing that additional support for its proposal to make changes to certain aspects of the Forward Capacity Market (FCM), ISO-NE has designed “on the fly” a new administratively-based capacity mechanism that bears little resemblance to the FCM’s

¹ *ISO New England Inc., et al.*, 131 FERC ¶ 61,065 (2010) (“April 23 Order”).

auction price-setting mechanism. ISO-NE's new capacity mechanism, in fact, reaches back to the flawed Locational Installed Capacity (LICAP) proposal for at least two of its design features: (1) administratively determined benchmark resource cost used to set prices and (2) the purchase of additional capacity beyond the Installed Capacity Requirement ("ICR"). These two highly-contested features of LICAP were ultimately rejected after more than two years of litigation, and were replaced by the FCM auction price-setting mechanism.² Four successful auctions later, ISO-NE and the incumbent generators appear to be ready to abandon the market aspects of the FCM, but their efforts to do so would result in a poorly formulated administrative price-setting scheme that would require resource-intensive litigation and subsequent proceedings over implementation characteristics. The MPUC urges the Commission not to accept ISO-NE's and incumbent generators' invitation to make the radical changes proposed in their initial briefs.

The MPUC supports and adopts herein by reference several aspects of the Joint Filing Supporters' second brief and supporting testimony. The MPUC generally agrees with the Joint Filing Supporters that the untested and un-vetted approaches to addressing the issues identified in the Commission's April 23, 2010 Order offered by ISO-NE and the incumbent generators in their First Briefs are clearly unjust and unreasonable. Specifically, MPUC supports and adopts by reference herein, the following points made by the Joint Filing Supporters in their second brief: (1) the ISO-NE's triggering conditions for the APR are too broad, as is the definition it proposes for OOM; (2) ISO-NE's proposed APR revisions will significantly harm state programs to promote energy

² See, generally, *Devon Power LLC*, 115 FERC ¶ 61,340 (2006) (summarizing the litigation over LICAP, and approves the settlement establishing the FCM).

efficiency, demand response, and renewable resources; (3) the dual pricing program proposed by ISO-NE unjustly favors existing generators and masks signals from the market to retire; (4) the “Benchmark” pricing provision of ISO-NE will frustrate competitive market driven goals that are the hallmark of the FCM design; (5) the carry forward of OOM from past FCA’s is not appropriate; (5) ISO-NE’s APR proposal introduces an unacceptable level of risk for market manipulation and anticompetitive behavior by market participants; and (6) the Commission should reject the term “true cost of new entry” as used by the incumbent generators and decline invitations to adopt an administrative cost of new entry (“CONE”) based on estimates of the cost of new resources.

The MPUC supports and adopts herein the Joint Filing Supporters’ argument and testimony in support of the argument that ISO-NE’s proposed triggering conditions for the APR are too broad, as is the definition of OOM. The MPUC did not object to the February 22, 2010 Joint Filing because ISO-NE had agreed that it would revisit the definition of OOM through the stakeholder process that was to follow the conclusion of the above docket.³ Now, in their first brief, ISO-NE indicates that “the standard of review applied to reviewed offers and the definition of OOM will be unchanged under the Revised FCM Proposal.”⁴

As the Joint Filing Supporters point out, the over-broad definition combined with ISO-NE’s proposed APR revisions will significantly harm state programs intended to

³ Various Revisions to FCM Rules Related to FCM Redesign, *ISO New England Inc., et al.*, Docket No. ER10-787-000 (filed Feb. 22, 2010) (“Joint Filing”), Transmittal Letter at 10 (committing to a “follow-on” stakeholder process which will, among other things, address refining the definition of OOM resources.)

⁴ First Brief of ISO-NE, Docket No. ER10-787 at p. 32, (July 1, 2010) (“First Brief of ISO-NE”).

promote energy efficiency, demand response, and renewable resources. The Commission has previously recognized that rules applying to out of market (“OOM”) resources should not impose burdens on or interfere with programs that advance legitimate state policy goals such as these.⁵ In fact other RTOs have begun to address this issue. For example, in a recent compliance filing the New York Independent System Operator (“NYISO”) stated:

The NYISO assumes that the Commission would agree that state programs should be presumed to be aimed at serving valid public policy goals. The NYISO therefore interprets the May 20 Order as directing it to consider the potential for payments or other benefits received by SCRs to cause uneconomic entry that would harm the capacity markets. The NYISO does not believe that any of the programs of which it is aware that are currently administered or approved by New York State, or a governmental instrumentality thereof, are currently causing uneconomic entry that would harm the capacity markets. The NYISO is therefore proposing to exclude all payments and the other benefits to SCRs under state programs from the Offer Floor calculation. The NYISO discussed this proposal with the Independent Market Monitor who agreed that it represented a reasonable approach at this time.⁶

