111 FERC ¶ 61,442
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

ISO New England Inc. Docket No. ER05-439-001

ORDER ON REHEARING

(Issued June 20, 2005)

1. PSEG Energy Resources & Trade LLC (PSEG) and Massachusetts Municipal Wholesale Electric Company[1] (Massachusetts Municipal, *et al*.) seek rehearing of a March 7, 2005 Order issued by the Commission in the above-captioned proceeding.[2] For the reasons discussed below, we will deny rehearing.

Background

2. On January 11, 2005, ISO New England Inc. (ISO-NE) submitted for filing revisions to ISO-NE's Market Rule 1, concerning the allocation of Real Time Reliability Must Run (RMR) Operating Reserve Charges (Real Time RMR Charges). In the transmittal sheet accompanying its filing, ISO-NE explained that under its then-existing cost allocation methodology, Real Time RMR Charges were allocated to participants based on a participant's Real Time "deviations" in the local areas where ISO-NE's RMR resources were located, *i.e.*, based on the extent to which a participant's Real Time load and/or generation in those areas deviated from the Day Ahead schedule.

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[1] Joined by Connecticut Municipal Electric Energy Cooperative, Braintree Electric Light Department, Reading Municipal Light Department, and Taunton Municipal Light Plant.

[2] *ISO New England Inc*., 110 FERC ¶ 61,250 (2005) (March 7 Order).

3. ISO-NE noted, however, that these Real Time deviations represented only a small portion of the overall load (the Real Time Load Obligation) in the local areas in which these deviations occurred, and failed to allocate the costs at issue to those participants who had created the need for RMR Resources to be committed, or to those participants who benefited from the availability of these resources. In addition, ISO-NE stated that its then-existing methodology posed an unfair burden, in particular, on participants engaging in virtual transactions.

4. In place of its then-exiting methodology, therefore, ISO-NE proposed that Real Time RMR Charges be allocated on a broader basis to those who benefit from the enhanced reliability provided by RMR resources, *i.e.*, to Real Time Load Obligations, as adjusted for any applicable bilateral transactions. ISO-NE stated that this revised cost allocation methodology would be appropriate, among other reasons, because it was the forecast of Real Time load (as well as the related reliability considerations for serving this load) that affects the dispatch of an RMR resource. ISO-NE stated that, consequently, its proposed methodology would better allocate Real Time RMR Charges to those who currently create the need for Daily RMR Resources to be committed.

5. In the March 7 Order, we accepted ISO-NE's filing, without modification or condition. First, we found that ISO-NE, under section 6.17(e) of the Interim ISO Agreement, was authorized to make its filing unilaterally without obtaining the vote of approval otherwise required under the governance rules of the New England Power Pool (NEPOOL).[3] Accordingly, we proceeded to a consideration of ISO-NE's filing on the merits. In doing so, we agreed with ISO-NE that allocating Real Time RMR costs based on Real Time deviations allocated costs to only a small subset of transactions in the affected region and allocated a significant level of costs to virtual traders. We also found that these Real Time RMR costs cannot be attributed in their entirety to Real Time deviations, or to the virtual supply transactions that had accounted for a significant percentage of these deviations. We also noted that while the amount of RMR commitments required to serve load are reasonably well-known prior to the Day Ahead market clearing process, ISO-NE is generally unable to commit all of the required

[3] Specifically, we found that failure to implement the changes specified in ISO-NE's filing would substantially and adversely affect the competitiveness or efficiency of ISO-NE's markets to the extent that ISO-NE's then-existing allocation methodology deterred virtual trading. We also agreed that further recourse to the stakeholder process would not allow for timely redress of the concerns identified by ISO-NE in its filing.

resources during the Day Ahead market. We found that, as such, the failure to commit Daily RMR Resources Day Ahead did not mean that the commitments are caused by deviations when, in fact, there are other factors that require ISO-NE to commit Daily RMR Resources after the Day Ahead market has closed.

6. We also found that it was appropriate to allocate Real Time RMR Charges to Real Time Load Obligations because the commitment of RMR Resources is made to protect the reliability of all loads. Specifically, we noted that it is the forecast of Real Time load, along with system contingency considerations for serving that load, that are the primary indicators determining the need to dispatch RMR Resources. In addition, we found that by broadening the pool of participants to whom these costs are allocated, ISO-NE's revised methodology would have the effect of reducing the per-MWh cost of Real Time RMR Charges.

