

first as directed by the Commission, and (2) the tariff revisions do not “provide certainty that double recovery of capital costs for generating equipment does not occur.”⁴

I. BACKGROUND

The January 2010 Order is the most recent of several orders in which the Commission directed ISO-NE to implement tariff provisions to ensure that double recovery of capital costs for generating equipment does not occur.⁵ The Commission’s concern over double recovery arose from a December 29, 2006 joint filing made by ISO-NE and NEPOOL, which included a proposal to update the Schedule 2 Capacity Cost (CC) rate.⁶ The MPUC protested several aspects of the filing, among them the fact that once generators began to receive revenues from the FCM settlement, they would be receiving two streams of revenue to compensate them for the same generating equipment necessary to generate energy and provide reactive service.⁷ In the resulting February 2007 Order, the Commission found that during the transition period, prior to the beginning of the first FCA commitment year, the Schedule 2 CC rate did not produce double recovery of capital costs for generating equipment used to generate energy and provide reactive service because FCM transition payments were below the cost of new entry (CONE) figure developed in the litigated proceeding leading up to the FCM.⁸ However, the the Commission stated that it “was concerned that double recovery could occur *during the first Forward Capacity Auction (FCA) because the FCA payments equal the cost of new entry.*”⁹

⁴January 5, 2010 Order, at P 8.

⁵ *Id.*

⁶ *Id.* at P 2.

⁷ *Id.*

⁸ February 2007 Order at P 30.

⁹ January 2010 Order at P 3 (emphasis added).

In response to a separate September 2008 complaint filed by the MPUC (Docket No. EL07-38-000) relating to the double recovery issue, ISO-NE filed a game theoretic analysis to demonstrate the absence of a double recovery issue.¹⁰ The Commission denied the MPUC complaint finding that the Schedule 2 payments, in addition to the FCM revenues, do not result in double recovery.¹¹

However, in a March 2009 Order in this proceeding, the Commission denied rehearing requests but repeated the requirement from the February 2007 Order that “ISO-NE must implement, prior to the commencement of the first FCA commitment year, tariff provisions that ensure that resources eligible for CC rate payments for reactive service under Schedule 2 do not receive double compensation.”¹² Again, in July 2009, in addressing NECPUC and other state entities’ request for rehearing in Docket No. EL07-38, the Commission made clear that even though it was denying rehearing in the complaint docket, the double recovery issue must still be addressed in the above-captioned docket:

In the February Order, we stated that the capacity cost component is “a negotiated value and is not set equal to, nor is it intended to recover, the cost of service of any particular generating Resource,” as would a rate based on a cost of service methodology. The Commission did not find that a negotiated rate cannot be compensatory. Rather, we found that the “capacity payments that were negotiated as part of the FCM transition period are at rates well below the agreed-to full (or gross) cost of new entry; they are not intended to allow full recovery of capital costs [and thus] the transition payments alone are not necessarily fully ‘compensatory.’” While, in fact, there are two distinct revenue streams, it does not follow that one of these streams necessarily fully compensates a qualified resource for all costs associated with the provision of reactive power service. Indeed, through the AEP method a portion of the fixed costs associated with shared equipment used to produce real energy and provide reactive service is assigned to the negotiated capacity cost component. The Commission is not convinced that over-recovery is occurring; nevertheless, out of an abundance of caution the Commission has directed ISO-NE in Docket No. ER07-397-000 to

¹⁰ *Id.* at P 4.

¹¹ *Id.*

¹² *Id.* at P 5.

propose tariff language to prevent potential over-recovery. The State Parties' arguments relating to that docket are more appropriately addressed in that separate proceeding.¹³

On April 6, 2009, ISO-NE filed a request for clarification of the requirement to file tariff provisions to ensure that double recovery does not occur. On January 5, 2010, the Commission denied ISO-NE's request for clarification, stating:

The Commission has held repeatedly that ISO-NE must file tariff provisions prior to the commencement of the first FCA Commitment Period to prevent double recovery. Although our previous analyses have found that bidding incentives in the Forward Capacity Auctions make double recovery "highly unlikely," and that incentives to sellers to submit bids that take into account revenues from the capacity component make double recovery "*less of a concern,*" such provisions remain necessary to provide certainty that double recovery of capital costs for generating equipment does not occur. This is consistent with our finding in the July 2009 Order, in which we stated while the Commission is not convinced that over-recovery is occurring, ISO-NE was nevertheless required to propose tariff language out of "an abundance of caution."¹⁴