While the solution proposed by NYISO deals with a different set of market rules and the state programs referenced are limited to demand response only, the differences in approaches between NYISO and ISO-NE is striking. ISO-NE rejects a bright line test to “distinguish OOM capacity that should trigger APR mitigation (i.e., that [is] used as a tool for price suppression) from capacity that should not trigger such mitigation because it does not inappropriately suppress market-clearing prices below a competitive level”⁷ because the Internal Market Monitor (“IMM”) “does not believe that it is possible to craft

⁵ NYISO, 124 FERC ¶ 61,170 (2010) at p. 137.

⁶ Resubmittal of Compliance Filing, NYISO, Docket Nos. ER10-2371 EL07-39-___ and ER08-695 ___, at p. 17 (filed Aug. 24, 2010).

⁷ April 23 Order at p. 77 (footnote omitted).

tariff language that will allow it to determine the intent behind a project's development,"⁸ while the NYISO presumed that the state demand response programs were serving legitimate state purposes and thus exempted from minimum offer price calculations the payments and other benefits from these programs. Unlike NYISO, ISO-NE has not even attempted to establish a bright line test or other mechanism to avoid interfering with state programs that advance legitimate policy goals.

As stated in the Joint Filing Supporters' second brief and attached testimony, ISO-NE's new proposal would thwart state initiatives to promote desirable capacity resources because the result of promoting such resources will be sharp increases in capacity prices based on what the market monitor thinks the correct price for that type of resource should be. For similar reasons the MPUC supports and adopts herein the Joint Filing Supporters' arguments and testimony in support of the arguments that state sponsored programs intended to realize the social value of renewable resources, energy efficiency, demand response, and greater reliability will be disincentivized under the proposals of ISO-NE and of the incumbent generators. Under those proposals the participation of FCM resources that are in part supported by state public policy programs will result in a higher capacity price for all of load due to the combined impact of the APR price and the purchase of more than the ICR or LSR. The irony of this result is that in many cases those higher capacity payments will go to some of the very resources the state programs were intended to displace thereby masking the incentives such resources might otherwise have to retire. The revised APR proposals are therefore extremely likely to frustrate and interfere with many legitimate and important state public policy goals.

⁸ First Brief of ISO-NE at p. 34.

The MPUC supports and adopts herein the Joint Filing Supporters' arguments and testimony in support of the arguments opposing the ISO-NE proposal's dual pricing provisions. These provisions will ensure existing capacity receives higher payments than new capacity for two decades. By providing existing resources an administratively set price higher than all other resources many uneconomic or socially undesirable existing generators will not be properly incented to retire. This result not only goes against the public policy goals of many New England states, it also goes against market principals, fundamental to the FCM design, favoring a single market clearing price.

The MPUC supports and adopts herein the Joint Filing Supporters' arguments and testimony in support of the arguments opposing ISO-NE's proposal to use "Benchmark" prices for OOM resources to establish the APR price. The MPUC agrees with the Joint Filing Supporters that ISO-NE's proposal will damage the competitive goals of the FCM and replace it with an administrative price setting mechanism. If changes must be made to the existing FCM those changes should minimize the need for administrative price-setting. The market-price setting auction mechanism is the hallmark of the FCM and distinguishes it from capacity mechanisms in other RTOs. Changes to the APR that cause the use of administrative-price setting rather than the FCM auction mechanism will detract from the most notable and most successful feature of the FCM market—the reliance on the market to set the price of capacity through competition among resources. As we stated in our March 15, 2010, comments on the ISO's section 205 filing, "Because the major strength of the FCM is that prices are competitively set rather than

administratively determined, design changes that cause more administrative price setting, have the potential to detract from the FCM's best feature."⁹

The MPUC supports and adopts herein the Joint Filing Supporters' arguments and testimony in support of the arguments that ISO-NE's APR proposal introduces an unacceptable level of risk for market manipulation and anticompetitive behavior by market participants. The supplemental testimony of James Wilson in support of the Joint filing Supporter's second brief presents strong evidence that unintended consequences of the new capacity market design proposed by ISO-NE exposes ratepayers to a greater risk of anticompetitive behavior by market participants. Many of the examples provided in his testimony show how both the two tiered pricing and the overly broad definition of OOM may allow market participants to engage in anticompetitive behavior. The MPUC agrees that the market manipulation risks are too great, ISO-NE's proposal is too untested, and the potential costs of anticompetitive behavior are too high to hazard moving forward with the proposal at this time.

