149 FERC ¶ 61,009
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Cheryl A. LaFleur, Chairman;
Philip D. Moeller, Tony Clark,
and Norman C. Bay.

ISO New England Inc. Docket Nos. ER14-2419-000
ER14-2419-001
EL14-52-000

ORDER ON COMPLIANCE FILING

(Issued October 2, 2014)

1. On May 30, 2014, pursuant to section 206 of the Federal Power Act (FPA),[1] the Commission directed ISO New England Inc. (ISO-NE) to revise its Transmission, Markets and Services Tariff (Tariff) to increase the Reserve Constraint Penalty Factors in its real-time markets and implement a two-settlement capacity market design, in order to address fleet-wide resource performance issues and help ensure reliability.[2] On July 14, 2014, ISO-NE submitted a compliance filing, as directed by the May 30, 2014 Order.[3] In this order, we accept in part, subject to condition, and reject in part ISO-NE's compliance filing, with different sections of the Tariff provisions to become effective June 9, 2014, December 3, 2014, and June 1, 2018, as requested. We direct a further compliance filing, as discussed below.

I. Background

2. On January 17, 2014, ISO-NE and the New England Power Pool Participants Committee (NEPOOL) jointly submitted two alternate proposals under section 205 of the

[1] 16 U.S.C. § 824e (2012).

[2] *ISO New England Inc. and New England Power Pool*, 147 FERC ¶ 61,172 (2014) (May 30, 2014 Order).

[3] As further discussed below, ISO-NE submitted its compliance filing in two parts, with three different requested effective dates for different Tariff sections. In this order, we will collectively refer to both parts of ISO-NE's filing as the "compliance filing."

FPA[4] to address fleet-wide capacity resource performance problems (January 17 Filing). ISO-NE proposed to address the resource performance problems by redesigning its Forward Capacity Market (FCM) to link capacity revenues to resource performance during reserve deficiencies through a two-settlement process. A resource that clears a Forward Capacity Auction (FCA) would receive a Capacity Base Payment, based on the auction clearing price, and Capacity Performance Payments (which could be positive, zero, or negative), based on the level of energy and reserves the resource provided in real-time during reserve deficiencies, known as Capacity Scarcity Conditions. A resource that does not participate or clear in a FCA would not receive a Capacity Base Payment, but would still be eligible for Capacity Performance Payments. NEPOOL alternately proposed to: (1) increase the Reserve Constraint Penalty Factors[5] for 30-Minute Operating Reserves and 10-Minute Non-Spinning Reserves; and (2) implement a new performance metric for measuring a resource's availability during peak hours.

3. In response, the Commission in the May 30, 2014 Order, instituted a section 206 proceeding,[6] finding that the existing Tariff was unjust and unreasonable because it failed to provide adequate incentives for resource performance, thereby threatening reliable operation of the system and forcing consumers to pay for capacity without receiving commensurate reliability benefits. However, the Commission also found that neither ISO-NE's nor NEPOOL's proposal, standing alone, represented a just and reasonable replacement rate. The Commission instead found that a modified version of ISO-NE's proposal combined with one aspect of NEPOOL's alternative proposal provided a just and reasonable solution. The Commission, therefore, directed ISO-NE to make a compliance filing implementing that solution.

4. The first modification the Commission directed ISO-NE to make to the two-settlement capacity market design concerned energy efficiency resources, which the Commission found are not similarly situated to other capacity resources because they do not actively perform in real-time and are therefore unable to respond to ISO-NE's proposed performance incentives.[7] Therefore, the Commission directed ISO-NE to

[4] 16 U.S.C. § 824d (2012).

[5] Reserve Constraint Penalty Factors are rates, in $/MWh, that are used within the real-time dispatch and pricing algorithm to reflect the value of Operating Reserve Shortages. ISO-NE Tariff § I.2.2. The Reserve Constraint Penalty Factor acts as a cap on the price that ISO-NE may pay to procure additional reserves. Reaching this cap signals that the system is in a reserve deficiency. May 30, 2014 Order, 147 FERC ¶ 61,172 at n.7.

[6] Docket No. EL14-52-000 was assigned to the FPA section 206 proceeding.

[7] May 30, 2014 Order, 147 FERC ¶ 61,172 at P 89.

submit Tariff revisions ensuring that energy efficiency resources' Capacity Performance Payments are calculated only for Capacity Scarcity Conditions during hours in which demand reduction values are calculated under the Tariff for that particular type of resource.

5. The second modification the Commission directed ISO-NE to make to the two-settlement capacity market design concerned binding intra-zonal transmission constraints. The Commission explained that, under ISO-NE's proposal, resources on the export side of an intra-zonal transmission constraint could be incented to submit energy market offer prices below their marginal operating costs in order to maximize their dispatch for energy or reserves and thereby maximize their Capacity Performance Payments for the duration of a Capacity Scarcity Condition, even though that additional energy production would not be useful or efficient because it could not reach the import side of the constraint. The Commission found that ISO-NE's proposal avoided this inefficiency in instances of *inter*-zonal transmission constraints but failed to do so for *intra*-zonal transmission constraints.[8] The Commission explained that a "comprehensive solution is to avoid creating the inefficient incentive in the first place by exempting all resources within a zone experiencing a Capacity Scarcity Condition and which are located on the export side of a binding transmission constraint."[9] The Commission found that "an exemption is appropriate in instances where an intra-zonal transmission constraint may lead to improper price signals to capacity resources."[10] Thus, the Commission directed ISO-NE "to submit Tariff revisions to address the improper price signals in this scenario or further explain why the exemption is not necessary."[11]

---

[8] Under ISO-NE's two-settlement capacity market design, when a Capacity Scarcity Condition exists only in one (or more) capacity zone(s) but not in the rest of the ISO-NE footprint, the Capacity Performance Payment would apply only to resources in the zone(s) experiencing the Capacity Scarcity Condition. In those circumstances, capacity outside the affected zone(s) would be capable of producing additional energy, but inter-zonal transmission constraints would prevent ISO-NE from delivering that energy to the affected zone(s). In essence, a shortage would be occurring in the import-constrained zone(s) but not in the rest of ISO-NE's footprint. The Commission noted that it would be inefficient to signal through Capacity Performance Payments the need for additional energy in the rest of the footprint, because additional energy from that area would not help alleviate the shortage in the import-constrained zone(s).

[9] May 30, 2014 Order, 147 FERC ¶ 61,172 at P 67.

[10] *Id.* P 62.

[11] *Id*.

6. As to the Reserve Constraint Penalty Factor changes, the Commission explained that those changes "are not intended to be a complete panacea to the region's resource performance problems, but rather part of a comprehensive solution that will enhance performance incentives in the near-term until ISO-NE's proposal, as adopted here, begins impacting real-time performance."[12] The Commission found the Reserve Constraint Penalty Factor changes "to be part of a just and reasonable solution, given the urgency of the reliability concerns facing the New England region and the incremental nature of the increases to the Reserve Constraint Penalty Factors."[13] Therefore, the Commission directed ISO-NE to submit as part of its compliance filing Tariff revisions increasing the Reserve Constraint Penalty Factors for 30-Minute Operating Reserves, from $500/MWh to $1,000/MWh, and 10-Minute Non-Spinning Reserves, from $850/MWh to $1,500/MWh.[14] The Commission acknowledged that the increased Reserve Constraint Penalty Factors may impact specific elements of ISO-NE's proposal, and therefore directed ISO-NE to submit as part of its compliance filing either Tariff revisions reflecting any adjustments that it believes are necessary in light of the Commission's decision to implement the Reserve Constraint Penalty Factor changes, or an explanation as to why no such adjustments are necessary.[15]

II. Summary of ISO-NE's Compliance Filing

7. ISO-NE's compliance filing reflects Tariff revisions intended to: (1) incorporate the higher Reserve Constraint Penalty Factors; (2) reflect a modified version of the two-settlement capacity market design to ensure that Capacity Performance Payments for energy efficiency resources are calculated only for Capacity Scarcity Conditions that occur during hours in which demand reduction values are calculated for the applicable resource type pursuant to the Tariff; and (3) address the Commission's concern regarding improper price signals that can arise from binding intra-zonal transmission constraints. These three aspects of ISO-NE's compliance filing are described in detail below. In addition, ISO-NE proposes three minor, non-substantive changes from the January 17 Filing resulting from the need to re-file the entire set of Tariff revisions.[16] ISO-NE submitted its compliance filing in two parts, with three different requested effective dates for different Tariff sections. In Docket No. ER14-2419-000, ISO-NE submitted Tariff records reflecting the increased Reserve Constraint Penalty Factors, with a requested

[12] *Id.* P 108.