On February 9, 2010, in response to the January 2010 Order, ISO-NE proposed a methodology that would net VAR capability cost associated with the minimum interconnected VAR capability from the FCM payment for resources that (1) are qualified VAR resources that have a capacity supply obligation, and (2) are associated to a capacity zone where there was insufficient competition or inadequate supply.¹⁵ However, after suppliers raised concerns with this approach, ISO-NE withdrew the netting provision and changed its compliance approach to proposing a tariff provision that would not apply to existing generators. Specifically, ISO-NE now proposes the following tariff language:

¹³ *Maine Public Utilities Commission v. ISO New England Inc.*, 128 FERC ¶ 61,012, at P 19 (2009).

¹⁴ January 2010 Order at P 8, citing *Maine Public Utilities Commission*, 128 FERC ¶ 61,012 at P 19.

¹⁵ See ISO-NE presentation to NEPOOL Markets Committee, February 9, 2010, available at http://www.iso-ne.com/committees/comm_wkgrps/mrkt comm/mrkt/mtrls/2010/feb9102010/index-p2.html. Since first three FCAs had sufficient competition and adequate supply, the VAR netting provisions would not apply to the first three FCA commitment periods.

By submitting a New Capacity Qualification Package, the Project Sponsor certifies that an offer from the New Generating Capacity Resource will not include any anticipated revenues the resource is expected to receive for its capacity costs as a Qualified Reactive Resource pursuant to Schedule 2 of Section II of this Tariff.¹⁶

In its presentation to NEPOOL, ISO-NE explained its interpretation of the guidance provided by the previous Commission orders:

if [the] FCA is competitive, [there] is no concern about double recovery, if the FCA clearing price is less than “true” cost of new entry, [there] is no concern about double recovery and if [the] FCA clearing price is set by a resource without VAR capability, [there] is no concern about double recovery.¹⁷

ISO-NE’s presentation concluded that “[t]here is no double recovery concern for the FCAs conducted to date.”¹⁸ The MPUC made a presentation indicating its concerns with ISO-NE’s approach.¹⁹ While ISO-NE’s proposal received the requisite NEPOOL support, several objections were lodged, including one by the Massachusetts Attorney General.²⁰

In the Joint Compliance Filing, the Joint Filers explain that ISO-NE’s proposed compliance provision will not become effective until the sixth FCA commitment year “because the submittal window for the New Capacity Qualification Packages for FCAs one through five have or will have been completed” by the time the proposed provision would become effective.²¹

In the course of the ISO-NE stakeholder process, the MPUC developed an alternative provision, similar to ISO-NE’s certification approach, except that MPUC’s tariff changes would (1) revise Schedule 2, (2) apply to the first FCA commitment year, and (3) apply to existing

¹⁶ Joint Compliance Filing, transmittal letter at 10.

¹⁷ISO-NE presentation to NEPOOL Markets Committee, April 14, 2010, slide 8, available at http://www.iso-ne.com/committees/comm_wkgrps/mrks_comm/mrks/mtrls/2010/apr13142010/index-p3.html.

¹⁸ *Id.*

¹⁹ See Attachment A, appended hereto.

²⁰ Joint Compliance Filing, transmittal letter at 13.

²¹ *Id.* at 12.

generators.²² MPUC reached out to ISO-NE in an effort to collaborate on a mutually-agreeable mechanism that would apply beginning with the first FCA commitment period and that would include existing generation. However, ISO-NE refused MPUC's request to alter the ISO-NE proposal.

