UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell

Consolidated Edison Company of New York
v.
Public Service Electric and Gas Company,
PJM Interconnection, L.L.C., and
New York Independent System Operator, Inc.

Docket No. EL02-23-001

ORDER AND OPINION ON INITIAL DECISION

(Issued December 9, 2002)

1. APPEARANCES *Donald J. Stauber* and *Charles E. McTiernan, Jr.* for Consolidated Edison Company of New York, Inc.

Kenneth G. Jaffe, Timothy A. Ngau, Bradley R. Miliauskas and *Richard P. Bonnifield* for Public Service Electric and Gas Company

Barry S. Spector, Arnold B. Podgorsky and *Paul M. Flynn* for PJM Interconnection, L.L.C.

Kenneth A. Barry and *Elizabeth Grisaru* for New York Independent System Operator, Inc.

Michael D. Cotleur and *Thomas J. Burgess* for the Trial Staff of the Federal Energy Regulatory Commission.

2. This case is before the Commission on exceptions to an initial decision issued in this proceeding on May 23, 2002.[1] At issue is interpretation of two contracts executed in 1975 and 1978, and a further amendment in 1978, governing the transfer of 400 MW and 600 MW of power through the New Jersey service territory of Public Service Electric and Gas Company (PSE&G) to specific delivery points in the New York City service area of Consolidated Edison Company of New York (ConEd). In this order, we affirm the initial decision in part, and modify

[1] Consolidated Edison Company of New York, Inc. (Complainant) v. Public Service Electric and Gas Company, PJM Interconnection, L.L.C. and New York Independent System Operator, Inc. (Respondents), 99 FERC ¶ 63,028 (2002) (Initial Decision).

that decision in part. Our actions here benefit customers by providing certainty concerning the rights and obligations of the parties to these contracts in light of the changes that have occurred in the electric industry in the wake of our Orders Nos. 888[2] and 2000.[3]

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[2]Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), Order No. 888-A, 62 Fed. Reg. 12,274 (March 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998), aff'd in relevant part, Transmission Access Policy Study Group, et al. v. FERC, 225 F.3d 667 (D.C. Cir. 2000), aff'd, New York v. FERC, 535 U.S. 1 (2002).

[3]Regional Transmission Organizations, Order No. 2000, FERC Stats. & Regs. P31,089 (1999), order on reh'g, Order No. 2000-A, FERC Stats. and Regs. P31,092 (2000) (Order No. 2000 and Order No. 2000-A, respectively), aff'd, Nos. 00-1174, et al. (D.C. Cir. Dec. 11, 2001) (order dismissing petitions).

Background[4]

3. In the late 1960s, PSE&G had ample generation capacity in the southern part of its system, but needed generation in the northern part of its system and additional transmission capacity to move power between the areas. Neighboring utility, ConEd had generation capacity north of New York City, but needed additional transmission capacity to move power to its load in New York City. Recognizing that their problems were reciprocal, the utilities cooperated on a solution. They agreed that ConEd would deliver 400 MW to PSE&G's northern zone and that PSE&G would deliver 400 MW to ConEd in New York City. To this purpose, they utilized the A Feeder line between Linden, New Jersey, and Goethals, New York, and constructed two transmission lines, the B Feeder line between Hudson, New Jersey, and Farragut, New York, and the J Line between Waldwick, New Jersey, and Ramapo, New York.

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[4]The background and issues to this case are presented in detail in the Initial Decision, 99 FERC ¶ 63,028 at PP 3-21, and also in the Commission's April 10, 2002 order on complaint establishing hearing procedures. Consolidated Edison Company of New York, Inc. v. Public Service Electric and Gas Company and PJM Interconnection, L.L.C., and New York Independent System Operator, Inc., 99 FERC ¶ 61,033 (2002) (April Order).

4. On May 22, 1975, the parties superseded their earlier contracts with a detailed contract setting forth the parties' rights and obligations concerning transfer of the 400 MW (1975 contract or 400 MW contract).[5] On May 8, 1978, the parties entered into a second contract calling for construction of additional transmission facilities, the K line between Waldwick and Ramapo, and the C Feeder line, between Hudson and Farragut, so as to deliver an additional 600 MW (1978 contract or 600 MW contract).[6] On May 9, 1978, the parties modified the 1975 contract, inter alia, to extend its term to coincide with that of the 1978 contract, i.e., "the end of the year 2020" (May 9, 1978 amendment).[7]

5. By the end of the century, each party apparently had a different idea of its obligations and benefits under these contracts. On November 15, 2001, ConEd filed a complaint with eight allegations that PSE&G had violated its contractual obligations. The root complaint was that PSE&G continually curtailed delivery of the contracted-for 1,000 MW. The parties also disagreed over whether the contracts obligated PSE&G, at its sole expense, to replace a spare transformer that had been damaged beyond repair. ConEd named also as respondents PJM Interconnection, L.L.C. (PJM), the independent system operator (ISO) to which PSE&G belongs, and the New York Independent System Operator (NYISO), the ISO to which ConEd belongs. The three respondents filed their answers on January 22, 2002. Numerous parties intervened in the proceeding.[8]

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[5] Exh. No. CE-6.

