

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

Devon Power LLC

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Docket Nos. ER03-563-000,
ER03-563-030 and
ER03-563-055

**COMMENTS OF THE MAINE PUBLIC UTILITIES COMMISSION
AND THE MAINE PUBLIC ADVOCATE
CONTESTING PROPOSED SETTLEMENT**

Pursuant to Rule 602(f) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or “Commission”),¹ the State of Maine Public Utilities Commission (“MPUC”) and the Maine Public Advocate² hereby submit these comments, with the affidavit of Dr. Thomas D. Austin attached, which together serve as the basis for contesting the proposed settlement offered by certain parties in the above-captioned proceeding on March 6, 2006. In spite of the substantial efforts of Administrative Law Judge Lawrence Brenner, NEPOOL Counsel and the parties in this case, the proposed settlement agreement, though an improvement over the LICAP mechanism previously proposed by ISO New England, Inc. (“ISO”), cannot be found just and reasonable.

I. SUMMARY OF POSITION

The core requirement of this case - the development of a capacity market based on locationality - has been largely disregarded in the proposal. It is entirely absent from the transitional mechanism. It is incorporated into the long-term mechanism in a manner that is flawed. For this reason alone, the proposed settlement is not just and reasonable. In addition,

¹ 18 C.F.R. § 385.602(f) (2005).

² The Maine Attorney General, though not a party to this proceeding, has authorized undersigned counsel to represent his agreement with these comments.

the settling parties have failed to provide substantial evidence upon which the Commission could base a reasoned decision. For example, the settling parties offer only two affidavits that touch on the transitional mechanism, neither of which include any relevant basis for determining the matter one way or the other. Indeed, as discussed below and in the affidavit of Dr. Austin, there are genuine issues of material fact that cannot be resolved on the record as it stands.

To meet the just and reasonable standard, the adopted resource adequacy solution should account for Maine's particular circumstances. Maine's industrial base, which is critical to the health of Maine's economy is heavily dependent on electric power.³ Further, Maine has the lowest per capita income of all of the New England states.⁴ It was the view that competitive markets would enhance the efficiency of electric generation supply that brought Maine to the forefront of the transition to competitive electric markets. As a result of pro-competitive policies, there is now a substantial surplus of capacity within the state. That, combined with a limited amount of export transmission capacity, means that there is no capacity crisis in Maine. Under these circumstances, it is especially ironic and unfair for the proposed resource adequacy mechanism to impose unreasonably high capacity payments on Maine ratepayers.

For all of these reasons, the proposed settlement should not be certified and accepted. The MPUC and the Maine Public Advocate encourage the Commission, if it is to accept the proposed settlement, to do so with the condition that the settlement is to be modified to adopt: (1) a \$2.00 per kW-Month interim rate for the Maine zone during the transitional period;⁵ (2) in the FCM, an auction-based determination as to whether the constraints for an import-constrained zone are binding; and (3) in the FCM, for the Maine zone, a CONE of \$6.50 per kW-Month.

³ See Austin Affidavit at P 10.

⁴ Maine Department of Labor, "2004 Per Capita Personal Income" (April 2005).

⁵ All loads in Maine would pay this price.

Alternatively, the disputed issues described herein should be severed and set for hearing, or the settlement should be rejected in its entirety and the matter set for hearing.

II. BACKGROUND

This proceeding had its genesis in a dispute over the level of compensation to which generators would be entitled when their units were designated Reliability-Must-Run (“RMR”) in a chronically constrained area (also known as a “load pocket” or, in New England, a “Designated Congestion Area” (“DCA”)) in Southwestern Connecticut (“SWCT”).⁶ While the Commission set forth the cost-recovery parameters for the RMR units, it also initiated the steps toward the development of a capacity market.⁷ In particular, the Commission sought to develop a location-specific capacity requirement, “so that energy markets alone are not the only way for suppliers in DCAs to recover costs.”⁸ Thus, the Commission directed the ISO to establish a mechanism that appropriately values and compensates New England capacity *based on location*.⁹

In response to the Commission’s directive, on March 1, 2004, the ISO filed its LICAP proposal. In setting the proposal for hearing, the Commission made observations and findings that indicated the importance the Commission placed on incorporating locationality into the market structure. For example, the Commission observed:¹⁰

In particular, *there are more generation resources within Maine than are necessary to meet local requirements within Maine or that can be exported from Maine*. Additionally, ISO-NE has identified two areas[,] Southwest Connecticut and Northeastern Massachusetts[,] [(“NEMA”)] as being load pockets. Because of

⁶ See *Devon Power LLC, et al.*, 103 FERC ¶ 61,082 (2003).

⁷ *Id.* at PP 1, 32.

⁸ *Id.* at P 31.

⁹ *Id.* at P 37.

¹⁰ See *Devon Power LLC, et al.*, 107 FERC ¶ 61,240 at P 9 n.16 (2004) (emphasis added).

transmission constraints, there are limitations on the amount of power that can be imported into these regions. As a result, at times resources located within the load pockets must be used to meet demand in the load pockets.

Similarly, the Commission found that:¹¹

The two geographic areas in New England that have reliability problems are NEMA/Boston and SWCT, which currently are identified as DCAs.

Ultimately, the Commission concluded:¹²

The New England market as a whole appears to have adequate capacity. At the same time, nearly all existing units within SWCT are needed for reliability. Additionally, ISO-NE has also recently conducted a Request for Proposals to obtain additional resources in SWCT. *Thus, the use of a local capacity market would better reflect the value of capacity in SWCT than the existing system-wide capacity market.* Thus, the use of a locational capacity market could be a solution to the Reliability Compensation Issues in SWCT.

