



July 13, 2009

The Honorable Kimberly D. Bose, Secretary
The Honorable Nathaniel J. Davis, Sr., Deputy Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

Re: ISO New England Inc., Docket No. ER09-873-___; Compliance Filing of ISO New England Inc.

Dear Secretary Bose and Deputy Secretary Davis:

In accordance with the Order issued by the Federal Energy Regulation Commission (“Commission”) on June 11, 2009 in Docket No. ER09-873-000 (the “June 11 Order”), ISO New England Inc. (the “ISO”) hereby submits an original and five copies of this compliance filing, which provides information required by the June 11 Order.

I. Background

A. The June 11 Order

In the June 11 Order, the Commission accepted changes to Section III.8.3.7 of Market Rule 1¹ (the “ICAP Import Rules”) establishing competitive bidding rules and a reformed penalty structure for energy offers associated with ICAP Import Contracts (the “ICAP Import Rule Revisions”). However, the Commission suspended the ICAP Import Rule Revisions for a nominal period and made them effective July 1, 2009, subject to refund, due to its “concerns with the reliability ramifications of the proposed penalty exemption contained in section

¹ Market Rule 1 is Section III of the ISO New England Inc. Transmission, Markets and Services Tariff, FERC Electric Tariff No. 3 (the “ISO Tariff”). Capitalized terms not otherwise defined herein have the meanings ascribed thereto in the ISO Tariff or the Participants Agreement.

III.8.3.7.3.1.2(b),” finding that the exemption had not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful.²

In order to address its concerns, the Commission directed (at P 32) more information be provided within 30 days of the issuance of the June 11 Order “regarding the effect this penalty exemption would have on reliability³ and the extent to which the exemption would not result in internal capacity resources being treated comparably to market participants with ICAP import contracts.”⁴

B. Context and Description of the Exemption

Under the ICAP Import Rules, Market Participants with ICAP Import Contracts must submit a Supply Offer (or Self-Schedule) – in the form of an External Transaction – in the Day-Ahead Energy Market and Real-Time Energy Market for the energy equivalent of the ICAP Import Contract amount for each hour of each Operating Day.⁵

The ICAP Import Rule Revisions include, in Section III.8.3.7.3.1.2 of Market Rule 1, a reformed penalty structure for failures to deliver the energy requested from External Transactions associated with ICAP Import Contracts.⁶ A capacity importer’s liability under that section for a “failure to deliver” penalty is determined by the ISO’s comparing “the hourly megawatt amount requested for delivery by the ISO for the transaction to the energy actually delivered under that energy transaction by the Market Participant in each required hour to calculate any hourly delivery shortfalls.”

² June 11 Order at P 31.

³ In a footnote in the June 11 Order, the Commission stated: “While we note that Operating Procedure No. 4 (Action During a Capacity Deficiency) would impose a restriction on the use of this penalty exemption during a severe reliability crisis, the Filing Parties have not sufficiently demonstrated the overall effect of this penalty exemption on reliability.”

⁴ In a footnote in the June 11 Order, the Commission stated: “We note that the Connecticut Parties, for example, allege that ‘An Import Capacity Contract with an op-out as proposed in Section III.8.3.7.3.1.2(b) creates special rules for capacity imports that are substantially different from the New England capacity suppliers’ obligations.’ Connecticut Parties Supplemental Comments at 4. In addition, section III.8.7.2 (Rights and Obligations of De-Listed Resources) of the ISO-NE OATT appears to restrict internal resources in a way that external resources would not be restricted if the proposed exemption were in place.”

⁵ See Market Rule 1 § III.8.3.7.1(c). The ICAP Import Rule Revisions require any Supply Offer to be “competitively priced” judged by the standards of the revised rules.

⁶ A “failure to offer” penalty may also be assessed under the circumstances described in revised Section III.8.3.7.3.1.1.

