UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Norwalk Power, LLC

Docket Nos. ER07-799-000
ER07-799-001
EL07-61-000

ORDER CONDITIONALLY ACCEPTING AND SUSPENDING RELIABILITY MUST RUN AGREEMENT, ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES, AND REQUIRING COMPLIANCE FILING

(Issued July 16, 2007)

1. On April 26, 2007, as supplemented on May 17, 2007, Norwalk Power, LLC (Norwalk) filed a proposed unexecuted Reliability Must Run Agreement (RMR Agreement) between itself, NRG Power Marketing Inc. (as Norwalk's agent) and the Independent System Operator New England, Inc. (ISO-NE), for Norwalk Harbor Units 1 and 2 located in southwest Connecticut. Norwalk is an exempt wholesale generator and is an affiliate of NRG Power Marketing, Inc. (NRG). In this order, pursuant to section 205 of the Federal Power Act (FPA),[1] we conditionally accept and suspend for a nominal period the proposed RMR Agreement, make it effective June 19, 2007, subject to refund, and establish hearing and settlement judge procedures. We also require certain modifications to the proposed RMR Agreement.

I. Background

2. Under ISO-NE's Market Rule 1, and subject to Commission approval, if ISO-NE determines that a generator is needed for reliability and that generator is not "satisfied" with its current compensation, the generator may file a cost-of-service Reliability Must

[1] 16 U.S.C. § 824d (2000).

Run (RMR) agreement with the Commission under section 205 of the FPA.[2] The Commission has held that it will approve an RMR agreement as a last resort, when the transmission provider *requires* the generator to remain available to provide reliability services.[3]

3. In 2003, the Commission began addressing the sufficiency of New England's capacity markets and the use of RMR agreements in constrained areas of the region, particularly Southwest Connecticut. The Commission subsequently rejected several RMR agreements, expressing concerns about the effect such contracts would have on the competitive market for capacity.[4] As an interim measure to address certain flaws the Commission identified in the New England capacity market, the Commission directed ISO-NE to institute revised bidding rules (called Peaking Unit Safe Harbor, or PUSH, bidding) to give low-capacity factor generating units operating in designated congestion areas the opportunity to recover their costs through the market.[5] PUSH bidding, however, proved to be an inadequate cost-recovery mechanism for generators, which led to the Commission acceptance of some RMR agreements. On January 12, 2007, the Commission conditionally approved the elimination of PUSH bidding, explaining that

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[2] *See* ISO New England, Inc., FERC Electric Tariff No. 3, Market Rule 1, section III, Appendix A, Exhibit 2 at 3.3.1, Second Revised Sheet No. 7461. Market Rule 1 was approved by the Commission in *New England Power Pool and ISO New England, Inc.*, 100 FERC ¶ 61,287, *order on reh'g*, 101 FERC ¶ 61,334 (2002), *order on reh'g*, 103 FERC ¶ 61,304, *order on reh'g*, 105 FERC ¶ 61,211 (2003).

[3] *See, e.g.*, *Berkshire Power Co., LLC*, 112 FERC ¶ 61,253 at P 22 (2005) (*Berkshire I*) (stating that "an RMR agreement should be viewed as a tool of last resort for a generator"); *Devon Power LLC*, 110 FERC ¶ 61,315 at P 40 (2005) (noting that "[t]he Commission has stated on several occasions that it shares the concerns… that RMR agreements not proliferate as an alternative pricing option for generators, and that they are used strictly as a last resort so that units needed for reliability receive reasonable compensation); *Devon Power LLC*, 103 FERC ¶ 61,082 at P 31 (2003) (*Devon II*) (finding "that RMR agreements should be a last resort).

[4] *See, e.g.*, *Devon Power LLC*, 102 FERC ¶ 61,314 (2003) (*Devon I*); *Devon II*, *reh'g granted in part and denied in part*, 104 FERC ¶ 61,123 (2003) (*Devon III*); *PPL Wallingford Energy LLC*, 103 FERC ¶ 61,085, *reh'g granted in part and denied in part*, 105 FERC ¶ 61,324 (2003) (*PPL Wallingford*).

[5] *Devon II* at P 33; *Devon III* at P 25-31.

ISO-NE has developed market mechanisms to provide more effective price signals and ensure adequate resources to support reliability.[6]

4. On June 16, 2006, the Commission approved a settlement adopting a different capacity market mechanism called the Forward Capacity Market (FCM).[7] Under the terms of the FCM Settlement Agreement, the currently applicable RMR agreements in New England will terminate at the beginning of the first commitment period of the FCM (June 1, 2010).

II. Norwalk's Filings

5. Pursuant to sections 205 and 206 of the FPA, Norwalk requests RMR treatment for an approximately 164 MW oil-fired unit (Norwalk Harbor Unit 1) and an approximately 172 MW oil-fired unit (Norwalk Harbor Unit 2). Norwalk Harbor Units 1 and 2 were originally coal-fired units and began commercial service in 1960 and 1963, respectively.

6. Norwalk requests approval of its unexecuted RMR Agreement to continue providing reliability services. According to Norwalk, these units are inefficient with slow start-up capabilities and low capacity factors. Norwalk claims that, without a cost-of-service agreement, it will be unable to recover its costs following the termination of PUSH bidding as of June 19, 2007. In December 2006, according to Norwalk, ISO-NE sent a letter to NRG confirming a reliability need for the Norwalk units. Norwalk also states that it meets the requirements of ISO-NE Market Rule 1 and pertinent Commission orders in order to be eligible for a cost of service RMR agreement.