Maine took issue with the LICAP proposal, in part, on the grounds that it failed to meet the locational objectives set by the Commission. As explained on brief: “[b]ecause the [LICAP] proposal fails to price differentiate load pockets from areas with sufficient or excess generation, the ISO proposal fails to meet the locational component” of a resource adequacy mechanism.¹³

On September 20, 2005, in response at least in part to the “sense of Congress” that the Federal Energy Regulatory Commission “carefully consider the States’ objections” to LICAP,¹⁴ the Commission held oral argument on the LICAP proposal and possible alternatives. In introductory remarks, Chairman Kelliher noted his particular concern that there was little new

¹¹ *Id.* at P 49.

¹² *Id.* at P 37 (citations omitted) (emphasis added).

¹³ Initial Brief of the Maine Public Utilities Commission, the Maine Public Advocate, the Vermont Department of Public Service and the Vermont Public Service Board, Docket Nos. ER03-563-030 and EL04-102-000 (April 15, 2005) at 27.

¹⁴ Energy Policy Act of 2005, Section 1236 (not codified).

generation being constructed in the NEMA and SWCT load pockets. He also articulated his commitment to considering alternatives to LICAP that would provide a greater assurance of entry of new generating capacity as compared to the LICAP proposal itself.¹⁵ One such alternative, submitted shortly before the oral argument by the MPUC and others, was a locational capacity market structure based on the “Central Resource Adequacy Markets” (“CRAM”) model, which had been developed by National Economic Research Associates (“NERA”), with modifications to reflect certain components of the LICAP proposal and also some aspects of PJM’s Reliability Pricing Model.¹⁶ In order to explore the possibility of a negotiated solution, the Commissioners initiated settlement proceedings.

Per the subsequent orders that Judge Brenner issued in this proceeding, a series of formal settlement meetings took place in Boston and Washington. As the time for reaching a decision expired, and interested parties met for the last time on January 30, 2006, it was clear to the MPUC that the settlement was not just and reasonable, was unsupported by the record, and would visit undue harm on Maine consumers. Disregarding Maine’s interests is particularly troublesome because Maine has probably gone as far as any state in embracing competitive electricity markets and in opening its doors to new generation. At a time of increasing skepticism about the competitive model and increasing resistance to siting generation, both in Maine and elsewhere, it is imperative that Maine receive the full locational benefits of pursuing those policies. Otherwise, elected officials will rightly ask why they should assume the political risks.

¹⁵ Oral Argument Transcript at 4, line 13-14.

¹⁶ The proposal also envisioned locational transition payments. Four State Commission Proposed Alternative to LICAP, Docket No. ER03-563 (September 13, 2005) at 13.

III. COMMENTS

A. Standard of Review

Approval of a contested settlement has been likened to the granting of a motion for summary judgment when no genuine issues of material fact exist.¹⁷ To that end, in *Trailblazer Pipeline Co.*,¹⁸ the Commission summarized the standards for reviewing contested settlements as follows:

[T]he Supreme Court has held that where a settlement is contested, the Commission must make “an independent finding supported by ‘substantial evidence on the record as a whole’ that the proposal will establish ‘just and reasonable’ rates.” Consistent with this requirement, Rule 602(h)(1)(i) of the Commission’s settlement rules provides that the Commission may decide the merits of contested settlement issues only if the record contains substantial evidence upon which to base a reasoned decision or the Commission determines that there is no genuine issue of material fact.

If the Commission finds that the record lacks substantial evidence, or finds that contesting parties or issues cannot be severed, Rule 602(h)(1)(ii) provides for the Commission either (A) to establish procedures for the purpose of receiving additional evidence on the contested issues or (B) to take other action which the Commission determines to be appropriate.

Finally, Rule 602(h)(1)(iii) provides that the Commission may sever either the contesting parties or the contesting issues from a settlement, while approving the remainder of the settlement as an uncontested settlement. The practice of severing contesting parties was adopted by the Commission as a method of giving consenting parties the benefit of their bargain, while providing the contesting parties an opportunity to have their objections decided on the merits.

¹⁷ See *New Orleans Public Service, Inc. v. FERC*, 659 F.2d 509, 512 (5th Cir. 1981) (“approval of a contested settlement is like the granting of a motion for summary judgment when there exist no genuine issues of material fact”).

¹⁸ See 87 FERC ¶ 61,110 at 61,438-39 (1999) (citations omitted).

Consistent with these standards, the Commission identified the following possible approaches for approving contested settlements:¹⁹

- (1) where the Commission renders a binding merits decision on each of the contested issues;
- (2) where approval of the contested settlement is based on a finding that the overall settlement as a package provides a just and reasonable result;
- (3) where the Commission determines that the benefits of the settlement outbalance the nature of the objections, in light of the limited interest of the contesting party in the outcome of the case; and
- (4) where the Commission approves the settlement as uncontested for the consenting parties, and severs the contesting parties to litigate the issues.

In addition, as provided in the regulations quoted above, the Commission can also sever and set for hearing the contested issues.²⁰ Otherwise, if the Commission determines that the standards for approval are not satisfied, it may reject²¹ or condition²² the contested settlement.

Of the various procedural avenues available to the Commission, in this particular instance the following are viable alternatives: (1) conditional acceptance of the settlement; (2) severance of the contested issues that have been raised and initiation of further procedures designed to resolve those issues; or (3) rejection of the entire settlement and initiation of a hearing. The Commission cannot accept the settlement in its entirety because the record lacks the substantial evidence that is a necessary prerequisite to: (1) resolving the contested issues on the merits; or (2) finding that the overall settlement as a package provides a just and reasonable result; or (3) that the benefits of the settlement outweigh the objections. As discussed more fully below, the

¹⁹ *Id.* at 61,439.

²⁰ 18 C.F.R. § 385.602(h)(1)(iii) (2005).

