

**STATE OF CONNECTICUT  
DEPARTMENT OF PUBLIC UTILITY CONTROL**

Docket No. 05-07-14PH02

) DPUC INVESTIGATION OF MEASURES  
TO REDUCE FEDERALLY MANDATED  
CONGESTION CHARGES (LONG TERM  
MEASURES)

**COMMENTS OF THE NEW ENGLAND  
POWER GENERATORS ASSOCIATION, INC.**

Pursuant to the Department of Public Utility Control's ("DPUC" or "Department") September 13, 2006, Interim Decision in the above-referenced proceeding ("Interim Decision"), the New England Power Generators Association, Inc. ("NEPGA") submits the following comments on the draft Master Agreement for Generation Projects, issued on September 22, 2006, as further amended on October 2, 2006 ("Master Agreement" or "Agreement").<sup>1</sup>

As discussed below, NEPGA is concerned that the proposed Master Agreement contains at least one serious flaw that, if not remedied, could jeopardize the lawfulness of the Agreement by requiring a Supplier to bid into the ISO New England, Inc.'s ("ISO-NE") Forward Capacity Market ("FCM") at specified levels. Unless this flaw is corrected, parties who transact under the Master Agreement could be vulnerable to challenge under federal laws as having engaged in anti-competitive and/or manipulative conduct, and the Department's goals to minimize locational costs on ratepayers may be seriously undermined.

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<sup>1</sup> The Interim Decision invited interested potential contract counterparties to file Comments on the Master Agreement on or before October 6, 2006. As discussed below, NEPGA's members are competitive generation suppliers in New England, who are potential counterparties to the Master Agreement.

## **I. Description of NEPGA**

NEPGA, a nonprofit corporation registered in the state of Massachusetts, is the largest trade association representing competitive electric generating companies in New England. NEPGA's member companies represent approximately 20,000 megawatts (MW) of generating capacity in all six states of the New England region.<sup>2</sup> NEPGA's mission is to promote sound energy policies which will further economic development, jobs, and balanced environmental policy. NEPGA believes that sustainable competitive markets are the best means to provide long-term, reliable and affordable supplies of electricity for consumers. All NEPGA members are also members of the New England Power Pool ("NEPOOL"), and their generation, reserve, and other services are subject to the control of ISO-NE.

## **II. Background**

### **A. Background of this Proceeding**

As described in the Interim Decision, this proceeding was opened by the DPUC to identify long-term measures to reduce "Federally Mandated Congestion Charges" ("FMCC") for Connecticut ratepayers. The proceeding follows the enactment of General Statutes of Connecticut § 16-243 M, known as Public Act 05-01, An Act Concerning Energy Independence ("EIA"), which defines FMCC as including but not limited to charges associated with "locational marginal pricing and reliability must run contracts"<sup>3</sup> which the Department has said includes charges from all locationally-differentiated product markets administered by ISO New England Inc. ("ISO-NE").<sup>4</sup> Section 12(c) of the EIA mandated that the Department issue a Request For

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<sup>2</sup> Background and additional information about NEPGA can be found at: <http://www.nepga.org>.

<sup>3</sup> Gen. Stat. Conn. § 16-1(41).

<sup>4</sup> Interim Decision at 2.

Proposals (“RFP”) for projects to reduce the impact of FMCCs on ratepayers<sup>5</sup> This proceeding has focused on long-term capacity needs in Connecticut during the period 2007 through 2021.

The Department subsequently released a needs assessment<sup>6</sup> and, on September 15, 2006, released its “Request for Proposals to reduce impact of FMCCs” (“RFP”) whose objective is to reduce the impact of FMCCs “by facilitating the development of new or incremental capacity sooner than might otherwise occur in the marketplace and by reducing or hedging the costs of FMCCs....”<sup>7</sup> The RFP accordingly seeks new demand resources or new generation capacity resources, including additional investments in existing generation that will increase capacity.<sup>8</sup>

**B. Proceedings Establishing a Forward Capacity Market in New England**

On June 16, 2006, the Federal Energy Regulatory Commission (“FERC”) issued an Order Accepting Proposed Settlement Agreement, which accepted a settlement that included provisions to establish the FCM to be administered by ISO-NE.<sup>9</sup> The FCM was developed in response to proceedings in which FERC determined that generators are “not earning sufficient revenues” and that New England needs additional infrastructure soon to avert violations of

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<sup>5</sup> EIA, § 12(c).