7. Norwalk claims that the proposed RMR Agreement is, with limited exceptions reflecting its specific circumstances, substantially in the form of the Appendix A, *pro forma* Cost-of-Service (COS) Agreement contained in Market Rule 1. According to Norwalk, the proposed RMR Agreement differs from the Market Rule 1, Appendix A *pro forma* COS Agreement with respect to modifications that reflect Commission orders accepting or directing variations in other applicants' RMR agreements filed under Market Rule 1 and that have been compiled by ISO-NE into its "working" *pro forma* COS Agreement. In addition, Norwalk proposes a revised section 5.2.2(d), which establishes an effective date of one day after a section 205 filing for revision of the Revised Monthly Fixed-Cost Charge in the event of the shut-down of one of the Units. Norwalk also proposes a new section 5.3, which provides for the future filing of an Environmental

[6] *ISO New England, Inc.*, 118 FERC ¶ 61,018 (2007) (PUSH Order).

[7] *Devon Power LLC*, 115 FERC ¶ 61,340 (2006) (FCM Settlement Order).

Compliance Cost Tracker under section 205. As detailed elsewhere in this order, both section 5.2.2(d) and section 5.3 were filed pursuant to section 206 of the FPA[8] because ISO-NE did not agree to their inclusion in the proposed RMR Agreement.

8. Under the proposed RMR Agreement, Norwalk would submit bids for energy and ancillary services based upon Stipulated Bid Costs, using a self-adjusting formula that reflects costs for fuel, variable operations and maintenance (O&M), and environmental allowances. Norwalk would also be entitled to a Monthly Fixed-Cost Charge (based on the requested annual fixed revenue requirement of $38,256,241) for Units 1 and 2, which would be paid by participants through ISO-NE's Monthly Settlement process for the New England markets. The Monthly Fixed-Cost Charge would be reduced by credits for amounts received from the New England markets in excess of the Stipulated Bid Costs from sales of energy and ancillary services, credits for any additional revenues related to these units, and for FCM Transition Payments. Norwalk states that the non-performance penalty provisions, which penalize a resource that fails to comply with a dispatch instruction from ISO-NE, have been revised from the *pro forma* COS Agreement to make them consistent with provisions accepted by ISO-NE and the Commission in recent orders.[9]

9. Norwalk requests that the RMR Agreement become effective June 19, 2007 and, unless terminated earlier, shall terminate at the earlier of June 1, 2011 or the first day of the First Commitment Period of the FCM (currently expected to be June 1, 2010) or the date on which another Commission-approved replacement for such capacity mechanism becomes effective and in which the resource is eligible to participate. Norwalk states that the RMR Agreement could also be terminated earlier, *inter alia*, if: (1) ISO-NE determines, or the Commission concludes as the result of a proceeding pursuant to section 206 of the FPA, that a plant or any unit is no longer needed for system reliability; (2) Units 1 and 2 are subject to Shut-down because of a catastrophic forced outage; or (3) over the preceding twelve month period the resource availability is less than fifty percent (50%).

III. Notice of Filings and Responsive Pleadings

10. Notice of Norwalk's filing was published in the *Federal Register*, 72 Fed. Reg. 29,148 (2007), with interventions and protests due on or before May 24, 2007. Notice of

[8] 16 U.S.C. § 824e (2000).

[9] *See, e.g., PPL Wallingford Energy LLC*, 118 FERC ¶ 61,242 (2007); *Berkshire Power Company, LLC*, 116 FERC ¶ 61,311 (2006) (*Berkshire III)*.

Norwalk's supplemental filing was published in the *Federal Register*, 72 Fed. Reg. 29,768 (2007), with interventions and protests due on or before June 7, 2007.

11. Timely motions to intervene were filed by: the Connecticut Department of Public Utility Control (CT DPUC), Northeast Utilities Service Company on behalf of the Northeast Utilities (NU) Companies[10], the Connecticut Office of Consumer Counsel (CT OCC), and the Attorney General for the State of Connecticut (CTAG).

12. The New England Power Pool (NEPOOL) Participants Committee and ISO-NE filed timely interventions and motions to reject, protests, or comments. The Connecticut Municipal Electric Energy Cooperative (CMEEC), CT DPUC, CT OCC, and CTAG (together, CT Parties) filed a joint motion to reject and protest.

13. Norwalk filed an answer to the joint motion to reject and protest, and to ISO-NE's comments.

IV. Discussion

A. Procedural Matters

14. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Norwalk's answer because it provides information that assisted us in our decision-making process.

B. Need for RMR Agreement

1. Norwalk's Filing

15. Norwalk argues that an RMR agreement is needed for its units because "without a cost-of-service agreement, Norwalk Harbor Units 1 and 2 will not be able to recover their costs."[11]

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[10] The NU Companies are: Connecticut Light and Power Company, Western Massachusetts Electric Company, and Public Service Company of New Hampshire.

[11] April 26 transmittal letter at 2.

16. Norwalk claims that it meets the requirements of ISO-NE Market Rule 1 and pertinent Commission orders to be eligible for a cost-of-service RMR agreement. Norwalk notes that ISO-NE has authority, pursuant to Market Rule 1, to negotiate power supply agreements for the purchase of electricity at cost-based rates from generation facilities that ISO-NE identifies as necessary to ensure reliability, but which are unable to recover their costs under current market conditions. Norwalk states that ISO-NE has determined that both units are currently needed to provide reliability service in Southwest CT and that, barring the addition of new generation or increased transmission capability, that need is expected to remain. Further, Norwalk contends that its presented testimony demonstrates that, in the absence of PUSH bidding, Norwalk Harbor Units 1 and 2 would not have recovered their facility costs[12] for calendar years 2004-2006 and are not expected to recover their facility costs in 2007 or during the remaining term of the proposed RMR Agreement.

