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June 17, 2010

VIA ELECTRONIC FILING

Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: ISO New England Inc. and New England Power Pool, Docket No. ER07-397-005; Motion for Leave to Answer and Answer of ISO New England Inc. and the New England Power Pool

Dear Ms. Bose:

Transmitted electronically for filing is the Motion for Leave to Answer and Answer of ISO New England Inc. and the New England Power Pool in the above-captioned docket.

If there are any questions concerning this filing, please call me at (202) 661-2205.

Very truly yours,

/s/ Howard H. Shafferman

Howard H. Shafferman
Counsel for
ISO New England Inc.

Enclosure

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

**ISO New England Inc. and
New England Power Pool**

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Docket No. ER07-397-005

**MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF
ISO NEW ENGLAND INC. AND THE NEW ENGLAND POWER POOL**

Pursuant to Rules 101(e), 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (the “Commission”),¹ ISO New England Inc.² (the “ISO” or “ISO-NE”) and the New England Power Pool Participants Committee (“NEPOOL”) (together, the “Filing Parties”) hereby submit a *Motion for Leave to File Answer and Answer* (“Answer”) to the protest filed by the Maine Public Utilities Commission (“MPUC”), Massachusetts Attorney General (“MA AG”), New Hampshire Public Utilities Commission (“NH PUC”) and Vermont Public Service Board (“VT PSB”) (collectively, “Protesters”) on June 2, 2010, in the above-captioned proceeding.³

I. INTRODUCTION AND EXECUTIVE SUMMARY

The Protest was filed in response to the *Compliance Filing of ISO New England Inc.* submitted on May 12, 2010 by the Filing Parties⁴ pursuant to the Commission’s directive in an

¹ See 18 C.F.R. §§ 385.101(e), 385.212 and 385.213 (2009).

² Capitalized terms used but not defined herein are intended to have the meaning given to such terms in the ISO New England Inc. Transmission, Markets and Services Tariff, FERC Electric Tariff No. 3 (“ISO Tariff”), the Second Restated New England Power Pool Agreement, and the Participants Agreement. Section II of the ISO Tariff contains the Open Access Transmission Tariff (“ISO OATT”). Section III of the ISO Tariff contains Market Rule 1. Section III.13 of Market Rule 1 contains the Forward Capacity Market (“FCM”) rules (“FCM Rules”).

³ See *ISO New England Inc. and New England Power Pool*, Protest of the Maine Public Utilities Commission, Massachusetts Attorney General, New Hampshire Public Utilities Commission and Vermont Public Service Board; Docket No. ER07-397-005 (June 2, 2010) (“Protest”).

⁴ See *ISO New England Inc. and New England Power Pool*, Compliance Filing of ISO New England Inc.; Docket No. ER07-397-005 (May 12, 2010) (“Compliance Filing”).

order issued on February 28, 2007, in Docket Nos. ER07-397, *et al.*, and referred to in subsequent orders.⁵ In that order, in pertinent part, the Commission found that the potential for double recovery of costs associated with the capability to provide reactive service is not a concern during the transition period of the Forward Capacity Market (the “FCM Transition Period”)⁶ because the capacity payment is below the cost of new entry.⁷ Concerned with a potential for double recovery to occur in the Forward Capacity Auction (“FCA”), the Commission directed the ISO to file tariff provisions, prior to the commencement of the first FCA commitment period on June 1, 2010, to ensure that resources eligible for Capacity Cost payments under Schedule 2 of the ISO OATT (*i.e.*, pursuant to the “VAR CC Rate” component of Schedule 2) do not receive double compensation through the FCA-derived capacity payments.⁸ Subsequent to the February 28, 2007 Order, the Commission issued a number of orders addressing the concern with double recovery. Importantly, in these orders, the Commission:

- Ruled that the Capacity Cost payments under Schedule 2 and the FCA-derived capacity payments under the FCM Rules are for distinct services,⁹ and that capability to provide reactive service is not to be compensated through the FCM;¹⁰

⁵ *ISO New England Inc. and New England Power Pool*, 118 FERC ¶ 61,163 at P 30 (2007) (requiring the ISO to file tariff provisions prior to the first Forward Capacity Auction (“FCA”) commitment period to prevent double recovery by resources eligible to receive both Capacity Cost payments under Schedule 2 of the ISO OATT and FCA-derived payments pursuant to Section III.13 of Market Rule 1) (“February 28, 2007 Order”); *order on reh’g*, 126 FERC ¶ 61,212 at P 18 (2009) (“March 9, 2009 Order”); *order on clarification*, 130 FERC ¶ 61,005 at P 8 (2010) (“January 5, 2010 Order”).

⁶ The transition period for the Forward Capacity Market (“FCM”) extended from December 1, 2006 to June 1, 2010.

⁷ *See* February 28, 2007 Order at P 30.

⁸ *See* February 28, 2007 Order at P 30.

⁹ *See Maine Public Utilities Commission v. ISO New England Inc.*, 126 FERC ¶ 61,090 at P 39 (2009) (“February 3, 2009 Order”), *order on reh’g*, 128 FERC ¶ 61,012 at P 13 (“July 8, 2009 Order”).