[13] *Id.*

[14] *Id.* P 107.

[15] *Id.* P 110.

[16] ISO-NE Transmittal at 2.

effective date of December 3, 2014, and certain changes to the Tariff's defined terms and FCM rules that must apply during the qualification process for FCA 9, to become effective June 9, 2014. In Docket No. ER14-2419-001, ISO-NE submitted Tariff records containing the majority of the Tariff provisions for the two-settlement capacity market design, to become effective June 1, 2018, the start of the Capacity Commitment Period associated with FCA 9.

III. Notice of Filing, Interventions, Comments, Protests, and Answers

8. Notice of the compliance filing was published in the *Federal Register*, 79 Fed. Reg. 42,782 (2014), with interventions and protests due on or before August 4, 2014. Numerous entities filed interventions.[17]

9. Timely filed protests or comments were submitted by Northeast Utilities, Connecticut and Rhode Island,[18] NEPOOL, Public Systems, Brookfield, First Wind, NESCOE, NEPGA and EPSA, PSEG Companies, and RENEW. On August 6, 2014, Verso submitted comments out-of-time.

10. On August 15, 2014, ISO-NE filed an answer to the protests. On August 28, 2014, NEPOOL filed an answer to ISO-NE's answer.

IV. Discussion

A. Procedural Matters

11. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2014), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

12. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2014), we will grant Verso's late-filed comments given its interests in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

[17] *See* Appendix A.

[18] Connecticut and Rhode Island consist of the Connecticut Public Utilities Regulatory Authority; the Connecticut Office of Consumer Counsel; George Jepsen, Attorney General for the State of Connecticut; the Connecticut Department of Energy and Environmental Protection; and the Rhode Island Public Utilities Commission.

13. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2014), prohibits an answer to an answer or protest unless otherwise ordered by the decisional authority. We will accept the answers filed in this proceeding because they provided information that assisted us in our decision-making process.

B. Substantive Matters

1. Higher Reserve Constraint Penalty Factors

a. ISO-NE's Compliance Proposal

14. As directed in the May 30, 2014 Order, ISO-NE proposes to increase the Reserve Constraint Penalty Factor for 30-Minute Operating Reserves from $500/MWh to $1,000/MWh, and to increase the Reserve Constraint Penalty Factor for 10-Minute Non-Spinning Reserves from $850/MWh to $1,500/MWh. ISO-NE requests an effective date of December 3, 2014 for the increased Reserve Constraint Penalty Factors. ISO-NE states that this effective date coincides with the planned implementation date for the energy market offer flexibility changes approved by the Commission in its October 3, 2013 order.[19] ISO-NE states that the offer flexibility changes and the Reserve Constraint Penalty Factor changes entail a complementary set of system software engineering and testing processes, and making them effective simultaneously will allow for considerable efficiencies. In addition, ISO-NE states that the proposed effective date will provide ISO-NE with sufficient time to implement and test the Reserve Constraint Penalty Factor changes on the new systems being developed to enable offer flexibility, while still ensuring that the higher Reserve Constraint Penalty Factors are in place before the critical winter period begins.[20]

15. ISO-NE explains that it has determined that there are two elements of the capacity market design – the Peak Energy Rent[21] mechanism and the Capacity Performance

[19] *ISO New England Inc. and New England Power Pool*, 145 FERC ¶ 61,014 (2013).

[20] ISO-NE Transmittal at 4-5.

[21] The Peak Energy Rent deduction is an element of the FCM design that is intended to discourage the exercise of market power in the energy market. With Peak Energy Rent, capacity payments are reduced for all generation resources when prices in the energy market go above a certain threshold level (i.e., strike price), which usually occurs when electricity demand is high. The Peak Energy Rent deduction does not affect the incremental incentives to produce energy because a resource's Peak Energy Rent deduction will be the same whether or not it produces energy.

Payment Rate[22] – potentially impacted by the increased Reserve Constraint Penalty Factors, but that each is most appropriately addressed outside the context of this compliance filing. ISO-NE explains that by increasing energy and reserve market revenue, the higher Reserve Constraint Penalty Factors will likely increase the amount of Peak Energy Rent deduction. ISO-NE states that the Commission correctly noted that the Peak Energy Rent deduction does not affect competitive suppliers' incremental incentives to produce energy, and so ruled that the issue is beyond the scope of the present proceeding.[23] ISO-NE states that it initiated a separate stakeholder process in July 2014 to review the Peak Energy Rent mechanism. ISO-NE states that any resulting changes to the capacity market design will be filed separately with the Commission.

16. As to the Capacity Performance Payment Rate, ISO-NE states that the higher Reserve Constraint Penalty Factors may affect the full Capacity Performance Payment Rate. ISO-NE explains that while the Reserve Constraint Penalty Factors are not a direct input into the formula for determining the Capacity Performance Payment Rate, they are a factor that affects certain parameter values used in that calculation. However, ISO-NE claims it is premature to attempt to recalculate the full Capacity Performance Payment Rate based on the higher Reserve Constraint Penalty Factors. ISO-NE states that this is because the full Capacity Performance Payment Rate will not be applicable until the Capacity Commitment Period beginning on June 1, 2024, so it will not be a factor in capacity resources' FCA supply offers until the relevant FCA to be conducted in February 2021. ISO-NE also states that it will review all the inputs into the calculation of the Capacity Performance Payment Rate during the six-year phase-in period, and, as the Tariff states, ISO-NE will file a revised full Capacity Performance Payment Rate, if appropriate.[24] ISO-NE explains that this review will enable ISO-NE to determine the actual effect of the higher Reserve Constraint Penalty Factors, subsequent to their implementation, on the various economic and system parameters used in the full Capacity Performance Payment Rate, rather than make prospective estimates of the presently uncertain impacts on those parameters.

17. ISO-NE states that the implementation of the new Reserve Constraint Penalty Factors does not implicate the appropriateness of the phase-in values of the Capacity Performance Payment Rate that apply prior to the Capacity Commitment Period commencing June 1, 2024. ISO-NE also asserts that the increased Reserve Constraint

[22] The Capacity Performance Payment Rate is an administratively-determined rate specified in ISO-NE's Tariff. As ISO-NE described in its January 17 Filing, the Capacity Performance Payment Rate is designed to achieve its loss-of-load probability standard of "one day in ten years," as described in ISO-NE's Planning Procedure No. 3.

[23] *Id.* at 5 (citing May 30, 2014 Order, 147 FERC ¶ 61,172 at P 110).

[24] ISO-NE Transmittal at 5-6.

Penalty Factors do not heighten the financial risk that capacity sellers face in the FCM during the phase-in period. Therefore, ISO-NE states that it is not necessary to adjust the phase-in values of the Capacity Performance Payment Rate because of the new Reserve Constraint Penalty Factors.[25]

b. Responsive Pleadings

18. Public Systems contends that ISO-NE's response to the May 30, 2014 Order's doubling of the Reserve Constraint Penalty Factors is unreasonable and incomplete. Public Systems states that because the Reserve Constraint Penalty Factors address the same scarcity pricing and performance issues as the two-settlement capacity market design, the Commission recognized that increasing the Reserve Constraint Penalty Factors could affect elements of that market design, including the proper Capacity Performance Payment Rate.[26] Public Systems states that while ISO-NE acknowledges that the Reserve Constraint Penalty Factor changes "potentially implicate" at least two elements of its capacity market design, ISO-NE improperly declines to address either issue at this point.[27] Public Systems argues that higher Reserve Constraint Penalty Factors mean more energy and ancillary service market revenues, which should decrease a new entrant's net cost of new entry. Public Systems notes that while the magnitudes of these changes cannot be known in advance, they can be estimated and modeled. Public Systems contends that because the level of the full Capacity Performance Payment Rate will affect market participants' decisions even in the near term, ISO-NE should ensure that the full Capacity Performance Payment Rate on file now reflects the best possible estimates using current inputs.[28] Public Systems argues that ISO-NE should have responded to the May 30, 2014 Order's decision to increase the Reserve Constraint Penalty Factors by reducing the phased-in Capacity Performance Payment Rate levels commensurately.[29]

19. Public Systems argues that ISO-NE's Compliance Filing fails to identify all the FCM variables affected by increasing the Reserve Constraint Penalty Factors. For instance, Public Systems contends that increasing the Reserve Constraint Penalty Factors should increase the expected energy and ancillary service market revenues for hypothetical and actual new entrants, reducing the revenues they need to receive from the

[25] *Id.* at 6-7.