The MPUC supports and adopts herein the Joint Filing Supporters' arguments and testimony in support of the arguments that CONE should not be redefined as a "true cost of new entry" as the incumbent generators use this term. The term "true cost of new entry" as used by the incumbent generators is a misnomer. The benchmarking proposals by ISO-NE and the incumbent generators would not produce the "true cost of entry." They would represent merely the market monitor's judgment of a "proxy" resource's net cost. CONE as used in the FCM is a much truer estimate of the cost of new entry, because it is based on FCM clearing prices. In recent auctions, new demand resources

⁹ Notice of Intervention and Comments of the Maine Public Utilities Commission and the Maine Public Advocate, Docket No. ER10-767 (March 15, 2010) at 7.

would have likely set the clearing price even absent any OOM resources were it not for the floor.¹⁰ While demand resources may have lower costs than new generators, this does not mean that their bids are not representative of the cost of new entry. As the Commission itself stated, “the [FCM] payments equal the cost of new entry.”¹¹ Substituting an administrative CONE for a competitively set CONE¹² is taking the capacity market in the wrong direction. Not only would an administratively set CONE be taking a step away from a successfully functioning market, but it would require resource-intensive litigation to determine the administratively-set benchmark(s).

The MPUC also agrees with the Joint Filing Supporters in at least one area of concern regarding the ISO-NE proposal to model all zones. The clearing mechanism that ISO-NE proposes to use when it models all zones all the time does not appear to be well thought out, and provides yet another example of the “on the fly” nature of the changes to the FCM proposed by ISO-NE in its first brief. In its that brief, ISO-NE describes the mechanism as seeking to “to minimize long-run costs by selecting the set of resources that maximizes social welfare while recognizing bi-directional and mesh network constraints,” and notes that it, “is likely to result in an optimization problem that requires extensive use of heuristic solution methods and is likely to produce multiple locally

¹⁰ Internal Market Monitoring Unit Review of the Forward Capacity Market Auction Results and Design Elements, *ISO New England*, at p. 2 (June 5, 2005). (available at http://www.iso-ne.com/markets/mktmonmit/rpts/other/fcm_report_final).

¹¹ *ISO New England, Inc. and NEPOOL Participants Committee*, 111 FERC ¶ 61,163 P.30 (2007).

¹² See, e.g., *Devon Power LLC*, 115 FERC ¶ 61,340 (2006), *Devon Power LLC*, 115 FERC ¶ 61,340 (2006) Devon at P27 “To ensure that the FCA clearing prices are determined competitively, the FCM is designed to allow new capacity to set the clearing price, thus providing a market-based measure of the cost of new entry.” See also *Devon Power LLC*, 107 FERC ¶ 61,240 P.111 (“Moreover, we note that, following the first FCA, CONE will be “calculated using the clearing prices of previous auctions” and thus will rely on competitive prices.”).

optimal solutions that the solution software would not be able to consistently identify.”¹³ While the meaning of these statements is not entirely clear, they suggest a certain level of subjectivity in the determination of how zones will clear. This subjectivity poses a significant risk that the auction results, to the degree they are based on zonal determinations, will be subject to challenge. The possibility for significant litigation over auction results will contribute to market uncertainty which may affect the level of new investment. Thus, ISO-NE should be required to provide more information about its proposed mechanism before the Commission rules on whether or not it is workable.

The incumbent generators also argue for changes to the FCM design and the MPUC supports and adopts herein the Joint Filing Supporters arguments opposing those changes. The MPUC agrees that (1) further broadening of the OOM definition is a step in the wrong direction; (2) that retroactive carry forward reaching back to the first three FCAs is unreasonable; (3) that more rigid use of the Internal Market Monitor’s “Benchmark” prices to set the APR price is unwise; and (4) that using an administrative demand curve rather than a competitive market price is a bad idea. As the Joint Filing Supporters note in their second brief, these proposals only serve to exacerbate the deficiencies in ISO-NE’s proposed changes.

The MPUC supports and adopts herein the Joint Filing Supporters’ and ISO-NE’s arguments in support of not carrying forward OOM from the first three FCA’s. OOM resources that bid into these auctions did so with the understanding of the rules that existed at the time of their entry into the market. It would be unfair to change those rules in a way that would likely have impacted the sponsors of those OOM resources decisions

¹³ First Brief of ISO-NE, at p. 58.

on whether to bid into the FCA, or perhaps their decision whether or not to develop the resources in the first place. The MPUC is quite concerned, given the level of surplus capacity in the region, that retroactively including the OOM resources that entered the FCM in the first three auctions will ensure that the APR kicks in for the foreseeable future, even without any new OOM being introduced. This would increase costs to load without mitigating any of the behavior that the APR is designed to mitigate, because the legacy OOM has already entered the market under a very different set of rules.