[6] Exh. No. CE-9.

[7] Exh. No. CE-7.

[8] For a list of the intervenors, see April Order, 99 FERC at 61,123.

6. The Commission recognized that resolution of the issues in this proceeding is of great importance not only to ConEd, PSE&G, PJM, and NYISO, but also to New York City's ability to receive dependable electric service, and to the future success of regional transmission organizations (RTOs) in other parts of the nation.[9] The Commission set the issues for hearing, and authorized the presiding judge to phase the case so as to decide first, by May 28, 2002, the three issues identified by ConEd as critical to service during the coming summer peak period:[10]

·whether PSE&G and PJM are obligated to render and whether ConEd is entitled to receive 1,000 MW of firm transmission service under the contracts, subject to curtailment only when a critical bulk power facility outage in PSE&G's northern zone impedes full service;

·whether transmission service to ConEd under the contracts should be curtailed on a non-discriminatory basis, pro rata with other firm services over PSE&G's affected transmission facilities; and

·whether PSE&G is obligated to provide a spare transformer and how the cost of that transformer should be allocated between PSE&G and ConEd.

The Commission said that if the case did not settle, it would issue its decision on the three critical issues (Phase I) by July 31, 2002. As for the remaining issues, the Commission instructed the presiding judge to issue an initial decision by November 25, 2002, and said that if the case still did not settle, it would issue its Phase II decision by March 1, 2003.[11]

7. At an April 17, 2002 prehearing conference, a fourth issue for decision during Phase I was added.[12] The presiding judge stated this issue as: What steps should PSE&G and PJM take in the short term (i.e., before the end of this summer's peak usage season) to assure that ConEd gets the service to which it is entitled?[13]

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[9] 99 FERC at 61,127.

[10] 99 FERC at 61,128. ConEd had requested the Commission to defer consideration of the other issues to permit the presiding judge to make a timely decision on the critical issues. ConEd's February 6, 2002 filing at 3.

[11] 99 FERC at 61,128.

[12] April 17, 2002 prehearing conference transcript at 25-26.

[13] 99 FERC ¶ 63,028 at P 40.

8. The Phase I hearing was held on May 1 and 2, 2002, with ConEd, PSE&G, PJM, NYISO and Trial Staff submitting testimony. Afterwards, the presiding judge directed the parties to brief the stipulated issues.

9. In the Initial Decision on the Phase I issues, the presiding judge found that although the contracted-for service is not firm, under Order No. 888 standards, neither is it interruptible, but lies in-between and far closer to firm than interruptible. He found that the 1975 contract for 400 MW requires transmission service that PSE&G may curtail only because of critical bulk-power facility outages in the northern part of its system. He found that the 1978 contract for 600 MW requires transmission service that PSE&G may not curtail for economic reasons, but only when "critical bulk-power system outages make it impossible for PS[E&G] to maintain such transfer", after PSE&G has met its responsibility to plan, design, and build its transmission system adequately to accommodate this transmission. He found that PSE&G is required to take or pay for whatever steps are necessary (including redispatch of generation within the PJM system) to provide the transmission service. He found that PSE&G may curtail any portion of the 1,000 MW when necessary to avoid shedding retail native load. He found that for any other causes justifying curtailment, service to ConEd may be curtailed pro rata with firm transmission customers under the PJM open access transmission tariff (OATT). Lastly, he found that the 1978 contract had ended PSE&G's responsibility to maintain a spare transformer.[14]

10. Pending a long range solution, arrived at preferably by negotiations among the parties, the presiding judge fashioned an interim solution for the summer peak period: ConEd's transactions with PSE&G would be treated, under the PJM OATT, as an injection into the PJM grid, in PSE&G's northern section, and a withdrawal from the PJM grid, at the southern section, where transmission lines connect to New York City. ConEd would be able to schedule the service and to receive basically the same service as an OATT point-to-point customer. ConEd would not need to pay an additional charge to reflect the marginal difference among the prices of

[14] 99 FERC ¶ 63,028 at PP 53, 65, & 74.

electricity at the specified locations; however, PJM might be entitled to charge for congestion costs.[15]

11. On June 2 and 4, 2002, ConEd, PSE&G, PJM, and Commission Trial Staff submitted briefs on exceptions. On June 11, 2002, ConEd, PSE&G, and NYISO submitted briefs opposing exceptions.[16]

12. On June 17, 2002, PSE&G, PJM, and Commission Staff filed a joint motion requesting appointment of a settlement judge, pursuant to Rule 603 of the Commission's Rules and Regulations, 18 C.F.R. § 385.603 (2002). The movants stated that the conclusion of the briefing of Part I presented an opportunity to focus on settlement prior to start of the Phase II hearing, in August. ConEd filed its acquiescence on June 26, 2002. On June 28, 2002, with the presiding judge's concurrence, the Chief Judge designated a settlement judge and required progress reports every 30 days.