²¹ *See, e.g., Exelon Corporation v. PPL Electric Utilities Corporation, et al.*, 114 FERC ¶ 61,298 (2006).

²² *See, e.g., Panhandle Eastern Pipe Line Co.*, 57 FERC ¶ 61,265 (1991).

relevant evidence in this case is limited. Further, the record does not dispose of genuine issues of material fact related to various aspects of the transition mechanism and the FCM, as reflected in the issues raised in Dr. Austin's affidavit.

The MPUC and the Maine Public Advocate are mindful of the fact that the process of identifying and instituting a locationally sensitive capacity market mechanism has been lengthy. Of course, that does not justify acceptance of a settlement agreement that is not just and reasonable. However, it does suggest that prolonging this process any more than necessary would be undesirable. For that reason, while rejection of the entire settlement is a viable option for the Commission to choose, and one that the MPUC and the Maine Public Advocate would find acceptable, the MPUC and the Maine Public Advocate do not here advocate that as the best solution.

Rather, the MPUC and the Maine Public Advocate strongly encourage the Commission to condition acceptance of the proposed settlement on certain modifications designed to resolve the concerns raised herein (in particular, Section III.B.3, below) and in Dr. Austin's affidavit, and thereby make the settlement as a whole just and reasonable as applied to utilities and customers throughout the region, including those located in Maine. While conditional acceptance does pose some risk that the settling parties will exercise their rights under Section I, Paragraph 2 to terminate the settlement agreement,²³ the MPUC and the Maine Public Advocate believe such risk is minimal given that the impact of resolving the concerns raised herein would be quite modest and most, if not all, parties desire to implement a capacity market sooner rather than later. Alternatively, as a second best option, the MPUC and the Maine Public Advocate support severing the issues raised herein for further inquiry. While this would avoid the potential for

²³ Settlement Agreement Resolving All Issues, Docket No.ER03-563-000, et al. (March 6, 2006) at 3.

termination associated with conditional acceptance, it would cause some delay in finally resolving the outstanding issues. That delay may result in further postponement of the implementation of the capacity market (depending on how long it takes to develop a record and reach resolution). These options, whatever their drawbacks may be, are at least viable under the circumstances. Approval of a contested settlement agreement that cannot be found to be just and reasonable on the current record is not.

B. Concerns Regarding the Transition Period.

1. The Commission Cannot Approve The Transition Mechanism Due To The Lack Of Evidence In The Record And The Existence Of Genuine Issues Of Material Fact.

There is virtually no evidence submitted in this case that addresses the merits of the specific interim payments being proposed. According to Rule 602(h)(1)(i) of FERC's Rules of Practice and Procedures:²⁴

If the Commission determines that any offer of settlement is contested in whole or in part, by any party, the Commission may decide the merits of the contested settlement issued, if the record contains substantial evidence upon which to base a reasoned decision or the Commission determines there is no genuine issue of material fact.

The affidavits of Robert Stoddard and David LaPlante, fail to provide substantial evidence on which the Commission can reasonably find that the transition arrangements are just and reasonable.

The affidavit submitted by Robert B. Stoddard contains only the following paragraph on the interim payments:²⁵

²⁴ 18 C.F.R. § 385.602(h)(1)(i) (2005) (emphasis added).

²⁵ Affidavit Of Robert B. Stoddard In Support Of Settlement Agreement, Docket No. ER03-563-055 (March 6, 2006) at 2, line nos. 21-28.

The Settlement Agreement includes nearly four years of interim Transition Payments beginning in December, 2006. Interim payments are necessary to retain those existing resources that are needed for system resource adequacy and to attract imports from other markets, such as New York and Canada, that have historically been important in maintaining the region's reliability. These interim Transition Payments serve as a bridge from the current market, which fails entirely to compensate adequately generators providing such benefits to the system, to the FCM, which is designed to provide such compensation. In the specific context of settling this proceeding, adopting these interim Transition Payments is in the public interest.

Mr. Stoddard's comments provide no basis on which the Commission can rely to approve the interim payments. As a preliminary matter, Mr. Stoddard's claim that the transition payments should be adopted is erroneously based on the application of the "public interest" standard, a standard that applies to uncontested settlements. The standard applicable to contested settlements, as is this case here, is the more rigorous "just and reasonable" standard.²⁶ More fundamentally, Mr. Stoddard's brief comment, supporting the general concept of providing "bridge" compensation in the form of interim payments to generators until the Forward Capacity Market becomes fully effective, is not nearly enough to satisfy the just and reasonable standard. Indeed, Mr. Stoddard offers no support - theoretical, empirical, anecdotal, or otherwise - to support the specific interim payments being proposed in the settlement agreement.

David LaPlante submits an affidavit that offers certain data to demonstrate that the interim payments will be lower than would have been the case had the LICAP mechanism approved in the Initial Decision been adopted.²⁷ First and foremost, the estimated level of LICAP payments that might have been in effect if the Commission had adopted the ISO's LICAP proposal with no modifications is irrelevant to a determination of whether the transition

²⁶ *Mobil Oil Corp. v. Federal Power Commission*, 417 U.S. 283, 314 (1974).