¹⁰ As the Commission explained:

(continued...)

- Concluded that there is no double recovery concern in a competitive FCA, because sellers in a competitive FCA will have an incentive to submit bids that take into account revenues from the VAR CC Rate component;¹¹ and
- Concurred that if a resource without VAR capability sets the FCA clearing price, there is no concern with double recovery.¹²

Nevertheless, out of “an abundance of caution,” these orders maintained the Commission’s directive for the ISO to file, prior to the first FCA commitment period, tariff provisions that eliminate the potential for double compensation through the FCM.¹³

To comply with the Commission’s directive, the ISO filed, prior to the commencement of the first FCA commitment period, revisions to Section III.13 of Market Rule 1 to incorporate a rule that eliminates the potential for resources that are eligible to receive compensation for the capability to provide reactive service under Schedule 2 to be compensated for those costs

(...continued)

Forward Capacity payments are designed to ensure resource adequacy and . . . the Forward Capacity Market itself is designed so that new capacity resources that seek to clear in the market have an incentive to bid a price which reflects the minimum revenue needed to support their investment costs, *net of other anticipated revenue streams*. . . [R]eactive service is a unique service the compensation for which is *not covered by capacity payments*, whether transition payment or auction revenues. . . . The CC Rate component . . . is a negotiated New England-wide rate for all VAR-capable resources that is designed to compensate qualified resources for their VAR capability to provide reactive service, *but not for the costs associated with the equipment of a particular generator* . . . [as] neither the FCM payments nor the payments under the CC Rate component arise from a *traditional cost-of-service methodology*....

February 3, 2009 Order at PP 39, 41-43 (emphasis added). *See also* July 8, 2009 Order at P 14; March 9, 2009 Order at P 17.

¹¹ February 3, 2009 Order at P 45. *See also* January 5, 2010 Order at P 4.

¹² *See* February 3, 2009 Order at P 47 (“if a capacity resource without VAR capability (e.g., a demand response resource) sets the auction clearing price, a new VAR-capable resource would not recover its VAR-related capital costs without the CC Rate component of Schedule 2 and, therefore, would not receive double recovery.”).

¹³ January 5, 2010 Order at P 8.

through the FCM (the “Market Rule Revision”).¹⁴ Nevertheless, Protesters have challenged the Market Rule Revision, alleging that it fails to comply with the Commission’s directive for two reasons. First, Protesters assert that the Market Rule Revision does not comply with the Commission’s directive because of the rule’s application in connection with the FCM qualification process, which results in the prospective implementation of the rule change.¹⁵ Second, Protesters contend that the Market Rule Revision does not comply with the Commission’s directive because it does not provide certainty that existing generators are not over-recovering capital costs for a particular generator’s equipment.¹⁶

As this Answer demonstrates, Protesters’ challenges to the Compliance Filing’s Market Rule Revisions are an attempt to re-litigate final Commission determinations and, consequently, must be rejected. As shown in Section III below, the Protest’s challenge to the application of the Market Rule Revision in the FCM qualification process is in fact a collateral attack on the Commission’s February 3, 2009 Order and July 8, 2009 Order, which ruled that compensation for capability to provide reactive service is not to be made through the FCM.¹⁷ Similarly, the Protest’s claim that the Market Rule Revision fails to provide certainty that existing generators are not over-recovering capital costs for a particular generator’s equipment is another attempt to re-assert Protesters’ prior claims that the FCA-derived capacity payments and the Schedule 2 Capacity Cost rate are two overlapping revenue streams compensating facilities for the same

¹⁴ The possibility of double compensation results from the receipt of compensation for capability to provide reactive service from both (1) Capacity Cost payments made to Qualified Generator Reactive Resources under Schedule 2 of the ISO OATT for the capability to provide reactive service, and (2) the FCA-derived capacity payments received by resources that clear in the FCA for capacity to ensure resource adequacy.

¹⁵ Protest at 6-7.

¹⁶ Protest at 7-8.

¹⁷ See July 8, 2010 Order at P 14; February 3, 2009 Order at P 45.

equipment. As the Commission has previously determined, neither of these payments bears any relationship to the cost of a particular generator's equipment, and Protesters' attempt to re-litigate this issue amounts to a collateral attack on earlier orders,¹⁸ and must be brought to an end.

Even though Protesters failed to show that the Market Rule Revision does not comply with the Commission's directive, they, nevertheless, offer alternative proposals that they assert can provide certainty that double recovery of the costs of a particular generator's equipment does not occur, commencing with the first FCA commitment year. As explained below, these alternatives are legally immaterial and substantively flawed. The only issue for the Commission to decide is whether the Market Rule Revision submitted in the Compliance Filing complies with the underlying orders.¹⁹ The fact that Protesters may have alternative methodologies for complying with the Commission's requirement is immaterial. Moreover, the alternatives advanced by Protesters are flawed, incomplete and have not been fully vetted through the stakeholder process.

