134 FERC ¶ 61,128
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

ISO New England Inc. Docket No. ER11-2427-000

ORDER ACCEPTING TARIFF REVISIONS IN PART
AND REJECTING TARIFF PROVISIONS IN PART

(Issued February 17, 2011)

1. In this order, the Commission accepts in part and rejects in part proposed tariff revisions submitted by ISO New England Inc. (ISO-NE) and the New England Power Pool Participants Committee (NEPOOL),[1] which pertain to the method of calculating ISO-NE's Peak Energy Rent (PER) mechanism, so as to enable that mechanism to more effectively fulfill the intent of the parties to ensure that the PER Strike Price approximates the operating costs of the marginal generating unit in New England when the region is approaching shortage conditions. The Commission also grants waiver of its 60-day notice requirements[2] to make those tariff provisions that are accepted here effective on December 22, 2010, as requested.

I. **Background**

A. **FCM and PER**

2. ISO-NE operates its Forward Capacity Market (FCM), pursuant to which capacity suppliers commit, on a three-year forward basis, to provide capacity to ISO-NE, and, in return, receive capacity payments. The FCM market rules provide that capacity suppliers have their monthly capacity payments reduced to account for PER.

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[1] ISO-NE and NEPOOL are referred to collectively herein as "the Filing Parties." The proposed tariff revisions are referred to as "the Joint Filing."

[2] Section 35.3 of the Commission's Regulations, 18 C.F.R. § 35.3 (2010), requires that all rate schedules or tariffs be tendered for filing with the Commission not less than 60 days prior to becoming effective. Section 35.11 allows waiver of the notice requirement for good cause shown.

3. The PER mechanism has two purposes: (1) to remove the incentive to raise prices in the Real-Time Energy Market by offsetting high real-time prices (above the PER Strike Price) with reductions in capacity payments, and (2) to act as a hedge for load against high prices (price spikes) in the energy market. The PER value is based on revenues that would be earned in the energy market by a hypothetical, proxy peaking unit. Generally, the PER value during high-priced hours in the Real-Time Energy Market reduces capacity payments. Generation and import resources with a capacity supply obligation (CSO)[3] are subject to PER adjustments (excluding self-supply CSO MWs). Demand resources are not subject to PER adjustments because they currently do not participate in ISO New England's energy markets.[4]

4. Sections III.13.7.2.7.1.1, III.13.7.2.7.1.1.1, and III.13.7.2.7.1.1.2 of Market Rule 1 of ISO-NE's Transmission, Markets and Services Tariff (Tariff) describe the current rules related to the PER mechanism, pursuant to which payments to new generating capacity resources and existing generating capacity resources with capacity supply obligations are decreased by the PER adjustment in each capacity zone. Each day ISO-NE calculates a PER Strike Price, using hourly integrated real-time Locational Marginal Prices (LMP).[5] For each hour in which the Real-Time LMP exceeds the PER Strike Price, ISO-NE calculates an Hourly PER value. The Hourly PER value is the difference between the Real-Time LMP and the PER Strike Price, adjusted by a scaling factor and an availability factor.[6]

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[3] In the FCM design, a capacity supply obligation is a commitment to be available to supply electric energy during shortage events, and capacity payments are based on each resource's performance during such events. *See* ISO-NE "Internal Market Monitoring Unit Review of the Forward Capacity Market Auction Results and Design Elements," *available at* http://www.iso-ne.com/markets/mktmonmit/rpts/other/fcm_report_final.pdf.

[4] *See* ISO-NE's "Monthly Market Operations Report, December 2010," *available at* http://www.iso-ne.com/markets/mkt_anlys_rpts/mnly_mktops_rtps/2010/2010_12_monthly_market_report.pdf.

[5] *See* Section III.13.7.2.7.1.1 of Market Rule 1.

[6] The scaling factor is, generally, the ratio of the actual hourly load value to the 50/50 peak load forecast, such that high load hours will have a higher weighting than low load hours. The availability factor is set to 95 percent. *See* Section III.13.7.2.7.1.1.1 of Market Rule 1.

5. The PER Strike Price is equal to the heat rate of a hypothetical resource called the PER Proxy Unit multiplied by the fuel cost of that same hypothetical resource. As currently set forth in the Tariff, the heat rate of the PER Proxy Unit is 22,000 Btu/kWh, and the fuel cost is the lower of the price of either: (1) ultra low-sulfur No. 2 oil measured at New York Harbor plus a seven percent markup for transportation; or (2) day-ahead gas measured at the Algonquin City Gate, as determined on a daily basis.[7]

6. For each month, the Hourly PER values for that month are summed to establish the Monthly PER value. ISO-NE then calculates the Average Monthly PER, defined as the average of the Monthly PER values for the 12 months prior to the Obligation Month. A capacity resource's monthly capacity payment for that Obligation Month is reduced by the product of the Average Monthly PER and the resource's CSO. That reduction results in a corresponding credit to load to reflect the reduced capacity price.[8]