<sup>6</sup> On August 25, 2006, the Department released a final “Report on the Electricity Sector Needs of Connecticut, 2007-2021” (“August 2006 Needs Assessment”). The August 2006 Needs Assessment found, among other things, that Connecticut needs 629 MW of incremental new capacity in 2007. Interim Decision at 8.

<sup>7</sup> Interim Decision at 10.

<sup>8</sup> See RFP at 10.

<sup>9</sup> See Explanatory Statement in Support of Settlement Agreement of the Settling Parties and Request for Expedited Consideration and Settlement Agreement Resolving All Issues, Docket Nos. ER03-563-000, *et al.* (March 6, 2006) (“FCM Settlement Agreement”); *Devon Power LLC*, 115 FERC ¶ 61,340 (2006) (“*Devon Power*”) *reh’g pending* (accepting the FCM Settlement Agreement).

reliability criteria.<sup>10</sup> The FCM establishes annual auctions to procure capacity three-plus years ahead of the relevant commitment period. The forward-looking auctions are to provide for a planning period that accommodates new entry, to allow new capacity to compete in the auctions.<sup>11</sup> The FCM is structured as a descending clock auction with bidding beginning for the first auction at two times the “Cost of New Entry” or “CONE” that was agreed upon in settlement. In subsequent auctions, the market design allows new capacity to set the clearing price in order to provide “a market-based measure of the cost of new entry.”<sup>12</sup>

The Explanatory Statement accompanying the FCM Settlement Agreement states that the FCM auction market “is designed to allow new capacity to set the clearing price, thus providing a market-based measure of the cost of new entry.”<sup>13</sup> In accepting the FCM Settlement Agreement, FERC found that the FCM construct “will provide a market-based mechanism to appropriately value capacity resources based on their location, satisfying cost-causation principles.”<sup>14</sup>

### **C. The Master Agreement for Generation Projects**

On September 22, 2006, the Department released a draft Master Agreement for Generation Projects (“Master Agreement”). The Master Agreement is a purely financial contract, structured as a contract for differences, with financial settlement against the FCM. The Master Agreement is to be used by generation Suppliers (or sellers)<sup>15</sup> that under the Agreement are entities responding to the RFP with plans to build and operate new generation resources in

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<sup>10</sup> *Devon Power* at P 63.

<sup>11</sup> *Id.* at P 16.

<sup>12</sup> *Id.* at P 27.

<sup>13</sup> FCM Settlement Agreement, Explanatory Statement at 3.

<sup>14</sup> *Devon Power* at P 65.

<sup>15</sup> Capitalized terms not otherwise defined herein are as defined in the Master Agreement.

Connecticut. Buyers under the contracts will be the Connecticut distribution companies, Connecticut Light and Power Company (“CL&P”) and The United Illuminating Company (“UI”).

Under the Master Agreement, although Suppliers are not physically supplying capacity to Buyers, Suppliers are required to qualify and bid the notional quantity of capacity specified in the Agreement into the Forward Capacity Auctions (“FCAs”) held by the ISO-NE in its administration of the FCM. Significantly, Section 3.3(b) of the Master Agreement restricts the bids of Suppliers into the FCA as follows: in the first FCA for a new generation resource, a physical quantity of capacity (equal to the notional quantity under the Agreement) must be offered in the FCA at a price “no less than 0.75 multiplied by CONE and no greater than 0.85 multiplied by CONE, for a term of one year,”<sup>16</sup> while in all subsequent FCAs for the remainder of the Term of the Agreement (or if the generation resource does not qualify as a new resource in its first FCA), the Supplier must bid this physical quantity of capacity into the FCA “such that it is a price-taker in the FCA.”<sup>17</sup> Thus, the Master Agreement requires Suppliers to bid physical quantities of capacity into the ISO-NE administered FCM at a price at least 15% below CONE (and possibly much lower).

### **III. Comments**

NEPGA members own and develop generation in New England and participate in the New England energy, capacity and ancillary services markets. Many NEPGA members were signatories to the FCM Settlement Agreement, and NEPGA members may participate in the Department’s RFP.