Conversely, the Market Rule Revision is the result of the ISO's methodical and comprehensive review of the Commission's directive in the February 28, 2007 Order and subsequent orders. It complies with the Commission's requirement in the underlying orders by providing certainty that double recovery of costs associated with capability to provide reactive service will not occur through FCA-derived capacity payments. Its prospective application, as shown herein, does not render this rule change any less compliant. In fact, this prospective

¹⁸ See, e.g., February 3, 2009 Order at 41-43.

¹⁹ See *PJM Interconnection, L.L.C.*, 111 FERC ¶ 61,257 at P 14 (2005); see also *Ameren Services Co. v. Midwest Independent Transmission System Operator, Inc.*, 131 FERC ¶ 61,210 at P 22 (2010) (explaining that the sole issue when evaluating a compliance filing is whether it satisfies the compliance requirements of the underlying order).

application is warranted by well-established Commission precedent,²⁰ and aligns with the Commission's findings with respect to the issue of double recovery.

Accordingly and as set forth in more detail herein, the Filing Parties respectfully request that the Commission grant leave to file this Answer, reject the Protest and approve the Market Rule Revision submitted in the Compliance Filing, without modification, suspension or hearing.

II. MOTION FOR LEAVE TO ANSWER

The Filing Parties hereby move, pursuant to Rule 212 of the Commission's Rules of Practice and Procedure,²¹ for leave to file this Answer to the Protest. As a general matter, the Commission's rules prohibit responses to protests.²² However, the Commission has the authority to waive this prohibition for good cause.²³ The Commission has found good cause to permit answers where they are otherwise prohibited in various circumstances, including where the answer would assure a complete record in the proceeding,²⁴ provide information helpful to the disposition of an issue,²⁵ permit the issues to be narrowed or clarified,²⁶ or aid the Commission in understanding and resolving issues.²⁷ The Filing Parties believe this Answer will assure a more complete record in this proceeding and otherwise assist the Commission in understanding and

²⁰ See fn. 29, *infra*.

²¹ 18 C.F.R. § 385.212 (2009).

²² See 18 C.F.R. § 385.213(a)(2).

²³ See 18 C.F.R. § 385.101(e) (2006).

²⁴ See, e.g., *Pacific Interstate Transmission Co.*, 85 FERC ¶ 61,378, at 62,443 (1998), *reh'g denied*, 89 FERC ¶ 61,246 (1999).

²⁵ See, e.g., *CNG Transmission Corp.*, 89 FERC ¶ 61,100, at 61,287 n.11 (1999).

²⁶ See, e.g., *PJM Interconnection, LLC*, 84 FERC ¶ 61,224, at 62,078 (1998); *New Energy Ventures, Inc. v. Southern California Edison Co.*, 82 FERC ¶ 61,335, at 62,323 n.1 (1998).

²⁷ See, e.g., *Tennessee Gas Pipeline Co.*, 92 FERC ¶ 61,009, at 61,016 (2000).

resolving the issues presented. Furthermore, the Commission has accepted answers by the Filing Parties under similar circumstances.²⁸ Accordingly, the Filing Parties respectfully request that the Commission grant their motion to provide the following Answer.

III. ANSWER

A. The Commission Should Accept the Market Rule Revision Because It Complies with the February 28, 2007 Order

Contrary to the Protest's erroneous claims, the Market Rule Revision, filed prior to the first FCA commitment year, is consistent with the Commission's February 28, 2007 directive, and its subsequent analyses and findings in the February 3, 2009 Order, March 9, 2009 Order and July 8, 2009 Order. The Market Rule Revision prohibits a resource capable of setting the FCA clearing price from including in its FCA offers Schedule 2 Capacity Cost revenues that it expects to receive for its capability to provide reactive service and, thereby, ensures that the FCA clearing price – a uniform clearing price, which forms the basis of the price to be paid to all resources whether or not they are VAR-capable resources – does not reflect such revenues. This, in turn, provides certainty that the FCA-derived capacity payments do not create double recovery of costs associated with the capability to provide reactive service.

The prospective application of the Market Rule Revision, which Protesters also challenge, does not make the rule change any less compliant. Not only is the prospective application required by well-established Commission precedent,²⁹ but it also is consistent with

²⁸ See *ISO New England Inc.*, 113 FERC ¶ 61,341 at P 6 (2005) (accepting ISO's answer to protests to 2006 rates); *ISO New England Inc.*, 109 FERC ¶ 61,383 (2004) (accepting ISO's answer to protests to 2005 rates); *ISO New England Inc.*, 97 FERC ¶ 61,304 (2001) (accepting ISO's answer to protests to 2002 rates).