2. Responsive Pleading

17. CT Parties urge the Commission to reject Norwalk's proposed RMR Agreement. They argue that Norwalk has failed to demonstrate that the Units have been or will be unable to recover their facility costs through participation in New England's competitive wholesale electric markets. They claim that, since the advent of the PUSH bidding regimen in 2003, these units have recovered more than their facility costs in each of the past four years, noting that Norwalk admits elsewhere that, in 2005, the Norwalk Harbor Units recovered more than their total revenue requirement.[13]

18. In addition, CT Parties contend that Norwalk's retrospective reconstruction of what the Norwalk Harbor Units would have earned in the absence of PUSH bidding remains unusable due to two methodological flaws. First, Norwalk took the in-merit and out-of-merit operating hours for the Units under PUSH as a given (failing to recognize that these units would operate in-merit more frequently without PUSH bidding). Second, Norwalk used the Connecticut Load Zone LMP rather than actual nodal LMPs to determine whether the Norwalk Units would have been dispatched in-merit and to

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[12] Facility costs are defined as the costs ordinarily necessary to keep a facility available, such as fixed O&M, administrative and general (A&G), and taxes. *See Bridgeport Energy LLC*, 112 FERC ¶ 61,077 at P 35 (2005) (*Bridgeport I*).

[13] According to CT Parties' estimations, Norwalk's units earned net inframarginal revenues above facility costs of almost $9 million in 2005 and more than $4 million in 2006. By contrast, Norwalk's estimations show net unrecovered facility costs of over $12 million in both 2005 and 2006.

calculate the level of inframarginal revenue that the Units would have earned.[14] According to CT Parties, Norwalk failed to address the relevant question, which is whether Norwalk has, in fact, experienced an ongoing and persistent inability to recover its costs in the market.

19. CT Parties argue that the Commission has explained repeatedly that generators operating in competitive markets are not entitled to a guarantee that they will recover their full cost of service, but only to a reasonable *opportunity* to recover their costs in the market. They further state that the Commission has made clear that cost-of-service agreements should not be the recovery floor for generators that are unable to earn a profit in a given year, as it is reasonable and expected in a competitive market that there will be periods where full cost recovery is not realized.

20. By contrast, CT Parties argue that the one known and measurable development is that under the terms of the Forward Capacity Market settlement, Norwalk's future financial performance will be aided by its receipt of roughly $12 million per year in transition payments. CT Parties contend that Norwalk seeks a preemptive RMR agreement to ensure against the possibility of future losses. CT parties ask the Commission to reject Norwalk's proposed RMR Agreement without prejudice, allowing Norwalk to re-file based on the experience of these units without PUSH bidding.

21. CT Parties also contend that Norwalk has failed to demonstrate that its presented facility costs are reasonable. Specifically, CT Parties note that because Norwalk has market-based rate authority, it is exempt from the Commission's requirements to keep records in accordance with the Commission's Uniform System of Accounts and does not file a FERC form 1. CT parties state that there is no indication in Norwalk's filing that any of the cost figures advanced as components of Norwalk's facility costs have been subject to audit by an independent firm. In addition, CT Parties question parent company debt service costs that have been allocated to Norwalk, including the nature and terms of these loans and whether they should be considered as facility costs in determining Norwalk's eligibility for RMR treatment. Finally, CT Parties question a $3 million maintenance cost primarily allocated to overhaul a turbine generator.

[14] Similar to Norwalk's retrospective analysis, CT Parties presume that Norwalk's projected revenues based upon the actual MWh output for the first two months of 2007 are subject to the same methodology flaw of failing to recognize that these units would operate in-merit more frequently without PUSH adders included in their bidding.

3. Norwalk's Answer

22. Norwalk reiterates that it has satisfied the criteria for an RMR agreement. Norwalk argues that using market revenues derived from PUSH bidding when the Commission is eliminating PUSH bidding provides a distorted picture. Norwalk states that because PUSH bidding is terminating as of June 19, 2007, any revenues earned under this mechanism have no bearing on what Norwalk can be expected to earn in the market going forward and are irrelevant to an analysis of whether Norwalk will recover its costs absent an RMR agreement. Norwalk also contends that CT Parties' analysis of Norwalk's cost recovery consists of a single spreadsheet with no underlying data, documentation or calculations, and, as a result, is irrelevant and unsupported.

23. Norwalk also contends that its projections of future cost recovery are correct and fully supported, noting that it made a supplemental filing to further support its projections for 2007-2010; the forecasted generation for 2007-2010 is an average of historical generation for the Norwalk Harbor Units since the predominant use of the Norwalk Harbor Units is for reliability. In addition, Norwalk notes that energy costs were derived using actual fuel and emission expenses for the first two months of 2007 and company forecasts for the remaining 10 months. Forecast energy revenues were derived consistent with the methodology used for the retroactive facility cost analysis.

24. Finally, Norwalk reiterates that it has the right to charge a fully compensatory cost-based rate and that this right cannot be restricted based on the level of losses Norwalk would sustain under a market-based rate. Norwalk states that it does not concede that it should be required to meet the facility costs test in order to propose and charge a just and reasonable full cost-of-service rate.

4. Commission Determination

25. Norwalk's proposed RMR Agreement raises issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed in the hearing and settlement judge procedures ordered below.

26. Our preliminary analysis of Norwalk's filing indicates that its proposed RMR Agreement has not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful. Therefore, we will accept Norwalk's proposed RMR Agreement for filing, suspend it for a nominal period, make it effective on June 19, 2007, subject to refund, and set it for hearing and settlement judge procedures.