²⁷ Affidavit of David LaPlante, Docket No. ER03-563-030 (March 6, 2006).

payments are just and reasonable.²⁸ The Commission never approved LICAP and ISO has now fully endorsed an alternative approach, the Forward Capacity Market (FCM).²⁹ Moreover, because none of the various demand curves before the Commission (including the load-developed demand curves that were less costly than that of ISO's) have ever been found to be just and reasonable, Mr. LaPlante's analysis of the comparative "savings" achieved by the transition payments cannot provide a foundation for finding the transition payments just and reasonable. A reduction from an unjust and unreasonable rate does not prove that the "reduced" rate is reasonable.³⁰

Further, the dollar per kW-Month figures given by Mr. LaPlante do not provide any indication of the impact of these transition payments on Maine consumers' electricity rates. As shown in Dr. Austin's affidavit, the transition payments will translate to almost a 10 percent rate increase for Maine's large and medium commercial and industrial consumers and a 6 percent increase for Maine's residential and small commercial consumers.³¹

²⁸ Even if these estimates had any relevance, and they do not, the ISO's cost projections for LICAP have varied so dramatically over the course of this proceeding that there are credibility questions surrounding current LICAP cost projections. For example, ISO previously claimed that "[w]hile it is impossible to project with certainty the actual cost of LICAP because it is a market and not a cost-of-service regime, the ISO projections show a five year net LICAP cost of just over \$2 billion." ISO Brief Opposing Exceptions at 132; *see also* Hearing Transcript at 2384, line nos. 13-25. Now, Mr. LaPlante claims that the transitional payments represent more than a 40 percent reduction from what would have been paid under LICAP between 2007 and 2010. *See* LaPlante Affidavit at P 13 (Table 5). Since most estimates put the total cost of the transition payments at approximately \$5 billion, ISO must now think that LICAP would have cost more than \$8 billion - four times as much as original projections.

²⁹ In a press release on the proposed settlement, the ISO stated its belief that the FCM will accomplish the objective of promoting "investment in existing and new power resources to meet future energy needs." http://www.iso-ne.com/nwsiss/pr/2006/march_6_settlement_filing.pdf

³⁰ The purported rationale that lower rates are necessarily reasonable, as the settling parties suggest, is inconsistent with FERC precedent. On various occasions the Commission has initiated hearings to gather evidence and establish a record before determining whether proposed rates were just and reasonable, even though they were lower than rates already in effect. *See, e.g., PP&L*, 82 FERC ¶ 61,153 (1998); *Dayton Power and Light Co.*, 82 FERC ¶ 61,143 (1998), *Cambridge Elec. Light Co.*, 75 FERC ¶ 61,177 (1996).

³¹ Austin Affidavit at P 15.

A hearing would reveal that the transition payments are not just and reasonable because they are far in excess of what is needed by generators to supplement revenues from energy and ancillary markets. For all of these reasons, the MPUC and Maine Public Advocate urge the Commission to either condition approval upon the settling parties agreement to modify the proposed settlement to resolve the disputed issues raised herein as discussed in section III.B.3, or in the alternative, sever the issues raised herein and set them for hearing.

2. The Interim Payments Cannot Be Found to Be Just and Reasonable.

a. The Transition Payments Fail to Incorporate a Locational Component.

i. The Proposed Settlement Disregards The Commission's Previous Findings And Directives In This Proceeding.

The transitional mechanism is fundamentally flawed because it fails to incorporate the concept of location in a manner that accounts for the Commission's previous determinations. In this proceeding, the Commission has already found that "*there are more generation resources within Maine than are necessary to meet local requirements within Maine or that can be exported from Maine.*"³² In total disregard of that finding, the transition payments impose the same substantial payments on Maine consumers as on consumers throughout the rest of New England, including the import-constrained regions of Massachusetts and Connecticut.

ii. Location Impacts Prices And Influences Development Of New Generation.

The lack of a locational component in the transition mechanism would suggest that surplus generation and the export constraint between Maine and the rest of New England have no impact on the markets. Experience suggests otherwise. For example, the congestion component of Maine's energy prices consistently reflects Maine's excess generation and the export

³² *Devon Power*, 107 FERC at P 9 n.16 (emphasis added).

constraint between Maine and the rest of New England.³³ Further, this price separation is a contributing factor to the decision not to build a planned gas-fired generator in Maine.³⁴

b. None Of The Reasons Offered For The Imposition of Such High Transition Payments Has Been Shown, On The Record, To Be True.

The purpose of the proposed settlement as described by Mr. Stoddard, is “to retain those existing resources that are needed for system resource adequacy and to attract imports from other markets, such as New York and Canada, that have historically been important in maintaining the region’s reliability.”³⁵ Dr. Stoddard has failed to show that the *level* of transition payments proposed in the settlement is needed to retain existing Maine generation. In fact, Dr. Austin suggests that most suppliers would remain in operation without any transition payments.³⁶ This is because, “[g]iven today’s level of gas and oil prices and the role they play in setting market energy prices, many generators who use other fuels are doing rather well.”³⁷ Dr. Austin further provides examples of utilities’ recent skyrocketing earnings, such as those for FPL Energy, which experienced a 70 percent increase in earnings for 2005.³⁸

The windfall for existing power supplies will be exacerbated by the lack of a Peak Energy Rent (“PER”) offset during the transition period, like the one that has been incorporated into the FCM, or some other protective mechanism. Because suppliers keep the PER during the transition period, there is no hedge against energy spikes, nor any disincentive for suppliers

³³ Austin Affidavit at P 8.

³⁴ Austin Affidavit at P 9.

³⁵ Stoddard Affidavit at P 6.

³⁶ Austin Affidavit at P 12.

³⁷ *Id.*

³⁸ *Id.*

raising energy prices. As the settling parties explained in their filing letter with respect to the FCM: “This PER deduction will act as both [a] disincentive for suppliers to raise prices in the energy market and a hedge against energy price spikes.”³⁹ For the same reasons that protective measures are warranted when the FCM is in place, similar measures are needed during the transition period; their absence is unreasonable.

Moreover, there is nothing in the record that establishes the level of payments needed to attract imports. As Dr. Austin’s affidavit points out, the recent ICAP prices in the New York unconstrained region (upstate) have been trading in the range of \$0.50 to \$1.00 per kW-Month,⁴⁰ substantially below the fixed transition payments. Thus, even if the transition payments are lowered significantly, as long as capacity prices in New England are at or above capacity prices in New York, suppliers will find it attractive to offer capacity in the New England market. Imports from New York will continue.

