130 FERC ¶ 61,188
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
and John R. Norris.

ISO New England Inc. and
New England Power Pool

Docket No. ER09-1546-001

ORDER ON COMPLIANCE FILING

(Issued March 18, 2010)

1. On October 2, 2009, the Commission issued an order conditionally accepting tariff revisions submitted by ISO New England Inc. (ISO-NE) and the New England Power Pool (NEPOOL) Participants Committee (collectively, Filing Parties) to address the market power mitigation of offers for resources that are committed to satisfy local and system-wide reliability needs.[1] On October 30, 2009, ISO-NE submitted a compliance filing consistent with the Commission's directives in the October 2009 Order. As discussed below, we accept ISO-NE's compliance filing, with its proposed revisions to Market Rule 1 to be effective on or after January 1, 2010, as requested.

I. Background

2. As discussed in the October 2009 Order, New England market participants are eligible to receive Net Commitment Period Compensation (NCPC) payments when a resource is dispatched out of economic merit for reliability purposes and the fuel and variable operating and maintenance (O&M) costs of operating the resource, as reflected in its time-based Supply Offer, exceed the revenue paid to the market participant in the energy markets.

3. In order to address market participants' incentives to place inflexible operating limits on their resources, on August 5, 2009, Filing Parties proposed revisions to the NCPC mitigation framework set forth in Appendix A of Market Rule 1 (August 5, 2009 Filing). Among other things, these revisions created a new category of mitigation, called

[1] *ISO New England Inc.*, 129 FERC ¶ 61,008 (2009) (October 2009 Order).

Reliability Commitment Mitigation, for the Supply Offers of resources committed to address local reliability needs. Reliability Commitment Mitigation replaces the existing conduct and NCPC thresholds with a single threshold that calls for mitigation when a resource's low-load cost (i.e., the cost of operating a resource at its minimum load for its minimum run time), as reflected in its Supply Offer, exceeds the low-load cost of the resource calculated based on its Reference Levels[2] by more than the lesser of 10 percent or $80/MW-day. Additionally, the proposed revisions included a provision that permits a resource owner who believes it has been mitigated below its fuel and variable O&M costs to submit a filing with the Commission within thirty days of receipt of the invoice that it is challenging to seek recovery of those costs pursuant to section 205 of the Federal Power Act (FPA).[3]

4. In the October 2009 Order, the Commission conditionally accepted the proposed revisions, agreeing that the proposed revisions provide for a more effective mitigation of the exercise of market power by generators. However, the Commission directed Filing Parties to: (1) extend the deadline by which a market participant must submit a section 205 filing to recover fuel and variable O&M costs from thirty days to sixty days; and (2) submit additional support for the use of the $80/MW-day threshold.

II. Compliance Filing

5. Consistent with the October 2009 Order, ISO-NE submitted a revised tariff sheet to change the deadline by which a market participant must submit a section 205 filing to recover fuel and variable O&M costs from thirty to sixty days. Additionally, ISO-NE submitted an affidavit from David LaPlante and Mario S. DePillis, Jr. (LaPlante-DePillis Affidavit), which explains the rationale for the $80/MW-day threshold.

6. Specifically, the LaPlante-DePillis Affidavit explains that the $80/MW-day threshold is appropriate because it reduces the incentive of high low-load cost resources, in particular, to overstate their supply offer parameters in order to increase NCPC revenues.[4] They use an example of a large oil-fired unit (representative of the type of unit frequently committed to address local reliability) to illustrate that the 10 percent criterion alone could give such a unit an incentive to offer inflexibly to earn NCPC revenues. Assuming the unit operates between 250 and 500 MW, has a 24 hour minimum run time and an 8,000 BTU/kW heat rate, an oil price of $15/MMBTU,

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[2] A resource's Reference Level is the Internal Market Monitor's estimate of that resource's fuel and variable O&M costs.

[3] 16 U.S.C. § 824d (2006).