27. As the Commission stated in *Bridgeport*, designation of a reliability need by ISO-NE does not guarantee Commission approval of an RMR agreement.[15] Instead, as we have stated previously, an RMR agreement should be viewed as a tool of last resort for a generator.[16] The Commission is aware that the Norwalk Harbor Units are relatively inefficient.[17] However, Norwalk's filing represents the first application for RMR treatment from a generation facility that is receiving transition payments under the terms of the FCM Settlement.[18] We note that it is not clear from the evidence to date that Norwalk *requires* a cost-of-service RMR agreement in addition to these transition payments to remain available to provide reliability service from these units.[19] In determining the threshold need for the proposed RMR Agreement, the hearing should also consider *inter alia* whether the particular debt service payments proposed by

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[15] *Bridgeport I* at P 32.

[16] *See supra* note 3.

[17] However, we note that Norwalk's answer which states that without a PUSH adder these units will be operated primarily for reliability and will be dispatched out-of-merit even at the stipulated bid levels associated with the RMR Agreement (Norwalk Answer at 5) seems to conflict with its testimony to establish its AFRR. In the testimony to establish the AFRR (Attachment H, Exhibit NRG-5 at 19), Norwalk states that under stipulated bidding "the unit is expected to operate nearer the marginal unit in the pool and region, and is thus expected to be required to follow load….This is in contrast to how the units have historically operated under PUSH bidding."

[18] Under the terms of the FCM Settlement Agreement, current transition payments equal $3.05 kW/month and will increase annually until capping at $4.10 kW/month during the 2009-2010 period. For Norwalk, this amounts to an additional annual cost recovery of approximately $12 - $17 million.

[19] For example, in support of the proposed RMR Agreement, the Lovinger testimony (Attachment H, Exhibit NRG-5 at 35) alleges that "Exhibit No. NRG-11, Schedule No. 6 is an analysis which demonstrates that the revenues which Applicant earned under PUSH bidding are not remotely representative of the revenues Applicant would have or will be able to earn in the market." However, Norwalk's historical PUSH revenues are neither presented in that exhibit nor anywhere else in either Norwalk's April 26, 2007 filing or May 17, 2007 supplemental filing, making this comparison impossible.

Norwalk and an additional $3 million expense for a turbine overhaul are appropriate inclusions in Norwalk's annual facility costs.[20]

28. In addition, addressing Norwalk's argument that it has a right to charge a fully compensatory cost-based rate (and should not be subject to the facility costs test), the Commission has been clear that an RMR agreement in a competitive market is not equivalent to a traditional cost-of-service rate.[21] On numerous occasions, the Commission has stated its view that RMR agreements represent "tools of last resort" and are transitional in nature.[22]

29. The Commission must examine the facts of each proposed RMR agreement to ensure that the rates and charges for the sale of electric energy are just and reasonable.[23] We find that whether the proposed RMR Agreement is necessary for Norwalk to recover its facility costs raises issues of material fact that cannot be resolved on the record before us, and are more appropriately addressed in the hearing and settlement judge procedures ordered below. If it is determined that the proposed RMR Agreement is necessary for Norwalk to maintain operations, then the hearing and settlement judge procedures established in this order should address Norwalk's cost of service, exclusive of the issues we address summarily below.

30. While we are setting these matters for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their dispute before hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.[24] If the parties desire,

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[20] The Commission has previously found that a one-time extraordinary maintenance expense of this magnitude may not be relevant when determining whether a cost-of-service RMR contract is necessary for a facility to remain in service, as it may be more appropriate for this cost to be capitalized and/or amortized over the expected life of the project, *Bridgeport I* at P 38.

[21] *See Bridgeport I* at P 32 (explaining that the Commission "do[es] not take the position that designation of a need for reliability from the ISO-NE guarantees Commission approval of an RMR contract").

[22] *See supra* note 3.

[23] 16 U.S.C. § 824d (2000); *Pittsfield Generating Co., L.P.*, 119 FERC ¶ 61,001 at P 16 (2007); *Bridgeport Energy, LLC*, 118 FERC ¶ 61,243 at P 41 (2007).

[24] 18 C.F.R. § 385.603 (2006).

they may, by mutual agreement, request a specific judge as a settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.[25] The settlement judge shall report to the Chief Judge and the Commission within 30 days of the date of the appointment of the settlement judge, 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 the commencement of a hearing by assigning the case to a presiding judge.

C. Reliability Determination

31. Norwalk included ISO-NE's reliability determinations for its Units with its supplemental filing.[26] In a letter dated December 18, 2006, ISO-NE confirmed to Norwalk that both Units are needed for system reliability.[27] Market Rule 1, the currently-effective rate schedule on file with the Commission, permits ISO-NE to determine whether units are needed for reliability. In support, ISO-NE's 2006 Regional System Plan (RSP) states that the Norwalk Harbor Units are frequently designated as daily second contingency (N-2) units needed to ensure reliability to the sub-region customers and maintain an operating reserve that will increase output when first contingencies (N-1) occur. Further, based on the operable capacity/area transmission requirement analysis, ISO-NE states that the Connecticut area assessment demonstrated a capacity deficiency after accounting for the loss of the single largest generating resource and the loss of the most critical transmission element. ISO-NE states that the Norwalk Harbor Units are needed to reliably serve forecast peak load for the summer 2007 period.

32. The Commission accepts ISO-NE's determination that Norwalk is needed for reliability, as we agree that these units are needed to ensure reliability in the Southwest CT load pocket. No party has challenged ISO-NE's determination and the Commission will not set this issue for hearing.

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

[26] May 17 Supplemental Filing at Exhibits NRG-13 and NRG-14.

[27] April 26 filing at Exhibit NRG-1.