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<sup>16</sup> Master Agreement § 3.39b(a.)(i). The Master Agreement defines CONE as it is defined in the FCM Settlement Agreement (*i.e.*, for the first FCA, CONE is as agreed upon by the settling parties). *See* Master Agreement, Art. 1 General definitions.

<sup>17</sup> *Id.*

NEPGA has serious concerns with the language in the bidding provisions of Section 3.3(b) of the Agreement that compel a Supplier to bid physical quantities of capacity into the ISO-NE administered FCA at prices specified in the Agreement. NEPGA also has significant concerns that the prices specified in the Agreement would be at least 15% below CONE (and possibly lower), and urges the Department to remove these and any other provisions in the Agreement that would create artificial restrictions to bid at a specified level.

Significantly, parties that sign a contract containing these provisions could be found to have violated federal antitrust laws, the intent of the FERC-accepted FCM Settlement Agreement and laws prohibiting manipulation of wholesale markets subject to FERC's jurisdiction. NEPGA believes it is critical for the Department to minimize any potential challenge to the Master Agreements and to ensure that parties to those contracts are not exposed to potential liability under federal laws. To correct this problem, NEPGA requests the Department to delete the provisions of Section 3.3(b) referenced above that would require the Supplier to bid at particular levels with regard to the ISO-NE's FCM auction, and instead to include a statement that bids into the FCAs must be in compliance with ISO-NE market rules and applicable laws.

As proposed, significant antitrust questions are raised by the inclusion of a requirement that Suppliers under the Master Agreement offer capacity into the FCM within a pre-established price range. By requiring parties to agree by contract to a specified level of bidding in the FCM auctions, the parties could be accused of price fixing in violation of Section 1 of the Sherman Antitrust Act<sup>18</sup> and/or Section 5 of the Federal Trade Commission Act.<sup>19</sup> If the federal government or third parties attempted to bring charges under such laws, both parties to

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<sup>18</sup> 15 U.S.C. § 1.

<sup>19</sup> 15 U.S.C. § 45.

the Master Agreement (*i.e.*, both the seller and buyer, including either CL&P or UI) could be vulnerable to antitrust liability. Indeed, under certain antitrust precedents, it is the Buyer under the Master Agreement that would most likely be deemed in violation and subject to associated liability.<sup>20</sup>

Furthermore, the FCM and its auction are FERC-approved wholesale market mechanisms that will be incorporated into the ISO New England Transmission, Markets and Services Tariff (“ISO-NE Tariff”).<sup>21</sup> The prices for capacity that will result from the first FCM auction and subsequent auctions are prices for wholesale power services subject to the FERC’s rate jurisdiction under Sections 205 and 206 of the Federal Power Act (“FPA”) and FERC’s regulatory oversight of those rates.<sup>22</sup>

Suppliers and Buyers, and possibly the Department, are vulnerable to being accused of, among other things, violating the basis of the FCM Settlement Agreement, and violating Section 222 of the FPA and rules adopted thereunder by FERC, which prohibit market manipulation.<sup>23</sup> The FCM Settlement Agreement clearly provides in the Explanatory Statement that “[c]onsistent with [FERC’s] objectives, the FCM is designed to price capacity resources accurately *to reflect the cost of new entry*. . . . To achieve this outcome, settling parties agreed

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<sup>20</sup> Of course, the associated damages for violations of the antitrust laws can be very substantial.

<sup>21</sup> ISO-NE has already filed with FERC to incorporate new tariff provisions for the initial transition years of the FCM. *See ISO New England Inc. and New England Power Pool*, Docket ER06-1465-000 (Sept. 1, 2006). Section 3.A of the FCM Settlement Agreement provides that, on or before February 15, 2007, ISO-NE will file the remaining tariff provisions to implement the full FCM construct.

<sup>22</sup> *See* FCM Settlement Agreement, Section II.G.3.b (providing that ISO-NE shall file the FCA results, including the detail of the awards and the price, under Section 205 of the FPA or make “such other filing as is necessary to establish the FCA results as filed rates”).