[4] LaPlante-DePillis Affidavit ¶ 10.

excluding normal start-up cost, yields a low load cost of $720,000. Thus, a 10 percent criterion alone, for example, would allow the unit to earn up to $72,000 daily in NCPC by increasing its minimum operating level by 25 MW. The $80/MW per day times its maximum operating level (in this example, 500 MW) would set a lower criterion of $40,000 per day and limit this incentive.[5]

7. The LaPlante-DePillis Affidavit also demonstrates that a market participant that offers its resource into the market with offer parameters that accurately reflect the costs and physical operating characteristics of the resource does not face significant risk of triggering the $80/MW-day cap. According to the LaPlante-DePillis Affidavit, fuel price fluctuations are the most likely source of mitigation below actual costs. The Internal Market Monitor utilizes a published fuel index price that represents an average of prices of trades that take place during a day to establish a resource's Reference Level; however, a market participant is required to purchase fuel at a single market price, which may be higher or lower than the average of trades used to construct the fuel index price.[6] Using inter-day fuel price variations as a proxy for variations within a day, the LaPlante-DePillis Affidavit determined that in 95 percent of all cases, day-to-day oil price increases were below 2.75 percent, and day-to-day natural gas price increases were less than 9.77 percent.[7] An analysis determined that, assuming a 3 percent increase in fuel prices, an oil fired steam boiler generator would not trip the $80/MW-day cap until the fuel price index reached a price of $26/mmBTU, which has not occurred since 1999. Assuming a 10 percent increase in fuel prices, a gas-fired combined cycle unit would not trip the $80/MW-day cap until the fuel price index exceeded $12/mmBTU, which has occurred only 6.1 percent of the time since 1999.[8]

8. As discussed in the October 2009 Order,[9] Filing Parties requested an effective date on or after January 1, 2010 because the implementation of certain revisions would require substantial changes to system commitment and dispatch software, settlements software, and Reference Level calculation software. Filing Parties stated that ISO-NE will provide two weeks' prior notice of the actual effective date.

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[5] *Id.* ¶¶ 13-19.

[6] *Id.* ¶ 23.

[7] *Id.* ¶ 24-25.

[8] *Id.* ¶ 31.

[9] October 2009 Order, 129 FERC ¶ 61,008 at P 8 & n.8.

9. ISO-NE explains that NEPOOL has noted its support for the rule change in the compliance filing based on the recommendation of support from the NEPOOL Markets Committee. However, under the Participants Agreement, only the NEPOOL Participants Committee can make filings on behalf of NEPOOL before the Commission, and the NEPOOL Participants Committee did not meet to discuss the compliance filing prior to the date of the filing.

III. Notice of Filing and Responsive Pleadings

10. Notice of Filing Parties' filings were published in the *Federal Register*, 74 Fed Reg. 59151 (2009), with interventions or comments due on or before November 20, 2009. Indicated Suppliers filed a protest, ISO-NE and Indicated Supplies filed answers.

11. Indicated Suppliers argue that ISO-NE's $80/MW-day threshold is based on unfounded speculation. According to Indicated Suppliers, ISO-NE provides no basis for its assumption that market participants will have the ability or, when countervailing incentives are taken into account, the incentive to pursue a strategy to inflate revenues. Indicated Suppliers state that the tariff sheets accepted by the October 2009 Order already constrain the ability of a market participant to overstate a resource's offer parameters. For example, the revised tariff sheets provide for ISO-NE to calculate Non-Dollar Based Reference Levels based on the original equipment manufacturer operating recommendations and performance data, applicable environmental operating permit information, and verifiable resource physical operating characteristic data. The revised tariff sheets also provide for mitigation of time-based offer parameters, such as minimum run time. Additionally, Indicated Suppliers contend that the 10 percent threshold itself prevents implementation of such a strategy.

12. In addition to protections provided by the ISO-NE tariff, Indicated Suppliers state that the civil penalties that would apply if a market participant's overstatement of offer parameters were deemed to constitute the submission of "false or misleading information" to ISO-NE or its market monitors would dwarf the net revenues that might be obtained through such a strategy. Indicated Suppliers note that various other sanctions might result, including the loss of a market participant's authorization to sell energy, capacity and ancillary services at market-based rates.