B. The Joint Filing

7. On December 21, 2010, the Filing Parties submitted revised tariff sheets pursuant to section 205 of the Federal Power Act (FPA)[9] in order to implement the following changes to the PER Mechanism under Market Rule 1: (1) revise the fuel cost of the PER Proxy Unit to reflect the higher of the price of oil or gas price, rather than the lower of those two prices; and (2) revise the calculation of the Average Monthly PER to reflect the average of the Monthly PER values for the previous six, rather than 12, months prior to the Obligation Month.[10] The Filing Parties propose to implement the proposed PER Strike Price revision (using the higher, rather than lower, fuel price) for the month of December 2010; retain the 12-month Average Monthly PER for a short period (the December 2010 and January 2011 Obligation Months); and switch to a six-month Average Monthly PER beginning with the February 2011 Obligation Month.

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[7] *See* Section III.13.7.2.7.1.1.1(b)(i)(ii)(iii).

[8] *See* Section III.13.7.2.7.1.1.2 of Market Rule 1.

[9] 16 U.S.C. § 824d (2006).

[10] Specifically, through January 2011, the Average Monthly PER will be equal to the average of the Monthly PER values for the 12 months prior to the Obligation Month, and beginning February 1, 2011, the Average Monthly PER shall be equal to the average of the Monthly PER values for the six months prior the Obligation Month. That is, the Filing Parties propose, beginning February 1, 2011, to replace the 12-month rolling average of Monthly PER with a six-month rolling average of Monthly PER.

8. The Filing Parties state that the proposed revisions were supported by NEPOOL at the December 10, 2010, Participants Committee meeting, with a vote of 73.28 percent in favor. ISO-NE believes that the proposed revisions strike a reasonable balance between the needs of the interested parties, and the Filing Parties urge the Commission to accept them in their entirety.[11] The Filing Parties also request waiver of the 60-day prior notice requirement to allow the proposed changes to become effective on December 22, 2010, one day after they were submitted for filing.

9. The Filing Parties do acknowledge, however, that the PER mechanism is complex and that other concerns about its design and functioning have been raised which warrant further consideration. For this reason, the Filing Parties have committed to undertake a stakeholder process to review all inputs and other aspects of the currently effective PER, alternative PER mechanisms, and their applicability to the FCM. The Filing Parties state that by July 1, 2012, they will either: (1) submit a filing to the Commission under section 205 of the FPA setting forth any resulting changes to the PER mechanism; or (2) submit an informational filing to the Commission reporting on the results of the stakeholder process, if there are no changes.[12]

II. Notice of Filing, Interventions, Responsive Pleadings, and Answers

10. Notice of the Joint Filing was published in the *Federal Register*, 76 Fed. Reg. 355 (2011), with interventions, comments, and protests due on or before January 11, 2011. The Maine Public Utilities Commission filed a notice of intervention, and the Massachusetts Department of Public Utilities (Massachusetts Commission) filed a notice of intervention and comments. Brookfield Energy Marketing LP; Calpine Corporation; Dominion Resources Services, Inc.;[13] Dynegy Power Marketing Inc. and Casco Bay Energy Company, LLC; Electric Power Supply Association; EquiPower Resources Corp.;[14] GDF Suez Energy Marketing NA, Inc.; Granite Ridge Energy, LLC; H.Q.

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[11] Transmittal Letter, Joint Filing, at 10 (citing *ISO New England, Inc. and New England Power Pool Participants Committee*, 132 FERC ¶ 61,136, at P 30 (2010) (noting the Commission's authority to balance equities at issue)).

[12] Transmittal Letter, Joint Filing, at 2.

[13] Dominion Resources Services, Inc. includes: Dominion Energy Brayton Point, LLC; Dominion Energy Manchester Street, Inc.; Dominion Energy New England, Inc.; Dominion Energy Salem Harbor, LLC; Dominion Nuclear Connecticut, Inc.; and Dominion Energy Marketing, Inc.

[14] EquiPower Resources Corp. includes: Dighton Power, LLC; Lake Road Generating Company, L.P.; and MASSPOWER.

Energy Services (U.S.) Inc.; Millennium Power Partners, P.P.; NAEA Energy Massachusetts, LLC; NAEA Newington Energy, LLC; New England Power Generators Association, Inc.; NextEra Energy Resources, LLC; Northeast Utilities Service Company; and PSEG Energy Resources & Trade LLC and PSEG Power Connecticut LLC filed timely motions to intervene. The GenOn Parties filed an untimely motion to intervene. Exelon Corporation (Exelon); the Capacity Suppliers;[15] the Indicated Suppliers;[16] the New England Conference of Public Utilities Commissioners (NECPUC); NRG Companies (NRG);[17] and the Retail Energy Supply Association (RESA)[18] filed timely motions to intervene, comments, or protests. On January 26, 2011, the Filing Parties[19] and Capacity Suppliers each filed an answer to the protests. On February 1, 2011, Indicated Suppliers filed an answer to the answers filed by Capacity Suppliers and the Filing Parties, and on February 3, 2011, RESA filed a motion to reject Capacity Suppliers' answer and an answer to the answers filed by Capacity Suppliers and NEPOOL.