Mr. Stoddard also asserts that the current market “fails entirely to compensate adequately generators providing such [resource adequacy] benefits to the system.”⁴¹ This statement is both unsupported and, as shown in Dr. Austin’s affidavit, untrue.⁴² Most generators are currently receiving more than adequate compensation from the New England markets as earnings reports so clearly indicate. However, for those units that are needed for reliability, but are not able to obtain sufficient revenues from energy and ancillary markets to cover their cost of service, there

³⁹ Explanatory Statement of the Settling Parties In Support Of Settlement Agreement and Request For Expedited Consideration, Docket No. ER03-563-000, et al. (March 6, 2006) at 13.

⁴⁰ Austin Affidavit at P 12.

⁴¹ Stoddard Affidavit at P 6.

⁴² Austin Affidavit at P 12.

is the option of seeking an RMR contract to cover the unit's cost of service.⁴³ The benefit of this approach is that the Commission will determine the cost of service for units that are actually needed for reliability and will determine whether their revenues fail to cover their cost of service. Having looked at both revenues and costs, the Commission can determine whether payments under an RMR contract are just and reasonable.

The transition payments are not supported by any of the information that would be necessary for the Commission to conclude that the payments are "just and reasonable" compensation.⁴⁴ In determining what amount of compensation is reasonable, on a cost-of-service basis, the Commission must look at both costs and revenues of the units claiming payment. The proponents of the proposed settlement, however, provide no examination of either side of the equation. As discussed above, if they did, it would show that much lower payment levels would be appropriate for the transitional period.

Because the payment levels have not been shown to be just and reasonable on the existing record, there is no rational basis for requiring Maine ratepayers to bear hundreds of millions of dollars in additional payments that the proposed settlement would impose on them during the transition period.

3. The Commission Should Modify the Settlement Agreement or Sever The Issues So That A Just and Reasonable Payment Level Can Be Set For Maine For The Transition Period.

In sum, with regard to the transition period, the MPUC and the Maine Public Advocate recommend that the Commission follow the course originally charted in this proceeding: to value capacity *by location*. If the Commission does that, the transition price for generators located in

⁴³ For example, Calpine has asked ISO to determine that its units are needed for reliability as the first step in seeking a RMR contract.

⁴⁴ Nor are they determined by competitive market forces, as they will be under the FCM.

Maine should be set at \$2.00 per kilowatt-month for the transition period; all loads in Maine would pay this price. This payment level would provide reasonable compensation (not a windfall) for the level of service provided.⁴⁵ As outlined in Dr. Austin's affidavit, this level of payment would be consistent with the purpose of maintaining imports with the New York region because prices would be similar to (modestly higher than) those experienced in New York.⁴⁶ Moreover, the comparison to New York prices is also reasonable because, as Maine stated on brief, ISO itself has looked to New York prices as an indicia of the reasonableness of Maine prices.⁴⁷ Finally, given the recent earnings reports of generators, this compensation is certainly adequate to supplement revenues from the energy and ancillary markets.

C. Concerns Regarding the Forward Capacity Market.

1. The FCM Fails To Give Appropriate Consideration To Location.

While not as dramatic as in the transmission payment mechanism, locationality is also an issue with the FCM. In particular, the long-term market structure relies on pre-auction determinations to determine whether there will be separate import-constrained zones. Before each auction, ISO will determine as a matter of administrative fiat whether the constraints for import constrained zones will bind (i.e., serve as the basis for price separation between such zones and the rest of New England). The market, in the form of auction results, does not determine whether there will be price separation. As explained by Dr. Austin, this administrative

⁴⁵ Austin Affidavit at P 12.

⁴⁶ In New York, the demand curve auctions for winter 2006 yield a price in the range of approximately \$0.50 to \$1.00. Austin Affidavit at P 12.

⁴⁷ Maine Initial Brief at 38.

determination process is inferior to allowing price separation to occur as a result of the auction process:⁴⁸

There are two problems here. First, even in the best of circumstances, the administrative determination will be made with incomplete information; that is, the bids. Second, and perhaps more disturbing, such administrative decisions can be unduly influenced by those with greater resources to devote to participation.

In addition, the process could result in the region buying capacity that cannot be delivered into the import constrained region.⁴⁹ In particular, higher prices could result from more units being selected (and paid) in the auction than are deliverable to the import-constrained region. The failure to model import constraints in the auction runs counter to the Commission's core interest of ensuring price separation to value capacity properly in import-constrained zones.⁵⁰

2. The Cost of New Entry And The Restrictive Collar Are Too High To Be Found Reasonable.

Another concern with the proposed FCM is the Cost of New Entry ("CONE"). A starting CONE of \$7.50 per kW-Month⁵¹ is too high to be reasonable, especially for Maine with its surplus of generation capacity and limited export capability. As applied throughout New England, the proposed CONE appears high when compared to PJM's proposed RPM, which applies a CONE of \$58.782 per kW-Year, or \$4.90 per kW-Month. With regard to Maine specifically, the CONE fails to reflect the fact that the cost of new entry in Maine is lower than the cost of new entry elsewhere due to lower land acquisition costs and construction expense. For example, ISO witness Reed found that land acquisition costs were three times higher in SWCT than in Maine and "construction labor rates varied by almost 50 percent from the areas

⁴⁸ Austin Affidavit at P 17.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ Settlement Agreement, Section III.F.

with the highest labor rates, NEMA/Boston, to the lowest, Maine.”⁵² Accordingly, the CONE for Maine should be significantly less than the CONE for other regions in New England, in particular NEMA and SWCT. Under the LICAP proposal, the Maine EBCC⁵³ was \$1.00 less than that in SWCT. Accordingly, it would be reasonable to reduce the CONE for Maine by that amount. Based on that rationale, a just and reasonable CONE for Maine would be \$6.50 per kW-Month.