D. Cost of Service

1. Norwalk's Filing

33. As stated above, whether the proposed RMR Agreement is necessary for Norwalk to recover its facility costs is set for hearing and settlement judge procedures. If the hearing ultimately determines that the RMR Agreement is necessary, then a just and reasonable cost of service rate will need to be established in this proceeding. While the hearing and settlement judge procedures established in this order should consider the entire cost of service, the Commission will rule summarily on certain other aspects of the RMR Agreement, and provide additional guidance for the ordered hearing, as discussed below.

34. Norwalk proposes cost recovery for the term of the RMR Agreement pursuant to the *pro forma* COS Agreement. Norwalk further proposes a proxy capital structure of 50 percent debt and 50 percent equity and a return on common equity (ROE) of 10.88 percent. Finally, Norwalk proposes a total annual fixed revenue requirement (AFRR) of $38,256,241.[28]

2. Responsive Pleading

35. CT Parties argue that if the proposed RMR Agreement is not rejected, then all issues relevant to the justness and reasonableness of that agreement should be set for hearing. NEPOOL states that the proposed RMR Agreement was not reviewed within the NEPOOL participant processes and requests careful scrutiny of the proposed changes, rates, and charges.

36. CT Parties urge the Commission to investigate several specific items related to Norwalk's proposed cost-of-service. These items include Norwalk's: (1) adjustment to test year maintenance charges, including Norwalk's proposed annual allocation for "one-time" turbine overhaul costs; (2) proposal to include negative salvage costs, including whether the annual allowance amount should be adjusted to reflect the estimated remaining useful life of the units, and whether all of these costs should be collected during the next three years (under Norwalk's proposed economic life) or put into an escrow account; (3) assignment of A&G costs using an allocation process based on employee interviews; (4) proposal to use a hypothetical capital structure, along with a 10.88 percent ROE and 7.88 percent cost of long-term debt; (5) proposal to use a cash working capital allowance of one-eighth of O&M expenses; (6) proposed allowance for

[28] April 26 filing at Exhibit No. NRG-6, Schedule 1 at 1.

state income taxes; (7) inclusion of a management fee; (8) proposed allowance for organization costs; and (9) proposed allowance of the cost of the instant rate case.

3. Commission Determination

37. The Commission's preliminary analysis as noted elsewhere in this order, indicates that the proposed rate in the RMR Agreement has not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful. Accordingly, the Commission has conditionally accepted the RMR Agreement, suspended it for a nominal period to be effective June 19, 2007, subject to refund and set it for hearing and settlement judge procedures.

38. While the hearing and settlement judge procedures established in this order should consider the entire cost of service, the Commission will rule summarily on certain other aspects of the RMR Agreement, and provide additional guidance for the ordered hearing, as discussed below.

Management Fee

39. Norwalk proposes to include a management fee in its cost-of-service because it states that the Norwalk Harbor Units are fully depreciated for rate base purposes, and the management fee provides an incentive to operate the units efficiently. CT Parties urge the Commission to reject Norwalk's proposed management fee, contending that it is duplicative because the proposed cost of service already includes a return. In support of this fee, Norwalk cites *Tarpon Transmission Co.*, 57 FERC ¶ 61,371 (1991) (*Tarpon*). CT Parties contend that *Tarpon* involves a natural gas pipeline, and no public utility precedent is cited. CT Parties further state that *Tarpon* did not involve generating units that were participating in a competitive market and opted to exit that market to "parlay their 'needed' status into contractual cost-of-service guarantees."[29] CT Parties believe that if approved, the RMR Agreement will guarantee that Norwalk will recover its cost of service at a level at least as high as was the case under PUSH bidding, providing sufficient incentive to keep Norwalk in service during its presumed economic useful life.

40. In its answer, Norwalk states that its reliance on *Tarpon* is entirely appropriate as, under the principles provided in *Tarpon*, the Commission approves the use of a management fee if plant investment is fully depreciated. Norwalk contends that those principles are equally valid whether that plant investment is gas or electric. In addition, Norwalk submits that it correctly included both a management fee and a return on

[29] CT Parties Motion at 37.

investment in its cost of service in a manner which is not duplicative. Norwalk states that the management fee is proposed as a proxy for Norwalk to earn some measure of return and has been computed strictly on the basis of plant investment, while Norwalk has proposed a return only on the non-plant components of rate base.

41. Norwalk includes a management fee in its proposed RMR Agreement because it states that these units are fully depreciated, and "[i]t is not reasonable to require a utility to operate an asset and provide a jurisdictional service without an opportunity to earn a return particularly where, as here, the RMR Agreement with ISO-NE provides for a reduction in payments if the plant is unable to meet its availability target."[30] Contrasting the proposed RMR Agreement with a traditional cost-of-service agreement, Norwalk states that "it is patently unfair to assess a plant that is required to run with penalties that would have to be paid out of operating costs as opposed to operating profits" since "the purpose of the RMR rate is to mirror what [Norwalk] properly could recover…were the markets not flawed."[31]

42. We reject Norwalk's proposed management fee. Norwalk's argument for the inclusion of a management fee fails to recognize the underlying rationale behind the use of RMR agreements. Contrary to Norwalk's assertion, the purpose of an RMR agreement is not to encourage efficient operation of a particular facility. Rather, as stated previously, the Commission views RMR agreements as tools of last resort - they are fundamentally different than "traditional" cost-of-service agreements. We clarified in *Bridgeport I* that the Commission's benchmark for granting RMR agreement approval is the concern that, absent an RMR agreement, the facility will be unable to continue operation.[32] This last resort standard is inconsistent with the proposed recovery of a management fee. The fixed payments provided under an RMR agreement allow generators the ability to recover their cost of continued operation, thereby ensuring that these units will be available to provide needed reliability service to ISO-NE customers. Thus, an additional incentive payment is not needed to make such units economically viable.