13. On July 19, 2002, ConEd filed, on behalf of itself, PSE&G, PJM, NYISO, and Commission Staff, a motion asking the Commission to delay issuing its anticipated July 31, 2002 decision for 45 days in view of the on-going settlement discussions. Also on July 19, 2002, ConEd filed a companion motion asking the presiding judge to postpone the procedural schedule for the remaining issues (Phase II) for approximately two months. By a notice of July 23, 2002, the Commission granted both requests. On September 13, 2002, the parties asked the Commission to delay issuing its decision on Phase I issues, and to extend the procedural schedule for Phase II of the proceeding. By a notice of September 19, 2002, the Commission extended the dates for the Phase II procedural schedule.

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[15] 99 FERC ¶ 63,028 at PP 82-83.

[16] On June 12, 2002, NYISO filed both a motion to file an amended brief, and the amended brief. On June 19, 2002, PJM filed an answer to NYISO's motion in which it asked the Commission either to not permit NYISO to add a substantive sentence to its brief or else to consider PJM's comments about the sentence. The Commission will accept both NYISO's amendment and PJM's comments.

Discussion

Firmness of Transmission Service

Initial Decision

14. The Initial Decision found that while the service under the contracts did not rise to the level of "firm transmission service" as defined in the Commission's pro forma tariff,[17] the right to curtail service is severely limited to "when critical bulk-power" facility or system outages impede service. According to the Initial Decision, the curtailment provisions "do not permit service to be curtailed merely because the utility performing the wheeling would have to run its generation out of economic merit to provide the service."[18] The Initial Decision therefore found that while the service is not a firm service under PJM's OATT, "it has a priority that prohibits its curtailment for purely economic reasons and requires PSE&G to take or pay for whatever steps are necessary (including redispatch of generation within the PJM system) to provide the service."[19]

Exceptions

15. On exception, PSE&G argues that the Initial Decision: (a) correctly determined that PSE&G is only required to deliver as much power (up to 1,000MW) to ConEd as ConEd delivers to PSE&G at Waldwick; (b) confirmed that service is not "firm" and not on par with native load; but (c) erroneously found that PSE&G must "take or pay for whatever steps are necessary (including redispatch of generation within the PJM system)" to provide up to 1,000 MW of transmission service to ConEd. PSE&G attributes this allegedly erroneous conclusion to the Initial Decision's ignoring its own axiom that "the most important evidence of what they wrought is the words of the contracts themselves."

16. PSE&G alleges that the Initial Decision was fueled by a mistaken view of the level of payments that the 1978 contract obligated ConEd to make, a mistake that leads to an unjust result.[20] PSE&G states that these costs do not include any amount to compensate PSE&G

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[17] See Order No. 888 at 31,931.

[18] 99 FERC ¶ 63,028 at P 52.

[19] Id. at P 65.

[20] The Initial Decision states, at P 18, that "ConEd was required to make a $57 million annual payment to PSE&G." PSE&G states that undisputed evidence shows that ConEd's total annual payments are approximately $14 million. PSE&G Brief on Exceptions at 13.

for the fixed costs of generating facilities or any variable costs of operating generating facilities off-cost, i.e., the costs to redispatch. In contrast, the current PJM rate for firm point-to-point transmission service would be $21.4 million plus surcharges of at least $3.6 million, plus any redispatch costs. According to PSE&G, this is unfair to PSE&G and consumers in PJM, since it is PJM's settled practice regarding grandfathered contracts not to assign redispatch costs to the transmission provider; instead, these costs would be reflected in prices in PJM's energy market.[21] PJM urges that any changes to the rules governing pricing of purchases in PJM's energy market are, therefore, beyond the scope of the proceeding.

[21] PSE&G Brief on Exceptions at 17-18.