In addition, during the early years of the FCM, before sufficient data on market determined prices of capacity are collected, the smoothing formula and the accompanying collar on price movement will keep the capacity price at artificially high levels. The collar prevents the capacity price from going below \$4.50 or above \$10.50 for the first year.⁵⁴ The floor may cause Maine ratepayers to pay higher prices than would otherwise be in effect (absent the floor) if the export constraint binds in the auction. Adjustment, of the CONE, as discussed above would provide some mitigation for this problem.

IV. CONCLUSION

WHEREFORE, the Maine Public Utilities Commission hereby requests that the settlement agreement not be certified and accepted as proposed, but rather, that acceptance be conditioned on modifying the settlement to adopt: (1) a \$2.00 per-kW Month interim rate for the Maine zone during the transitional period;⁵⁵ (2) in the FCM, an auction-based determination as to whether the constraints for an import-constrained zone are binding; and (3) in the FCM, for the

⁵² Docket No. ER03-563-030, Exhibit No. ISO-3 (Reed Testimony) at 26 .

⁵³ The acronym EBCC stands for Estimated Benchmark Cost Capacity.

⁵⁴ *See, e.g.*, LaPlante Affidavit at P 17.

⁵⁵ All loads in Maine would pay this price.

Maine zone, a CONE of \$6.50 per kW-Month. Alternatively, the issues identified herein should be severed and set for hearing in order to establish a record upon which a reasoned decision can be reached.

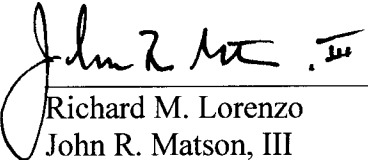
Respectfully submitted,

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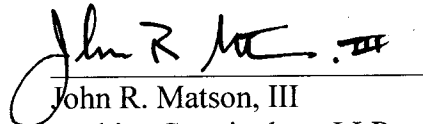
Attorneys for the Maine Public
Utilities Commission

Dated: March 27, 2006

CERTIFICATE OF SERVICE

In accordance with Rule 2010 of FERC's Rules of Practice and Procedure,⁵⁶ I hereby certify that I have served a copy of the foregoing "Notice of Intervention Of The Maine Public Utilities Commission" upon those parties listed on the official service list prepared by the Secretary of the Commission in this proceeding.

Dated at Washington, D.C.,
this 27th day of March, 2006



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18 C.F.R. § 385.2010 (2005).

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

Devon Power LLC)	Docket Nos. ER03-563-000,
)	ER03-563-030 and
)	ER03-563-055
)	
)	

STATE OF MAINE)	ss
County of Kennebec		

AFFIDAVIT OF THOMAS D. AUSTIN

Introduction

1. My name is Thomas D. Austin. I am employed as an economist for the Maine Public Utilities Commission, 242 State St., Station 18, Augusta, ME, 04333. My qualifications are listed in the testimony that I previously filed in this docket (Exhibit MV-1).

2. While the Maine PUC is not a party to the proposed settlement agreement, I and my colleagues participated actively in the negotiations that produced it. I attended all of the settlement conferences and was also a member of several of the committees charged with developing certain portions of the proposal, particularly the Forward Capacity Market (FCM). During this process, I worked closely with Messrs. Stoddard, Bidwell, Crampton, and LaPlante who have filed affidavits in support of the agreement.

3. In this affidavit, I will deal with four primary topics:
- A. The importance and impact of locational considerations in developing an efficient capacity market,
 - B. The transition payments which would be charged to electricity customers in Maine,
 - C. A significant flaw in the way the proposed FCM market recognizes (or fails to recognize) physical constraints in the transmission system, and
 - D. The cost of new entry (CONE) for the Maine zone.

The Importance and Impact of Locational Considerations

4. It is axiomatic that a capacity adequacy mechanism designed to assure reliable electric service must recognize the locations of load and generation and the fact that transmission systems can never provide unlimited capacity to move electricity from one location to another. Failure to recognize this will create a number of problems, including siting generation in places where it cannot improve system reliability, encouraging over-investment in transmission plant to accommodate generation that is sited in the wrong place, and sending incorrect price signals to both generators and customers. If a capacity adequacy mechanism fails to properly reflect these locational aspects, then it will, at best, produce expensive and economically inefficient results. At worst, such a system will collapse.

5. In his affidavit, David LaPlante, on behalf of ISO New England (ISO-NE), asserts that “[s]ince there is limited transmission out of Maine, and a good deal of generation in Maine, some have speculated that Maine might be an export constrained zone. These results [his estimated future LICAP prices] show that Maine is in fact not an export constrained zone and therefore appropriately pays the same price as the rest of New England.”

6. Estimating capacity prices in future years is, at best, an inexact science. In fact, earlier in this case, Mr. LaPlante stressed the inherent uncertainty in making such projections. (Exhibit No. ISO-1 at 20-21). No one should accept the assertion that such estimates are adequate to reach Mr. LaPlante’s conclusion that Maine is not a constrained zone.

7. Under SMD (Standard Market Design), the energy market LMP (Locational Marginal Price) includes a congestion component. If a location is export constrained in a given hour, then the congestion component of the LMP is negative. In such cases, additional generation at that location would not be dispatched (or if it were dispatched then other local generation would need to be backed down). In other words, this additional generation would not contribute to the reliability of the grid, due to transmission constraints.