[26] Public Systems Protest at 8-9.

[27] *Id.* at 9.

[28] *Id.* at 11-12.

[29] *Id.* at 15.

capacity market. Thus, Public Systems argues that the Commission should direct ISO-NE to update the Offer Review Trigger Prices and Net Cost of New Entry values incorporated into the system-wide demand curve, to reflect the increased Reserve Constraint Penalty Factors, before the next FCA is held.[30]

20. Connecticut and Rhode Island contend that the Commission's May 30, 2014 Order violates the Due Process Clause and the Administrative Procedure Act (APA) because, according to Connecticut and Rhode Island, it gave parties no notice of the Commission's intention to combine ISO-NE's section 205 proposal with aspects of NEPOOL's section 205 proposal. Connecticut and Rhode Island argue that these procedural failures deprive the Commission of the evidentiary record that it must have to determine that the combination of the two-settlement capacity market design and higher Reserve Constraint Penalty Factors produces a just and reasonable result. Contending that the combined design will raise shortage prices to unprecedented levels,[31] Connecticut and Rhode Island state that ISO-NE offers no testimony or other evidence as part of its compliance filing that could justify the combined approach. Therefore, Connecticut and Rhode Island argue that the Commission cannot meet its burden under section 206 of establishing that the Commission-directed rule revisions submitted by ISO-NE constitute a just and reasonable replacement for the previous shortage-pricing mechanism.

21. Connecticut and Rhode Island contend that if the Commission accepts ISO-NE's explanation that it is necessary to delay assessment of the full Capacity Performance Payment Rate so that it can collect data and perform a study based on the actual effects of the increased Reserve Constraint Penalty Factors, there is no basis to implement phased-in performance incentives. Connecticut and Rhode Island note that the same data showing the actual impact of higher Reserve Constraint Penalty Factors will be equally essential to determining the justness and reasonableness of the phase-in Capacity Performance Payment Rate values. Therefore, Connecticut and Rhode Island argue, the Commission has been provided with no basis to find that either the full Capacity Performance Payment Rate or the phase-in Capacity Performance Payment Rate values are just and reasonable.[32]

22. Connecticut and Rhode Island state that ISO-NE's proposal to integrate higher Reserve Constraint Penalty Factors into its Tariff without any alteration of Capacity Performance Payment Rates is flawed for two reasons. First, Connecticut and Rhode Island assert that, under both the "correct" expected value of lost load and ISO-NE's "erroneous" cost of new entry metrics, implementing the Commission-initiated program

[30] *Id.* at 15-16.

[31] Connecticut and Rhode Island Protest at 2.

[32] *Id.* at 9.

as ISO-NE proposes will produce combined shortage pricing rate structures that will cause market-wide inefficiencies and drive up customer charges substantially beyond the zone of reasonableness. Second, Connecticut and Rhode Island state that, although the higher Reserve Constraint Penalty Factors create new revenue opportunities for generators, ISO-NE has not recalibrated the dynamic de-list bid threshold, originally proposed at $3.94 per kW-month, to reflect the increased Reserve Constraint Penalty Factors.[33] Connecticut and Rhode Island state that if the Commission decides to proceed with the two-settlement capacity market design, ISO-NE should retain the existing $1.00 per kW-month de-list bid threshold.[34] However, Connecticut and Rhode Island urge the Commission to refrain from implementing the two-settlement capacity market design and order ISO-NE to implement only the higher Reserve Constraint Penalty Factors.

c. Commission Determination

23. We accept ISO-NE's Tariff provisions regarding the increased Reserve Constraint Penalty Factors that ISO-NE filed in Docket No. ER14-2419-000 with an effective date of December 3, 2014, as requested. ISO-NE's Tariff revisions increase the Reserve Constraint Penalty Factor for 30-Minute Operating Reserves from $500/MWh to $1,000/MWh, and increase the Reserve Constraint Penalty Factor for 10-Minute Non-Spinning Reserves from $850/MWh to $1,500/MWh. We find that these Tariff revisions comply with the Commission's compliance directive in the May 30, 2014 Order. Further, accepting the Tariff revisions with the December 3, 2014 effective date, as ISO-NE requests, will allow ISO-NE to more efficiently make the complementary set of software changes necessary to implement the new Reserve Constraint Penalty Factor values and the energy market offer flexibility changes, while also making the new values effective in sufficient time to enhance near-term resource performance incentives prior to the critical winter period.[35]

24. We also accept ISO-NE's proposal to retain the Capacity Performance Payment Rate and the dynamic de-list bid threshold at the levels that ISO-NE originally proposed in the January 17 Filing. With respect to the full Capacity Performance Payment Rate, which will not go into effect until FCA 15 for the 2024-2025 Capacity Commitment Period, we agree with ISO-NE that it is appropriate to review the $5,455/MWh rate after ISO-NE has additional information on the effects of the higher Reserve Constraint Penalty Factors on the Capacity Performance Payment Rate calculation. Given that the Reserve Constraint Penalty Factors have only an indirect impact on certain parameters

[33] *Id.* at 10.

[34] *Id.* at 17-18.

[35] May 30, 2014 Order, 147 FERC ¶ 61,172 at PP 108-109.

used to calculate the Capacity Performance Payment Rate, which may or may not change the full Capacity Performance Payment Rate depending on whether and how other inputs change, we agree with ISO-NE that it is appropriate to make any necessary adjustments to the full $5,455/MWh rate based on the increased Reserve Constraint Penalty Factors' actual impacts on system parameters. This approach is consistent with the Tariff provisions the Commission directed in the May 30, 2014 Order, and that we accept here, which require ISO-NE to review the Capacity Performance Payment Rate with stakeholders, after all parties gain experience with the two-settlement capacity market design, and to file a new Capacity Performance Payment Rate if a change to that rate is appropriate.[36]

25. With respect to the initial two Capacity Performance Payment Rates of $2,000/MWh and $3,500/MWh, no party has submitted evidence that these rates are inappropriate due to the higher Reserve Constraint Penalty Factors that the Commission directed in the May 30, 2014 Order. As ISO-NE explains, these phase-in values were chosen as a way of reducing capacity suppliers' financial risk and uncertainty during the initial years of the new two-settlement capacity market design. As ISO-NE stated in the January 17 Filing, the $2,000/MWh and $3,500/MWh rates were not calculated values, but rather were chosen because they are roughly one-third and two-thirds, respectively, of the calculated $5,455/MWh rate.[37] While ISO-NE acknowledges that the increased Reserve Constraint Penalty Factors may have an indirect effect on the full Capacity Performance Payment Rate, there is no evidence that this effect would yield a Capacity Performance Payment Rate that is less than either $3,500/MWh or $2,000/MWh. Further, we note that multiple parties in this proceeding, including both ISO-NE and NEPOOL, have acknowledged that the performance incentive provided by the higher Reserve Constraint Penalty Factors is significantly less than the incentive provided by the Capacity Performance Payments in the two-settlement capacity market design.[38] Absent evidence to the contrary, we conclude that it is improbable that the higher Reserve Constraint Penalty Factors, and associated performance incentive, necessitate Capacity

[36] *See* Tariff § III.13.7 Performance, Payments and Charges in the FCM (30.0.0) at III.13.7.2.5 ("The ISO shall review the Capacity Performance Payment Rate in the stakeholder process as needed and shall file with the Commission a new Capacity Performance Payment Rate if and as appropriate.")

[37] Testimony of Matthew White in January 17 Filing at 113.