17. According to PSE&G, the Initial Decision also fails to give effect to the language of the contract. PSE&G argues that the only facilities to be "utilized" that could adjust power flows are the Phase Angle Regulators (PARs),[22] which were constructed as part of the interconnections, and that the operative language of each contract specifically contemplated that power transfers would be effected by adjustments to the PARs. Further, argues PSE&G, the Initial Decision violated settled judicial and Commission precedent by looking at only the curtailment and "utilizing" sections of the 1975 and 1978 contracts (§§ 4.1 and III.B, respectively), to the exclusion of the rest of the contracts. PSE&G states that the "utilizing" section is critical because it specifies the particular facilities, i.e., only the transmission facilities; therefore, this specifically excludes generation facilities. Furthermore, the limits to the ability to curtail cannot be used to expand PSE&G's obligation beyond the "utilization" of the specific facilities. In sum, PSE&G asserts that no language can be found in the contracts to require PSE&G to go off-cost (redispatch) to support the service.

18. PSE&G argues that the Initial Decision also fails to account for the significant wording differences between the agreements. PSE&G states that the differences in the curtailment provisions mean that the 1975 contract has a lower curtailment priority.[23] PSE&G asserts that if an outage in the northern zone of its system reduces its ability to transfer power to

[22] PARs are electrical devices that have the ability within certain physical limits to control power flow through a particular component of the transmission network.

[23] The 1975 contract curtailment provision (§ 4.1) reads "when critical bulk-power facility outages in the northern portion of the PSE&G system would, in the opinion of PS, reduce PS's ability to provide such transfer." In contrast, the 1978 contract (§ III.B) states "when critical bulk-power system outages make it impossible" to effect the transfer.

ConEd so that it would have to employ facilities other than the interconnection and transmission facilities to be "utiliz[ed]" to re-deliver power, i.e., generating facilities, the curtailment language expressly permits PSE&G to curtail the transfer. In addition, changed condition language of the 1978 amendment to 1975 contract contemplated that the service was conditioned on changed conditions.[24]

19. PSE&G also alleges that the parties' course of performance and other evidence confirms that PSE&G did not agree to use "whatever means necessary" to maintain the service. PSE&G highlights the adoption of the operating procedures under the contracts by both companies in 1984. ConEd's procedures state that PARs will be used to achieve the desired magnitude of power flow. In addition, the procedures state "PSE&G will wheel up to 1000 MW under normal conditions provided there are no actual or contingency overloads which require PSE&G to operate off-cost." Similarly, PSE&G's operating procedures, adopted at the same time, are virtually identical. PSE&G maintains that the procedures clearly show that the parties understood that the 1975 contract did not, under any circumstances, require it to operate off-cost for the 400 MW.

[24] In the May 9, 1978 amendment, at § 1, language was added to the 1975 contract to state that "should conditions change . . . such that PS shows that in order to meet the power transfer obligation . . . PS is required to perform substantial additional construction . . . [and] the parties, at the request of PS, shall conduct a joint study to determine what other compensation might be appropriate in light of such change. . . ."

20. PSE&G claims that the Initial Decision's interpretation would give ConEd the equivalent of firm OATT transmission service, to which the Initial Decision found it was not entitled. PSE&G states that, in the 1970s, it was understood that firm service was subordinate to the utility's native load customers in all respects. Also, not only would firm service be curtailed, the utility would not obligate itself to operate uneconomically to provide service without compensation, as ConEd included in its contract with NYPA.[25] Thus, PSE&G objects, the Initial Decision gives ConEd the financial equivalent of firm point-to-point transmission service since it will be shielded from any financial exposure to congestion costs, the defining characteristic of firm service in PJM.

[25] ConEd's contract with NYPA includes compensation for redispatch costs, if necessary to maintain service. Exh. No. PS-5 at 3.

21. PSE&G also claims that the Initial Decision fails to take into account the impairment provisions of the contracts. ConEd conceded that conditions on its system sometimes impair the ability of PSE&G to deliver power. In addition, unrebutted evidence of ConEd's planning studies shows that connection of new generation has impaired PSE&G's ability across the Linden-Goethals A circuit by at least 200 MW, and that this occurs regularly, "especially in summer high load periods."[26] In addition, it appears that future impairments will result from the interconnection of new generating plants beginning in 2003.[27] Based on these facts, PSE&G asserts that ConEd is responsible for some of the reduced deliveries and has permanently impaired PSE&G's ability to deliver power to ConEd.

