

NEPOOL to make filings, on an emergency/expedited basis, to revise or amend NE-SMD in order to ensure adequate levels of compensation for generators providing needed reliability products and to incent market participants to build infrastructure, implement demand-side management programs, or take other appropriate measures to reduce the need for NRG's units or provide for appropriate compensation to these units.

26. CT DPUC further argues that since Connecticut ratepayers will pay most, the Commission should order that the ISO NE be required to examine the reliability need for any of these units upon written request by the CT DPUC and issue a finding within 60 days of such a request.

Commission Response

27. The RMR agreements filed by the Applicants in this proceeding were negotiated with ISO-NE in accordance with MRP 17.3. The Applicants state that they are not required to establish the need for these agreements because they were negotiated under the authority of ISO-NE.¹³ ISO-NE states that it has conducted a reliability assessment for Connecticut for the years 2003 and 2006 and has determined that, absent any transmission improvements or new resources, largely all of the existing resources in Connecticut are needed for reliability.¹⁴ ISO-NE further states that the appropriate format to be used for cost-of-service agreements is the pro forma RMR agreement that is a part of Market Rule 1.¹⁵

28. ISO-NE is concerned that, under its current market rules and mitigation policies, some generators needed for reliability in load pockets—*i.e.*, in DCAs—may be unable to recover their full fixed and variable costs and not be available for reliability. Ultimately, New England proposes to allow for such cost recovery with a combination of scarcity pricing and location-specific capacity payments. Until these features are implemented, however, ISO-NE has proposed (and the Commission has accepted) relaxed mitigation rules for units in DCAs with the intent to provide for sufficient cost recovery. In particular, under Market Rule 1, generators in DCAs would be permitted to submit bids up to the level of the fully allocated cost-of-service of a new combustion turbine, the "CT Proxy"

bid. This safe harbor bid includes a fixed cost adder designed to recover the fixed costs of a new CT over the total number of hours of congestion in the DCA. However, NRG states that its units operate during far fewer hours, and if it receives only the CT Proxy price for the power it supplies, it will fail to recover its costs.¹⁶ NRG asks the Commission to approve temporary RMR contracts for its units that would pay them their full cost-of-service until ISO-NE is able to implement locational ICAP or some other form of locational capacity requirement.

29. RMR contracts suppress market-clearing prices, increase uplift payments, and make it difficult for new generators to profitably enter the market. That is because under current market rules, generators operating under a cost-of-service RMR contract must offer power under a Stipulated Bid Cost that includes stipulated marginal, start-up and no-load costs. The units are then entitled to a monthly fixed cost payment to the extent that revenues earned from the energy market, including any payments for start-up and no-load costs, do not recover allowable capacity costs and fixed O&M costs. As a result, expensive generators under RMR contracts receive greater revenues than new entrants, who would receive lower revenues from the suppressed spot market price. In short, extensive use of RMR contracts undermines effective market performance. In addition, suppressed market clearing prices further erode the ability of other generators to earn competitive revenues in the market and increase the likelihood that additional units will also require RMR agreements to remain profitable. Therefore, we believe that ISO-NE, rather than focusing on and using stand-alone RMR agreements, should incorporate the effect of those agreements into a market-type mechanism.

30. The Commission discussed the subject of RMR agreements when ruling on the NE-SMD proposal in the September 20 Order. The order reaffirmed previous rulings that ISO-NE has the authority to enter into cost-of-service RMR agreements, the flexibility to address specific RMR situations when entering into agreements, and the requirement to file the agreements for review by the Commission.¹⁷ In the December 20 Order the Commission added that it expects ISO-NE to enter into RMR agreements with only those

units that are needed for reliability and that the Commission expects that the agreements will be in effect only for the period during which the units are needed for reliability.¹⁸

31. The Commission believes that RMR agreements should be a last resort and that the proliferation of these agreements is not in the best interest of the competitive market as they affect other suppliers participating in this market, especially those suppliers operating within the same DCA. Implementation of NE-SMD provides some of the needed price signals in this regard; however we believe, as many commenters in this proceeding as well as the NE-SMD proceeding have noted, a location-specific capacity requirement or a deliverability requirement is needed so that energy markets alone are not the only way for suppliers in DCAs to recover costs.¹⁹ We believe that the current situation in NEPOOL may not allow suppliers in DCAs an adequate opportunity to recover their costs and that a location-specific capacity requirement must be in place. ISO-NE and NEPOOL need to expeditiously address the issue of resource adequacy within the DCAs as well as other transmission constraints in New England that include areas affected by export constraints as well.

32. On the basis of the foregoing discussion, we will deny the Applicants' request to recover their full cost-of-service through an RMR contract and instead: (1) Direct the recovery of only forward maintenance costs through the RMR; and (2) direct ISO-NE to modify its market power mitigation mechanism to permit selected high cost but seldom run units in DCAs to raise their bids so as to recover their fixed and variable costs through the market (a Peaking Unit Safe Harbor Bid). These temporary rules are to remain in effect until ISO-NE makes a filing and places into effect certain changes to the market prior to the 2004 summer peak season as identified below. In this regard, we have changed only the form in which the Applicant's will be able to recover their fixed and variable costs, *i.e.*, use of a safe harbor bid within the market rather than an RMR contract.

33. Upon further review of Market Rule 1, we will, pursuant to Section 206

¹³ Application at fn.6.

¹⁴ Application at Attachment 1.

¹⁵ Market Rule 1, Appendix A, Exhibit 4, Original Sheet Nos. 260–287. Market Rule 1 was approved by the Commission as part of the September 20 Order approving NE-SMD (100 FERC ¶ 61,287 (2002)).

¹⁶ NRG states that the average overall capacity factor of the facilities subject to the proposed agreements is 8 percent. Filing at 5.

¹⁷ 100 FERC ¶ 61,287 at P 50.

¹⁸ 100 FERC ¶ 61,344 at P 33.

¹⁹ In the September 20 Order we directed NEPOOL to develop a locational mechanism together with the other Northeastern ISOs. At that time, the assumption was that the region was pursuing a Northeastern RTO. Consequently, the Commission did not provide a date certain when it expects the mechanism to be in place, only that it be implemented in accordance with a final SMD rule.