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[15] In their pleading, the Capacity Suppliers refer to themselves as the "Indicated Capacity Suppliers," but we will refer to them herein as "Capacity Suppliers" in order to avoid confusion with the "Indicated Suppliers." The Capacity Suppliers include: Brookfield Energy Marketing LP; Casco Bay Energy Company, LLC; Dynegy Power Marketing, Inc.; Dominion Energy Brayton Point, LLC; Dominion Energy Manchester Street, Inc.; Dominion Energy Marketing, Inc.; Dominion Energy New England, Inc.; Dominion Energy Salem Harbor, LLC; Dominion Nuclear Connecticut, Inc.; Dighton Power, LLC; Lake Road Generating Company, L.P.; MASSPOWER; GenOn Energy Management, LLC; GenOn Canal, LLC; GenOn Kendall, LLC; Granite Ridge Energy, LLC; NAEA Energy Massachusetts, LLC; NAEA Newington Energy, LLC; New England Power Generators Association, Inc.; and NextEra Energy Resources, LLC.

[16] The Indicated Suppliers include: Constellation Energy Group, Inc.; Hess Corporation; Macquarie Energy LLC; and BP Energy Company.

[17] NRG includes: NRG Power Marketing LLC; Connecticut Jet Power LLC; Devon Power LLC; Middletown Power LLC; Montville Power LLC; Norwalk Power LLC; and Somerset Power LLC.

[18] RESA includes: Champion Energy Services, LLC; ConEdison Solutions; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Energy Plus Holdings, LLC; Exelon Energy Company; GDF SUEZ Energy Resources NA, Inc.; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Just Energy; Liberty Power; MXenergy; NextEra Energy Services; Noble Americas Energy Solutions LLC; PPL EnergyPlus; and Reliant Energy Northeast LLC.

[19] The answer is filed by NEPOOL and joined in part by ISO-NE.

III. Discussion

A. Procedural Matters

11. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2010), the notices of intervention and the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2010), we will grant GenOn Parties' late-filed motion to intervene, given its interest in this proceeding, the early stage of this proceeding, and the absence of undue prejudice or delay.

12. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2010), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the Filing Parties' and Capacity Suppliers' answers and Indicated Suppliers' answer to those answers because they have provided information that assisted us in our decision-making process.

13. We accept Indicated Suppliers' and RESA's answers primarily to address Indicated Suppliers' claim that the affidavit attached to Capacity Suppliers' answer is responding to the Joint Filing rather than to protests and that Capacity Suppliers did not provide this evidence in timely fashion (i.e., with their comments), and RESA's motion to reject Capacity Suppliers' answer on similar grounds. In our view, the affidavit of Dr. Milgrom attached to Capacity Suppliers' affidavit is responsive to the protests, not merely to the original Joint Filing, and we therefore will not reject it.

B. Analysis

14. As discussed below, the Commission accepts the proposed revisions to the method of calculating the PER Strike Price, but rejects the proposal to move from a 12-month rolling average to a six-month rolling average for purposes of calculating the Average Monthly PER.

1. Change to Method of PER Strike Price Calculation

a. ISO-NE and NEPOOL's Proposal

15. The Filing Parties state that experience has shown that the PER mechanism is not functioning as intended. According to the Filing Parties, the PER Strike Price has been lower than intended, and, therefore, the PER mechanism has been triggered more often than expected, and ultimately, deductions from capacity payments have been larger than

expected.[20] Additionally, the Filing Parties posit that the PER Strike Price has been at levels well below the operating costs of the most expensive oil and gas units.[21]

16. ISO-NE believes that these unintended outcomes are largely the result of basing the fuel cost of the PER Proxy Unit on the lower, rather than the higher, of the price of oil or gas. ISO-NE states that when the PER mechanism was adopted in 2006, the prices of the two fuels were similar, explaining that oil and gas prices historically have been closely linked, because there is a high degree of substitutability between these fuels for a significant segment of the market. The Filing Parties provide data showing that the spread between the two prices has widened substantially in recent years.[22]

17. To remedy this situation, the Filing Parties propose to revise the method of selecting the fuel price index that determines the PER Proxy Unit. Specifically, the PER Proxy Unit would be indexed to the marginal fuel, which shall be the higher of either the price of ultra low-sulfur No. 2 oil measured at New York Harbor, plus a seven percent markup for transportation, or the price of day-ahead gas measured at the Algonquin City Gate, as determined on a daily basis, rather than the lower of those two prices. The Filing Parties believe that, with this change, the PER Strike Price will better approximate the operating costs of the marginal generating unit in New England when the region is approaching shortage conditions.[23]

b. Positions of the Parties

18. Exelon, the Capacity Suppliers, the Massachusetts Commission, NECPUC, and NRG urge the Commission to accept the proposed changes to the PER Strike Price calculation. The Massachusetts Commission and NECPUC also state that the PER mechanism is being triggered more often than was anticipated when adopted. They state

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[20] According to ISO-NE, the total PER deductions from June 2010 through the December 2010 Obligation Month settlement will reduce generators' capacity revenue by more than $100 million, and average nearly $15 million per month during the first seven months of the Capacity Commitment Period. *See* Transmittal Letter, Joint Filing, at 6 n. 23.