[38] ISO-NE, Tariff Filing, Docket Nos. ER14-1050-000, et al., at 27 (filed Jan. 17, 2014); NEPOOL, Comments, Docket Nos. ER14-1050-000, et al., at 28 (filed Feb. 12, 2014); Massachusetts Department of Public Utilities and New Hampshire Public Utilities Commission, Comments, Docket Nos. ER14-1050-000, et al., at 15, 17-18 (filed Feb. 11, 2014).

Performance Payment Rates that are lower than the $2,000/MWh and $3,500/MWh phase-in values. Therefore, we agree with ISO-NE that these values do not need to be adjusted at this time as a result of the increased Reserve Constraint Penalty Factors.[39]

26. Protestors argue that ISO-NE has failed to offer an evidentiary basis for retaining the dynamic de-list bid threshold[40] of $3.94 per kW-month in light of the increased Reserve Constraint Penalty Factors, and that the Commission should therefore retain the existing dynamic de-list bid threshold of $1.00 per kW-month. We disagree. Connecticut and Rhode Island assert that the increased Reserve Constraint Penalty Factors will affect three inputs in the formula for calculating the dynamic de-list bid threshold—the Capacity Performance Payment Rate, the expected Capacity Balancing Ratio, and the expected hours of Capacity Scarcity Conditions.[41] We find Connecticut and Rhode Island's assertions regarding these inputs to be speculative and unsupported. While a change in the Capacity Performance Payment Rate could necessitate a change in the dynamic de-list bid threshold, no such change is warranted in this proceeding given our finding, explained above, that the $2,000/MWh Capacity Performance Payment Rate

[39] Similarly, while ISO-NE states that the higher Reserve Constraint Penalty Factors may impact the Peak Energy Rent mechanism, we reiterate that the potential inefficiency created by the Peak Energy Rent mechanism exists independent of the increase to the Reserve Constraint Penalty Factors and does not affect competitive suppliers' incremental incentives to produce energy. *See* May 30, 2014 Order, 147 FERC ¶ 61,172 at P 110. Accordingly, we agree with ISO-NE that reconsideration of the Peak Energy Rent mechanism would be more appropriately conducted separate from the instant proceeding, and we note that ISO-NE has already commenced a separate stakeholder process for that purpose.

[40] In the January 17 Filing, ISO-NE explained the following with respect to the dynamic de-list bid threshold: "In the current FCM, there are two types of de-list bids that enable a resource to leave the capacity market for a single Capacity Commitment Period. Resources that wish to leave the market at prices equal to or above $1.00/kW-month must submit Static De-List Bids in advance of the [FCA] for review by the [Internal Market Monitor]. If resources wish to leave the market at prices below $1.00/kW-month, they may submit a Dynamic De-List Bid during the Forward Capacity Auction without review by the [Internal Market Monitor]...The Dynamic De-List Bid threshold should be set at the level of a competitive offer into the FCM. If a resource bids competitively, there is no need for the [Internal Market Monitor] to review its offer. However, if a resource bids above competitive levels, it may be attempting to exercise market power and its de-list bid should be reviewed." January 17 Filing, Testimony of David LaPlante and Seyed Parviz Gheblealivand at 53-54.

[41] Connecticut and Rhode Island Protest at 17.

used to calculate the $3.94/kW-month does not need to be changed as a result of the increased Reserve Constraint Penalty Factors.

27. As for the expected Capacity Balancing Ratio input in the formula for the dynamic de-list bid threshold, Connecticut and Rhode Island's expert witness states that the higher Reserve Constraint Penalty Factors' "enhanced incentives to cure shortages, when they occur at peak times," will reduce the average Capacity Balancing Ratio.[42] Similarly, with respect to the expected hours of Capacity Scarcity Conditions, Connecticut and Rhode Island's expert witness states that the number of hours "can reasonably be expected to fall, particularly initially."[43] However, the record reflects no support for either of these conclusory statements. While these inputs to the formula for calculating the dynamic de-list bid threshold could change as a result of the increased Reserve Constraint Penalty Factors,[44] Connecticut and Rhode Island's conclusory assertions about these formula inputs alone provide insufficient basis to conclude that the dynamic de-list bid threshold must be changed, or that the existing $1.00/kW-month threshold would be appropriate under the two-settlement capacity market design.

28. For these reasons, we are not persuaded that a revision to the dynamic de-list bid threshold of $3.94/kW-month is warranted at this time. We note that, pursuant to the Tariff, the dynamic de-list bid threshold is recalculated no less often than once every three years and the recalculation results must be filed with the Commission after the Internal Market Monitor reviews the results with stakeholders.[45]

29. Furthermore, we are not persuaded by arguments that ISO-NE should also reassess certain other FCM-related values, including Offer Review Trigger Prices, Cost of New Entry, and Net Cost of New Entry, in light of the higher Reserve Constraint Penalty Factors. The Tariff sets forth a process by which the increased Reserve Constraint Penalty Factors will be reflected in these other FCM-related values. Pursuant to the Tariff, Offer Review Trigger Prices are recalculated using updated data no less often

[42] *Id.* at Att. A, 23-24.

[43] *Id.* at Att. A, 24.

[44] We note that any potential impacts the increased Reserve Constraint Penalty Factors might have on the expected Capacity Balancing Ratio and expected number of hours of Capacity Scarcity Conditions would be indirect, thereby rendering those alleged impacts particularly speculative in the absence of supporting evidence.

[45] Tariff § III.13.1, III.13.1 Forward Capacity Auction Qualification (26.0.0) at III.13.1.2.3.1.A.

than once every three years,[46] and updates to the Cost of New Entry and Net Cost of New Entry are recalculated using updated data coincident with that process.[47] In addition, during years in which ISO-NE does not recalculate the Offer Review Trigger Prices, Cost of New Entry, and Net Cost of New Entry, ISO-NE adjusts these values by updating inputs to the capital budgeting model on which they are based. The model inputs are updated with current industry index values,[48] including Massachusetts Hub On-Peak electricity prices and futures prices.[49] Because these hub prices will reflect the increased Reserve Constraint Penalty Factors, the adjusted Offer Review Trigger Prices, Cost of New Entry, and Net Cost of New Entry will also, over time, reflect the revenue impact of the increased Reserve Constraint Penalty Factors on capacity suppliers. Given these well-established, Commission-approved processes for updating Offer Review Trigger Prices, Cost of New Entry, and Net Cost of New Entry, we will not at this time direct an additional update as part of this proceeding.

30. As to Connecticut and Rhode Island's arguments that the Commission violated parties' due process rights by directing ISO-NE to implement both the increased Reserve Constraint Penalty Factors and the two settlement capacity market design, and that the Commission lacked sufficient evidence to determine that such a combination would

[46] Tariff at Appendix A, Appendix A Market Monitoring, Reporting and Market Power Mit (35.0.0) at III.A.21.1.2.

[47] *Id.* § III.13.2 Annual Forward Capacity Auction (25.0.0) at § III.13.2.4.

[48] *Id.* at Appendix A, Appendix A Market Monitoring, Reporting and Market Power Mit. (35.0.0) at III.A.21.1.2(e); *id.* § III.13.2 Annual Forward Capacity Auction (25.0.0) at III.13.2.4.