7. We also considered, but rejected, various protest arguments challenging ISO-NE's revised methodology, including the argument that ISO-NE's revised methodology failed to give Load Serving Entities an incentive to purchase enough energy in the Day Ahead market to serve their loads. We found that with the exception of Connecticut and Vermont, participants in ISO-NE's markets currently schedule virtually all of their load (between 90 to 100 percent) in the Day Ahead market, given the hedging benefits provided by this scheduling option. We also noted that we expected this practice to continue and that the broader allocation of Real Time RMR Charges, made possible by ISO-NE's revised methodology, would remove the existing disincentive to engage in virtual trades and price-responsive load scheduling in the Day Ahead market. In turn, we noted that the alleviation of these disincentives would reduce the existing occurrence of under-scheduling in certain ISO-NE regions, including Connecticut.

8. Finally, we rejected protesters' argument that the Commission should defer ruling on ISO-NE's proposal until such time as ISO-NE's Locational Installed Capacity market is implemented in 2006. We found that the need for ISO-NE's proposed revisions to its RMR allocation methodology had been sufficiently demonstrated by ISO-NE and should not be deferred.

Requests for Rehearing

9. As a procedural matter, PSEG and Massachusetts Municipal, *et al*., argue that the March 7 Order erred in concluding that section 6.17(e) of the Interim ISO Agreement Authorized ISO-NE to file its proposal pursuant to section 205 of the Federal Power Act (FPA). PSEG asserts that ISO-NE failed to demonstrate that the existing Real Time RMR cost allocation methodology created imminent harm to the New England market,

including that segment of the market represented by virtual traders. Massachusetts Municipal, *et al*., argue that under the facts and circumstances presented here, the right to submit a section 205 proposal regarding ISO-NE's Real Time RMR cost allocation methodology resided in NEPOOL, not ISO-NE.

10. PSEG and Massachusetts Municipal, *et al*., also assert that ISO-NE's prior methodology (based on Real Time deviations) was not flawed because it was consistent with cost causation principles as opposed to the revised methodology accepted by the March 7 Order, which they claim is not. Massachusetts Municipal, *et al*., contend that the March 7 Order departs, in this regard, from the Commission's findings in *New England Power Pool*,[4] and *Midwest Independent Transmission System Operator, Inc.*[5] PSEG adds that virtual transactions in the Day Ahead market can have a direct impact on the need to commit RMR resources, either in Real Time or in the Day Ahead markets, and that cost causation principles require that the related cost be allocated to the responsible virtual transactions. In addition, PSEG asserts that because the bids of all parties contribute, on balance, to the need to commit RMR units in the Day Ahead market, it is incorrect to say that one group of participants is disproportionately impacted. PSEG adds that ISO-NE's prior methodology, flawed as it was, should have been maintained until such time as all of the costs at issue can be assigned based on a better, *i.e.,* more accurate understanding of their precise cause.

11. Massachusetts Municipal, *et al*., assert that the revised methodology ignores Day Ahead scheduling practices and the fact that deviations from Day Ahead schedules can cause ISO-NE to bring on-line higher-cost resources with shorter start-up times. Massachusetts Municipal, *et al*., further assert that even assuming that Real Time deviations neither cause, nor should be required to bear, all responsibility for Real Time RMR Charges, it does not follow that *all* Real Time RMR Charges should be allocated to Real Time Load.

12. PSEG and Massachusetts Municipal, *et al*., also argue that ISO-NE's prior cost allocation methodology provided a hedging tool that the revised methodology eliminates. PSEG argues that the March 7 Order failed to adequately address PSEG's protest argument on this issue, *i.e.,* its argument that the revised methodology will undermine the ability, and therefore the incentive, of market participants to hedge their Real Time RMR

[4] 107 FERC ¶ 61,183 at P 8 (2004) (*NEPOOL*)

[5] 108 FERC ¶ 61,163 at P 587 (2004) (*Midwest ISO*).

Charge exposure by covering their positions in the Day Ahead market. PSEG asserts that, by contrast, under ISO-NE's prior methodology, a participant that had covered its obligations in the Day Ahead market could not be assessed Real Time RMR charges and was therefore able to balance its schedules consistent with its risk tolerances. PSEG claims that, by contrast, the revised methodology undermines the ability and incentive to hedge Real Time RMR cost by adjusting Day Ahead positions. PSEG adds that, in turn, ISO-NE's revised methodology will undermine the efficient operation of New England's multi-settlement system and is at odds with the Commission's prior determination that if a participant covers its position Day Ahead, it should be hedged against Real Time RMR Charges.[6] PSEG further argues that while the Commission concluded, in the March 7 Order, that it expects the existing level of load that hedges its position on a Day Ahead basis to continue, the Commission failed to explain how or why.

