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To: NECA Board of Directors  
From: The Power Markets Committee  
Date: February 27, 2007  
Re: Power Markets Committee Report

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The following is the report of the Power Markets Committee for the March 1, 2007 Board meeting.

## 1. PJM-RELIABILITY PRICING MODEL ("RPM")

PJM has been diligently implementing the FERC approved RPM settlement during the past two months with the first auction scheduled for early April, 2007. As opposed to having fixed transition payments, PJM will be using its RPM to value forward capacity in four regions, each comprised of locational deliverability areas (LDAs), three times during 2007 (Spring, Summer and Fall) for delivery years 2007/08, 2008/09 and 2009/10, respectively. Ultimately PJM wants the auctions to be held three years in advance of the delivery years. Each of the first three auctions will produce "gross" ICAP prices for the four regions – Eastern PJM (NJ, Philadelphia and Delmarva Peninsula), Southwestern PJM (MD and DC), MAAC plus Allegheny, and the entire RTO. "Net" ICAP values will include a reduction equal to the average historical net energy and ancillary service revenues earned by gas turbine peakers in each LDA.

Generating units' capacity payments will be based on their geographic location and actual availability during summer and winter peak hour periods. PJM has defined 23 locational deliverability areas (LDAs), and will likely expand the number of regions for each RPM auction in the future, down to the LDA level, to reflect more detailed supply / demand conditions. Ultimately there may be individual ICAP prices for each LDA in Eastern PJM and the rest of MAAC, and prices outside of MAAC plus Allegheny may be identical if the transmission interfaces are not binding.

In anticipation of the first auction PJM has posted various data underlying the auction which have indicated that market power was a potential concern. In response, PJM is essentially requiring cost-based offers of practically all units that wish to submit non-zero offers that are derived as a function of primarily estimated incremental going forward fixed operations and maintenance costs. Thus, in those regions where supply is tight, the RPM demand curves will be clearing the auctions. Indications thus far are that eastern and southwestern generating units (those in the constrained areas) will see net ICAP values on the order of \$40-\$50/kW-Yr in these first auctions, while generating units located outside of these constrained regions will see much lower values, likely only \$5-10/kW-yr. Because the early auctions' delivery years are fast approaching, it is not expected that new entry will play any material role in the early auctions. Considerable debate continues with respect to whether the prices (and ultimately the RPM demand curves' price levels) will be high enough to incentivize new entry.

One wrinkle is the Fixed Resource Requirement (FRR) option available to utilities and other LSEs that can demonstrate that they have long-term capacity arrangements sufficient to meet their capacity obligations (self-supply). Under FRR, these LSEs can “opt out” of RPM and avoid the associated charges (and revenues if they own generation), but there will be a five year minimum term to prevent them from moving in and out of the RPM auctions.

## **2. FORWARD CAPACITY MARKET (“FCM”) RULES – NEW ENGLAND**

On February 15th ISO New England filed with FERC proposed market rules to implement FCM. Though supported by a 79% vote of NEPOOL, NEPOOL did not join the filing due to its length (200+ pages) and ISO's inclusion of a number of arguments designed to pre-empt participants' protests of various issues. NEPOOL will be filing separate comments.

The rules were first put forth by ISO in draft form in November, and through 32 separate meetings of the Markets and other stakeholder technical committees, were refined, and were voted by the NEPOOL Participants Committee on February 8. In developing the rules, much emphasis was placed on the section of the rules regarding qualification of resources to participate in the Forward Capacity Auction, since that area of the Settlement Agreement had less detail than many others. As ISO notes in its filing, the qualification rules are lengthy and fairly stringent due to the low level of financial assurance required prior to clearing in the auction, and to the physical nature of the FCM. Other sections of the rules that stirred controversy include the treatment of imports and exports, particularly as relates to the controllable DC ties with Canada and Long Island; a concern on the part of some demand resource providers that the 'composite resource' treatment contemplated in the Settlement and in the rules will not be effective to allow summer-only demand resources to participate in the market; and a concern that the current interconnection queue process, based on a first-come, first-served priority, might not be the best method for allocating interconnection space to competing projects.

In many areas, the rules incorporate the settlement language directly, and, while there is debate in some parts of the rule about the intent and meaning of the settlement, the collective view of ISO and the NEPOOL and state regulatory stakeholders was to implement, as closely and completely as possible, the terms of the settlement agreed to last spring.

### **3. THE COMMISSION'S RULEMAKING REFORMING THE OPEN ACCESS TRANSMISSION PROVISIONS OF ORDERS 888 AND 889.**

On February 16, 2007 the Federal Energy Regulatory Commission issued a "Massive" rulemaking reforming the provisions of the Open Access Transmission and Information System rules that were prescribed in Orders 888 and 889 of 1996. For the most part the new rules require Transmission Providers in "unorganized markets" to reform their practices in determining "Available Transmission Capacity," establishing long term and short term firm transmission rights, enhancing transmission planning, making more transparent through reporting requirements on the OASIS systems their practices in determining who gets long term and short term transmission rights and establishing a new transmission service known as "conditional firm transmission service." The changes directed by this order are clearly directed toward transmission practices of jurisdictional transmission providers that are NOT subject to regulation under tariffs approved by the Commission for ISO's and RTO's (in our case ISO-New England). Nevertheless the Commission has ordered ISO's and RTO's to make a compliance filing within 210 days of the publication of the new rule in the Federal Register demonstrating how and in what ways the current ISO and RTO tariffs are equal to and /or superior to the provisions of the new rule. Based on a preliminary analysis of the rule it would appear that both the New York ISO's and New England RTO's tariff rules are superior in providing transparent and open access transmission service on a non-discriminatory basis to transmission customers in their respective control areas. Hence it is not likely that there will be difficulties in making the requisite compliance filings except that a compliance filing will consume staff time and have to be filed in approximately seven months from late February, 2007 (*i.e.* ca. late September, 2007).

### **4. SUGGESTIONS FOR A POWER MARKETS CONFERENCE**

In light of the intense interest in and complexity of the FCM market rules, the power Markets Committee recommends NECA, in conjunction with ISO-New England, convene a conference to explain the new FCM rules to interested participants. The Committee suggests a June time frame for such a conference.