²⁹ See, e.g., *ISO New England Inc. and New England Power Pool*, 131 FERC ¶ 61,065 at P 152 (2010) ("...we will not require ISO-NE to implement the inflation adjustment with FCA # 4 as NEPGA and EPSA request, because the qualification process has already begun for the fourth FCA and it would not be reasonable to change the expected CONE in the middle of that process."); *ISO New England Inc.*, 119 FERC ¶ 61,045 at P 68 (2007) ("...the rules governing capacity resource qualification . . . should be transparent to all participants – existing and new – prior to the beginning of the qualification process."); see also *New York Independent System Operator, Inc.*, 122 FERC (continued...)

the Commission's determinations that double recovery is not a concern: (i) during the FCM Transition Period,³⁰ (ii) when the FCA clearing price is below the cost of new entry,³¹ (iii) when an FCA is competitive,³² and (iv) when the FCA clearing price is set by a resource without VAR capability.³³ Consequently, double recovery is not a concern for the first three FCAs, as each of these FCAs have been certified by the ISO's Market Monitor,³⁴ and accepted by the Commission, as competitive.³⁵ The absence of double recovery during these FCAs is also evidenced by the fact that the FCA clearing prices for each of these FCAs were below, not equal to, the cost of new entry.³⁶ Finally, the FCA clearing prices for the first three FCAs were not set by a VAR-capable resource, but the capacity clearing price floor provisions of Section III.13.2.7.3 of Market Rule 1. The ISO, however, recognizes that these assessments have yet to

(...continued)

¶ 61,211 at PP 130, 147 (2008) (accepting new mitigation measures prospectively, without refunds “as market participants can neither revisit economic decisions nor retroactively alter their conduct”); *New England Power Pool*, 87 FERC ¶ 61,045, at p.61,198 (1999) (agreeing with NEPOOL that modifications to market rules should be applied prospectively, “so that market participants will know the rules that will apply at the time they make their market decisions.”).

³⁰ See March 9, 2009 Order at P 16; February 28, 2007 Order at P 30.

³¹ See March 9, 2009 Order at P 16.

³² See February 3, 2009 Order at P 45.

³³ See *id.* at P 47.

³⁴ See *ISO New England Inc.*, Forward Capacity Auction Results Filing at 2, 9, 12-13, Docket No. ER08-633-000 (March 3, 2008) (certifying results of first FCA); *ISO New England Inc.*, Forward Capacity Auction Results Filing at 2, 8-10, Docket No. ER09-467-000 (Dec. 23, 2008) (certifying results of second FCA); *ISO New England Inc.*, Forward Capacity Auction Results Filing at 3, 9-10; Docket No. ER10-186-000 (Oct. 30, 2009) (certifying results of third FCA).

³⁵ See *ISO New England Inc.*, 130 FERC ¶ 61,145 (2010); *ISO New England Inc.*, 127 FERC ¶ 61,040 (2009); *ISO New England Inc.*, 123 FERC ¶ 61,290 (2008). See also *Devon Power LLC*, 115 FERC ¶ 61,340 at PP 17, 101, 130, *order on reh'g*, 117 FERC ¶ 61,133 (2006) (finding the Transition Payments “significantly less than the estimated cost of new entry of a new peaker, a type of plant whose costs are lower than most, if not all, other plants . . . These payments are significantly lower than the \$7.50/kW-month CONE used to begin the FCM auction, which, as discussed below, we find reasonable.”).

³⁶ February 3, 2009 Order at P 40. See also July 8, 2009 Order at P 19; March 9, 2009 Order at P 16.

take place for the fourth and fifth FCAs and, consistent with its role, the ISO's Market Monitor commits to work directly with the Commission to address the presence of potential double compensation if either of these FCAs are found to be non-competitive and the FCA clearing price is set by a new VAR-capable resource.

B. The Protest Is an Attempt to Re-litigate Final Commission Determinations and, Consequently, Must be Rejected

The Protesters claim that the Market Rule Revision does not address the Commission's directive in the February 28, 2007 Order because of its application in the FCM qualification process when there allegedly are other alternative "options" that can be implemented prior to the sixth FCA commitment year,³⁷ and provide certainty that "existing generators are not over-recovering capital costs for generating equipment."³⁸ As demonstrated in the Compliance Filing, the Market Rule Revision is based on the Commission's determinations in the February 28, 2007 Order and subsequent analyses and rulings, which the Protesters seek to re-litigate in this proceeding. Moreover, the so-called "options" that Protesters contend are implementable for the first FCA commitment period conflict with prior Commission rulings, as explained below. Because the Protest is an attempt to re-litigate issues fully litigated and determined in final Commission orders, it must be rejected as a collateral attack.

1. The Protesters' Challenge to the Application of the Market Rule Revision in the FCM Qualification Process is an Attempt to Re-litigate the Commission's Ruling that Compensation for Capability to Provide Reactive Service Is Not to be Made Through the FCM

Protesters challenge the Market Rule Revision because of its application in the FCA qualification process, which results in prospective application of the Market Rule Revision. As

³⁷ Protest at 6-7.

³⁸ Protest at 8.

the Compliance Filing demonstrates, and further discussed herein, the application of the Market Rule Revision in the FCA qualification process is consistent with settled Commission rulings. Therefore, the Protest must be rejected.