13. PSEG also questions whether ISO-NE's revised methodology, as the March 7 Order found, will send the proper price signals to the market. PSEG argues that there is no linkage between Real Time Load Obligations and the incurrence of reliability costs. PSEG also challenges the Commission's assumption that broadening the pool over which Real Time RMR Charges are spread will be beneficial to the market. PSEG argues, to the contrary, that lower costs are only desirable when they reflect the true cost of a service and/or product. PSEG also argues that Real Time RMR Charges are reliability costs and that allocation to network load would be a more efficient alternative that should have been considered by the Commission when addressing ISO-NE's filing.

14. PSEG and Massachusetts Municipal, *et al*., also challenge the finding made by the Commission in the March 7 Order that ISO-NE's prior methodology deterred virtual trading activities. Specifically, PSEG disputes the assertion that there has been decreased virtual trading activity in the congested Northeast Massachusetts (NEMA) market. PSEG submits that regardless, any such change would be attributable to factors other that ISO-NE's prior Real Time RMR Charge allocations. In addition, PSEG rejects ISO-NE's assertion that the loss of a single virtual trader from the New England market was evidence that ISO-NE's prior methodology had a negative impact on virtual trading. PSEG argues, to the contrary, that the loss of market opportunities resulting from efficient price convergence explains market exit.

[6] PSEG Rehearing Request at 10, *citing New England Power Pool and ISO New England, Inc.,* 105 FERC ¶ 61,211 at P 50 (2003) (November 2003 Order).

15. Massachusetts Municipal, *et al*., also challenge the connection drawn by the Commission, in the March 7 Order, between virtual trading and price convergence. Massachusetts Municipal, *et al*., argue that even assuming that this connection could be made, the Commission failed to support its finding that ISO-NE's prior allocation methodology deterred virtual trades and thus limited the ability of these transactions to provide market efficiencies, including price convergence. Massachusetts Municipal, *et al*., assert that regardless, the March 7 Order failed to consider the effects of the revised methodology on the market as a whole.[7]

Discussion

16. We will deny rehearing of the March 7 Order. First, we reject the argument that ISO-NE's filing was unauthorized under section 6.17(e) of the Interim ISO Agreement. As we noted in the March 7 Order, ISO-NE adequately demonstrated in its filing that failure to implement the changes it sought would substantially and adversely affect the competitiveness or efficiency of ISO-NE's markets, given the significant cost burdens imposed on virtual traders under ISO-NE's then-existing Real Time RMR Charge cost allocation methodology (and the corresponding effects of these cost burdens on the efficient operation of the market as a whole). ISO-NE also demonstrated in its filing that further recourse to the stakeholder process would not have allowed for a timely implementation of the tariff revisions required to address these concerns.[8]

17. We also reject the argument that ISO-NE's prior allocation methodology for allocating its Real Time RMR Charges is a more equitable methodology than the revised

[7] On April 21, 2005, ISO-NE filed an answer to the rehearing requests submitted by PSEG and Massachusetts Municipal, *et al*., and on May 6, 2005, Massachusetts Municipal, *et al*. submitted an answer to ISO-NE's answer. Rule 213(a) of the Commission's Rules of Practice and Procedure , 18 C.F.R. § 385.214 (2004), prohibits an answer to a rehearing request or an answer to an answer, unless otherwise permitted by the decisional authority. We are persuaded to accept the answers filed by ISO-NE and Massachusetts Municipal, *et al*. and therefore will accept them.

[8] *See also ISO New England Inc.*, 96 FERC ¶ 61,255, *clarified*, 97 FERC ¶ 61,078 (2001) (upholding ISO-NE's use of its section 6.17(e) authority). We also note that under ISO-NE's currently-effective operating framework, as a regional transmission organization, ISO-NE retains this filing authority. *See* Participants Agreement at section 11 and the Transmission Owners Agreement at sections 3.04(c) and (e).

methodology accepted in the March 7 Order. In fact, as we found in the March 7 Order, ISO-NE's prior allocation of its Real Time RMR Charges was made to only a small subset of its overall market, resulting in a burdensome per-unit cost disproportionately borne by virtual traders. We also found that this cost burden threatened the ability of virtual traders to participate in ISO-NE's markets and thus threatened to minimize, if not eliminate, the market benefits attributable to their trading activities. We also found (for the reasons discussed below) that ISO-NE's revised methodology was more consistent with cost causation principles.