In addition to supporting the arguments of the Joint filing parties as noted above, the MPUC, in its First Brief, suggested that ISO-NE should in its second brief compare the cost impact of the proposal outlined in the February section 205 filing¹⁴ the cost impact of its new proposal submitted in its First Brief. The MPUC recognizes that at this point there is no Commission order mandating such cost analysis, but the MPUC firmly believes that this information should be a part of the decision making process. ISO-NE did recently provide stakeholders with a truncated analysis of how its current proposal might have worked if it were in place during the first three Forward Capacity Auctions. The MPUC appreciates the analysis, and it provides some limited information to help stakeholders understand the new APR proposal. Unfortunately the usefulness of the analysis is limited both by the data made available and by the fact that it fails to compare the prospective costs of the new proposal to those outlined in the 205 filing made in

¹⁴ The two page general justification for making changes to the APR cited at page 4, n.12 of the ISO-NE transmittal letter in this docket should not provide a model for providing the cost impact of a specific proposal. The MPUC is hopeful that ISO-NE will actually develop projections of price impacts of its July 1 proposal in meeting its commitment to provide *quantitative* and *qualitative* information on the need for and the impacts, including costs, of a major design initiative.

February.¹⁵ If not included in ISO-NE's second brief, the MPUC strongly urges ISO-NE to provide stakeholders, in its third brief, with more complete estimates of the costs of the February proposal relative to costs of its new proposal. If this information is not provided either in the second or third brief, the MPUC requests that the Commission direct ISO-NE to produce it in a supplemental filing following the third brief.

Dated: September 1, 2010

Respectfully submitted,

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/s/ Jacob A. McDermott

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¹⁵ Impact Analysis Memo for ISO July 1 FCM Filing, *ISO-NE* (August 25, 2010) (*see e.g. at p. 2* discussion regarding the straight lining of delist below the floor used in the analysis) (attached hereto as Exhibit 1).

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document either by first class mail or electronic service upon each party on the official service list compiled by the Secretary in this proceeding.

Dated at Hallowell, Maine, this 1st day of September, 2010.

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EXHIBIT 1



memo

To: ISO Stakeholders

From: Robert Ethier, Vice President, Market Development

Date: August 25, 2010

Subject: Impact Analysis for ISO July 1 FCM Filing

Created at the request of regional stakeholders, attached please find an impact analysis of the Alternative Price Rule (APR) changes proposed in ISO New England's July 1 Forward Capacity Market (FCM) Filing. This analysis shows the potential impact of the proposed APR had it been in effect for the first three Forward Capacity Auctions (FCAs).¹

I hope that you find this analysis informative, constructive and responsive. Please contact me with any questions or comments.

Analytic Approach

The analysis uses actual offer and bid data, and the amount of capacity demanded (the Installed Capacity Requirement), from each of the first three FCAs. For each FCA, four figures are constructed, illustrating the potential impact of the ISO's proposed APR. These figures are discussed below.

First Figure

The first figure is the supply curve used to actually clear the FCA. This supply curve includes the effect of the floor price, so there are no bids or offers below the floor. The clearing price is shown, and is the intersection between the supply and demand curves. For each of the first figures, the clearing price is the floor price.

Second Figure

The second figure is identical to the first, except that all resources identified as Out-of-Market (OOM) by the Market Monitor have their offers repriced as would occur under the proposed APR. The supply curve in this figure reflects the repricing of those OOM resources. For these examples, all OOM generation resources are repriced at \$8.00/kW-mo and all other OOM resources are repriced at \$5.50/kW-mo. These values are not intended to reflect an estimate of the resources' costs but are intended to illustrate the effect of repricing OOM resources on the proposed APR supply curve.

¹ These results are subject to certain assumptions and limitations. For example: the MW totals will not be identical to those in the FCA Informational Filings because the analysis simplifies treatment of certain auction complexities, such as interfaces and export constrained areas, RTEGs, repowerings, and incremental new resources; assumptions are also made about the level at which OOM resources would be repriced, and about the specific offer behavior of resources below the floor price.

As long as the repriced OOM resources are priced above the APR clearing price, it makes no difference what price level is chosen for repricing. That is, raising the prices further in these examples would have no effect on the APR clearing price. In each case, the APR clearing price is the same as the actual clearing price. This is because the FCA floor price prevents participants from submitting bids and offers below the floor price so the market will not clear below this level. The APR in this case does not raise the price above the floor price because the amount of OOM resources in the FCA is less than the excess capacity remaining in the FCA at the floor price in each of the first three FCAs.