Specifically, in the February 3, 2009 Order, the Commission ruled that the costs associated with the capability to provide reactive service are *not* to be compensated through the FCM.³⁹ As the Commission explained:

Forward Capacity payments are designed to ensure resource adequacy and . . . the Forward Capacity Market itself is designed so that new capacity resources that seek to clear in the market have an incentive to bid a price which reflects the minimum revenue requirement needed to support their investment costs, *net of other anticipated revenue streams*.⁴⁰

[R]eactive service is a unique service the compensation of which is *not covered by capacity payments*, whether transition payment or auction revenues.⁴¹

Given this ruling, the Market Rule Revision ensures that the FCA-derived capacity payments do not include compensation for costs associated with the capability to provide reactive service by requiring New Generating Capacity Resources to certify during the FCA qualification process that their FCA offers will not include any anticipated Capacity Cost revenues expected to be received under Schedule 2 of the ISO OATT.

Contrary to the Commission's final ruling, Protesters take the position that the FCA-derived capacity payments should reflect the costs associated with the capability to provide reactive service. This is evidenced in the alternative proposals advanced by Protesters. The alternative proposals, included in Attachment A of the Protest, seek to modify Schedule 2 of the ISO OATT to either: (a) eliminate the Schedule 2 Capacity Cost payment for a generating

³⁹ February 3, 2009 Order at P 41. *See also* July 8, 2009 Order at P 14; March 9, 2009 Order at P 17.

⁴⁰ February 3, 2009 Order at P 39 (emphasis added) (footnote omitted).

⁴¹ *Id.* at P 41 (emphasis added).

resource that “successfully bid into the FCA,”⁴² or (b) require the generating resource to provide an affidavit attesting that the FCA-derived capacity payment was not sufficient to recover the costs associated with the Qualified Generator Reactive Resource’s equipment.⁴³ Putting aside the fundamental problems with these alternatives, which are addressed in Section III.B below, these proposals are wholly inconsistent with the Commission’s findings discussed above. Through the first proposal, Protesters seek to eliminate the Schedule 2 Capacity Cost payment for resources that “successfully bid into an FCA,” contrary to the Commission’s ruling that payments under Schedule 2 and the payments under the FCM Settlement Agreement (both FCM Transition Period and FCA-derived capacity payments) are for separate services.⁴⁴ The second proposal also is inconsistent with the Commission’s ruling that payment for the capability to provide reactive service should not be made through the FCM.⁴⁵ The Commission has a long-standing policy of prohibiting parties from using a protest to re-litigate an issue decided by the Commission in a prior proceeding.⁴⁶ Such changes can only be made through a Section 206

⁴² See Protest, Attachment A at 10 (proposing that a Qualified Generator Reactive Resource “is not entitled to a schedule 2 CC payment” if it “successfully bids into the FCA”, a concept rejected by the Commission in the February 3, 2010 Order).

⁴³ See *id.* at 11 (proposing, as a so-called “compromise,” Schedule 2 Capacity Cost payment to a Qualified Generator Reactive Resource only if it can attest that the costs of the equipment for its particular generator were not recovered through the FCA-derived capacity payment).

⁴⁴ February 3, 2009 Order at P 39. See also July 8, 2009 Order at P 13.

⁴⁵ February 3, 2009 Order at P 41. See also July 8, 2009 Order at P 14.

⁴⁶ See, e.g., *California Independent System Operator*, 119 FERC ¶ 61,313 at P 76 (2007) (“protest on this issue constitutes a collateral attack on the Commission’s prior order . . . such changes can only be made pursuant to FPA section 206”).

complaint that demonstrates a “significant change in circumstances.”⁴⁷ The Protesters have not pursued a Section 206 complaint.

Implementation of these proposals would also introduce the problems identified by the Commission in the February 3, 2009 Order; namely, that eliminating the Schedule 2 Capacity Cost payment “would amount to a material change in the compensation parties reasonably expected,”⁴⁸ and could potentially lead a New Generating Capacity Resource to “raise its offers [in the FCA] to cover those lost CC Rate component payments,” which would result in “the same level of total compensation . . . , but raising the FCM clearing price payable to *all* resources should [a New Generating Capacity Resource] be the marginal resource.”⁴⁹

2. The Protest’s Challenge to the Market Rule Revision’s “Focus” on Expected Revenues is Another Attempt to Re-Assert Prior Cost-of-Service-Based Claims that the FCA Capacity Payment and the Schedule 2 Capacity Cost Payment Compensate Resources for the Same Equipment

Protesters assert that the Market Rule Revision does not comply with the Commission’s directive because it does not provide certainty that existing generators⁵⁰ are not over-recovering the *costs of their generating equipment*.⁵¹ This claim is another attempt by Protesters to re-assert

⁴⁷ *Id.*; *Alamito Co.*, 43 FERC ¶ 61,274 at p. 61,753 (1988) (“Absent a showing of significant change in circumstances, the relitigation of an issue is simply not justified. Sound public policy reasons support the Commission’s policy against relitigation of issues.”).

⁴⁸ February 3, 2009 Order at P 46.