13. Indicated Suppliers also question ISO-NE's analysis in determining that the $80/MW-day threshold would not result in systematic and significant over-mitigation. Indicated Suppliers note that natural gas use by New England's generation has increased dramatically over the last 10 years, so units that will be run out-of-merit for reliability reasons in the future are less likely to be oil-fired and more likely to be natural gas-fired. Indicated Suppliers also note that natural gas prices have been more volatile historically, particularly in more recent years, than suggested in the LaPlante-DePillis Affidavit. Indicated Suppliers question the fuel price index used in ISO-NE's analysis. An analysis by Paul Hank (Hank Affidavit), using published natural gas prices at the Algonquin city-

gate over the period November 1, 2006 to November 11, 2009, shows average day-to-day volatility of 21 percent using a 95 percent confidence interval.[10] Also for this time period, an analysis by Mohan Chakragiri (Chakragiri Affidavit) determined that a combustion turbine unit owned and operated by Mirant Kendall would have been mitigated in 30 instances as a result of day-over-day increases in natural gas prices.[11] In 7 of these instances, there would have been no mitigation but for the $80/MW-day threshold. According to the Chakragiri Affidavit, this results in over-mitigation due to the $80/MW-day threshold of approximately $85,538.10.[12]

14. In response to the Indicated Suppliers' protest, ISO-NE maintains that market participants have an incentive to overstate offer parameters to increase their NCPC payments. While Indicated Suppliers suggest that offer parameters are "hard-wired" into the ISO-NE tariff, ISO-NE notes that market participants do have flexibility with respect to the values submitted for these offer parameters. For example, ISO-NE states that section III.A.5.3.1(e) of Appendix A of Market Rule 1 permits a 100 percent increase in offer parameters that are expressed other than in time or dollars, including data that are "minimum values," and notes that other existing general mitigation thresholds are structured in a similar manner. ISO-NE notes that, for non-constrained areas, the concern that a market participant will overstate physical characteristic offer parameters is tempered by the competition faced by the market participant. However, a market participant with a generating unit located in a constrained area does not face competition, and thus has little market-based disincentive to overstate the physical characteristic offer parameters of the resource.

15. Further, ISO-NE states that Indicated Suppliers' protest mischaracterizes the revised rules and the manner in which the Internal Market Monitor administers them. ISO-NE states that Indicated Suppliers' assertion of over-mitigation is premised on the incorrect notion that, in determining whether NCPC mitigation is necessary, the Internal Market Monitor will use a fuel price index applicable to the *day before* the operating day. However, ISO-NE asserts that, in analyzing the risk of over-mitigation, day-to-day fuel index price changes were simply used "as a proxy for variations within a day, but [these] are likely to be higher than the intra-day variations."[13] In actually determining whether NCPC mitigation is necessary, the Internal Market Monitor uses the indexed fuel price

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[10] Hank Affidavit ¶ 11.

[11] Chakragiri Affidavit ¶¶ 9-10.

[12] *Id.* ¶ 13.

[13] ISO-NE Dec. 7, 2009 Answer at 6, citing LaPlante-DePillis Affidavit ¶ 24.

for the operating day to which the market participant's Supply Offer pertains, which is usually available by mid-afternoon of the day before the operating day.

16. In response to ISO-NE's answer, Indicated Suppliers note that ISO-NE has not identified the specific natural gas price index that the Internal Market Monitor uses. Indicated Suppliers state that the Algonquin Citygate Midpoint price index is typically published for internet subscribers at 6:00 p.m. the evening prior to the operating day and is widely available at about 7:00 a.m. on the operating day. Because this index is only published once for a given day, there is no update with which to perform an "intra-day" volatility analysis. Indicated Suppliers also question why ISO-NE relied on day-over-day price volatility in its analysis, if it has the ability to examine intra-day price volatility.

IV. <u>Discussion</u>

17. Rule213 (a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2), prohibits an answer to a protest and an answer to an answer unless otherwise ordered by the decisional authority. We will accept ISO-NE's and Indicated Suppliers' answers because they have provided information that assisted us in our decision-making process.

18. We find that ISO-NE has complied with the October 2009 Order by submitting a revised tariff sheet to change the deadline by which a market participant must submit a section 205 filing to recover fuel and variable O&M costs from thirty to sixty days. Additionally, we find that ISO-NE has justified why the $80/MW-day threshold is appropriate.