[21] According to ISO-NE, the PER Strike Price frequently has been below the operating costs of virtually all of the oil-fired generators in New England (which, according to the Filing Parties, comprise approximately 25 percent of New England's generating resources). *Id*. at 6-7.

[22] *See* Transmittal Letter, Joint Filing, at 8 Figure 2.

[23] *See* Joint Filing, Testimony of Dr. Robert Ethier (Ethier Testimony) at 4-5.

that, while the original intent of the PER mechanism was to reduce capacity payments to generators only when the region approaches shortage conditions, in practice, the PER mechanism is being triggered in many hours when there is no shortage. This, in turn, results in larger deductions to generators' capacity payments than originally envisioned. Similarly, the Capacity Suppliers contend that using the lower, rather than the higher, of the fuel oil or natural gas price has prevented the PER mechanism from functioning as intended. The Capacity Suppliers state that after averaging less than $0.08/kW-month between February 2008 and July 2009, the Monthly PER increased to $2.065/kW-month in August 2010.[24]

19. NRG states that the proposed revisions, including the changes to the PER Strike Price calculation and gradual phasing in of the modifications, represent a significant compromise between capacity suppliers and capacity purchasers. NRG explains that since the first FCM Capacity Commitment started in June 2010, it and other capacity suppliers have been subject to PER deductions far in excess of the FCM designers' intent and expectations. According to NRG, the PER deduction has been repeatedly triggered even while real-time energy prices have remained at relatively low levels.[25]

20. Indicated Suppliers and RESA, however, seek rejection of the Joint Filing, arguing that the proposed tariff changes are unjust and unreasonable, due to concerns based largely on the timing of the change in the method of calculating the PER Strike Price. According to the Indicated Suppliers, the timing of the proposed FCM amendments would effectuate a revenue shift from load suppliers to generation-based capacity suppliers. Indicated Suppliers argue that there is nothing unexpected about gas prices being lower than oil prices, and nothing unexpected about oil being the marginal cost

[24] According to the Capacity Suppliers, while the rolling average has the effect of smoothing the impact of spikes in the Monthly PER values, it is merely spreading the pain, because the full amount of the Monthly PER for any given month, e.g., the $2.065/kW-month, is ultimately deducted from capacity payments. They further argue that when such deductions are compared with capacity payments of $4.50/kW-month (or $4.21/kW-month for generators in Connecticut) for the 2010/2011 Commitment Period, there can be no question as to the enormous detrimental impact of the PER on generators with Capacity Supply Obligations. Capacity Suppliers Comments at 8-10.

[25] NRG states that over the past seven months, oil prices have increased, while natural gas prices came down. This disconnect results in the PER triggering even when prices are set by "mid-merit" generating resources, which are routinely relied upon by ISO-NE to meet load, and does not represent the price of the marginal unit when the system is entering scarcity conditions, as contemplated by the plain language of the tariff. The result is that a substantial PER deduction is being assessed even though capacity suppliers are receiving no excess energy rents in the market. *See* NRG Comments at 1-2.

fuel, because oil-fired generators are often the marginal units. Indicated Suppliers argue that this proposed tariff revision was moved too quickly through the stakeholder process, and they object to implementing the change on less than 60 days' notice. They assert that load suppliers, who have entered into contracts to provide service to their own customers and priced those contracts on the basis of their expectations of PER credits, will not be able to recoup those lost PER credits, and will be economically damaged thereby. Indicated Suppliers state that the applicability of this change to reduce the amount of the Monthly PER for past months gives this change "a retroactive effect that changes the benefits and burdens of those past transactions and undermines the business considerations upon which the parties relied."[26]

21. RESA similarly takes issue with the manner and timing with which the proposed revisions were developed. In particular, RESA states that any supposed problem that the revisions are designed to address has not been properly identified or vetted through the stakeholder process and on reasoned consideration of the PER feature within the FCM as a whole.[27] Moreover, RESA argues that the proposed revisions to the PER Strike Price calculation may cause significant harm to load-serving entities (LSE) with fixed price contracts, which reasonably relied upon the PER credits in pricing services to load.[28] RESA argues that LSEs had no indication, from ISO-NE or otherwise, that this change would occur effective December 21, 2010 and, therefore, LSEs rightfully relied on existing Commission-approved Tariff provisions to develop pricing, lock in contracts with end-use customers, and provide offers for default supply obligations.[29]

22. In response to RESA's assertions regarding the stakeholder process, the Filing Parties state that the stakeholder process complied with the Participants Agreement, and the maximum notice possible of this filing was provided to shareholders. NEPOOL further asserts that at the December 10, 2010 Participants Committee meeting, participants rejected a motion to delay this filing by one month.[30]

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[26] Indicated Suppliers Protest at 23.