⁴⁹ February 3, 2009 Order at P 47.

⁵⁰ For completeness, the Filing Parties note that the Market Rule Revision does not apply to Existing Generating Capacity Resources, for the FCM design already has protections in place that address the limited circumstances under which an Existing Generating Capacity Resource has the ability to influence the FCA clearing price and, therefore, additional tariff language is not necessary. *See* Compliance Filing at 11-12. Indeed, Protesters have acknowledged the fact that the existing mechanisms in the FCM design already eliminate the concern over double recovery. *See* Protest, Attachment A at 8 (noting that “market rule 1 does not require actions by existing resources (except in the chase of changes in qualifying capacity or in the case of dynamic de-list bids, which *if accepted would eliminate the concern over double recovery*)”) (emphasis added).

⁵¹ Protest at 8.

their prior claims that the FCA-derived capacity payment and the Schedule 2 Capacity Cost rate are two overlapping revenue streams compensating generating facilities for the *same equipment*⁵² – an argument that the Commission has rejected several times because it is premised on the faulty notion that these payments are based on the costs of particular generator’s equipment on a cost-of-service basis.⁵³ Accordingly, the Protest must be rejected.

Protesters claim that the Market Rule Revision does not comply with the Commission’s directive because it “focuses” on a resource’s *anticipated Capacity Cost revenues* as a Qualified Generator Reactive Resource under Schedule 2 instead of the *costs of equipment associated with a particular generator*.⁵⁴ Contrary to Protesters’ erroneous claim, the Market Rule Revision complies with the Commission’s directive by ensuring that double recovery of a resource’s costs for its capability to provide reactive service does not occur in a manner that is dependent on the costs associated with a particular generator’s equipment.

As the Commission determined in the February 3, 2009 Order:

[N]either the FCM payments nor the payments under the CC Rate component arise from a traditional cost-of-service methodology, under which specific costs are allocated to a service class to produce a set rate. On the contrary, both the CC Rate component and the FCM payments (both transition and auction) are not “cost-of-service” rates based on the *costs of the particular generators providing the two distinct products* – VAR Service and capacity.⁵⁵

Neither of these payments is based on the cost of particular generators’ equipment. In fact, the FCA clearing price paid for capacity service is a market-based amount, and the Capacity Cost

⁵² See Protest, Attachment A at 11 (describing the MPUC’s compromise approach as requiring a generator to attest that the FCA-derived capacity payment does not recover the capital costs for its specific generator’s equipment necessary to provide reactive service).

⁵³ See July 8, 2009 Order at P 15; March 9, 2009 Order at PP 15-17; February 3, 2009 Order at P 43.

⁵⁴ Protest at 6-7 (emphasis added).

⁵⁵ February 3, 2009 Order at P 43.

rate is a fixed, negotiated rate paid for the capability to provide reactive service.⁵⁶ Given this, the Market Rule Revision provides that resources may not include in their FCA offers any expected Capacity Cost revenues under Schedule 2. This construct is also consistent with the Commission's finding that, under the FCM design, bidders have an incentive to bid a price which reflects the minimum revenue needed to support investment cost *net of expected revenues from other revenue streams*.⁵⁷

Because the Protest simply seeks to re-litigate the Commission's prior determination that the FCA-derived capacity payments and the Schedule 2 Capacity Cost rate component are not cost-of-service rates based on a particular generator's equipment, it must be rejected as an impermissible collateral attack.⁵⁸

C. Because the Market Rule Revision Complies with the February 28, 2007 Order, the Commission Should Adhere to Its Applicable Precedent and Decline to Examine the Alternatives; In Any Event, the Alternatives Advanced by the Protesters Are Flawed

As shown in Section III.A., above, the Market Rule Revision complies with the February 28, 2007 Order. Protesters nonetheless offer alternative proposals purportedly preventing double recovery commencing with the first FCA commitment year. Consistent with governing precedent, the Commission should decline to examine these alternative proposals because the

⁵⁶ February 3, 2009 Order at P 42 (“The CC Rate component of the second service, reactive service, is a negotiated New England-wide rate for all VAR-capable resources that is designed to compensate qualified resources for their VAR capability to provide reactive service, but not for the costs associated with the equipment for a particular generator.”).

⁵⁷ See February 3, 2009 Order at P 44 (“We agree with ISO-NE that any potential for double recovery is sufficiently reduced to ensure that the CC Rate component is just and reasonable. That is, qualified, VAR-capable generating resources have an incentive to reduce their FCM bids by the amount of their net revenues from the CC Rate component, given that resources which do not provide reactive service (e.g., demand resources and imports) do not need to recover the costs of such reactive service.”).

⁵⁸ See *supra* notes 46 & 47.

Market Rule Revision is compliant with the governing order. In any event, these proposals are substantively flawed.