19. Indicated Suppliers argue that ISO-NE provides no basis for its assumption that market participants will have the ability or, when countervailing incentives are taken into account, the incentive to pursue a strategy to inflate revenues. As the Commission discussed in the October 2009 Order, the purpose of NCPC mitigation is to prevent the exercise of market power by resources that face no competition.[14] Despite Indicated Suppliers' assertions that there are strong disincentives to overstating offer parameters, this does not change the fact that a market participant with a generating unit located in a constrained area does not face competition, and thus has the opportunity to take advantage of its position to increase its NCPC payments. Further, contrary to Indicated Suppliers' assertions, the ISO-NE tariff does not currently include sufficient constraints on the ability of a market participant to overstate a resource's offer parameters, making the $80/MW-day threshold unnecessary. As ISO-NE points out in its response, the existing provisions of Appendix A of Market Rule 1 permit market participants flexibility

[14] October 2009 Order, 129 FERC ¶ 61,008 at P 12.

with respect to the values submitted for offer parameters.[15] Moreover, the LaPlante-DePillis Affidavit demonstrates why the 10 percent threshold alone was not a sufficient constraint.[16]

20. Indicated Suppliers also argue that the $80/MW-day threshold would result in systematic and significant over-mitigation and question the fuel price index used by ISO-NE, as well as ISO-NE's use of data from 1999 through 2008 in its analysis. We note that, in determining that the $80/MW-day threshold is an appropriate "lower of" cap, ISO-NE's Internal Market Monitor performed an analysis similar to the one performed to demonstrate the efficacy of the 10 percent of low-load cost threshold. Specifically, in justifying the 10 percent threshold, ISO-NE's Internal Market Monitor determined that "[t]he primary cause of an instance of over-mitigation would be an inter-day fuel price deviation, which would involve an increase in fuel prices between the time mitigation is performed the afternoon before the Operating Day and the time the fuel is purchased on the intra-day market during the Operating Day."[17] The Internal Market Monitor used inter-day fuel price changes from 1999 to 2008 as a proxy for variations within a day, and determined that in 95 percent of days, the increase in natural gas prices was lower than 10 percent.[18] Indicated Suppliers did not suggest that the Internal Market Monitor use a specific natural gas price index or a shorter time period in determining that the 10 percent threshold was appropriate, and we find that Indicated Suppliers have presented no evidence to demonstrate that a similar analysis should not be used by the Internal Market Monitor to support the $80/MW-day threshold.

21. Further, as ISO-NE points out in its answer, Indicated Suppliers' assertion that the $80/MW-day threshold would have resulted in over-mitigation seven times between November 1, 2006 through November 11, 2009 is based on a misunderstanding of the manner in which the Internal Market Monitor administers mitigation processes. Instead of using a day-before fuel price to determine the Commitment Cost Threshold, as Mr. Chakragiri used in his analysis for Indicated Suppliers, ISO-NE actually uses the indexed

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[15] ISO-NE points to section III.A.5.3.1(e) (establishing a general mitigation threshold for increases greater than 100 percent in offer parameters that are expressed other than in time or dollars, including data that are "minimum values") and section III.A.5.3.1(d) (establishing a general mitigation threshold for increases greater than 2 hours in elements expressed in time, such as minimum run time).

[16] LaPlante-DePillis Affidavit ¶¶ 13-19.

[17] August 5, 2009 Filing at 17.

[18] *Id.*

fuel price for the Operating Day to determine the Commitment Cost Threshold.[19] ISO-NE reasonably concludes that price variations within a day are generally smaller than price variations between days. Thus, ISO-NE's analysis, based on between day price variations indicating little risk of over-mitigation, provides stronger assurance that its proposal is unlikely to over-mitigate. Moreover, as discussed in the October 2009 Order, should over-mitigation occur, a market participant may submit a filing to the Commission under FPA section 205 to seek cost recovery.[20]

The Commission orders:

ISO-NE's compliance filing is accepted, with its proposed revisions to Market Rule 1 to be effective on or after January 1, 2010, as requested.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[19] *See* ISO-NE December 7, 2009 Answer at 7-8. Although ISO-NE does not specify the gas price index used in its analysis, the issue of the precise index to be used was not raised when ISO-NE proposed revisions to the NCPC framework and mitigation, and Commission accepted the proposal without reliance on the choice of any particular price index.

[20] October 2009 Order, 129 FERC ¶ 61,008 at P 18.