43. In response to Norwalk's arguments about risks associated with non-performance penalties under the RMR Agreement, we find that Norwalk is not under any obligation to pursue the proposed RMR Agreement. In reaching our determination, we considered the

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[30] April 26 filing at Exhibit No. NRG-5 at 33:8-12.

[31] *Id*. at 33-34.

[32] *Bridgeport I* at P 39.

additional cost recovery available from capacity transition payments (ranging from approximately $12 million to $17 million during the period of the proposed RMR Agreement) under the FCM Settlement. We also note that similar older, depreciated units in New England have not been granted the recovery of a management fee, even before the approval of capacity transition payments in New England.

44. This fee is not part of the approved *pro forma* COS Agreement in New England, and Norwalk has not justified its recovery here. Norwalk is directed to submit a revised RMR agreement within 30 days of the issuance of this order to reflect the removal of the proposed management fee.

Return on Equity

45. Norwalk proposes an ROE of 10.88 percent, consistent with what the Commission has approved for prior RMR applicants in New England. Norwalk states that this return is well below the zone of reasonableness in light of regulatory and other risks that it faces.

46. CT Parties argue that, in the instant context, the ROE used by Norwalk should be considerably below 10.88 percent, especially in light of Norwalk's argument that these units have only three more years of economically useful life. CT Parties contend that, as these Norwalk's units would remain under RMR contract during the rest of their useful lives, there is little risk basis for granting a 10.88 percent ROE.

47. In its answer, Norwalk reiterates that its' proposed ROE is consistent with what the Commission has approved previously in New England, including for Norwalk or its affiliates.

48. We will allow Norwalk to use a 10.88 percent ROE. We found in *Devon IV* that a 10.88 percent ROE is a conservative proxy for merchant generating facilities.[33] We have used a proxy rate of return on common equity in this circumstance before, and will continue to do so. [34]

[33] *Devon Power LLC*, 106 FERC ¶ 61,264 at P 23 (2004) (*Devon IV*).

[34] *Id.*

E. Proposed Revisions to the *Pro Forma* Cost of Service Agreement

1. Norwalk's Filing

49. As noted above, Norwalk's proposed RMR Agreement contains certain provisions which differ from the *pro forma* COS Agreement contained in Market Rule 1. First, Norwalk proposes to modify the *pro forma* COS Agreement by adding a new section 5.3, which provides for subsequent filings of an Environmental Compliance Cost Tracker under section 205 of the FPA. Second, Norwalk offers a revised section 5.2.2(d) establishing an effective date of one day after a section 205 filing for revision of the Revised Monthly Fixed-Cost Charge in the event of the shut-down of one of the Units. Norwalk notes that because ISO-NE has not agreed to these revisions to the pro forma COS agreement, Norwalk submits these revisions pursuant to section 206 of the FPA.

50. Norwalk states that new section 5.3 to the Norwalk RMR Agreement would provide for a subsequent section 205 filing of an Environmental Compliance Cost Tracker. Norwalk states that section 5.3 is necessary because there are several pending Connecticut Department of Environmental Protection (CT DEP) regulations and actions that will likely require Norwalk to incur environmental compliance expenses in order to remain available through the term of the RMR Agreement. According to Norwalk, those regulations and actions are not yet sufficiently developed at this point so as to permit a reasonable projection of the precise cost of compliance.[35] Norwalk points out, however, that the Commission has previously approved provisions reserving an RMR applicant's right to make a section 205 filing to recover additional costs which are not precisely quantifiable, but are likely to occur.[36] Norwalk claims that the Environmental Compliance Cost Tracker will provide a mechanism for funding new environmental compliance costs that Norwalk claims it will likely incur in order to remain available to provide reliability service during the term of the RMR Agreement.

51. Norwalk states that current section 5.2.2(d) of the *pro forma* COS Agreement provides that, if both Norwalk Harbor Units 1 and 2 are shut down due to a Forced Outage, then the Owner shall remain entitled to receive the full amount of the Fixed-Cost Charge only through the shut-down date. However, in the event that only one of the Norwalk Harbor Units is shut down due to a forced outage, Norwalk states that current section 5.2.2(d) of the *pro forma* COS agreement provides that the agreement shall remain in full force and effect with respect to the remaining unit, and the owner shall

[35] Exhibit NRG-12, Direct Testimony of Cynthia L. Karlic at 5-8 (discussing Norwalk's need for the Environmental Compliance Cost Tracker).

[36] April 26 transmittal letter at 14 (*citing Berkshire III*; *Bridgeport I*).

promptly file amendments to the resource's monthly fixed-cost charge with the Commission to reflect the cost-of-service for the remaining Norwalk Harbor Unit. Norwalk proposes to add a sentence to section 5.2.2(d) that would establish that "[t]he Revised Monthly Fixed Cost Charge shall be effective on the day after the Shut-Down Date and shall be collected, subject to refund, pending final acceptance by the Commission."[37]

2. Responsive Pleadings

52. ISO-NE and CT Parties state that, under section 206 of the FPA, Norwalk must demonstrate why the existing provisions in the *pro forma* COS agreement are unjust and unreasonable without the Environmental Compliance Cost Tracker and why the proposed revisions are just and reasonable. Both parties claim that Norwalk has failed to meet either burden. ISO-NE states that any such demonstration must include an explanation of why the opportunity for recovery of those environmental costs through the Annual Fixed Revenue Requirement and stipulated bidding (for variable costs) would be unjust and unreasonable. CT Parties also state that Norwalk could recover environmental compliance costs by submitting a section 205 filing. CT Parties further state that to the extent Norwalk could not make a section 205 filing within the requisite 60 days, Norwalk would have the right to make a filing and seek a waiver of any such requirement.

