

UNITED STATES OF AMERICA 105 FERC ¶ 61,263  
FEDERAL ENERGY REGULATORY COMMISSION

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

ISO New England, Inc.

Docket No. ER04-23-000

ORDER ACCEPTING AMENDED RELIABILITY AGREEMENT FOR FILING AND  
SUSPENDING PROPOSED RATES, SUBJECT TO REFUND, AND ESTABLISHING  
HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued December 1, 2003)

1. In this order, the Commission accepts the Amended Reliability Agreement (Agreement) between ISO New England, Inc. (ISO-NE) and Devon Power LLC (Devon) governing the operation of Devon generating units 7 and 8 located in southwest Connecticut. For the reasons discussed below, the Commission will conditionally accept the Agreement and suspend the rates (proposed Reliability Charge), make them subject to refund, and institute hearing and settlement judge procedures. This Agreement benefits customers in southwest Connecticut by ensuring the availability of generation and, consequently, the reliable supply of electricity until additional generation becomes available.

**Background**

2. On October 2, 2003, Devon filed this Reliability-Must-Run (RMR) Agreement pursuant to Section 205 of the Federal Power Act (FPA).<sup>1</sup> The Agreement provides for an extension of the term of an existing Reliability Agreement for an additional 12-month period.<sup>2</sup> Prior to entering into the existing Reliability Agreement with ISO-NE, Devon applied to ISO-NE to deactivate Devon 7 and 8. In July 2002, ISO-NE denied the application after concluding that the generating units were needed to maintain reliability until new generation (Milford Station) is activated. The existing Reliability Agreement was entered into in August 2002 under the assumption that the Milford Station would achieve commercial operation by October 2003.

3. Two events occurred that affect the existing reliability agreements. The first was the acceptance by the Commission of New England Standard Market Design (SMD),

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<sup>1</sup> 16 U.S.C. § 824(e) (2000).

<sup>2</sup> See ISO-NE, 101 FERC ¶ 61,341 (2002), reh'g pending.

which includes the new Market Rule 1.<sup>3</sup> Second, in 2003, through a series of orders, the Commission addressed the issue of RMR agreements in NEPOOL.<sup>4</sup> After receiving several filings for proposed RMR agreements for generating units in congested areas within NEPOOL, the Commission established the Peaking Unit Safe Harbor (PUSH) bidding mechanism. The temporary PUSH mechanism permits peaking units with capacity factors of 10 percent or less to bid into the market at the PUSH bid level. The PUSH bid level, determined for each eligible unit, provides the opportunity to recover fixed and variable costs through the market rather than through RMR agreements.

4. According to ISO-NE, the Milford Station is not yet commercially operational; therefore, an extension of the existing reliability agreement is needed until Devon 7 and 8 are no longer needed to address regional capacity shortages and transmission constraints. The proposed Agreement, negotiated pursuant to Sections 18.4 and 18.5 of the Restated NEPOOL Agreement (RNA), reflects the need to compensate Devon for the continued operation of these units.<sup>5</sup>

5. The proposed Agreement amends the existing RMR agreement with respect to terms and conditions and revises rates for a one-year extension, until October 1, 2004. The amendments to the existing agreement primarily reflect changes to the NEPOOL market that occurred with the implementation of SMD on March 1, 2003. Among the changes is the elimination of the negotiated revenue sharing provision under the existing agreement. This provision allowed Devon to retain 10 percent of any market-generated profits while it operated under the negotiated fixed cost payments of the RMR agreement. Since the proposed Agreement intends that Devon recover fixed costs at rates approved by the Commission in this proceeding, the amended Agreement provides that all market revenues (including those from a future locational ICAP market) generated by Devon be credited against the cost-of-service rates. The Agreement can be terminated by ISO-NE with 60 days notice given prior to March 1, 2004, if the ISO determines that the Devon units are no longer needed for reliability.

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<sup>3</sup> New England Power Pool (NEPOOL) and ISO New England, Inc., 100 FERC ¶ 61,287 (2002).