1. Under Applicable Precedent, the Only Issue the Commission Must Decide Is Whether the Market Rule Revision Satisfies the ISO's Compliance Requirement

As the Filing Parties and the Protesters both acknowledge, the ISO submitted the Market Rule Revision as a compliance filing directed by the February 28, 2007 Order. As the Commission has explained, “[t]he only issue in a compliance proceeding is whether the filing complies with the underlying order.”⁵⁹ The fact that another party may develop an alternative methodology for complying with the Commission requirement in question is immaterial. So long as the filing party satisfies its compliance requirement, the Commission should accept the compliance filing.⁶⁰ Thus, as a matter of law, the Protesters’ alternatives are immaterial. Because (as explained above) the Market Rule Revision complies with the Commission’s directives, the Commission should accept the Market Rule Revision, and decline to examine the Protesters’ alternatives.

⁵⁹ *PJM Interconnection, L.L.C.*, 111 FERC ¶ 61,257 at P 14 (2005); *see also Ameren Services Co. v. Midwest Independent Transmission System Operator, Inc.*, 131 FERC ¶ 61,210 at P 22 (2010) (explaining that the sole issue when evaluating a compliance filing is whether it satisfies the compliance requirements of the underlying order).

⁶⁰ This principle is similar to that utilized by the Commission for Section 205 filings. When reviewing a Section 205 filing, the Commission will determine whether the public utility’s filing is just and reasonable, regardless of whether a protesting party has developed an alternative proposal that might also be just and reasonable. *See Southern California Edison Co., et al.*, 73 FERC ¶ 61,219 at p.61,608 n.73 (1995) (“Having found the Plan to be just and reasonable, there is no need to consider in any detail the alternative plans proposed by the Joint Protesters.” (citing *City of Bethany*, 727 F.2d at 1136)). Here, the ISO submitted a filing that complies with the February 28, 2007 Order; any alternative proposals submitted by another party are immaterial.

2. In Any Event, the Alternatives Advanced by Protesters to Support their Claim that the Market Rule Revision Does Not Comply with the Commission’s Directive Are Seriously Flawed, Incomplete, and Have Not Been Fully Vetted Through the Stakeholder Process

As explained above, the Market Rule Revision is compliant with the Commission’s directive, and therefore the Commission should not even examine the alternatives offered by the Protestors. In any event, though, the alternatives advanced by the Protesters are seriously flawed, are not fully developed and have not been vetted through the stakeholder process.

As the Compliance Filing explains, immediately following the Commission’s January 5, 2010 Order, the ISO initiated discussions with stakeholders to provide for the compliance efforts to be fully vetted through the stakeholder process given the extensive history associated with the Commission’s directive in the February 28, 2007 Order.⁶¹ To that end, as early as February, the ISO presented at the Markets Committee one of the proposals that it had been considering for addressing the Commission’s directive. This initial proposal (referenced in the Protest) considered the netting of the Schedule 2 Capacity Cost payments associated with the minimum interconnected reactive service capability from the FCA-derived capacity payment for New Generating Capacity Resources that are also Qualified Generator Reactive Resources and are associated with a Capacity Zone where either the Inadequate Supply or Insufficient Competition conditions were triggered.

Contrary to Protesters’ insinuations, the ISO did not withdraw this initial proposal simply because “suppliers raised concerns.”⁶² Rather, the ISO chose not to further develop that initial proposal because the concerns raised by the stakeholders (not just the suppliers) at the Markets Committee validated fundamental flaws about which the ISO had also developed concerns.

⁶¹ See Compliance Filing at 9-10, 13.

⁶² Protest at 4.

Indeed, due to its concerns, the ISO was already pursuing the development of the Market Rule Revision submitted in the Compliance Filing.⁶³

The other alternative advanced in the Protest – *i.e.*, “utiliz[ing] the offset provision in the Forward Reserve Market as a possible model to deal with the double recovery issue”⁶⁴ was also not vetted through the stakeholder process. Setting this aside, there are at least two reasons why a mechanism that provides for the netting of the Schedule 2 Capacity Cost rate from the FCA clearing price similar to the netting that takes place between the Locational Forward Reserve Market (“LFRM”) clearing price and the FCA clearing price simply does not work.

The first reason that the LFRM netting cannot serve as a model in the context of VAR resources and the FCM is very simple. All resources that qualify to provide forward reserves in the LFRM also qualify to provide capacity in the FCM, so netting is straightforward. However, not all resources that qualify to provide capacity in the FCM can provide VARs (and so qualify for payment of the VAR CC Rate), so netting the VAR CC payments and FCM payments is not practicable.