[27] RESA notes that the sheer lack of transparency and the speed with which the proposal was made and approved shows an utter lack of due process and illustrates that the proposal will not result in just and reasonable rates. *See* RESA Protest at 2, 9.

[28] *Id*. at 8.

[29] *Id*. at 13-14.

[30] Filing Parties Answer at 7-8.

23. In their response to the protests, the Capacity Suppliers state that protestors seek to delay or block the correction of a critical flaw in the existing PER mechanism and thereby retain the benefits of an unintended financial windfall that LSEs enjoy under the current rule. The Capacity Suppliers state that the proposed change to the use of the higher of, rather than the lower of, gas prices as the fuel for the hypothetical PER Proxy Unit will help ensure that the PER mechanism fulfills the PER design objective in three ways. First, it will discourage energy market manipulation by mitigating the economic incentive that the calculation of the Hourly PER – based solely on real-time prices – creates for under scheduling load requirements in the real-time Energy Market.[31] Second, it will improve the PER mechanism's performance as a hedge for LSEs against spot energy price spikes by reducing the variance of payments and profits.[32] Third, it will improve the PER mechanism's performance in coordinating energy and capacity market revenues by reducing the mismatch between PER deductions (based on real-time prices) and energy revenues.[33]

c. Commission Ruling

24. We agree with the Filing Parties' arguments that the PER mechanism is not functioning as intended. The Commission finds that the proposed tariff changes revising the calculation of the PER Strike Price to reflect the higher of the price of oil or gas are just and reasonable, because they would enable the PER Strike Price to more closely approximate the operating costs of the marginal unit during shortage conditions. The PER mechanism is intended to remove the incentive to raise prices in the energy markets.[34] To do so, it uses a PER Proxy Unit to represent the resource with the highest

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[31] Capacity Suppliers Answer, Attachment A, Affidavit of Dr. Paul Milgrom at P 13, 15 (Milgrom Affidavit). Dr. Milgrom asserts that, under the current PER rule, PER deductions can exceed the generators' actual peak energy rents to such an extent that LSEs pay *less* when energy market prices are higher in the real-time market. That is, load, in aggregate, is overcompensated for spikes in energy prices. *Id.*

[32] *Id.* at P 17.

[33] *Id.* at P 18-20.

[34] *See Devon Power LLC*, 115 FERC ¶ 61,340, at P 24, 29 (2006) (FCM Settlement Order):

> 24. Capacity suppliers will have their monthly capacity payments reduced to account for [certain] phenomena. First a "peak energy rent" sum will be deducted from monthly capacity payments. The peak energy rent sum . . . is based on revenues that would be earned in the energy market by a

(continued…)

running cost in the market; the PER Strike Price is intended to reflect the running costs of that highest-cost unit.[35] Such a unit will be dispatched only when the LMP is at or above the unit's running costs. However, under the existing calculation method, the PER Strike Price can be lower than that highest-cost unit's running costs. Thus, when ISO-NE calculates the PER adjustment using a PER Strike Price that does not accurately reflect that highest-cost unit's running costs,[36] the PER adjustment could be greater than the net energy revenue that actual units with similar running costs would receive. As a result, resources with higher running costs than the PER Strike Price would have an incentive to raise their offer prices in the capacity market to offset a PER adjustment that they would anticipate to be larger than their expected energy revenues. The proposed revisions are likely to make the PER Strike Price a closer approximation of the revenue earned by such

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> hypothetical, proxy peaking unit. . . . The peak energy rent deduction is designed as a hedge for load against price spikes in the energy market.
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> 29. . . . [T]he peak energy rent deduction is intended to help mitigate incentives to create price spikes in the energy market. [The parties] assert that, while it may be profitable to raise prices in the energy market, the peak energy rent mechanism will remove any profits gained from the rise in prices because the extra revenues earned in the energy market are deducted from capacity payments.

[35] *See* Transmittal Letter, Joint Filing at 6, footnote omitted:

> The PER Strike Price was intended to approximate the operating costs of the marginal generating unit in New England when the region is approaching shortage conditions [and] . . . should be at or just above the price level at which the large majority of fossil-fuel resources are able to operate in the energy market and recover their out-of-pocket fuel and other operating costs.

[36] As discussed above at P 4 and 6, for each hour in which the Real-Time LMP exceeds the PER Strike Price, ISO-NE calculates an Hourly PER value, which is the difference between the Real-Time LMP and the PER Strike Price (with certain adjustments). ISO-NE then sums the Hourly PER values for each month to establish the Monthly PER value. Subsequently, ISO-NE averages the Monthly PER values, and deducts each resource's Average Monthly PER value from the resource's capacity payments.

high-cost units, thereby lessening that incentive for such units to raise their offer prices in the capacity market.