53. As for the proposal itself, ISO-NE and CT Parties both characterize Norwalk's Environmental Compliance Cost Tracker as premature because the exact timing and actuality of costs incurred remain unclear. ISO-NE states that Norwalk has not provided any details or reasoned projections about the type of expenses that may be incurred or the range of costs expected. ISO-NE further states that an Environmental Compliance Cost Tracker-like proposal should not be made effective until more definitive information about the anticipated environmental regulatory requirements and the associated costs are known and the Commission can determine whether an Environmental Compliance Cost Tracker-like clause would be necessary to keep a unit needed for reliability in service. Similarly, CT Parties state that Norwalk's justification for the Environmental Compliance Cost Tracker appears to be based more on speculation than fact.

54. ISO-NE and CT Parties also express concern regarding the language of Norwalk's proposed section 5.3.1. CT Parties state that they fear that, under the Environmental Compliance Cost Tracker, Norwalk could make a filing now to begin recovering these costs before the obligation is fixed and known because Norwalk's proposed section 5.3.1 of the Environmental Compliance Cost Tracker refers to filings made on the basis of a reasonable expectation. ISO-NE states that if the Commission finds the Environmental

[37] April 26 transmittal letter at 13.

Compliance Cost Tracker provision to be just and reasonable that the Commission should strike section 5.3.1 as unnecessary and counter-productive. ISO-NE explains that ISO-NE has no special expertise regarding the review of environmental compliance plans and associated expenses so the requirement would only delay the timely sharing of critical information by Norwalk with the Commission.

55. ISO-NE notes that, while it did work with Norwalk on the basic provisions of the proposed RMR Agreement, it did not agree with the changes submitted by Norwalk pursuant to section 206.

56. NEPOOL did not offer any substantive objections to Norwalk's proposed revisions but nevertheless urges the Commission to scrutinize and consider carefully the proposed rates and changes to the *pro forma* COS agreement which are being filed pursuant to section 206, the Environmental Compliance Cost Tracker and the revised section 5.2.2(d).

3. Norwalk's Answer

57. Norwalk responds to criticism of the Environmental Compliance Cost Tracker stating that it is an essential component of the proposed rate structure without which reliability service could be jeopardized. In support of its argument, Norwalk cites to potential compliance costs associated with pending CT DEP regulations as well as compliance costs associated with reducing visible emissions as per a set of priorities prepared by Norwalk and submitted to the CT DEP. Norwalk states that, if it is unable to secure funding for such expenditures in a timely manner, it may be unable to comply with CT DEP's environmental regulations and requirements, which may force Norwalk to declare a forced outage and issue a notice of shutdown. Norwalk therefore contends that a single-cost section 205 filing with a pre-approved effective date for the commencement of funding is critical to ensure access to the monies needed for reliability. Norwalk states that intervenors' concerns about recovery of costs before they are known are unfounded because Norwalk will have to support all Environmental Compliance Cost Tracker costs in its section 205 filing. Norwalk claims that, considering these circumstances, the Environmental Compliance Cost Tracker is just and reasonable and the *pro forma* COS Agreement without an Environmental Compliance Cost Tracker is clearly unjust and unreasonable.

4. Commission Determination

58. Section 206(b) of the FPA provides that "the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable,

unduly discriminatory, or preferential shall be upon . . . the complainant."[38] Accordingly, Norwalk bears the burden to (1) establish that Market Rule 1 as currently filed with the Commission is unjust and unreasonable with regard to the compensation of generating facilities needed, as relevant here, for reliability in Connecticut, and (2) if that showing is made, to further show that its proposed amendments to Market Rule 1 are just and reasonable.[39]

59. We agree with ISO-NE and CT Parties that Norwalk has not met its burden under section 206 to establish that the current provisions of Market Rule 1 regarding the compensation of generating facilities needed for reliability in Connecticut are unjust and unreasonable, nor has Norwalk shown that its alternatives, namely the Environmental Compliance Cost Tracker and the revised *pro forma* COS agreement section 5.2.2(d), are just and reasonable. As noted by CT Parties, Norwalk has not demonstrated why, in particular, recovery of environmental compliance costs through post hoc section 205 filings would be unjust and unreasonable. In this regard, we also agree with ISO-NE and CT Parties that Norwalk's Environmental Compliance Cost Tracker is premature because the exact timing and actuality of costs being incurred and to be recovered are unclear. In support of its Environmental Compliance Cost Tracker proposal, Norwalk asserts that the filing of a general rate case is time consuming. That alone, however, is an insufficient justification. Norwalk also states that it is concerned that without the proper funding to comply with CT DEP's environmental regulations and requirements, it could remain in noncompliance and, in turn, be forced to declare a forced outage, thereby harming reliability in Connecticut. Norwalk does not demonstrate that it is currently in noncompliance with any CT DEP regulations or that noncompliance will necessarily and immediately lead to a forced outage or that recovering its environmental costs in its rates more quickly will necessarily avoid a forced outage. In short, we agree with ISO-NE and CT Parties that Norwalk has not demonstrated sufficient need for this cost recovery mechanism nor has Norwalk convinced us that the existing processes for environmental compliance cost recovery are unjust or unreasonable. Accordingly, we reject Norwalk's proposed section 5.3.