22. Commission Trial Staff assert that the presiding judge erred in requiring PSE&G to incur redispatch costs to provide service, since no language in either contract so provides. Staff points out that the only evidence of an obligation to redispatch is the 1984 Operating Memorandum addressing the 1978 contract, where it appears that PSE&G is obligated to go "off-cost" if necessary to support the 600 MW transfer, but only under normal operating conditions.[28]

ConEd's Brief Opposing Exceptions

23. In response, ConEd maintains that service must be maintained even if PSE&G is required to use generating resources to support the service. ConEd observes that the Commission, following governing principles of contract law, considers contract construction, "to be considered as a whole . . . not from particular words, phrases," and that "contracts must receive a reasonable construction according to the intention of the parties at the time of

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[26] A November 1996 In-City Capacity Requirements Study conducted for ConEd states at B-3, "Although the total amount of transmission capacity with PSE&G is above 1,000 MW, these ties collectively cannot be loaded to their full rating during summer high load periods due to cable limits within Con Edison's system when both Cogen Technologies (an Independent Power Producer) and Arthur Kill generation are operating at full capacity." Exh. No. CE-41 at 21. PSE&G also submitted power flow data (Exh. No. PS-33) and the results of a circuit analysis at Goethals (Exh. No. PS-37) that show a reduction in deliveries of approximately 100 MW and a 200 MW impairment, respectively, following the 1992 interconnection of the Cogen Technologies plant on the Linden-Goethals A Feeder.

[27] December 13, 2000 Interconnection Study for the KeySpan Energy Project, PSE&G Exh. No. 6 at 9.

[28] Commission Trial Staff's Brief on Exceptions, Phase I, at 6-7, citing Exh. No. PS-12.

executing them" (citing Villages of Jackson Center, 91 FERC ¶ 63,013 (2000), which cites 17A Am. Jur.2d Contracts § 385 (1999)). In addition, the Commission considers that interpretation of an integrated agreement is directed to the meanings . . . in light of the circumstances' of the transaction and comports with the agreement as a whole (citing Boston Edison Company v. FERC, 856 F.2d 361, 365- 67 (1st Cir. 1988)). ConEd asserts that the second controlling principle is the preservation of contract rights. Preserving the sanctity of contracts, even if circumstances make it more burdensome is also required.

24. ConEd asserts that PSE&G must use all available means to render service. It says that the service provisions provide only one reason to curtail the service, i.e., when critical bulk power outages on the northern portion of PSE&G's system impair its ability to provide service, a conclusion supported by all the evidence.

25. ConEd argues that substantial investment supports the conclusion that the companies envisioned that transfer would continue on a regular and continuous basis, both contracts including a non-impairment requirement, i.e., neither party could add generation or load such that it would impair performance under the contracts. In addition, the 1978 contract had a plan, design, build and operate clause which required PSE&G to "plan, design, build and operate its system so as to supply its own load, meet its obligations to PJM, and wheel 600 MW to C[on]E[d]."[29] ConEd points out that the Commission indicated this as a difference in "firmness" in the April Order.[30] However, ConEd asserts that the difference is not in firmness, but in how service is to be provided, i.e., the 400 MW is less dependent on internal transmission facilities, but the 600 MW is dependent on transmission paths.

26. For these reasons, the Initial Decision concluded that the service was neither "firm" nor "interruptible" as those terms are used today by utilities which provide service under

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[29] Citing the 1978 contract at III.B.

[30] Citing 99 FERC at 61,126.

an OATT; however, the two agreements were *sui generis*,[31] and mean exactly what they say.[32] Under contract law, the presiding judge stated, a party must perform unless its agreement excuses such performance, and PSE&G was free to negotiate any manner of restrictions. PSE&G, though, argues that it may curtail for economic reasons and it must only adjust the PAR settings to be in compliance. The Initial Decision stated that to accept PSE&G's contention, that by referring to certain facilities, the contracts limited PSE&G's responsibility to the use of only those facilities, would represent a completely unjustified reading of the texts.[33]

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[31] Constituting a class alone.

[32] 99 FERC ¶ 63,028 at P 53.

[33] Id. at P 57.

27. ConEd also responds to PSE&G's argument that it is not obligated to redispatch because generation is not mentioned in contracts. ConEd replies that when read together, the service and curtailment provisions indicate that generation is required. Since outages refer to generation outages, the contracts envision that generation facilities would be used to effectuate the service. The Initial Decision also concluded that there is no support to demonstrate that PSE&G is not obligated to use generation.[34]

28. ConEd also maintains that the record supports a finding that all available means are necessary to support the service. ConEd states that the record indicates that: (a) facilities were built specifically to support ConEd's native load; (b) ConEd paid for facilities; (c) payments were fixed costs, not dependent on use; (d) no reduction in payments if service is curtailed and each contract prohibits addition of generation if it will impair service; and (e) for the 1978 contract, very high payments – 38% return on equity with full recovery within three years. ConEd also asserts that under the circumstances at the time, it would not have attached its generation to native load on an interruptible basis.