<sup>23</sup> *See* 18 C.F.R. § 1c.2; *Prohibition of Energy Mkt. Manipulation*, Order No. 670, FERC Stats. & Regs. ¶ 31,202 at P 25 (2006) (“Market Manipulation Order”).

that price formation by the market will rely primarily on the bids of New Capacity.”<sup>24</sup> In accepting the FCM Settlement Agreement, FERC found that it was reasonable because FCM would “provide a market-based mechanism to appropriately value capacity resources based on their location, satisfying cost-causation principles.”<sup>25</sup>

Requiring parties to the Master Agreement to bind Suppliers to submit bids that are discounted to between 75% and 85% of the cost of new entry is a contrivance if any such bid is inconsistent with the average cost of new entry, as such bidding requirement is devised to avoid review by the ISO Market Monitoring Unit and the Alternative Price Rule adopted in the FCM Settlement Agreement.<sup>26</sup> Thus, this bidding device is directly contrary to the basis of the FCM Settlement Agreement, and the cost-causation principles that FERC found were supported by the FCM Settlement Agreement. By valuing capacity resources through a market-based mechanism, which FERC found reasonable, the FCM Settlement Agreement recognizes that auctions may clear at, below or even above CONE—efforts to constrain auction results so that it will always clear below CONE are contrary to the market-based cost-causation principles FERC endorsed.<sup>27</sup>

The Master Agreement in its current form also raises questions of compliance under FERC’s rules prohibiting market manipulation, both for any parties to the Agreement and, because of the broad scope of the rules, potentially for the Department itself. FERC has broadly

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<sup>24</sup> FCM Settlement Agreement, Explanatory Statement at 26 (emphasis added).

<sup>25</sup> *Devon Power* at P 65.

<sup>26</sup> FERC accepted the Alternative Price Rule, which permits the resetting of the auction clearing price if the ISO-NE Market Monitor observes offers that are deemed “out of market”. See *Devon Power* at P 109.

<sup>27</sup> Indeed, while the FCM auction may clear at competitive prices above or below CONE, FERC accepted the agreed-upon CONE for the first auction year, finding it was a “reasonable estimate of the cost of new entry and basis for the beginning price in the FCM auctions.”<sup>27</sup>

interpreted its rule prohibiting energy market manipulation as allowing FERC to “police all forms of fraud and manipulation that affect natural gas and electric energy transactions and activities the Commission is charged with protecting,” including “*any action, transaction, or conspiracy for the purpose of impairing, obstructing or defeating a well-functioning market.*”<sup>28</sup> This rule applies to any “entity,” not just FERC-jurisdictional utilities and could reach conduct outside of a FERC-jurisdictional transaction, such as a purely financial contract for differences, that is intended to affect, or recklessly affects, a FERC-jurisdictional transaction (*e.g.*, sales into the FCM).<sup>29</sup>

NEPGA appreciates that the Department would not have intended to propose a pricing mechanism in violation of federal law in its development of an RFP and Master Agreement. In fact, NEPGA supports the Department’s goals of creating incentives to address locational capacity needs in Connecticut and minimizing the long-term costs of FMCCs to ratepayers. NEPGA is very concerned, however, about the elements of the RFP process that could put both contracting parties in a questionable position, including potential liability, under antitrust and federal trade laws, as well as the FPA. Moreover, NEPGA submits that the RFP and Master Agreement process should not be undertaken in an attempt to undermine the policies in the FCM Settlement with respect to price signals for new generation. To best preserve the goals of the EIA and the Department’s RFP of procuring new generation resources in order to mitigate FMCC costs to ratepayers, NEPGA urges the Department to remove these contractual provisions.

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<sup>28</sup> Market Manipulation Order at PP 25, 50 (emphasis added).

<sup>29</sup> *See id.* at PP 18, 22.

V. **Conclusion**

WHEREFORE, NEPGA respectfully submits these Comments and requests that the Department grant the relief requested by modifying the terms and conditions of the Master Agreement as discussed herein.

Respectfully submitted,

/s/ Angela O'Connor  
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Dated: October 6, 2006

**CERTIFICATE OF SERVICE**

I hereby certify that, on this 6<sup>th</sup> day of October, 2006, I have caused a copy of the foregoing to be mailed either via electronic service list or first class mail, to all parties on the service list in this docket.

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