18. While PSEG and Massachusetts Municipal, *et al*., suggest that virtual trading activity and the efficient operation of the overall market was not being harmed by operation of ISO-NE's prior allocation of its Real Time RMR Charges, the data cited by ISO-NE suggests otherwise. In fact, when the cost of virtual trading goes up, virtual trading activity, as ISO-NE has reported, decreases.[9] Contrary to PSEG's assertion, for example, the NEMA market, after October 2004, continued to experienced congestion in the Day Ahead market, but not in the Real Time market, *i.e.*, a price disparity that might have been minimized, or even eliminated, by increased virtual trading activities. While these virtual trading activities would have inured to the financial benefit of virtual traders and would have benefited the market as a whole, the incentive to trade, in this case, was effectively negated by the prohibitively high Real Time RMR Charges existing at the time.

19. We also reject the argument that ISO-NE's revised allocation methodology is inconsistent with cost causation principles. Because it is the forecast of Real Time load and the need to reliably serve this load that requires ISO-NE to commit and dispatch an RMR resource, it is appropriate that ISO-NE's Real Time RMR Charges be allocated on the basis of load. Specifically, it is the existence of this Real Time load that primarily creates the need to dispatch an RMR resource.

20. By contrast, a virtual trade does not affect the need to ultimately commit a resource because virtual transactions do not impact the amount of generation required to satisfy ISO-NE's reliability requirements. While virtual trading in the Day Ahead market can cause the commitment of an RMR resource to move to Real Time, it does not affect the total level of RMR resources required to serve load reliably. In addition, while

[9] *See* ISO-NE initial filing at 9.

decremental bids can trigger the need to commit RMR-related resources in the Day Ahead market, virtual traders will continue to shoulder a portion of these costs.[10]

21. We also reject the suggestion that our rulings in *NEPOOL* or the November 2003 Order were inconsistent with our findings in the March 7 Order. In *NEPOOL*, the Commission concluded that requiring 50 percent of the transmission costs at issue in that case to be allocated to network load was inconsistent with cost causation principles and an existing market rule requirement (Market Rule 1, section 3.2.3(h)), supporting NEPOOL's adherence to a cost causation analysis. Similarly, in the November 2003 Order, we determined that the measure for allocating Operating Reserve costs should be based on the identification of those participants responsible for the commitment of these resources. In the instant case, we also relied on a cost causation analysis and found, based on the facts and evidence presented (relating in significant part to virtual trading activities, as discussed above), that ISO-NE's revised methodology was more consistent with cost causation principles than its prior methodology. By contrast, neither *NEPOOL* nor the November 2003 Order discussed or otherwise relied on the effects of virtual trading activities on the allocations at issue in those cases.

22. Nor does the March 7 Order depart from our findings in *Midwest ISO*, which also relied on a cost causation analysis in finding that the Day Ahead generator shortfall uplift costs at issue in that case would be allocated to those expected to benefit from the commitment of additional resources. In *Midwest* ISO, we also noted that the proposed allocation methodology had not been protested and in accepting that methodology, we did not determine that there was only one way to allocate those costs, nor did we address issues relating to virtual trading activities.

23. We also disagree that virtual transactions can affect the magnitude of Real Time RMR charges by displacing in the Day Ahead market physical generation with high start and no-load costs. As mentioned above, while virtual transactions may shift costs between the Day Ahead and Real Time markets, virtual trading does not cause these costs to be incurred. We also disagree that if a participant meets its load obligations in the Day

[10] ISO-NE noted in its filing, however, that contrary to its then-existing cost allocation methodology applicable to the Real Time market, Day Ahead RMR charges were already being allocated on a broader basis. ISO-NE also noted, however, that it was committed to exploring the continued appropriateness of these Day Ahead RMR allocations through its stakeholder process. *See* ISO-NE filing at p. 6, note 16.

Ahead market, then it should be "hedged" against any Real Time RMR Charges. In fact, while participation in the Day Ahead market should permit participants to hedge against certain costs, *i.e.*, costs attributable to market volatility in the Real Time market, participants should not be entitled to avoid legitimate reliability costs designed to serve ISO-NE's total load.

24. Nor do we believe that ISO-NE's revised methodology will increase the likelihood of under-scheduling or increase the volatility of Real Time RMR Charges. As we noted in the March 7 Order, participants currently schedule virtually all of their load in the Day Ahead market, with only limited exceptions. We do not expect this practice to be altered as a result of ISO-NE's revised allocations, nor has any credible evidence to the contrary been presented here. Finally, we note ISO-NE's commitment to actively monitor the impact of its revised allocation methodology, including its impact on scheduling practices.

The Commission orders:

Rehearing of the March 7 Order is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.