[49] *Id.* at Appendix A, Appendix A Market Monitoring, Reporting and Market Power Mit (35.0.0) at III.A.21.1.2(e)(4) ("The energy and ancillary services offset values…shall be adjusted by inputting to the capital budgeting model the most recent Henry Hub natural gas futures prices…and the Massachusetts Hub On-Peak electricity prices and the Algonquin City Gates natural gas prices for the 12 months following the time of the update…"); *id.* § III.13.2 Annual Forward Capacity Auction (25.0.0) at III.13.2.4 ("Between recalculations, [Cost of New Entry] and Net [Cost of New Entry] will be adjusted for each Forward Capacity Auction pursuant to Section III.A.21.1.2(e), except that the energy and ancillary services offset will be adjusted using publicly available data for [Massachusetts] Hub On-Peak electricity futures through the commitment period of the FCA and will not be adjusted based on natural gas prices.").

produce just and reasonable rates, we find those arguments to be unrelated to compliance and more appropriately raised on rehearing.[50]

2. Treatment of Energy Efficiency Resources and Non-Substantive Changes

a. ISO-NE's Compliance Proposal

31. ISO-NE proposes to add Tariff provisions that ensure that energy efficiency resources' Capacity Performance Payments are calculated only for Capacity Scarcity Conditions during hours in which demand reduction values are calculated under the Tariff for that particular type of resource. Specifically, ISO-NE proposes that the Capacity Performance Score for an energy efficiency resource be set to zero during any Capacity Scarcity Condition outside of the resources' measured hours. However, ISO-NE explains that because a single demand resource may be composed of both energy efficiency assets and other asset types, it is important that only the performance score of any energy efficiency assets – not the entire demand resource – be set to zero if the Capacity Scarcity Condition occurred outside of the applicable measure hours. Therefore, ISO-NE proposes Tariff language stating that "the Actual Capacity Provided[51] and Capacity Supply Obligation associated with any Energy Efficiency Demand Response Asset shall be excluded from the calculation of the resource's Capacity Performance Score."[52]

---

[50] We note that Connecticut and Rhode Island have, in fact, raised these same arguments in their request for rehearing of the May 30, 2014 Order. *See* Connecticut and Rhode Island, Request for Rehearing, Docket Nos. ER14-1050-000, ER14-1050-001, and EL14-52-000, at 6-7 (filed June 30, 2014). Accordingly, the Commission will address those arguments in its order on rehearing of the May 30, 2014 Order.

[51] Actual Capacity Provided varies by resource, but, generally, for a Generating Capacity Resource, it refers to the sum of the resource's output, plus the resource's Real-Time Reserve Designation, during a Capacity Scarcity Condition; for an Import Capacity Resource, it refers to net energy delivered. The resource's performance payment during any reserve deficiency interval is determined by comparing its Actual Capacity Provided during that interval to its share-of-system obligation during that interval. If the two quantities are equal, the resource earns zero performance payment during that interval. If its Actual Capacity Provided is greater than or less than its share-of-system obligation, it is paid or charged, accordingly, the difference at the administratively-set Capacity Performance Payment Rate, which is initially $2,000/MWh.

[52] ISO-NE Transmittal at 7.

32. ISO-NE also refiled the Tariff provisions the Commission directed ISO-NE to resubmit in order to implement the two-settlement capacity market design, but ISO-NE proposes three minor, non-substantive changes. First, ISO-NE states that a provision in the new design that allows a resource to opt out of a previous multi-year commitment period election is being revised to include a new deadline for the ninth FCA because the previously included deadline passed before the submission of the Compliance Filing. Second, ISO-NE states that two references to the date on which the Tariff revisions were filed are being updated. Third, ISO-NE states that the Tariff changes here incorporate language changes approved by the Commission in its recent order on the sloped demand curve for the FCM.[53]

b. Commission Determination

33. We accept, subject to condition, ISO-NE's Tariff provisions, including the non-substantive changes, concerning the Tariff definitions and FCM rules that ISO-NE submitted in Docket No. ER14-2419-000, to become effective June 9, 2014, as requested. Further, with the exception of Tariff section III.13.7, which we reject as discussed below,[54] we accept, subject to condition, the Tariff revisions ISO-NE filed in Docket No. ER14-2419-001, including ISO-NE's compliance proposal with respect to treatment of energy efficiency resources, to become effective June 1, 2018, as requested. We direct ISO-NE to submit a further compliance filing revising Tariff section III.13.7, as discussed below.[55] A Capacity Performance Score of zero during a particular time interval ensures that a resource will not be subject to Capacity Performance Payments if a Capacity Scarcity Condition occurs during that time interval. Therefore, ISO-NE's proposal to set the Capacity Performance Score at zero for an energy efficiency resource during any Capacity Scarcity Condition outside of the resource's measured hours ensures that energy efficiency resources will not be subject to Capacity Performance Payments outside those resources' measured hours. Further, we agree with ISO-NE that, because a single demand resource with a Capacity Supply Obligation may be composed of both energy efficiency assets and other asset types, it is appropriate to set only the Capacity Performance Score of the energy efficiency portion of the resource equal to zero. We therefore find that ISO-NE's proposed treatment of energy efficiency resources complies with the Commission's directive in the May 30, 2014 Order.

---

[53] *Id.* at 2-3 (citing *ISO New England Inc. and New England Power Pool Participants Committee*, 147 FERC ¶ 61,173 (2014)).

[54] *See infra* P 56.

[55] *See* Appendix B for details on which Tariff sections we accept, reject, and accept subject to condition in this order.

3. Improper Price Signals Caused by Intra-Zonal Transmission Constraints

a. ISO-NE's Compliance Proposal

34. ISO-NE states that the Commission correctly noted that during Capacity Scarcity Conditions resources on the export side of a binding intra-zonal transmission constraint could have an incentive to submit energy offer prices below their actual marginal operating costs in order to maximize their Capacity Performance Payments. ISO-NE states that those offer prices would be designed to maximize the resource's dispatch for energy, beyond the useful or efficient amount that could be delivered to the import side of the constraint.

35. ISO-NE states that an exemption is not necessary to address the improper price signal problem, however, because it can be addressed by other means and without the inefficiencies that an exemption would produce. Specifically, ISO-NE states that, while an exemption would eliminate the improper incentive the Commission identified in the energy market, it would introduce improper price signals into the FCM because a resource on the export side of a binding intra-zonal transmission constraint would not need to incorporate into its capacity offer price the potential for negative Capacity Performance Payments when it does not perform up to its share-of-system obligation due to the transmission constraint. Therefore, ISO-NE states that an exemption may enable resources that expect to perform relatively poorly, whether due to transmission constraints or merely contemporaneously with transmission constraints, to submit lower offer prices in the FCA than resources with similar characteristics but that are not located on the same side of an intra-zonal transmission constraint. According to ISO-NE, the exemption would also create a perverse incentive for resources to benefit from locating in the weakest parts of the New England transmission system, where their capacity is less useful. ISO-NE states that this would result in less reliable resources clearing the FCA, thereby reducing the reliability of the system.

36. ISO-NE states that rather than wholly exempt a resource on the export side of a binding intra-zonal constraint from being subject to Capacity Performance Payments, those payments should instead be adjusted when binding intra-zonal transmission constraints occur during Capacity Scarcity Conditions to eliminate any incentive to offer inefficiently in the energy market, while preserving an appropriate deduction from the resource's Capacity Base Payment for non-performance during Capacity Scarcity Conditions.[56] To accomplish this, ISO-NE proposes that resources on the export side of an intra-zonal constraint should not be credited (for Capacity Performance Payment

[56] ISO-NE notes that the capacity clearing price will compensate resources on the export side for accepting an obligation to perform during Capacity Scarcity Conditions that affect the import side.

purposes) for any *energy* generated during a reserve deficiency if that energy cannot alleviate the reserve deficiency. However, ISO-NE proposes to credit resources for all *reserves* provided during a reserve deficiency because, according to ISO-NE, additional reserves typically can help alleviate a reserve deficiency, even when those reserves are being provided on the export side of the constraint. ISO-NE explains that in such situations energy is not scarce on the export side of the intra-zonal constraint, but reserves are scarce at the zonal level, including on the export side of the constraint.

37. ISO-NE proposes to determine whether additional energy can help alleviate a particular reserve deficiency by looking at whether a Reserve Constraint Penalty Factor is reflected in the locational marginal price (LMP) at the generation node where a resource is located. ISO-NE explains that if the additional energy supply capability on the export side of the constraint would not enable generation to be re-dispatched to provide additional reserves that alleviate the zonal condition, then the additional energy is not useful and the LMP would not include the Reserve Constraint Penalty Factor.[57] Thus, if the LMP includes the Reserve Constraint Penalty Factor during the interval, additional energy is beneficial; if the LMP does not include the Reserve Constraint Penalty Factor additional energy is not beneficial. ISO-NE refers to this indicator as a Reserve Constraint Penalty Factor Nodal Impact Test (Nodal Impact Test).[58]

38. Under ISO-NE's proposal, if the Nodal Impact Test shows that there is no scarcity price signal in the LMP for energy at a resource's node during the reserve deficiency, then the resource's Actual Capacity Provided[59] will be equal to the resource's Real-Time Reserve Designation, i.e., the amount of reserves the resource is providing. In other words, the amount of energy the resource is providing will be treated as zero for the purpose of calculating the resource's Actual Capacity Provided. ISO-NE states that, under this proposal, it could be possible for a resource on the export side of a binding constraint to have a real-time energy output that exceeds the resource's share-of-system forward obligation, but its energy output will be treated as zero in calculating the resource's Actual Capacity Provided if ISO-NE determines that the energy the resource is providing is not helpful in alleviating the reserve deficiency. As a result, this resource may receive negative Capacity Performance Payments despite providing more than its share-of-system forward obligation. However, as noted above, if the resource is providing reserves, those reserves will count toward its Actual Capacity Provided.[60] ISO-NE notes that the payment for reserves does not create an incentive for the resource

[57] Transmittal at 16.