8. Analysis of the congestion costs in Maine demonstrates that Maine is an export-constrained zone.¹

Table 1
Percent of Hours when Real Time Congestion Occurred
Maine Zone, 2005

Month	Hours of Real Time Congestion			Hours of ME/NH RT Congestion		
	Total	Off-Peak	On-Peak	Total	Off-Peak	On-Peak
Jan 2005	5.6%	5.0%	6.6%	4.3%	3.6%	5.3%
Feb 2005	4.2%	0.5%	8.6%	1.5%	0.0%	3.3%
Mar 2005	13.6%	4.5%	22.8%	4.7%	3.7%	5.7%
Apr 2005	21.8%	7.5%	41.4%	17.8%	7.0%	32.6%
May 2005	29.8%	13.5%	49.7%	27.2%	13.5%	43.8%
Jun 2005	32.6%	16.0%	50.0%	22.8%	8.2%	38.1%
Jul 2005	42.9%	20.8%	72.2%	26.5%	8.0%	50.9%
Aug 2005	42.5%	20.2%	65.2%	28.9%	9.3%	48.9%
Sep 2005	45.3%	22.7%	71.1%	33.1%	17.4%	50.9%
Oct 2005	28.2%	6.8%	56.6%	10.5%	3.5%	19.7%
Nov 2005	15.1%	4.1%	30.3%	2.1%	0.5%	4.3%
Dec 2005	25.8%	8.6%	46.7%	1.3%	0.0%	3.0%
Annual	25.8%	10.8%	44.0%	15.1%	6.2%	26.0%

This table shows the percentage of hours in which congestion actually occurred in 2005.

For example, in July 2005, Maine was export constrained 42.9% of the time.

Furthermore, these constraints were much more prevalent during on-peak times (72.2% of on peak hours) than in off-peak periods (20.8%).

What is important for this purpose is the timing of binding transmission constraints for exports from Maine. The table above clearly demonstrates that export constraints occur during high load periods, which are also the times when reliability problems are likely to occur. As the table indicates, export constraints out of Maine

¹ This chart is based on Real Time LMP's as reported by ISO-NE.

occur during about two-thirds of summer on-peak hours and in 44% of the on-peak hours for the entire year. They are substantially less likely during off-peak periods. In other words, at the times when reliability problems are most likely to occur, Maine is typically export constrained. Conversely, when loads are modest and reliability problems less likely, the export constraints typically do not bind.

The table also summarizes those times when congestion was greater in Maine than in New Hampshire. This is useful in that it helps show where the transmission constraints actually occurred. When congestion is greater in Maine than New Hampshire, it suggests that there is a constraint between Maine and New Hampshire. For those hours where the congestion costs in New Hampshire are lower (more negative) this generally suggests that there are constraints between New Hampshire and other points in New England, particularly Massachusetts.

9. This analysis demonstrates that in 2005 exports from Maine were often constrained during high load hours, particularly the Summer and, to a lesser extent Winter, on-peak hours. From this data, I believe that additional generation in Maine would have provided little or no reliability benefit to the system in 2005 because the system was transmission constrained during high load hours.

Moreover, the constraints lower the prices that generators in Maine receive, which would discourage siting new plants in the region. Maine has had some proposed plants, most notably the ANP Gorham Plant, cancelled in recent years. I believe one reason for such cancellations has been the fact that generation prices in Maine are, and should be, relatively low due to the existence of surplus capacity, congestion and other factors.

10. No one can say with certainty how long Maine will continue to be export constrained. While it is possible that some existing generators may shut down, there are a number of plans for new generation, particularly wind generation in various stages of development. Another key driver will be the level of load growth (or decline) over the next few years. In particular, Maine's economy is struggling, in part due to the high cost of energy in the Northeast as compared to other parts of the country and the world.

Transition Payments Are Too High

11. There is relatively little discussion of the basis for the transition payments for the years 2006/07 through 2009/10. Mr. Stoddard offers his view that the transition payments are necessary to retain existing resources and to attract imports from other markets, but offers nothing to explain why the specific payment rates are appropriate. Mr. LaPlante observes that the transition payment rates are below his projection of the prices that would have resulted had ISO-NE's previous LICAP proposal been implemented.

12. Whatever the purpose of the transition payments, they will play little or no role in retaining existing resources. In today's market, I believe that many generators would remain on the system regardless of any transition payments. Given today's level of gas and oil prices and the role they play in setting market energy prices, many generators that use other fuels are doing rather well. For example, in its Fourth Quarter Release, FPL

Energy, whose New England holdings include significant amounts of nuclear and hydro generation reported a 70% increase in earnings for 2005 and cited “significantly improved market conditions” in the NEPOOL Market.² Another example is Dominion which pointed to its “fuel diversity in New England” as part of its “Environment for Success.”³ Similarly, stock analysts have predicted that the transition payments will provide a significant earnings boost for firms with generating assets in New England.⁴

On the other hand, there may be some generators that do need significant payments in order to remain on the system. However, under the proposed settlement, a generator needed for reliability has the opportunity to seek an RMR contract and be paid more than the transition payment. The result here is that generators who do not need the transition payment in order to remain will accept the payment, regardless of their lack of need. However, for those who need more, or who can make a convincing case to that effect, will receive more through an RMR side payment. If the transition payment were substantially reduced, we would presumably see more RMR contracts, lower overall costs, and an adequate number of units remaining on the system.

The situation for imports from other areas is slightly different. All else equal, one would reasonably expect that a higher transition price could attract additional resources from outside the region. The question is: what price is high enough? Recently, the ICAP price in upstate New York has been trading in the range of \$0.50 to \$1.00. While these

² See http://media.corporate-ir.net/media_files/irol/88/88486/presentations/4q05slides.pdf at pages 17 and 21.