II. PROTEST

A. The Joint Compliance Filing's Proposed Tariff Changes Fail to Provide Certainty that Double Recovery Will Not Occur Beginning in the First FCA Commitment Year

ISO-NE concedes that its proposal cannot take effect until the sixth FCA commitment year rather than the first FCA commitment year as directed by the Commission.²³ Thus, on its face, ISO-NE's proposal does not comply with the Commission's January 2010 Order.²⁴ ISO-NE argues that even though its proposal will not take effect until the sixth FCA commitment year, the Joint Compliance Filing nevertheless complies with the January 2010 Order because of the proposal's "prospective application of the rule changes, which is consistent with well-established Commission precedent."²⁵ This argument is based on the flawed assumption that ISO-NE's proposal is the only option capable of complying with the Commission's January 2010 Order. However, this is not the case. It is possible to ensure that there is no double recovery for the **first** FCA commitment year, as requested by the Commission.

Through the stakeholder process, the MPUC has provided one possible option, which would focus the certification approach on the Schedule 2 rather than the qualification rules for

²²MPUC presentation to NEPOOL Markets Committee, April 14, 2010, slide 11, available at http://www.iso-ne.com/committees/comm_wkgrps/mrkt_comm/mrkt/mtrls/2010/apr13142010/index-p3.html.

²³ Joint Compliance Filing, transmittal letter at 12.

²⁴ See January 2010 Order at P 8.

²⁵ Joint Compliance Filing, transmittal letter at 12.

FCM.²⁶ Another approach suggested during the NEPOOL stakeholder process was to utilize the offset provisions in the Forward Reserve Market as a possible model to deal with the double recovery issue. In fact, in the Forward Reserve Market, the FCA clearing price is subtracted from the Forward Reserve Market clearing price in determining the payment to Forward Reserve Market resources. Even the mechanism originally developed by ISO-NE (but later withdrawn) suggested that it was possible to arrive at a formula for an offset.²⁷ Thus, while there may be other approaches in addition to the approach suggested by the MPUC, the proposed tariff changes presented in the Joint Compliance Filing fail to comply with the Commission's directive because they exempt new and existing generators from any inquiry concerning potential double recovery during the first five commitment periods.

B. The Joint Compliance Filing Proposal Fails to Provide Any Certainty That Over-Recovery Will Not Occur Among Existing Generators

ISO-NE concedes that there is no certification requirement for existing generators, stating that such certification is not necessary because existing generators can affect the clearing price only through de-list bids.²⁸ According to ISO-NE, the Commission directed it to provide certainty that “*the FCA clearing price does not include any anticipated revenues from the Schedule 2 Capacity Cost payment.*”²⁹ However the Commission's directive was not drafted so narrowly. The Commission required ISO-NE to implement tariff provisions that provide certainty that double recovery of the “*cost of generating equipment does not occur.*”³⁰ Notably, this requirement does not direct ISO-NE to focus on what revenues were included in the clearing

²⁶MPUC presentation to NEPOOL Markets Committee, April 14, 2010, slide 11, available at http://www.iso-ne.com/committees/comm_wkgrps/mrks_comm/mrks/mtrls/2010/apr13142010/index-p3.html.

²⁷See ISO-NE presentation to NEPOOL Markets Committee, February 9, 2010, available at http://www.iso-ne.com/committees/comm_wkgrps/mrks_comm/mrks/mtrls/2010/feb9102010/index-p2.html.

²⁸ Joint Compliance Filing, transmittal letter at 11.

²⁹ *Id.* at 10 (emphasis added).

price. If that were the case, the Commission would not have required certainty that over-recovery does not occur beginning in the first FCA commitment year because there would be no way to affect the bidding in the first FCA since it occurred several years ago.³¹ Accordingly, the proposed tariff revisions do not provide certainty that existing generators are not over-recovering capital costs for generating equipment.

C. The Commission Should Require ISO-NE to Implement Compliant Tariff Language

The Commission directed ISO-NE to implement tariff provisions prior to the commencement of the first FCA Commitment Period to ensure that double recovery of capital costs for generating equipment does not occur. The Joint Compliance Filing does not comply with the Commission's directive. To be compliant, any tariff revisions should address the two issues **not** addressed by ISO-NE's proposal: (1) implementation in the first FCA commitment year, and (2) application to existing and new generation resources. The MPUC has proposed one possible alternative involving Schedule 2 certification that it believes is closer to providing the certainty requested by the Commission than ISO-NE's proposal. The Forward Reserve Market offset provisions provide another model that would achieve the Commission's objective. There are likely other approaches as well.³² For these reasons, the Joint Protestors request that the

³⁰ January 2010 Order at P 8.