[58] *Id.* at 20.

[59] *See supra* n. 51.

[60] ISO-NE Transmittal at 24.

to submit an energy market supply offer below its marginal cost. ISO-NE states that in the energy and reserves markets, there are no market offers to supply reserves; rather, the energy supply offer price is used to determine the unit's co-optimized energy dispatch and/or reserves assignment.

b. Responsive Pleadings

39. Several protesters contend that ISO-NE's compliance proposal should be rejected, arguing that it does not comply with the Commission's directive to provide an exemption or explain why an exemption is not necessary to address the inefficient incentives the Commission identified.[61] Protesters also contend that the Commission should order ISO-NE to provide an exemption from Capacity Performance Payments for resources on the export side of an intra-zonal transmission constraint during Capacity Scarcity Conditions, as directed in the May 30, 2014 Order.[62] NEPOOL notes that ISO-NE's compliance proposal received no support in the stakeholder process.[63]

40. Several protesters contend that ISO-NE's compliance proposal produces discriminatory, illogical and unreasonable results. For instance, protesters contend that ISO-NE's compliance proposal would impose penalties on resources that are actually performing, or perhaps even over-performing, consistent with their obligation.[64] Protesters argue that this treatment violates the premise underlying the two-settlement capacity market design that "resources that provide more energy and reserves should be paid more."[65] RENEW contends that ISO-NE has proposed a significant market design change from ISO-NE's original two-settlement capacity market design, based on assumptions presented for the first time in the compliance filing and without stakeholder scrutiny.[66] Several protesters also note that, although an intra-zonal constraint may limit the deliverability of the energy over the intra-zonal constraint, it does not negate the

[61] RENEW Protest at 3, First Wind Protest at 7, PSEG Companies Protest at 5-6.

[62] NEPOOL Protest at 1-3 (citing May 30, 2014 Order, 147 FERC ¶ 61,172 at P 67, Brookfield Protest at 14-15, NEPGA and EPSA Protest at 4, PSEG Companies Protest at 3-6, Northeast Utilities Protest at 3, Verso Comments at 10).

[63] NEPOOL Protest at 1.

[64] NEPOOL Protest at 6-7, PSEG Companies Protest at 6-7, NEPGA and EPSA Protest at 8, Brookfield Protest at 2, First Wind Protest at 2-3.

[65] NEPGA and EPSA Protest at 6, PSEG Companies Protest at 7-9, RENEW Protest at 11, First Wind Protest at 13, NEPOOL Protest at 13-14.

[66] RENEW Protest at 15-16.

valuable contribution that the energy provides to the capacity zone and to the reduction of the severity of the deficiency triggering the Capacity Scarcity Condition.[67]

41. Public Systems disputes ISO-NE's assertion that an exemption encourages resources to locate in weaker areas of the transmission system. Public Systems contends that exempting resources due to transmission constraints avoids an unfair disadvantage and puts the exempt resources in a position no better than resources that do not face the constraint. Public Systems further contends that an exemption avoids discouraging resources to locate where the transmission system is weakest, which Public Systems asserts is beneficial because local generation resources tend to be needed most where the transmission system is weakest.[68] Public Systems and First Wind note that ISO-NE's resource qualification and interconnection study processes – which include analyses of overlapping impacts of multiple new resources – should help to ensure that new capacity resources bolster rather than weaken the transmission system.[69]

42. Brookfield argues that under ISO-NE's compliance proposal resources would have an incentive to deviate from dispatch instructions because they are rewarded for providing reserves and penalized for providing energy. In addition, several protesters argue that ISO-NE's different treatment of energy and reserves could lead to inefficient behavior, such as resources reducing their output to relieve the constraint, submitting offers above their marginal costs in order to ensure that they are not dispatched for energy, or otherwise failing to follow dispatch instructions.[70]

43. Northeast Utilities contends that the proposal is based on the incorrect assumption that reserves in an export-constrained area are deliverable to import-constrained areas when the reserves are converted to energy to replace an energy-producing resource within the import-constrained area that has gone offline. Northeast Utilities asserts that ISO-NE's reasoning that all energy produced on the export side of a constraint has no value leads to the illogical result that reserves in the export-constrained area that replace a non-performing resource in the import-constrained area also should have no value. Northeast Utilities explains that this is because once the reserves are converted to energy,

[67] NEPGA and EPSA Protest at 7-8, Brookfield Protest at 10-11, First Wind Protest at 14-15.

[68] Public Systems Protest at 20-21.

[69] *Id.*, First Wind Protest at 19-20.

[70] Brookfield Protest at 14-15, NEPGA and EPSA Protest at 7-8, RENEW Protest at 14-15, Northeast Utilities Companies Protest at 2-3.

the revised Capacity Performance Payment calculation would set the energy value to zero.[71]

44. Several protesters argue that ISO-NE's compliance proposal discriminates against resources on the export side of an intra-zonal transmission constraint, and in favor of resources on the export side of an inter-zonal constraint.[72] RENEW and NEPGA and EPSA contend that regardless of whether a resource is on the export side of a binding intra- or inter-zonal transmission constraint, the energy it provides to relieve a Capacity Scarcity Condition will be limited, not eliminated, by the constraint.[73] RENEW states that resources behind an intra- or inter-zonal transmission constraint should be given equal credit for the amount of energy (and corresponding reliability benefit) they provide to the capacity zone to relieve a Capacity Scarcity Condition. RENEW also argues that the mere fact that price separation for resources on the export side of an intra-zonal transmission constraint is reflected in the energy market, rather than in the FCA clearing price, as occurs with price separation for resources on the export side of an inter-zonal transmission constraint, does not justify subjecting significant penalties on the former.[74]

45. NEPOOL argues that ISO-NE's compliance proposal is an out-of-time challenge to the Commission's requirements and is an effort to impose, without following NEPOOL and Commission processes, unilateral tariff changes that are not required by the May 30, 2014 Order and go well beyond the Commission's compliance directive. NEPOOL states that the proper procedure for ISO-NE to go beyond the compliance directive is to submit such changes under section 205 of the FPA. NEPOOL contends that ISO-NE's compliance proposal, if accepted by the Commission, would circumvent NEPOOL's rights to have a NEPOOL-supported alternative proposal considered on equal footing with one proposed by ISO-NE and would undermine the incentive for ISO-NE to meaningfully engage and collaborate with market participants.[75]

---

[71] Northeast Utilities Protest at 2-3.

[72] Brookfield Protest at 12-13, RENEW Protest at 7, NEPGA and EPSA Protest at 12-13.

[73] RENEW Protest at 10, NEPGA and EPSA Protest at 12-13.

[74] RENEW Protest at 10.

[75] NEPOOL Protest at 12-13.