25. We further agree with the Filing Parties that the price separation between gas and oil prices ($5/MMBtu for gas and $15/MMBtu for oil on average as of October 2010), has widened substantially and, as a result, the PER is being triggered more often than anticipated, particularly during the hours when there are no shortage conditions in the New England region. Consequently, the reductions in capacity payments to generators have been larger than anticipated. As noted by ISO-NE, the total PER deductions from June 2010 through the December 2010 Obligation Month settlement have reduced generators' capacity revenue by more than $100 million.[37] The Filing Parties state that the PER Strike Price has been below the operating costs of all oil-fired generators in New England. As the Filing Parties note, the change to the marginal fuel, from the "lower" to the "higher" of the price of oil or gas price, would cause the PER Strike Price to more closely approximate the operating costs of the marginal generating unit in ISO-NE.

26. Concerns regarding proper use of the stakeholder process are addressed below.

2. Change from 12-Month Rolling Average to 6-Month Rolling Average

a. ISO-NE's and NEPOOL's Proposal

27. According to the Filing Parties, changing the fuel price to the higher of the price of oil or gas will ensure that the PER Strike Price will increase. But, absent other revisions to this Market Rule, the impact of this change on the PER deduction would not be fully realized for 12 months, as Monthly PER values (newly calculated using the "higher of" price) are, over time, rolled into the 12-month Average Monthly PER. The PER revisions filed here change the calculation of the Average Monthly PER such that it is the average of the Monthly PER values for the six months prior to the Obligation Month. This is accomplished by adding a tariff provision specifying that through January 2011, the Average Monthly PER will be equal to the average of the Monthly PER values for the 12 months prior to the Obligation Month, and that beginning February 1, 2011, the Average Monthly PER shall be equal to the average of the Monthly PER values for the 6 months prior to the Obligation Month.

28. The Filing Parties state that shortening the rolling average "is more an issue of balancing interests than it is a market design issue."[38] According to the Filing Parties,

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[37] Transmittal Letter, Joint Filing at 6 n. 23.

[38] *Id*. at 2.

during stakeholder discussions, generators proposed to eliminate any rolling average and base the PER deduction on the Monthly PER value for the single month prior to the Obligation Month, while LSEs sought continuance of the 12-month rolling average, arguing that they reasonably relied on current Market Rules, and that it would be unfair to change the Market Rules on short notice and in a manner that significantly impacts the economics of their contracts. [39] Noting their LSE members' general support for the proposed revisions to the PER Proxy Unit calculation,[40] the Filing Parties contend that, on balance, shortening the rolling average to six-months will adequately ensure that generators are charged lower PER deductions more quickly, as the older Monthly PER values – calculated using the lower fuel price – would not be factored into the calculation of the PER deduction at all.

b. Positions of the Parties

29. The Capacity Suppliers, Exelon, the Massachusetts Commission, and NECPUC support a six-month rolling average beginning with the calculation of the PER deduction for February 2011, asserting that the proposal represents a reasonable and fair resolution of an issue (i.e., the incorrect calculation of the PER Strike Price) that virtually all stakeholders agree requires resolution.[41] The Capacity Suppliers state that a number of its suppliers actively participated in the negotiations that yielded this proposal, and the generator sector uniformly voted in favor of it in the NEPOOL Participants Committee.

30. The Indicated Suppliers, however, state that the proposal to shorten the rolling average should be rejected or set for hearing, arguing that, without any mechanism to ensure that load suppliers have received the full benefit of the PER reduction, the revision would cause a revenue shift from load suppliers to generation-based capacity suppliers and arbitrarily and retroactively reduce the amount otherwise owed to load suppliers.[42] According to the Indicated Suppliers, if a six-month rolling average is used in February 2011, only the months of August 2010 through January 2011 will be included in the calculation to determine the PER offset for February 2011. Thus, load suppliers will lose the uncollected value of the PER deduction for January 2010 through July 2010 periods,

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[39] *Id*. at 9-10.

[40] The Filing Parties state that "LSEs generally supported adoption of a PER Strike Price based on the higher of oil or natural gas, but did not support elimination of the current 12-month rolling average calculation of the Average Monthly PER." *Id.* at 10.

[41] Capacity Suppliers Comments at 1-3.

[42] Indicated Suppliers Protest at 4, 35.

including the high PER summer months. For example, analysis by the Indicated Suppliers shows that if both the change to the "higher of" PER Proxy Unit calculation and the elimination of the 12-month rolling average are made as proposed, without including any deductions due to the change to the "higher of" pricing, the PER deduction that would have been $0.57/kW-month in March 2011 using the 12-month rolling average will instead be only $0.19/kW-month in March 2011 using the six-month rolling average. The Indicated Suppliers state the shortened rolling average would occur at the direct expense of load suppliers that already have entered into contracts based upon an expectation that the PER deduction would offset their costs of supplying capacity to load.[43] The Indicated Suppliers argue that the Filing Parties have failed to provide an adequate justification for the change.[44]