29. ConEd also states that use of generation for firm service under the OATT does not foreclose its use where the parties have a contract. ConEd continues that, while curtailment does not have to be pro rata, the similarities between firm and the subject contracts justify the use of generation, since the contracts contain performance and curtailment provisions. In addition, the PJM manual reference states that generation would be used to support the transfer.[35] ConEd points to the use of the same planning criterion under the OATT and the contracts, i.e., a first-contingency criterion, as a basis for using generation. PSE&G maintains capacity to experience a first contingency without curtailing firm service – therefore, services under the OATT and the contracts should be curtailed only after the occurrence of a first contingency. Finally, asserts ConEd, the performance and non-impairment guarantees are suggestive of substantial firmness. Given their firmness, the use of generation should be at least equivalent to its use in connection with OATT services.

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[34] Id. at PP 48 & 51.

[35] PJM Manual for Transmission Operations, at 2-21, Exh. No. CE-32.

Commission Decision

30. Initially, the Commission wishes to commend the parties and the presiding judge on their expeditious and thorough examination of the issues presented.

31. A central issue in determining the nature of the service in question in this case is whether PSE&G must redispatch in order to support the service. Strong arguments can be marshaled on either side of this issue. ConEd argues that PSE&G must redispatch. Among other things, it points to the contract language specifying the circumstances under which PSE&G may curtail the service, and to the 1978 contract provision obligating PSE&G to "plan, design, build and operate its system so as to supply its own load, meet its obligations to PJM, and wheel 600 MW to Con Edison." ConEd also asserts that the circumstances surrounding the execution of that contract indicate that a broad service obligation should be imposed on PSE&G, particularly the fact that the contract was a substitute for ConEd's plan to build a DC tie from Ramapo to Farragut dedicated to transferring 600 MW. Further, ConEd maintains that under the contract, PSE&G received a generous return on its investment in the facilities used to support the service, and points out that its payments under the contract are made on a fixed basis rather than on an "as used" basis, and that the contracts do not provide for any reduction in payments when service is curtailed. ConEd also states that service under the two contracts has been regarded as firm in various reports and studies conducted by ConEd, some of which PSE&G participated in.

32. PSE&G, in contrast, presents some strong arguments as to why it need not redispatch. It points to the fact that the requirement to redispatch or use additional generation to support the service is not spelled out in either of the contracts, whereas various facilities needed to support the service were specifically enumerated. PSE&G states that the contracts contain no provisions comparable to those in a later 1991 contract with ConEd committing PSE&G to redispatch generating facilities to transfer power for ConEd. Nor is payment for redispatch specified in the contracts. Rather, payments under the contracts were designed only to compensate for the cost of facilities used to support the service. PSE&G also notes that the contracts were filed as facilities agreements, as opposed to transmission service contracts, for NYISO. Further, PSE&G states that the engineering studies that preceded each contract evaluated only the use of PAR adjustments to transfer power, not the use of off-cost generation.

33. The Commission believes that in the ambiguous circumstances of these contracts, as they must be interpreted in the post-Order No. 888 and post-Order No. 2000 world, the most persuasive evidence of what those contracts mean is the actual operating procedures for ConEd and PSE&G, summarized on p. 27 of PSE&G's brief on exceptions, which have been in effect since 1984 (although PSE&G asserts ConEd unilaterally rescinded its operating procedure last year). Briefly, these operating procedures provide that under normal system conditions, if PSE&G encounters off-cost conditions, it will limit the wheel to 600 MW but will operate off-

cost, i.e., redispatch to maintain the 600 MW wheel. The procedures provide that under abnormal system conditions, if off-cost conditions are encountered, PSE&G and ConEd will evaluate their systems to see what solution is most economical, but that, under ConEd's version of the procedures, PSE&G will operate off-cost to support the 600 MW wheel if that is most economical. Under capacity emergency conditions, the procedures provide only that PSE&G can curtail the wheel to maintain supply service to its customers. Presumably, PSE&G should operate off-cost in this situation if it is necessary and economical (compared to other options available to ConEd) to do so, although the procedures do not specifically provide for this.[36] The gist of these procedures then, is that PSE&G will not redispatch and operate off-cost to support the 400 MW wheel, but will do so to support the 600 MW wheel if that is most economical given ConEd's other alternatives. We believe this captures the essence of the contracts as they should be interpreted given all of the circumstances of their execution and the subsequent conduct of the parties.

34. In its brief opposing exceptions (at 22-23), ConEd attempts to downplay the significance of these operating procedures by citing testimony from its witnesses who asserted that the operating procedures were developed at a time when ConEd was flush with capacity, and were developed as an accommodation to PSE&G by system operators who are responsible for the day to day operations of the transmission system rather than by planners who focus on long term considerations. ConEd states that although its system operators could accept less than full performance by PSE&G under some circumstances, its witnesses testified that interruptible service would not have satisfied either company's supply requirements at the time the agreements were negotiated, and that ConEd could not and would not have agreed to non-firm service under the agreements.