<sup>4</sup> Devon Power LLC, et. al., 103 FERC ¶ 61,082 (2003)(April 25 Order) , order on reh'g, 104 FERC ¶ 61,123 (2003)(July 24 Order); PPL Wallingford Energy LLC, 103 FERC ¶ 61,185 (2003), reh'g pending, (collectively, PUSH Orders).

<sup>5</sup> ISO-NE states that it negotiated the Amended Reliability Agreement pursuant to Sections 18.4 and 18.5 of the Restated NEPOOL Agreement rather than Market Rule 1 because it is an extension of the existing Reliability Agreement that was negotiated in accordance with the RNA. Additionally, ISO-NE states that the Commission affirmed the authority of ISO-NE to enter into RMR agreements in the order accepting the New England Standard Market Design. See 100 FERC ¶ 61,287 at P 50.

6. Devon proposes an initial Reliability Charge of \$6.09/kW for both units 7 and 8. This rate reflects certain determinations that were made in the PUSH Orders regarding PUSH bid levels for other units that Devon's parent company, NRG, operates, including other units at the Devon station. Those determinations include a return on equity of 10.88 percent. Devon states that it is proposing this rate in order to meet the Commission's test for a one-day suspension. Devon is also proposing that the Commission approve an alternative rate of \$7.35/kW that includes, among other things, a return on equity of 13.39 percent. Devon states that it is willing to forgo this alternative rate until the Commission issues an order on rehearing of the July 24 Order.

7. Devon requests that the Commission establish an effective date for the Agreement of October 3, 2003, which reflects a one day suspension.

### **Notice of Filings, Protests, and Interventions**

8. Notice of Devon's Agreement filing was published in the Federal Register, 68 Fed. Reg. 68,118 (2003) with protests and motions to intervene due on or before October 16, 2003. Timely motions to intervene were filed by Exelon Corporation and NU Operating Companies (and Select Energy, Inc.). New England Consumer-Owned Entities (NECOE) filed a timely motion to intervene, protest, and to reject the Agreement. Timely motions to intervene, and comments, or protests were filed by Dominion Energy Marketing, Inc. (DEMI), ISO-NE, PSEG Energy Resources and Trade LLC (PSEG), and NSTAR Electric and Gas Corporation (NSTAR). Motions to intervene out of time, comments, and protests were filed by the Connecticut Department of Public Utility Control (CT DPUC) and the United Illuminating Company (UI).

9. ISO-NE filed a motion for leave to respond and a response to the protest of NSTAR, the comments of PSEG, the protest of DEMI, and the protest of NECOE. Devon filed a motion to file an answer out of time and answer to the motion to reject filed by NECOE, and an answer to the protests filed by NSTAR, DEMI, and ISO-NE.

### **Discussion**

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,<sup>6</sup> the timely unopposed motions to intervene serve to make the parties that filed them parties to the proceeding. Notwithstanding that Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. ' 385.213 (2002), generally prohibits the filing of an answer to a protest, we find that good cause exists to grant Devon and ISO-NE's answers as they assisted in our understanding and resolution of the issues. We will grant UI's and the CT DPUC's motions to intervene out of time given their interest in this proceeding, the early stage of the proceeding and the absence of any undue prejudice or delay.

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<sup>6</sup> 18 C.F.R. § 385.214 (2003).

11. ISO-NE filed comments supporting the need for the Agreement until the Milford Station becomes operational, at which time these Devon units would no longer be needed to maintain reliability. ISO-NE further states that reliability studies performed by the ISO indicate that the capacity shortage and transmission constraints that led to the original agreement are expected to continue. ISO-NE states that it will reassess the need for the Agreement once the Milford Station becomes operational and will exercise its termination rights if prudent.

12. ISO-NE also supports revisions made to Section 3.1.1 of the Agreement to eliminate revenue sharing under the previous agreements and other revisions to take into account the new market structure under New England SMD. The ISO states that the revenue sharing in the previous agreements, allowing Devon a 10 percent share of revenues from additional profits from participating in the market, are no longer needed because the Agreement gives Devon cost-of-service rate certainty that is above the negotiated rates of the original agreements. The ISO states that all potential sources of revenue, including locational ICAP, would offset the payments under the Agreement.