³¹ ISO-NE has also suggested that as long as the market is competitive, there is no need to ensure that there is no double recovery. This claim misinterprets the Commission's orders which provided that, in spite of the game theoretic analysis, certainty is required that generators are not over-recovering the cost of generating equipment. ISO-NE ignores the fact that the Commission required the filing of tariff provisions to be effective in the first FCA commitment year that will ensure no double recovery; in spite of the fact that the Commission had already found that the first two auctions were competitive. See INTMMU, *Internal Market Monitoring Unit Review of the Forward Capacity Market Auction Results and Design Elements*, at 5 (June 5, 2009) ("INTMMU Report"), available at http://www.iso-ne.com/markets/mktmonmit/rpts/other/fcm_report_final.pdf.^S If a finding of competitiveness were all that was required, it is doubtful that the Commission would have denied ISO-NE's request for clarification.

³² In New York, under a demand curve approach, offsets for energy and ancillary services revenues (including voltage support) are made to an administratively determined cost of new entry figure. Because the FCM uses a market mechanism (rather than an administrative determination) to set Cost of New Entry, it is not possible to use

Commission reject the Joint Compliance Filing and direct ISO-NE to develop a mechanism which complies with the January 2010 Order.

III. CONCLUSION

For these reasons stated above, the Joint Protestors request that the Commission direct ISO-NE to develop tariff language (1) that ensures over recovery is not occurring in the first FCA commitment year, and (2) that applies to both existing and new generation. Alternatively, the Joint Protestors request that the Commission suspend the effective date of the Joint Compliance Filing and set the matter for hearing.

Respectfully submitted,

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the NYISO approach. However, it is noteworthy that the NYICAP price contains an implicit offset for voltage support revenues. See New York Independent Transmission System Operator, Inc., *Tariff Revisions to Implement Revised ICAP Demand Curves for Capability Years 2008/2009, 2009/2010 and 2010/2011*, Docket No. ER08-283-000 at p. 16 (filed November 30, 2007).

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the service list compiled by the Secretary in this proceeding either by U.S. Mail or electronic service, as appropriate. Dated at Washington, D.C., this 2nd day of June, 2010.

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ATTACHMENT A

THE ORDER ON CLARIFICATION
IN DOCKET NO. ER07-397

HOW TO COMPLY WITH THE FERC REQUIREMENT TO FILE
TARIFF FILINGS TO PROVIDE CERTAINTY THAT DOUBLE
RECOVERY DOES NOT OCCUR BEGINNING WITH THE FIRST
FCM PERFORMANCE YEAR

Why a tariff change that focuses on the qualification of
new resources in the FCM does not provide the
requisite certainty that double recovery will not occur
beginning in June of 2010.

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What the Commission said in its Order on Clarification;

- We deny the request for clarification. The Commission has held repeatedly that ISO-NE must file tariff provisions prior to the commencement of the first FCA Commitment Period to prevent double recovery. Although our previous analyses have found that bidding incentives in the Forward Capacity Auctions make double recovery “highly unlikely,” and that incentives to sellers to submit bids that take into account revenues from the capacity component make double recovery “/ess of a concern” such provisions remain necessary to provide certainty that double recovery of capital costs for generating equipment does not occur. This is consistent with our finding in the July 2009 Order, in which we stated while the Commission is not convinced that over-recovery is occurring, ISO-NE was nevertheless required to propose tariff language out of “an abundance of caution.”
- The Commission affirmed the requirement from two previous orders that “ISO-NE must implement, prior to the commencement of the first FCA commitment year, tariff provisions that ensure the resources eligible for CC payments for reactive service under Schedule 2 do not receive double compensation.”

ISO New England Inc. and New England Power Pool, Order on Clarification, Docket No. ER07-397, 130 FERC ¶ 61,005 (2010)

THE NEED FOR CERTAINTY APPLIES TO BOTH NEW AND EXISTING GENERATORS

- In its request for clarification, ISO argued:
 - its conduct and filing of its analyses comply with the February 2007 Order and demonstrate that the costs of reactive power capability qualified Generator Reactive Resources will not be reflected in the resources' capacity offers, and
 - the Commission reviewed ISO-NE's analyses in the February 2007 Order and correctly found that the capacity payments under the FCM settlement agreement and capability payments for reactive service under the Schedule 2 CC rate do not result in double recovery.
- FERC rejected this claim because of the lack of certainty provided by the game theoretic analysis.
- Certainty that there is not over recovery must be provided for both new and existing generation.