31. Similarly, RESA argues that a sudden change in or elimination of the credit will have devastating effects on its fixed price contracts customers, because PER credits to load are relied upon in pricing the services for its long-term fixed price contracts. RESA argues that if the Commission does not reject the proposed revisions, it should make any changes prospective only, to become effective at the start of the next capability year. Also positing that waiver of the 60-day filing requirement is unjustified, RESA contends that ISO-NE must work with all stakeholders to explore whether and how the PER mechanism should be changed, and what transition measures should be put in place to implement that change.[45]

32. In response to the Capacity Suppliers and RESA, the Filing Parties state that shortening the rolling average was intended to address concerns expressed in the stakeholder process that, absent any such change, it would be a full year before the PER deduction is based only on the revised PER Strike Price.[46] They also note that during that six-month period, buyers in the FCM will continue to reap benefits from PER deductions that reflect, for some months, the use of unexpectedly large numbers of

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[43] *Id*. at 21.

[44] According to the Indicated Suppliers, the testimony of the Vice President for Market Development for ISO-NE, Dr. Ethier, attached to the Filing Parties' proposed revisions, does not support shortening the 12-month rolling average. *Id.* at 17.

[45] RESA Protest at 10.

[46] The Filing Parties further explain that allowing the PER revisions to take effect as requested addresses some immediate concerns with the PER mechanism, while still allowing those who seek further changes to the PER mechanism an opportunity to pursue those changes in the upcoming stakeholder process. *See* Filing Parties Answer at 12-14.

Hourly PERs, but thereafter will pay capacity charges that are reduced by PER deductions more in line with the purpose of the PER.

33. In NEPOOL's view, the PER revisions are strictly prospective in nature and modify only the formula for the calculation of payments in future months. NEPOOL states that the PER revisions do not change payments that have already occurred. Rather, according to NEPOOL, the PER adjustment is a formula rate that is applied monthly, uses historical data (which, in this case, also happens to be historical PER adjustments), and can be changed in the same prospective manner as any other market rule.[47] NEPOOL also states that the Indicated Suppliers and RESA propose a standard for market rule changes that would prevent any change to the formula for the PER adjustment for at least 12 months, and that, while voluntary adoption of such a standard might be reasonable in certain instances, such a standard is not legally required to permit changes like those at issue here.

34. In response to Capacity Suppliers' and the Filing Parties' answers, Indicated Suppliers reiterate the argument that the Filing Parties have not shown that the change from 12-month averaging to six-month averaging is just and reasonable.[48] According to Indicated Suppliers, the Filing Parties concede that it was the change to the method of calculating the PER Strike Price, rather than the change from the 12-month to a six-month average, that had been vetted in the stakeholder process previously, and on this basis, Indicated Suppliers urge the Commission to reject the elimination of the rolling 12-month average.[49]

c. <u>Commission Ruling</u>

35. The Commission rejects the Filing Parties' proposed tariff changes to shorten the rolling average period from 12 to six months. We note, however, that this finding is made without prejudice to the Filing Parties submitting a different proposal intended to address the same concerns as the revisions proposed here.

36. The Indicated Suppliers and RESA argue that the change from a 12-month rolling average to a six-month rolling average is at the direct expense of LSEs that already entered into contracts based upon an expectation that the PER deduction would offset their costs of supplying capacity to load. Indicated Suppliers argue:

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[47] *Id*. at 16-17.

[48] Indicated Suppliers Answer to Answers at 4.

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

> But for the proposed change to a 6 month rolling average, the load suppliers would expect in February 2011 to receive a PER deduction based upon the rolling average of the previous 12 months (February 2010 through January 2011). If the rolling average used in February 2011 is instead the 6 month rolling average, only the months of August 2010 through January 2011 will be included in the calculation to determine the PER offset for February 2011. Thus, load suppliers will lose the uncollected value of the PER deduction for past periods, including the high PER summer months. As June, July, August and September 2010 were high cost summer months with relatively high Monthly PERs (see Appendix A), the inability to collect the full deduction for these months has a particularly detrimental impact on load suppliers.[50]

37. Similarly, RESA states:

> By shortening the 12-month rolling average to a six-month rolling average, ISO-NE would prevent PER generated in previous months from being credited to load. This is because PER generated in a single month is credited back to load over the next 12 months. Shortening this time period prevents the full credits banked from flowing through the formula to load. PER accrued pursuant to the Tariff in the summer of 2010 (whether the level was appropriate or not) is a rate collected for service and the rate is not finally reconciled until the following 12-month period has expired.[51]

38. Indicated Suppliers' and RESA's concern arises because of the averaging method used by ISO-NE to calculate and deduct PER deductions from capacity suppliers and credit them to load. As an example, assume that, in the 12 months prior to a particular Obligation Month, for the first six of those 12 months, the Monthly PER Value was $10 per month, and for the second six of those 12 months, the Monthly PER Value was $1 per month. Averaged over 12 months, the Average Monthly PER Value would be $5.50 per month; thus, capacity suppliers would incur a PER deduction of $5.50 for that Obligation Month, and load would receive a credit of the same amount. But if, instead of averaging over 12 months, ISO-NE averages over the second six-month period, when Monthly PER Values are lower, then the Average Monthly PER Value would be $1.