Subsections (a) – (d) of revised Section III.8.3.7.3.1.2 specify conditions under which an hourly delivery shortfall will *not* be assessed. Subsection (b) sets forth the particular exemption on which the Commission has focused (the “Exemption”):

(b) Except during hours when the ISO declares system-wide OP4 event, if a priced energy transaction supporting an ICAP Import contract is associated with the New York Control Area and the Market Participant does not deliver energy to the New England Control Area when requested during hours that the Real-Time Energy Market price at the source location is higher than the Real-Time LMP at the associated New England Control Area external node, no delivery shortfall shall be assessed.

Section II, below, provides the information requested by the Commission with respect to the Exemption.

II. Information Requested by the Commission

This section addresses whether the Exemption has any effect on reliability, and the extent to which the Exemption would not result in internal capacity resources being treated comparably to Market Participants with ICAP Import Contracts.

A. Whether the Exemption Has Any Effect on Reliability

The Exemption will have no effect (*i.e.*, adverse impact) on reliability. Moreover, it is economically efficient.

As identified by the Commission in footnote 37 of the June 11 Order, the Exemption (by its terms) would not excuse a delivery shortfall during hours in which a system-wide OP4 event is occurring. The ISO implements OP4 in response to a capacity deficiency, and the inapplicability of the Exemption during OP4 events means that it cannot have an adverse impact on reliability during such events.

Given the inapplicability of the Exemption during OP4 events, the Commission’s question about the reliability impact of the Exemption is thus applicable only to non-OP4 hours. Importantly, the New England bulk power system is, by definition, not in a capacity deficiency when OP4 conditions are not present.⁷ Accordingly, excusing non-delivery during certain non-OP4 hours when prices are higher in New York will not have an adverse impact on reliability.

While the Exemption reflects reliability considerations associated with OP4 events, the Exemption primarily reflects economic considerations associated with the arbitrage of prices between New York and New England. Removing the Exemption would require capacity

⁷ Of course, loss of a generating resource or transmission line may cause temporary reliability concerns; however, system operating reserves are dispatched to address these problems.

importers to sell energy to New England when the price in New York is higher than in New England. Proponents of removing the Exemption argue that this is appropriate because New England has “purchased the resource” and should be entitled to energy from it, when economic in New England. However, this argument fails to recognize that it is not economically efficient to force Market Participants to sell from a high-cost area to a low-cost area. A “failure to deliver” penalty designed to encourage such uneconomic flow cannot prevent prices from rising in New England as Market Participants in New England take advantage of the opportunity to receive higher prices in New York by exporting energy until the prices in the two regions are near equilibrium. The Exemption recognizes that requiring uneconomic energy from capacity imports cannot prevent other energy transactions from naturally arbitraging prices between New York and New England. Removing the Exemption will not increase the flow of energy into New England and therefore has no practical impact on reliability.

In summary, the Exemption has no adverse impact on reliability and is economically efficient. Since there are no capacity deficiencies during non-OP4 hours, removing the Exemption will force uneconomic flows of energy with no reliability benefits.

The ISO does not intend, by its statements in this filing, to preclude stakeholder discussion of the appropriateness of the continuation of the Exemption in rules applicable with the implementation of the Forward Capacity Market in June 2010. The ISO will consider fully any concerns and issues that stakeholders may raise during the consideration of such rules.

B. The Extent to Which the Exemption Would Not Result in Internal Capacity Resources Being Treated Comparably to Market Participants with ICAP Import Contracts

The Exemption results in comparable treatment between capacity imports and internal New England generation, for at least two reasons.

First, the ISO does not require New England Market Participants with internal generation serving as capacity resources to sell energy at a price that is less than their cost of producing the energy. The Exemption similarly assures that Market Participants who are importing capacity from New York are not required to provide the associated energy at a price that is less than their cost of acquiring such energy at the external interface. This is best understood by isolating the distinct mechanisms required in order for a capacity importer to offer priced energy associated with its capacity imports. Initially, the New York resource designated as backing the capacity import will be bid into the New York energy market.⁸ The capacity importer cannot export energy out of New York at the resource’s clearing price. Instead, it must pay the real-time market price at the pertinent New York external (proxy) node, which reflects the clearing of all New York resources, as well as transmission constraints. Thus, it would not be consistent with

⁸ The resource may or may not receive a dispatch instruction from the NYISO to produce energy. The actual operating status of the designated resource only matters if NYISO is experiencing a capacity shortage.

treatment of internal resources to make the capacity importer sell its energy into New England when the real-time market price it has *actually paid* for the energy (at the pertinent New York external node with New England) is higher than the price at New England's external node with New York.