13. ISO-NE protests certain aspects of the proposed rates and urges the Commission to investigate and set them for hearing. These include: lack of justification for proposed O&M expenses; amount of rate base and depreciation expenses; lack of support for the negative salvage amounts; and the method used to allocate A&G expenses. NECOE also protests rate components including return on equity, O&M and A&G expenses, organizational and acquisition costs, and treatment of maintenance activities.

14. The CT DPUC states that the Agreement should allow Devon to recover only amounts above market-based rates necessary to keep the units in operation and that Devon should be required to demonstrate a revenue shortfall. The CT DPUC also states that Devon should be encouraged to maximize its revenue in the markets to offset the RMR payments. NSTAR states that the proposed rates should be thoroughly scrutinized and that the Commission should not approve the alternative rates proposed by the Applicants. DEMI asks the Commission to set the proposed rates for hearing. NECOE states that ISO-NE has failed to exercise its authority by not conducting an independent analysis of the proposed rates.

15. In its answer, Devon disputes the rate issues raised by interveners (except for certain Organizational Costs which Devon states were included in error) and provides additional support including affidavits.

16. Several interveners state that these units should be required to operate under the PUSH rules. UI, NSTAR, DEMI, and NECOE reference the rationale for the PUSH mechanism and the PUSH Orders as a basis for rejecting the Agreement. UI states that the Applicants provide no reason for treating Devon 7 and 8 differently than other generating units. NSTAR states that these units should operate under the PUSH

mechanism, or if they do not qualify, operate in the market. DEMI urges the Commission to establish hearing procedures to evaluate whether these units are exempt from the PUSH mechanism, and NECOE states that the Applicants should be required to demonstrate why making these units operate as PUSH units is inappropriate. In addition, NECOE states that the Commission should take action to ensure that the units cannot be deactivated if the Agreement is rejected and the units therefore are to operate under the PUSH mechanism.

17. ISO-NE responded, stating that Devon 7 and 8 are not eligible for PUSH treatment because their capacity factors for 2002 exceeded the 10 percent threshold. The ISO also states that while the Commission disfavors RMR agreements, the use of RMR agreements may still be necessary. ISO-NE also notes that NECOE has not offered an alternative method of compensating Devon 7 and 8.

18. Devon answers that the PUSH Orders did not prohibit the use of RMR agreements and did not indicate the circumstances in which an RMR agreement would be appropriate. Devon also states that these units are not eligible to bid as PUSH units and that, absent the RMR agreement, would recover only a minimal amount of going forward costs. In support, Devon presents projections of inframarginal and ICAP revenues that these units could expect from the market.

19. PSEG states that ISO-NE's reliance on RMR agreements is the result of a dysfunctional market design that, even with PUSH bidding, does not allow generators to recover their revenue requirements. PSEG states that the proper valuation of capacity in constrained areas will be addressed with capacity market changes to take place on June 1, 2004 and that the Agreement should not extend beyond that date. UI also states that, should the Commission grant the extension of the Agreement, the term should be only until June 1, 2004, when new installed capacity rules are supposed to go into effect. ISO-NE responds that the comments of PSEG address issues that are beyond the scope of this proceeding.

### **Commission Response**

20. The Commission accepts the Amended Reliability Agreement for filing and sets the proposed Reliability Charges for hearing. We note that there are sufficient differences between the Agreement for Devon 7 and 8 and the RMR agreements the Commission rejected in favor of the PUSH mechanism.

21. The PUSH Orders expressed the Commission's preference for using market mechanisms rather than relying on cost-of-service ratemaking to retain adequate generating capacity within congested regions. However, while parties reference the PUSH Orders as a reason for rejecting the Agreement, the Commission did not preclude ISO-NE from using RMR agreements. We agree with ISO-NE that the July 24 Order

addressed the relationship between existing RMR agreements and the PUSH mechanism in general. While the July 24 Order clarified that a unit covered by an RMR contract could not also operate in the market as a PUSH unit, it did not state that when an RMR contract expired the unit could not be subject to a new RMR contract.<sup>7</sup>