³ Morgan Stanley 2006 Global Electricity and Energy Conference (March 16, 2006) <http://www.dom.com/investors/pdf/morganstanley031606.pdf>

⁴ Jefferies’ LICAP Update, Jefferies & Company (March 16, 2006).

prices may change in the future, it is not at all clear that New England needs prices in the \$3.00 to \$4.00 range in order to attract imports.

13. If there is no economic or reliability-based justification for the transition payments and, I do not believe that there is, the payments are no more than transfer payments from customers to generators. As I have indicated, the primary effect of the payments is to set the threshold for RMR contracts and to provide additional payments to those generators whose going forward costs are already largely covered in the energy or other markets. Given the export constraints out of Maine, one could argue that the appropriate transition costs for Maine should be close to zero. Rather than going that far, however, I suggest that the transition price for generators located in Maine be set at \$2.00 per kilowatt-month for the transition period. All loads in Maine would pay this lower price. To the extent that generation in Maine exceeds the Maine load share of capacity, the excess payments would be used to reduce the prices paid by customers elsewhere in New England.

I believe this proposal is consistent with Mr. Stoddard's goals of allowing existing generation to remain on the system and attracting any necessary imports from other regions.

14. I have three comments pertaining to Mr. LaPlante's conclusion that Maine customers will pay less under the transition payments than they would under LICAP. First, as I discussed in paragraph 8 (above), his analysis understates the impact of export constraints in Maine. Second, unlike LICAP, the transition payments do not include a

PER (Peak Energy Rent) offset. Mr. Laplante tries to account for this by assuming a \$0.48 PER offset in his calculation of net LICAP costs. Given the recent changes in gas and oil prices and forecasts of future prices, I believe he should have used a much higher PER offset. Finally, and most obviously, the LICAP costs were unacceptable and unreasonable. Even if the transition payments are lower than an accurate estimate of the LICAP costs, that does not make them acceptable or reasonable.

15. The transition payments will have a significant impact on Maine customers. By my estimate, the transition payments will cost Maine customers about \$300 million over the transmission period. This translates to an overall increase in rates for customers ranging from 6% for residential and small C&I (commercial and industrial) customers to about 10% for medium and large C& I customers. These increases come on top of the recent major price increases due to higher fuel costs.

A Flaw in the FCM Proposal

16. In general, I believe that the FCM model is well designed and deserving of the Commission's endorsement. Conceptually, FCM is very similar to both the approach developed in the papers by Thomas Welch and me, and to NERA's CRAM report, each of which I attempted to include as part of my original testimony in this case. More importantly, FCM was developed with input of a wide range of experts and participants, including those who filed affidavits in support of the settlement. My major caveat here is

that it is remarkably difficult to design a workable capacity adequacy market. I hope and believe that we have done a good job, but only time will tell.

17. My major concern about FCM is in the manner in which it recognizes transmission constraints and allows prices to separate among regions. Here, FCM takes a clear step backward from the SMD energy market which is already in place. In the energy market, units bid into the market and an optimization model determines which bids to accept, given the availability of transmission and other operating parameters. Whether there is, in fact, a constraint in any particular hour is an output of the optimization process. If it is cheaper to increase generation in constrained areas up to the transportation limit, the model does so. If not, then not. But the guiding principle is to let the bids and the transmission network ultimately determine whether there will be binding transmission constraints.

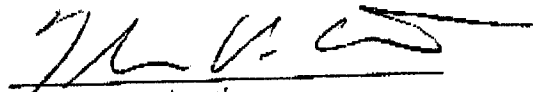
The FCM market could, and should, act in a similar manner, allowing for the fact that it is trying to minimize capacity costs, not energy costs. Under FCM, however, the existence of binding constraints is determined by an administrative process prior to receiving any bids or determining which bids to accept. There are two problems here. First, even in the best of circumstances, the administrative determination will be made with incomplete information, that is the bids. Second, and perhaps more disturbing, such administrative decisions can be unduly influenced by those with greater resources to devote to participation.

To illustrate the problem, suppose that ISO did not anticipate any congestion and ran the auction to produce a single clearing price. Then, when the bids come in, we find

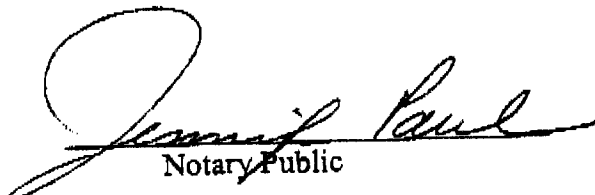
that the low cost bids are all from a single region and that if all the needed capacity is purchased from these low cost bids, then there will, in fact, be a transmission constraint. (This is not an unlikely outcome if one believes Mr. Reed's testimony regarding the difference in plant construction costs among regions.) If these low cost bids are all taken, as they would be as I understand the proposed FCR, then we would have buy too much capacity in the low cost region, and have inadequate generation in other areas of NEPOOL. At this point, we have not met the reliability goals. We could either accept not meeting our reliability goals or enter into another round of RMR contracts or similar out-of-market actions to attract additional capacity to the regions with reliability problems. If this occurs, reliability would be maintained, but at the price of buying more generation than we need.

18. Beyond this structural concern, I also believe that the initial level of CONE may be too high for some regions. For example, Mr. Reed has testified that the costs of constructing new plant vary significantly by region, with Maine being the lowest cost.

Being first duly sworn, I declare that I have reviewed the foregoing in its entirety,
and I further declare that it is true and accurate to the best of my knowledge, information
and belief.


Thomas D. Austin.

Subscribed and sworn to before me this 27th day of March, 2006.


Notary Public

JENNIFER PAUL
NOTARY PUBLIC • MAINE
MY COMMISSION EXPIRES JUNE 21, 2007

My Commission Expires:
[SEAL]