BUT THE ISO-NE PROPOSED COMPLIANCE APPLIES ONLY TO NEW RESOURCES

- The tariff provision proposed by ISO-NE would add the following language to the provisions in market rule 1 relating to the qualification of new resources:
- By submitting a New Capacity Qualification Package, the Project Sponsor certifies that an offer from the New Generating Capacity Resource will not include any anticipated revenues the resource is expected to receive for its capacity cost as a Qualified Reactive Resource pursuant to Schedule 2 of Section II of this Tariff.

Why this tariff provision is noncompliant with the Commission's order

- This provision cannot apply to new resources that bid in FCA 1-3, because they have already qualified and bid in the auction. Probably does not apply to FCA 4 since qualifications have already occurred before June 1, 2010.
- This provision has no application to existing resources.
- Most if not all of these resources receive schedule 2 capital cost payments. Nothing in the Commission's order indicates that the double recovery prevention tariff language was to be limited to new resources.
- Schedule 2 payments amount to approximately \$22 million annually.

EXISTING GENERATORS DO NOT HAVE TO SUPPLY NEW QUALIFICATION FORMS EACH YEAR

- Under the FCM market rules existing generators are automatically entered into the auction. The ISO-NE website provides the following information:
 - **How does an existing capacity resource qualify for the Forward Capacity Auction (FCA)?**
 - Any listed existing capacity resource that does not request to change the qualification form sent to it, on April 2, 2007 for the first FCA, by the ISO will automatically be entered into the FCA consistent with the characteristics defined on the qualification form. An existing capacity resource must submit any export, permanent delist, or delist bids above 0.8x CONE during the qualification process.

HOW CAN THE ISO PROVIDE CERTAINTY THAT FOR EXISTING RESOURCES DOUBLE RECOVERY OF CAPITAL COSTS FOR GENERATING EQUIPMENT DOES NOT OCCUR?

- First, the provision must prevent double recovery beginning in the first FCA performance year.
- Second the tariff provisions should not be limited to new resources.
- Third, the tariff provision should not require extensive ISO-NE review to ensure that double recovery does not occur.

AN ALTERNATIVE THAT WOULD BE COMPLIANT WITH THE FERC ORDER

- Because market rule 1 does not require actions by existing resources (except in the cases of changes in qualifying capacity or in the case of dynamic de-list bids, which if accepted would eliminate the concern over double recovery), a more administratively feasible approach is to focus on Schedule 2.
- Schedule 2 tariff language could be effective to prevent double recovery in 2010 rather than three or four years later.

WHY SCHEDULE 2 TARIFF PROVISIONS ARE A BETTER WAY TO COMPLY WITH FERC'S DIRECTIVE

- Schedule 2 does not differentiate between new and existing generators.
- Placing the tariff language in schedule 2, facilitates application of the double recovery prevention tariff language to begin in 2010.
- Schedule 2 does not interfere with the mechanics of the Forward Capacity Market

Two Possible Approaches Under Schedule 2

One approach:

A resource that successfully bids into the FCA for any given year is not entitled to a schedule 2 CC payment.

- While this is the easiest approach to implement and most consistent with the FERC's order requiring certainty that double recovery does not occur, the MPUC suggests a compromise approach.

Compromise Approach

- **The owner of a generating resource that successfully bids into the FCA for any given year beginning in the first FCA is not eligible to receive a CC payment for any month in the year for which it has a capacity obligation unless an officer of the owner of that generating unit signs an affidavit stating:**
 - **In the absence of schedule 2 cc payment, the owner of the generation unit would not recover the capital costs for the equipment necessary to provide reactive service.**
 - **If requested by ISO-NE the generator agrees to provide documentation to support this statement.**

Next Steps

- Because the ISO proposal is not compliant, MPUC will not support.
- Instead of supporting the ISO proposal, the MPUC will bring the Schedule 2 alternative to the Tariff committee.

QUESTIONS?