35. However, if truly firm service in all circumstances was what ConEd really intended when the contracts were executed, ConEd should have had the contracts drafted in a much more iron clad and less ambiguous manner than what ultimately was agreed to. In these circumstances, the Commission believes that the parties' course of conduct over many years has

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[36]The Commission assumes that if off-cost redispatch is appropriate to support a transaction in both "normal" or "abnormal" circumstances, it certainly should be called upon, if necessary and economical, in emergency conditions when there is increased likelihood of service curtailment and the consequences of that curtailment are likely to be more severe.

substantial weight and should be the factor most relied on by the Commission in interpreting the conflicting provisions of the contracts at issue in this case. The reasons offered by ConEd for this "accommodation" do not support a different interpretation of the contracts now that the parties disagree on how they should be implemented.

36. The Commission's finding that PSE&G and PJM are required to redispatch only to support the 600 MW wheel is consistent with: the origin of the 400 MW contract as a generation exchange contract; the absence of the "plan, design, build, and operate" language in the 400 MW contract; and the payment for facilities feature of the 600 MW contract. This finding is also consistent with the fact that the 600 MW wheel, but not the 400 MW wheel, was agreed to as an alternative to ConEd building a DC tie. PSE&G would have to occasionally redispatch in order to provide service comparable to that provided by a DC tie.

37. In making the finding that PSE&G and PJM are required to redispatch to support the 600 MW wheel, the Commission recognizes PJM's concern (expressed at p. 33 of its brief on exceptions) that if ConEd incurs no incremental costs as a result of its bids, there is no discipline on its bids, and PJM could be forced to redispatch its generation when there is no reliability reason or economic reason to do so. (PSE&G at 32 of its brief on exceptions makes a similar argument concerning congestion costs resulting from off-cost generation used to support the wheel.) ConEd address this concern, at p.7 of its brief opposing exceptions, where it states that ConEd's practice has not been to demand transfer of 1000 MW under the agreements without regard to the redispatch costs incurred by PSE&G and without regard to ConEd's need for the service. ConEd further states that it is cognizant of the cost of transmission service and will continue to use the service under the agreements in a reasonable manner that serves the economic and reliability needs of its retail customers.

38. The Commission views ConEd's representations concerning when it would require redispatch as essentially a commitment to a comparison of options available to ConEd before redispatch by PSE&G and PJM is required.[37] Until last year, such a comparison of options was an integral part of the operating procedures used by both ConEd and PSE&G. The Commission agrees with ConEd that this is a reasonable operating practice, and instructs the

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[37]Thus, contrary to ConEd's statements in the record indicating otherwise, the Commission assumes that ConEd will not necessarily request the full 1000 MW under the contracts without comparing PSE&G's redispatch costs against the cost of other options available to ConEd.

parties to include this practice in all formal procedures adopted to implement the 600 MW contract in the future.

39. The Commission has found that under the 400 MW contract, although it is as firm as the 600 MW contract in other respects, PSE&G and PJM need not redispatch to provide the transmission service. However, we see no reason why the parties cannot firm up the 400 MW contract by entering into a supplemental agreement whereby PSE&G and PJM are required to redispatch to support the 400 MW transmission. In light of ConEd's demand-supply situation, the Commission very strongly encourages the parties to do so. The need for efficient economic incentives and the equitable principle of cost recovery following cost causation would indicate that ConEd should pay any resulting costs of redispatch. However, this would appear to be contrary to the existing practice on PJM's system. Accordingly, the Commission would like the record further developed on this issue before it makes a final decision concerning the recovery redispatch costs for both the 600 MW contract and for a "firmed-up" 400 MW contract.[38] In particular, the Commission would like the record further developed concerning the following issues concerning grandfathered contracts:

1) How often has PSE&G redispatched to support the contracts in question, prior to the formation of PJM and subsequent to the formation of PJM? For each instance when redispatch costs were incurred, the parties should consider when such costs were incurred, the amount of such costs, for what contract the costs were incurred, and how those costs were recovered.

2) Has PSE&G or PJM redispatched to support grandfathered through and out transmission for other non-PJM members? How do the attributes of the redispatch costs incurred for these non-PJM members compare to the costs incurred for ConEd described in issue 1?

3) Are the policy and practical reasons for the adoption of PJM's policy of recovery of these redispatch costs associated with grandfathered contracts still valid today? Why or why not? Should they apply to these ConEd contracts as well? Why or why not?