Second, even setting aside the technical capability/comparability problem, implementation of a mechanism for netting the Schedule 2 Capacity Cost rate from the FCA

⁶³ Among the fundamental flaws of the ISO’s initial proposal was its inconsistency with the Commission’s determination that compensation for the capability to provide reactive service is not to be made through the FCM. Rather than ensure that such costs are not compensated through the FCM, the proposal presumed that the FCA clearing price reflected the Schedule 2 Capacity Cost payments associated with the minimum capability to provide reactive service under Inadequate Supply or Insufficient Competition conditions, but only provided for the netting of those costs from VAR-capable resources, allowing non-VAR capable resources to receive a FCA-derived capacity payment based on a FCA clearing price that was assumed to reflect costs associated with a service that non-VAR resources could not provide. The ISO also was concerned with the potential impact that such a proposal could have on resource participation in the Schedule 2 Capacity Cost program, a concern also shared by the Commission. *See* July 8, 2009 Order at P 22 (“While the capacity cost component is not a cost-of-service rate . . . this negotiated rate does compensate qualified resources for their VAR capability and thereby provides an inducement to provide reactive power service outside the deadband.”). With the stakeholder feedback, the ISO conducted a methodical and comprehensive review of all the Commission’s orders issued in Docket Nos. ER07-397 and EL07-38, and formulated the Market Rule Revision to address the Commission’s directive.

⁶⁴ Protest at 7.

clearing price does not work, because the settlement rules that would establish such a construct had to be known in advance of the first FCA so that resources could have taken this into account when constructing their FCA offers.

The Protest also advances the MPUC’s so-called “compromise” alternative that the ISO did not support.⁶⁵ This MPUC alternative is inconsistent with prior Commission determinations, as demonstrated in Section III.A above, and undermines the existing market construct.⁶⁶ The MPUC alternative, which completely disregards the fact that neither the FCA-derived capacity payment nor the Schedule 2 Capacity Cost payment is based on an individual unit’s equipment costs,⁶⁷ is an attempt to resolve the double recovery concerns through a cost-of-service construct. Setting aside the fact that the FCA clearing price and the Schedule 2 Capacity Cost rate are not cost-of-service rates, “treating these two payment methodologies as if they were derived from a cost-of-service basis,” as the Commission correctly found in the February 3, 2009 Order, “results in misleading, if not inaccurate, conclusions.”⁶⁸ Moreover, whereas the Market Rule Revision prevents the FCA clearing price from reflecting the costs associated with the capability of

⁶⁵ The MPUC “compromise” approach as described in Section III.A, would revise Schedule 2 of the ISO OATT to provide that “a generating resource that successfully bids into the FCA for any given year” cannot receive Capacity Cost payment under Schedule 2 unless a corporate officer of that generating unit attests that without the Schedule 2 Capacity Cost payment, it cannot recover the costs for its generator’s equipment necessary to provide reactive service. Protest, Attachment A at 11.

⁶⁶ The ISO notes that, contrary to the Protesters’ representation, the ISO reached out to representatives of the MPUC immediately after their indication at the March 9-10 meeting of the Markets Committee that the MPUC had an alternative proposal to see whether the proposals could be reconciled in any way, recognizing the importance of this issue to the MPUC. Because the MPUC alternative provided for a cost-of-service approach to resolve the double recovery concern, the ISO could not support the MPUC proposal, but nevertheless made suggestions on how the proposal could be improved.

⁶⁷ The FCA-derived capacity payment, as discussed in Section III.A, is based on a uniform clearing price that forms the basis for the price to be paid to all resources whether or not they are VAR-capable resources. *See* February 3, 2009 Order at P 39. That is, it is not a unit-by-unit pay-as bid construct. The Schedule 2 Capacity Payment – a negotiated rate – also is not designed to compensate for the costs of a particular generator’s equipment. *See* February 3, 2009 Order at P 42.

⁶⁸ February 3, 2009 Order at P 43.

providing reactive service, which are to be paid under Schedule 2, the MPUC proposal does not, in any way, provide certainty that compensation for that capability is not reflected in the FCA-derived capacity payment to non-VAR capable resources.

Even setting aside these fundamental problems, the MPUC alternative is incomplete and its implementation methodology is unclear. Unlike the prior and stakeholder-unvetted alternatives advanced in the Protest, the MPUC alternative was considered and voted by NEPOOL Transmission Committee, but failed to receive the requisite level of support, with only 20% in favor. The MPUC chose not to present its proposal to the NEPOOL Participants Committee for a vote. Notably, the Market Rule Revision submitted in the Compliance Filing received broad stakeholder support.⁶⁹

The Market Rule Revision addresses the Commission's directive to the ISO in the February 28, 2007 Order and the orders issued subsequent to the February 28, 2007 Order by prohibiting a resource capable of setting the FCA clearing price – consistent with competitive market behavior – from including in its FCA offer expected revenues from the Schedule 2 Capacity Cost rate component. The Market Rule Revision provides certainty that the FCA clearing price will not include Schedule 2 Capacity Cost anticipated revenues and, therefore, eliminates any potential for double compensation.

⁶⁹ See Compliance Filing at 13.

IV. CONCLUSION

For the reasons stated herein, the ISO and NEPOOL respectfully request that the Commission grant their motion for leave to answer and consider the answer provided herein. Ultimately, the Commission should reject the Protest and accept the Compliance Filing, without modification, suspension or hearing.

Respectfully submitted,

ISO NEW ENGLAND INC.

NEW ENGLAND POWER POOL

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Date: June 17, 2010

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 17th day of June, 2010.

/s/ Pamela S. Higgins
Pamela S. Higgins