46. Verso states that ISO-NE's proposal would subject Verso to negative Capacity Performance Payments based on circumstances that Verso has no ability to anticipate, control, or fix, and that are not Verso's fault. For example, Verso argues that it is fundamentally unfair to be assessed a negative Capacity Performance Payment because of the actions of third parties causing constraints. Verso states that it has no tools to avoid negative Capacity Performance Payments and argues that the Commission has stated that market participants must be given the tools to avoid or reduce penalties if such tools do not reduce system reliability.[76]

47. RENEW and First Wind further argue that an exemption is not necessary. First Wind explains that it would be extraordinarily risky for a resource to offer below its marginal operating costs. For example, First Wind states that resources with a Capacity Supply Obligation are required to submit their offers into the day ahead market, and when making such offers could not in any reliable fashion predict whether a Capacity Scarcity Condition would occur on the operating day, or the actual hours when it might occur.[77] In addition, First Wind notes that if binding transmission constraints were consistent and predictable so far in advance, ISO-NE should create a new zone.[78]

48. First Wind contends that the Commission should conclude that an exemption is not required and should not entertain ISO-NE's compliance proposal or any other variations because, even if less harsh than ISO-NE's compliance proposal, they would be similarly flawed. First Wind states that, if the Commission concludes that some procedure is required as a last line of defense against resources offering below their marginal cost in order to increase Capacity Performance Payments, the Commission could require ISO-NE to limit the performance credit for resources located on the export side of an intra-zonal constraint to the level at which such resource was performing in the hour prior to the commencement of the Capacity Scarcity Condition. While First Wind does not believe ISO-NE's compliance proposal or an alternative proposal based on such proposal should be accepted, First Wind states that the Commission should ensure that resources be credited under the two-settlement capacity market design for the energy that they deliver during Capacity Scarcity Conditions.[79]

---

[76] Verso Comments at 7-8 (citing *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,091, at 31,308 (2000)).

[77] First Wind Protest at 11-12.

[78] *Id.* at 19.

[79] *Id.* at 21.

49. RENEW argues that ISO-NE's compliance proposal will frustrate state renewable energy and global warming solutions policies by raising costs. Specifically, RENEW argues that ISO-NE's compliance proposal will undermine energy efficiency and frustrate state policies by devaluing generation resources including wind power and other renewable power. RENEW asserts that the wind resources are most likely to be the most efficiently priced and most competitive resources behind the transmission constraints given that they make use of free fuel.[80]

50. NESCOE requests additional time to consider ISO-NE's compliance proposal and potential alternatives. NESCOE explains that market participants have only had one meeting to evaluate the change in expected FCM outcomes. NESCOE notes that there may be unintended consequences from ISO-NE's compliance proposal that warrant further consideration, especially as they relate to existing resources that have already submitted their offers for the upcoming FCA.[81]

c. ISO-NE Answer

51. ISO-NE states that, contrary to protesters' assertions, the compliance proposal is not inefficient and does not lead to anomalous results, and it in no way constitutes a penalty. ISO-NE reiterates that in a fully functioning and uncapped energy market, a resource would not earn scarcity revenue for the energy it provides on the export side of a binding intra-zonal transmission constraint. ISO-NE explains that its compliance proposal to the short-term price signal problem accomplishes exactly the same thing, in the context of the two-settlement capacity market design. ISO-NE states that what protesters decry as a penalty is not a penalty because the Capacity Base Payment is a prepayment for energy and reserves to be delivered during Capacity Scarcity Conditions, and deducting a portion of this prepayment when the scarcity price signal in the energy market at the resource's location is zero ensures that the capacity market does not provide a financial reward, on balance, in circumstances where the appropriate scarcity price for energy is zero. ISO-NE explains that by eliminating a financial gain for selling energy to be delivered during scarcity, when the appropriate price for energy at the resource's location turns out to be zero, its proposal avoids creating a damaging incentive for resources to locate in weak areas of the transmission system where their capacity may be of limited use, which it contends is a problem that would be worse than the short-term inefficiency the Commission directed ISO-NE to address.

[80] RENEW Protest at 17-18.

[81] NESCOE Comments at 5-7.

52. In response to arguments that its proposal will lead to unfair or illogical outcomes, ISO-NE explains that under the circumstances identified, the appropriate scarcity price signal for energy is zero. ISO-NE contends that protesters' assertions that the two-settlement capacity payments should value energy provided at a price greater than zero, when the appropriate scarcity price signal is actually zero, defies logic as well as sound market design.[82] ISO-NE notes protesters' concern that its proposal can lead to circumstances where a transmission limit is minor, so a resource delivers energy at or close to its full Capacity Supply Obligation, and yet will receive a net negative performance payment. ISO-NE states that this may occur because additional (marginal) energy the resource supplies is not useful in alleviating scarcity due to the transmission constraint, and in the energy market – thus under the two-settlement capacity market design– the resource's appropriate energy scarcity price signal is zero.[83]

53. ISO-NE explains that in discussing the instant compliance filing with stakeholders, it assembled and provided information on the frequency of intra-zonal transmission constraints during past reserve deficiencies. ISO-NE states that the data indicates that past intra-zonal transmission constraints during reserve deficiencies are concentrated at distant areas of the New England power system (primarily in Maine). ISO-NE states that the data is indicative, albeit not dispositive, that a transmission exemption would primarily benefit resources located at the periphery of the transmission system and that are chronically unable to contribute to system reliability during Capacity Scarcity Conditions.[84] ISO-NE argues that a greater proliferation of these overpaid and under-contributing resources in weak areas of the transmission system will not be a cost-effective use of consumer' capacity payments, and may do little to promote reliability.

54. ISO-NE argues that its proposal does not create any incentives to withhold or engage in other negative behaviors. For example, ISO-NE explains that a resource cannot increase its reserve MW assignment by altering its energy price offer, or by deviating from its energy dispatch, because during Capacity Scarcity Conditions the dispatch system has already assigned to the unit the maximum reserves that it can provide – and the maximum reserves for which it will be credited in settlement.[85]

---

[82] ISO-NE Answer at 7.

[83] *Id.* at 9.

[84] *Id.* at 11 (citing Appendix 2 of ISO-NE's presentation posted at: http://www.iso-ne.com/committees/comm_wkgrps/mrkts_comm/mrkts/mtrls/2014/jul89102014/a03_iso_presentation_07_08_14_r2.pptx).

[85] ISO-NE Answer at 16-18.

d. NEPOOL Answer

55. NEPOOL argues that the compliance proposal does not reflect an economically pure design and is unnecessary to achieve efficient market and long-term reliability goals. NEPOOL states that ISO-NE's long-term reliability concerns are only valid if ISO-NE anticipates that it will fail to follow the Tariff requirement that any persistently congested part of the system be defined as a separate capacity zone and/or resolved as appropriate and necessary in the regional system planning process.[86] NEPOOL further argues that if ISO-NE's proposal is a two-settlement market design, then a resource would get credit for all the MWs of energy delivered in real-time at its location. NEPOOL contends that such an outcome is logical since delivery of energy, up to the transmission limit, is valuable because it is flowing through the constraint and helping to meet the need on the other side of the constraint.[87]

e. Commission Determination

56. We reject ISO-NE's compliance proposal concerning improper price signals caused by binding intra-zonal transmission constraints.[88] Further, based on the record now before us, we find that an exemption is not necessary for resources on the export side of an intra-zonal transmission constraint during a Capacity Scarcity Condition. We direct ISO-NE to submit a further compliance filing to revise Tariff section III.13.7 by removing the language in Tariff sections III.13.7.2.2(a) and III.13.7.2.2(b) that reflects this aspect of ISO-NE's instant compliance proposal. In directing the additional compliance filing, we intend for ISO-NE to conform Tariff sections III.13.7.2.2(a) and III.13.7.2.2(b) to the language ISO-NE originally proposed in its January 17 Filing.

57. We find, based on the record before us, that the exemption the Commission identified in the May 30, 2014 Order is not necessary. Although ISO-NE acknowledged in its compliance filing that improper price signals caused by intra-zonal constraints are a problem, ISO-NE also provided additional information that indicates the intra-zonal transmission constraints in the New England region that result in potential problematic improper price signals are of limited geographic scope. Other parties also submitted additional information concerning intra-zonal transmission constraints in the region indicating that the incentive for capacity resources to submit energy market offers below their actual marginal costs is weaker than contemplated by the Commission. Based on this additional evidence provided in this compliance proceeding, we conclude that the

[86] NEPOOL Answer at 6.

[87] *Id.* at 8.

[88] *See supra* PP 36-38.

improper price signal problem the Commission identified in the May 30, 2014 Order is limited in scope.