60. Similarly, Norwalk has not met its burden for revision of the *pro forma* COS agreement section 5.2.2(d). Norwalk has failed to demonstrate why the *pro forma* COS agreement is unjust and unreasonable without a provision establishing an effective date of one day after a section 205 filing for revision of the Revised Monthly Fixed-Cost Charge

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[38] 16 U.S.C. § 824e(b) (2000).

[39] *See, e.g., Richard Blumenthal et al. v. ISO New England, Inc.*, 117 FERC ¶ 61,038 at P 56 (2006); *American Elec. Power Serv. Corp.*, 113 FERC ¶ 61,050 at P 18 (2005).

in the event of the shut-down of one of the Norwalk Harbor Units. Norwalk also has failed to demonstrate that an earlier effective date is necessarily just and reasonable. We find that Norwalk did not meet its burden under section 206. Accordingly, we reject Norwalk's proposed revision to section 5.2.2(d).

61. For the foregoing reasons, Norwalk is directed to submit a revised RMR agreement within 30 days of the issuance of this order to reflect the removal of both section 5.3 and the revisions to section 5.2.2(d).

F. Termination Date

62. CT Parties state that should the proposed RMR Agreement not be rejected, the term of the proposed contract should be limited to no more than one year, rather than the proposed three years. CT Parties argue that a one-year term is consistent with Market Rule 1 (specifically, Appendix A, Exhibit 2, section 3.2.5) which provides that RMR agreements shall be for a term of one year from the effective date, with renewals as necessary provided that ISO-NE finds the unit(s) still necessary for reliability. CT Parties argue that since Norwalk's basis for requiring an RMR agreement is a speculated forecast, then any agreement should be limited to one year in duration without prejudice to Norwalk's seeking to extend the agreement at the end of the term subject to financial eligibility.

63. In its answer, Norwalk notes that CT Parties have raised these issues before and their arguments have been rejected. Norwalk further notes that the Commission has repeatedly authorized RMR agreements with terms extending until the implementation of FCM.[40]

64. The termination date of the proposed RMR agreements has been addressed in prior RMR orders. The Commission has stated that it would consider RMR agreements that expire when the LICAP mechanism is implemented.[41] The FCM Settlement Agreement explicitly states that the beginning of the first commitment period (June 1, 2010) will be considered to be the implementation or effectiveness of a LICAP mechanism. Thus, consistent with prior RMR orders, we will not restrict the instant RMR Agreement to a one-year term.

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[40] Norwalk cites *Consolidated Edison Energy Massachusetts, Inc.*, 118 FERC ¶ 61,233 (2007); *PSEG Power Connecticut, LLC*, 110 FERC ¶ 61,020, at P 56 (2005); *Milford Power Company, LLC*, 110 FERC ¶ 61,299, at P 81 (2005).

[41] *Devon V* at P 72; *Devon VI* at P 25, 29.

G. Notice Requirement

65. As stated elsewhere in this order, the issue of whether the proposed RMR Agreement is necessary for Norwalk to remain available to provide reliability service is set for hearing and settlement judge procedures. If the hearing determines that the RMR Agreement is necessary, then the ensuing discussion of notice will be pertinent.

66. Norwalk requests waiver of the Commission's 60-day prior notice requirement[42] and asks that the Commission accept the filing and permit it to become effective on June 19, 2007. Norwalk argues that, because it is filing the proposed RMR Agreement in advance of the commencement of service there under, it satisfies the Commission's standards for waiver of prior notice. Norwalk contends that it was unable to complete negotiations with ISO-NE a full sixty days prior to June 19, 2007.

67. In its supplemental filing, Norwalk renews its request that the Commission accept the proposed RMR Agreement for filing effective June 19, 2007, the day PUSH bidding terminates. Norwalk contends that granting the requested effective date is fully consistent with Commission policy that, where a filing is supplemented in good faith to provide the Commission with additional information, the Commission allows the applicant to retain its initial filing date.

68. The Commission has granted waiver where: (1) agreements are intended to permit a generator needed to assure system reliability to operate; (2) the applicant may only learn upon very short notice which units will be RMR units; and (3) the applicant may not be able to file 60 days prior to the commencement of service due to this short notice.[43] Norwalk began negotiating the RMR Agreement with ISO-NE on March 9, 2007. Negotiations continued but Norwalk and ISO-NE were unable to agree on at least two provisions, pursuant to section 206. Norwalk therefore filed the unexecuted RMR Agreement on April 26, 2007. In light of these circumstances, we find good cause to grant waiver of the 60-day prior notice requirement.

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[42] *See* 16 U.S.C. § 824d (2000); 18 C.F.R. § 35.3 (2006).

[43] *See Mirant Americas Energy Marketing, LP*, 105 FERC ¶ 61,359 at P 14-16 (2003), *reh'g denied*, 112 FERC ¶ 61,056 (2005); *see also Milford Power Co*., 110 FERC ¶ 61,299 at P 25 (2005).

The Commission orders:

(A) Norwalk's proposed RMR Agreement is hereby conditionally accepted for filing, as modified and suspended for a nominal period, to be effective June 19, 2007, subject to refund.

(B) Norwalk is hereby directed to submit a compliance filing with thirty (30) days of the date of this order, as discussed in the body of this order.

(C) 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 the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning Norwalk's proposed RMR Agreement. However, the hearing will be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (D) and (E) below.

(D) Pursuant to Rule 603 of the Commission's Rules of Practice and procedure, 18 C.F.R. § 385.603 (2006), the Chief Administrative Law Judge is hereby directed 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 within five (5) days of the date of this order.

(E) Within thirty (30) days of the date of the appointment of the settlement judge, 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.

(F) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in this proceeding in a hearing room of the Commission, 888 First Street, N.E. Washington, D.C. 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)

Kimberly D. Bose,
Secretary.