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[50] Indicated Suppliers Protest at 23-24.

[51] RESA Protest at 16.

RESA states that LSEs often offer fixed price contracts to customers (which can be either customers purchasing services as part of a state retail access program or customers served via the local utility provider of last resort solicitations), and the PER credits to load are relied upon in pricing the services in these often long-term arrangements.[52]

39. While the Commission agrees with the Filing Parties that consideration of this issue might require a balancing of interests between generators and LSEs, we disagree that a six-month rolling average properly balances those interests. Rather, we find that it is reasonable to consider the fact that LSEs often offer fixed-price contracts to customers, and the PER credits to load are relied upon in pricing the services in these often long-term arrangements.[53]

40. The Commission thus rejects the Filing Parties' proposal, as submitted here, to move, on an immediate basis, from a 12-month rolling average to a six-month rolling average for the calculation of PER. While shortening the rolling average period might expedite for generators the effect of the tariff changes that are accepted herein, it does not account for the above-mentioned interests of the LSEs. To that end, our rejection is without prejudice to the development of a different proposal. Because we reject the proposal to shorten the rolling average period, we do not need to address the arguments as to whether the proposal violates the File Rate Doctrine, or constitutes retroactive ratemaking, or whether the stakeholder process was properly utilized in developing that proposal.

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[52] *Id*. at 5; *see also* Indicated Suppliers Protest at 21.

[53] We further note that the timing of the transition is particularly troubling, since it will transfer from load to generators all of the benefits of the PER mechanism for high cost summer months. *See* Indicated Suppliers Protest at 23-24:

> If the rolling average used in February 2011 is instead the 6 month rolling average, only the months of August 2010 through January 2011 will be included in the calculation to determine the PER offset for February 2011. Thus, load suppliers will lose the uncollected value of the PER deduction for past periods, including the high PER summer months. As June, July, August and September 2010 were high cost summer months with relatively high Monthly PERs (see Appendix A), the inability to collect the full deduction for these months has a particularly detrimental impact on load suppliers.

3. Waiver of 60-Day Notice Requirement

a. Filing Parties' Proposal

41. Pursuant to section 35.11 of the Commission's rules and regulations of the Commission's rules and regulations,[54] the Filing Parties request waiver of the 60-day notice requirement so that the proposed PER revisions may become effective on December 22, 2010, one day after the revisions were submitted for filing, with implementation of the modified PER Strike Price for the entire settlement month of December 2010. They state that good cause exists to grant the requested waiver of the 60-day notice requirement for the PER Revisions. According to the Filing Parties, ISO-NE and most stakeholders agree that the substantive change to the higher of the two fuel prices for the PER Proxy Unit is appropriate. They assert that enabling the modified PER Strike Price immediately will best address the unexpected problems with the current PER mechanism, as described above, and will ensure the improved functioning of the PER mechanism – both as deterrent of market manipulation and as a hedge for load – in the short term.

b. Positions of the Parties

42. RESA argues against granting the waiver because, it asserts, the Filing Parties did not show good cause for a waiver, and the Commission has consistently denied waiver when the rate to be imposed will cause a rate increase for customers.[55]

43. The Filing Parties state in their answer that good cause exists to accept the requested wavier of the 60-day notice requirement, and immediate effectiveness of the rates will best address concerns regarding unintended, higher levels of historic Hourly PER, and help ensure the improved functioning of the PER mechanism. They state that the Commission routinely grants waivers of prior notice requirements in situations that correct flaws in, or otherwise improve, rules for these markets.[56]

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[54] 18 C.F.R. § 35.11 (2010)

[55] RESA Protest at 16-17.

[56] Filing Parties Answer at 14.

c. **Commission Ruling**

44. As we stated in *Central Hudson Gas & Electric Corp.*,[57] the Commission will not grant a waiver of the 60-day notice requirement absent a strong showing of good cause. Here, the Filing Parties have demonstrated that the current method of PER calculation is preventing the PER mechanism from achieving its important purposes, namely, removing the incentive to raise prices in the Real-Time Energy Market by offsetting high real-time prices with reductions in capacity payments, and acting as a hedge for load against high prices (price spikes) in the energy market. Also, in light of the 12-month rolling average method of calculation that is now in the Tariff, the sooner the new method of calculation (i.e., using the higher of, rather than lower of, gas or oil prices to calculate the PER Strike Price) goes into effect, the sooner that new value will be reflected in the 12-month rolling average. This is beneficial, because it will more accurately achieve the purposes of the PER. Therefore, the Commission grants the request for waiver.

The Commission orders:

(A) Waiver of the 60-day notice requirement is hereby granted.

(B) The Filing Parties' proposed tariff revisions are hereby accepted in part and rejected in part, effective December 22, 2010, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

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[57] 60 FERC ¶ 61,106, at 61,338, *reh'g denied*, 61 FERC ¶ 61,089 (1992).