Carry-forward of OOM resources from one FCA to the next is reflected in this analysis. The carry-forward MW were not reduced by retirements or load growth as would occur under the proposed APR. Not reducing the carry-forward MW will result in more OOM resources being carried-forward in the analysis than would actually occur, overstating the price effect of the proposed APR.

Third Figure

To provide a better illustration of the potential effects of the proposed APR, the third figure extends the supply curve below the floor price, but without applying the APR. Extending the supply curve requires assumptions about the price level at which resources would withdraw from the FCA in the absence of the floor price. The assumption made for this analysis is that resources would withdraw from the FCA “evenly” between the floor price and a price of zero. That is, in the third figure the quantity in the FCA at the floor price is the quantity that actually cleared in the FCA, and the quantity in the FCA at a zero price would be zero. Half of the MW in the FCA at the floor price would have withdrawn from the auction at a price halfway between the floor price and a zero price under this assumption. As with the assumption about the repricing of OOM resource, it is not expected that the extended supply curve represents what would have actually happened had the floor price not been in place; There is no way to know what bidding behavior would have been without the floor price. Rather, the extended supply curve is intended to allow a richer set of possible outcomes compared with those produced by using just the submitted bids and offers alone. These outcomes may better illustrate results that might occur once the floor price is no longer in effect.

As in the first two figures, for the third figure, the clearing price is determined by the intersection of the supply and demand curves, and the demand is the Installed Capacity Requirement. However, in this third figure, the supply curve does not reprice OOM. Rather, the OOM resources are part of the extended supply curve remaining in the auction beyond the floor. The clearing price calculated for each FCA using the extended supply curve is below the floor price, which is to be expected given the excess supply in the FCA at the floor price.

Fourth Figure

The fourth and final figure for each FCA combines the extended supply curve with application of the APR, so OOM resources are repriced to a higher amount than offered and thus removed from the extended supply curve. This effectively shifts the supply curve to the left and results in a higher clearing price when compared with the third figure, which demonstrated the ‘natural’ clearing price with OOM supply in the auction. This higher price (shown in the fourth figure) is the APR clearing price that would be paid to existing resources, while the lower price (shown in the third figure) is the “natural” clearing price that would be paid to all new resources.

Results and Caveats

For each of the past FCAs, using the actual supply curve and applying the proposed APR has no impact on the calculated price because any effect of the proposed APR is masked by the floor price – in fact, if the floor price had not been in place both the natural clearing price and the APR price would have been below the floor price. This is illustrated by the first two figures for each FCA.

The figures with the extended supply curve better illustrate the potential effects of the proposed APR. For each FCA, the extended supply curve results in a price where supply just equals demand that is below the floor price. When OOM resources are repriced and the proposed APR is applied, the price increases. The calculated price increases due to the application of the proposed APR when the supply curve is extended below the floor price are \$0.01/kW-mo for FCA 1, \$0.14/kW-mo for FCA 2, and \$0.17/kW-mo for FCA 3. The price increase grows in each FCA because as OOM MW are carried-forward, the total OOM MW in subsequent FCAs increase. In these examples, the carried-forward MW are not reduced by retirements and load growth, as they would be under the proposed APR. Existing resources would get the higher APR price (shown in the fourth figure), while new resources would receive the lower, natural clearing price under the ISO proposal (shown in the third figure).

It is useful to note that changing the assumption about the level at which OOM resources are repriced under the APR would only matter if the resources were repriced to levels below the calculated APR clearing price. At any level above the calculated APR clearing price, there would be no change in the calculated APR clearing price. This is because it does not matter where on the supply curve the repriced OOM resources are if they are above the intersection of supply and demand; a price of five dollars or fifty dollars produces the same effect because they are “out of the money” and do not clear in the market.

The results of this analysis are intended only to illustrate the impacts of the proposed APR and should not be interpreted as showing what the natural clearing price would have been absent a floor price, or the level at which OOM resources would have been repriced had a repricing rule been in effect. Because certain details are not reflected in this analysis (e.g. adjusting carry-forward MW for retirements and load growth), the results should be treated as indicative. Also, the MW totals do not precisely match those in the FCA Informational Filings because the analysis simplifies treatment of certain auction complexities, such as interface and export constraints, RTEGs, repowerings, and incremental new resources. Changing the assumptions about bid and offer behavior below the floor price and about repricing could have significant effects on the results shown here, but the recalculated prices would not exceed the floor price.