58. In the May 30, 2014 Order, the Commission specifically explained that the improper price signal caused by intra-zonal transmission constraints is problematic "because it incents a generating resource on the export side of the constraint to submit energy market offer prices that are below its actual marginal operating costs in order to be dispatched at the greatest quantity possible and thereby maximize its Capacity Performance Payment."[89] The evidence provided in this compliance proceeding indicates that this incentive is less of a concern than the Commission understood based on the record in the underlying proceeding.

59. As discussed above, ISO-NE presented information to stakeholders on the frequency of intra-zonal transmission constraints during reserve deficiencies. The information indicates that most generation nodes (nearly 80 percent) were never on the export-side during Reserve Constraint Penalty Factor activations in the 24-month period from June 1, 2012 through May 31, 2014. In addition, as ISO-NE explains in its answer, intra-zonal transmission constraints during reserve deficiencies have historically been concentrated at the periphery of the New England power system, primarily in Maine. Based upon the evidence provided in this compliance proceeding, we conclude that the problem the Commission identified in the May 30, 2014 Order is limited in geographic scope.

60. Furthermore, we agree with RENEW and First Wind that it is unlikely that a resource would attempt to exploit the incentive to offer below its marginal operating costs due to the substantial risk involved in making such an offer under these circumstances. Given the difficulty of predicting the overlapping occurrence and duration of a Capacity Scarcity Condition and an intra-zonal transmission constraint, we are persuaded that it is highly risky for a resource to offer energy into the real-time market at levels that create an operating loss—with the hope that a Capacity Scarcity Condition and intra-zonal transmission constraint will occur simultaneously and last for a sufficient amount of time—and that the resource's Capacity Performance Payments would cover that loss and provide additional revenues.[90] Therefore, we conclude that the incentive for resources to offer below their actual marginal costs is offset by the risks associated with responding to that incentive, and is therefore less of a concern than the Commission considered it to be in the May 30, 2014 Order.

---

[89] May 30, 2014 Order, 147 FERC ¶ 61,172 at P 67.

[90] First Wind Protest at 11.

61. We further agree with protesters' assertions that ISO-NE's Tariff, including the FCM rules and transmission planning procedures, provide mechanisms that help prevent and address (even if they do not fully alleviate) recurring intra-zonal transmission constraints and make it difficult for a resource to anticipate, three years in advance, whether it will be on the export side of an intra-zonal transmission constraint. For example, under the FCM rules, if ISO-NE determines during the FCA qualification process that, due to transmission system limitations, a new resource will be unable to provide the full amount of capacity indicated in its qualification package, ISO-NE can limit the resource's qualified MW of capacity accordingly.[91] Additionally, if an intra-zonal transmission constraint frequently arises in a particular location and is expected to continue, the Tariff requires ISO-NE to consider the constraint in its annual assessment of transmission transfer capability, and possibly create a new capacity zone so the constraint can be modeled in the FCA.[92]

62. In short, the record now indicates that the potential improper price signal problem that the Commission identified in the May 30, 2014 Order is of limited geographic scope and that the incentive for capacity resources to submit energy market offers below their actual marginal costs is weaker than contemplated. We, therefore, find that an exemption is not necessary.

The Commission orders:

(A) ISO-NE's proposed Tariff provisions submitted in Docket No. ER14-2419-000 are hereby accepted, subject to condition, to become effective June 9, 2014 and December 3, 2014, as requested, as discussed in the body of this order.

(B) ISO-NE's Tariff provisions submitted in Docket No. ER14-2419-001 are hereby accepted in part, subject to condition, and rejected in part, with the conditionally accepted provisions to become effective June 1, 2018, as requested, as discussed in the body of this order.

---

[91] Tariff § III.13.1 Forward Capacity Auction Qualification (26.0.0) at III.13.1.1.2.3(b), III.13.1.1.2.5.1; *see also* ISO-NE Planning Procedure No. 10, § 5.6(c) and § 5.7.2 (explaining that ISO-NE can limit a new resource's qualified capacity to an amount that will not diminish the transfer capability across any transmission line below the level of achievable transfers during reasonably stressed conditions, or diminish the reliability or operating characteristics of the New England system).

[92] *See* Tariff § III.12 Calculation of Capacity Requirements (9.0.0) at III.12.4; *id.* at Att. K, Att K Regional System Planning Process (12.0.0) at § 3.1.

(C) ISO-NE is hereby directed to submit a compliance filing, within 30 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

Appendix A

Interventions	
Attorney General for the State of Connecticut	Maine Public Utilities Commission
Brookfield Energy Marketing LP (Brookfield)	New England Power Generators Association, Inc., (NEPGA)
Calpine Corporation *	New England Power Pool Participants Committee (NEPOOL)
Commissioner of the Connecticut Department of Energy and Environmental Protection and Connecticut Public Utilities Regulatory Authority	New England States Committee on Electricity (NESCOE)
Connecticut Office of Consumer Counsel	Northeast Utilities Service Company (Northeast Utilities)
Connecticut Municipal Electric Energy Cooperative, Massachusetts Municipal Wholesale Electric Company, New Hampshire Electric Cooperative, Inc., and Vermont Electric Cooperative (Public Systems)	NRG Companies
Dynegy Marketing and Trade, LLC	PSEG Companies
Electric Power Supply Association (EPSA)	Renewable Energy New England, Inc. (RENEW)
Emera Energy Services, Inc.	Rhode Island Public Utilities Commission
Exelon Corporation	United Illuminating Company
First Wind Energy, LLC (First Wind)	Verso Paper Corp (Verso)
GDF SUEZ	* Denotes out-of-time filing

Appendix B

Tariff sections accepted, rejected, and accepted subject to condition in Docket Nos. ER14-2419-000 and ER14-2419-001.

Docket No. ER14-2419-000 Tariff Sections:

ISO New England Inc.
FERC FPA Electric Tariff
ISO New England Inc. Transmission, Markets and Services Tariff

Disposition	Tariff Section	Effective Date
Conditionally Accept	I.2, I.2 Rules of Construction; Definitions, 64.0.0	6/9/2014
Conditionally Accept	Section III TOC, Section III - Table of Contents, 19.0.0	6/9/2014
Conditionally Accept	III.2, III.2 LMPs and Real-Time Reserve Clearing Prices Calculation, 10.0.0	12/3/2014
Conditionally Accept	III.13.1, III.13.1 Forward Capacity Auction Qualification, 27.0.0	6/9/2014
Conditionally Accept	III.13.2, III.13.2 Annual Forward Capacity Auction, 26.0.0	6/9/2014
Conditionally Accept	III.13.8, III.13.8 Reporting and Price Finality, 11.0.0	6/9/2014

Docket No. ER14-2419-001 Tariff Sections:

ISO New England Inc.
FERC FPA Electric Tariff
ISO New England Inc. Transmission, Markets and Services Tariff

Disposition	Tariff Section	Effective Date
Conditionally Accept	I.2, I.2 Rules of Construction; Definitions, 65.0.0	6/1/2018
Conditionally Accept	Exhibit IA, Exhibit IA ISO-NE Financial Assurance Policy, 32.0.0	6/1/2018
Conditionally Accept	Section III TOC, Section III - Table of Contents, 13.0.0	6/1/2018
Conditionally Accept	III.1, III.1 Market Operations, 19.0.0	6/1/2018
Conditionally Accept	III.13.1, III.13.1 Forward Capacity Auction Qualification, 21.0.0	6/1/2018
Conditionally Accept	III.13.2, III.13.2 Annual Forward Capacity Auction, 18.0.0	6/1/2018
Conditionally Accept	III.13.3, III.13.3 Critical Path Schedule Monitoring, 4.0.0	6/1/2018
Conditionally Accept	III.13.5, III.13.5 Bilateral Contracts in the Forward Capacity Market, 9.0.0	6/1/2018
Conditionally Accept	III.13.6, III.13.6 Rights and Obligations of Capacity Resources, 15.0.0	6/1/2018
Reject	III.13.7, III.13.7 Performance, Payments and Charges in the FCM, 30.0.0	6/1/2018
Conditionally Accept	III.13.8, III.13.8 Reporting and Price Finality, 6.0.0	6/1/2018
Conditionally Accept	Appendix A, Appendix A Market Monitoring, Reporting and Market Power Mit, 25.0.0	6/1/2018