22. We find that ISO-NE exercised its authority appropriately when it entered into the Agreement. In the case of Devon units 7 and 8, the only avenue open to ISO-NE to ensure that these units remain in operation for reliability in southwest Connecticut is to offer an RMR agreement. We therefore disagree with intervenor requests that this issue be set for hearing. Because this Agreement was negotiated pursuant to the pre-SMD provisions of the RNA rather than Market Rule 1, the Commission requires confirmation of the allocation method for the costs of the Agreement. The original RMR agreement was entered into before SMD when the costs were socialized across NEPOOL. The implementation of Market rule 1 under SMD requires that the costs of RMR agreements be borne by the customers in the zones in which the units are located.<sup>8</sup> Therefore, ISO-NE is directed to ensure that the costs of the Agreement are allocated only to those customers in the local areas where these units are satisfying reliability requirements.

23. We find that the proposed term of 12 months is appropriate given the uncertainties regarding the commercial operation of new capacity that would eliminate the need for the Agreement and the fact that ISO-NE has the ability to terminate the Agreement should that be prudent. We also do not find persuasive the arguments that the Agreement should terminate on June 1, 2004 when new installed capacity rules are to be in effect, since all market revenues are credited against the cost-of-service.

24. Although the Commission found that the rates contained in existing Reliability Agreement were properly reviewable under Section 205 of the FPA,<sup>9</sup> those rates were the result of mediated negotiations with participation by Commission Staff, and as a result were not set for hearing. However, the rates proposed in the Amended Reliability Agreement were not negotiated and are instead based on a proposed cost-of-service. Our preliminary analysis of the proposed rates indicate that they have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Accordingly, as discussed further below, we will accept the proposed rates for filing, suspend them for 1 day to become effective on October 3, 2003, subject to refund, and set them for hearing.

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<sup>7</sup> July 24 Order at P 56.

<sup>8</sup> 100 FERC ¶ 61,287 at P 61-62.

<sup>9</sup> 101 FERC ¶ 61,341 at P 14.

25. In order to provide the parties an opportunity to resolve these matters among themselves, we will hold the hearing in abeyance and direct settlement judge procedures, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.<sup>10</sup> If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in this proceeding; otherwise, the Chief Judge will select a judge for this purpose.<sup>11</sup> The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of this order concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

26. The Commission will, however, make specific findings regarding an issue that was addressed in the PUSH Orders. We accepted the use of a return on equity of 10.88 percent in the July 24 Order (pending on rehearing); and, therefore, we do not believe it is necessary to revisit the issue in this proceeding.

27. Regarding NECOE's comment that ISO-NE has not fulfilled its obligations in analyzing the proposed rates, we find that because these rates were submitted in accordance with, and are reviewable under Section 205 of the FPA, it is not ISO-NE's responsibility to determine whether the rates are just and reasonable. Additionally, concerns over revenues that these units may earn when a new capacity regime is implemented on June 1, 2004 are addressed by the fact that all revenues earned by these units from the market will be credited against the rate.

The Commission orders:

(A) The Amended Reliability Agreement filed on October 2, 2003 is accepted for filing, suspended for 1 day to become effective October 3, 2003, subject to refund, and set for hearing.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by Section 402(a) of the Department of Energy Organization Act and by the FPA, particularly Sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the FPA (18 C.F.R., Chapter I), a public hearing shall be held in Docket No.

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<sup>10</sup>18 C.F.R. § 385.603 (2003).

<sup>11</sup>If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience. ([www.ferc.gov](http://www.ferc.gov) – click on Office of Administrative Law Judges).

ER04-23-000 concerning the justness and reasonableness of the proposed Reliability Rates contained in the Amended Reliability Agreement, as discussed in the body of this order. As discussed in the body of this order, the hearing will be held in abeyance to give the parties time to conduct settlement judge negotiations.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2003), the Chief Administrative Law Judge is hereby authorized to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge in writing or by telephone within five (5) days of the date of this order.

(D) Within sixty (60) days of the date of this order, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

(E) If the settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding administrative law judge, to be designated by the Chief Administrative Law Judge, shall convene a conference in these proceedings in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates, and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.