Second, the position of capacity importers under the Exemption, with its non-applicability during OP4 conditions, is consistent with the prerogatives of Market Participants with internal New England generation serving as capacity resources. That is, Market Participants are able to sell energy to New York during normal system conditions (presumably when New York's prices are higher than New England's), but the energy from capacity resources is subject to recall from New York when certain steps in OP4 are reached, whether or not New York prices are higher.⁹ The Exemption and the recall obligation are comparable mechanisms that help to protect New England reliability during OP4 conditions.

⁹ In such conditions, it is unlikely that a capacity importer will be selling energy at a loss because the pricing in New England will reflect the prevailing scarcity conditions. *See* ISO Tariff § III.7.2A(c).

III. Conclusion

The ISO requests the Commission to accept its compliance filing, and to find that the Exemption is just and reasonable.

Respectfully submitted,

By: James H. Douglass
James H. Douglass, Esq.
ISO New England Inc.
One Sullivan Road
Holyoke, MA 01040-2841
Tel: (413) 540-4559
Fax: (413) 535-4379
E-mail: jdouglass@iso-ne.com

By: Howard H. Shafferman
Howard H. Shafferman, Esq
Ballard Spahr Andrews & Ingersoll, LLP
601 13th Street NW
Suite 1000 South
Washington, DC 20005-3807
Tel: (202) 661-2200
Fax: (202) 661-2299
E-mail: hhs@ballardspahr.com

Counsel for ISO New England Inc.

Attachment

cc : Parties to Docket No. ER09-873 (electronically), Governance Participants (electronically) and entities listed in Attachment 1

Attachment 1

**New England Governors
and Utility Regulatory
and Related Agencies**

Connecticut

The Honorable M. Jodi Rell
State Capitol
210 Capitol Ave.
Hartford, CT 06106

Connecticut Department of Public Utility Control
10 Franklin Square
New Britain, CT 06051-2605

Maine

The Honorable John E. Baldacci
One State House Station
Rm. 236
Augusta, ME 04333-0001

Maine Public Utilities Commission
State House, Station 18
242 State Street
Augusta, ME 04333-0018

Massachusetts

The Honorable Deval Patrick
Office of the Governor
Rm. 360 State House
Boston, MA 02133

Massachusetts Department of Public Utilities
One South Station
Boston, MA 02110

New Hampshire

The Honorable John H. Lynch
State House
25 Capitol Street
Concord, NH 03301

New Hampshire Public Utilities Commission
21 South Fruit Street
Suite 10
Concord, NH 03301-2429

Rhode Island

The Honorable Donald L. Carcieri
State House Room 115
Providence, RI 02903

Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Vermont

The Honorable James H. Douglas
109 State Street, Pavilion
Montpelier, VT 05609

Vermont Public Service Board
112 State Street, Drawer 20
Montpelier, VT 05620-2701

**New England Governors
and Utility Regulatory
and Related Agencies**

Elia Germani, President
New England Conference of
Public Utilities Commissioners, Inc.
c/o RI Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

William M. Nugent
Executive Director
New England Conference of
Public Utilities Commissioners, Inc.
50 Forest Falls Drive, Suite 6
Yarmouth, ME 04096-6937

Harvey L. Reiter, Esq.
Counsel for New England Conference
of Public Utilities Commissioners, Inc.
c/o Stinson Morrison Hecker LLP
1150 18th Street, NW, Suite 800
Washington, DC 20036-3816


Power Planning Committee
New England Governors' Conference, Inc.
76 Summer Street, 2nd Floor
Boston, MA 02110-1226

Heather Hunt
Executive Director
New England States Committee on Electricity
242 Whippoorwill Lane
Stratford, CT 06614

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 13th day of July, 2009.



Pamela S. Higgins
Ballard Spahr Andrews & Ingersoll, LLP
601 13th Street, N.W., Suite 1000 South
Washington, D.C. 20005
(202) 661-2258