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[38]In light of the uncertainty concerning how redispatch costs should be recovered, perhaps the parties should agree to put payments for redispatch costs in an escrow account or otherwise subject to refund pending the resolution of this issue.

4) Is there anything about the operation of LMP or the Commission's SMD rulemaking that would lead to a particular method of recovery of redispatch costs associated with grandfathered contracts? Why or why not?

5) Does PJM's recovery method properly reflect the fact that redispatch costs associated with grandfathered contracts may be incurred more by some grandfathered customers than others? Why shouldn't the policy be changed to require cost recovery from the specific customers causing the costs? How hard is it to measure for whom costs are incurred? Why?

The Transformer Issue

Initial Decision

40. The Initial Decision found that PSE&G was not obligated to maintain a spare transformer at all times because no language in the contracts expressly so required.[39] The Initial Decision also rejected ConEd's position, that § 6.4 of the 1975 contract[40] required PSE&G to

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[39] 99 FERC ¶ 63,028 at P 71.

[40] Section 6.4 of the 1975 contract is headed "Catastrophe or Condemnation." It states, "If all, or a material part, of any of the facilities of each interconnection should be destroyed or damaged to such a degree that one or both interconnections are no longer useful, or condemned, or if less than a material part shall be destroyed, damaged or

replace the spare transformer because there was no evidence of a catastrophe.[41] Lastly, the Initial Decision found that ConEd had not provided ample evidence that good utility practice dictated an obligation on PSE&G's part to replace the spare transformer.

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condemned, the proceeds of any insurance or any condemnation award shall be payable to the party or parties in whom title exists, and the party or parties shall repair, restore, or reconstruct the damaged, destroyed, or condemned facilities in such a manner as to restore the facilities to substantially the same general character or use as the original interconnection or to such other character or use as the parties may then mutually agree. The rights, titles, interests and carrying-charge responsibilities of the parties for the repaired, restored or reconstructed facilities shall continue as provided in this Agreement unless mutually agreed otherwise.

[41] 99 FERC ¶ 63,028 at P 72.

Exceptions

41. On exceptions, ConEd argues that the Initial Decision applied the wrong contractual provision to the dispute and misapplied the standard of good utility practice. ConEd states that the Initial Decision erroneously relied on § 5.2 of the 1975 contract, which expressly required PSE&G to maintain a spare transformer but which was deleted by § 4 of the May 9, 1978 amendment.[42] ConEd points out that the transformer described in § 5.2 was never purchased or added to the interconnection.

42. Instead, ConEd asserts that the correct provisions are: § 1.1 of the 1975 contract, which requires PSE&G to construct portions of the Hudson-Farragut interconnection, together with Schedule 1 of that contract, which lists the facilities to be constructed there, including, at

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[42]Section 5.2 of the 1975 contract states, "When the normal power flow through the two Waldwick 345/230 kv transformers exceeds the normal rating of a single unit, PS will provide, at its own expense, an additional 345/230 kv transformer of approximately 500-mva capacity for use as a standby spare at Waldwick which may also be used as a spare for the Hudson Station of PS or the Goethals Station of Con Edison."

Section 4 of the May 9, 1978 amendment states, "Section 5.2 of the Two-Party Agreement [1975 contract] shall be deleted when all of the PS facilities defined in Item I-B of the Second Hudson-Farragut Agreement [1978 contract] have been completed and placed in commercial operation."

the Hudson Station, a 500 MVA 345/230 autotransformer;[43] § 2.1, which requires PSE&G to own, operate, and maintain the facilities described in Schedule I; and § 6.4 of the 1975 contract, which covers repair, restoration, or reconstruction of all or a material part of the interconnection facilities if no longer useful or destroyed or condemned, to substantially the same general character and use.[44]

[43]Section 1.1 of the 1975 contract obligates PSE&G to "construct and make available to Con Edison the portions of the Hudson-Farragut interconnection described in Schedule I." Schedule I at item 2 lists the cited transformer.

[44]See n.44, supra.

43. ConEd argues that PSE&G is contractually committed to provide and maintain a spare transformer, this responsibility beginning when the original Hudson-Farragut 500 MVA 345/230 autotransformer, provided by PSE&G under the parties' May 27, 1969 agreement,[45] was replaced by two autotransformers, as required by § I.B.1.b of the 1978 contract.[46] Once the original Hudson Station transformer was retained as a spare, according to ConEd, PSE&G was required to maintain it (per § 2.1 of the 1975 contract) and if destroyed, replace it or restore it to the same general character or use as the original facilities (per § 6.4 of the 1975 contract).

44. ConEd also argues that good utility practice dictates that PSE&G maintain a spare transformer, since use of a spare reduces the length of transmission outages if a primary transformer fails. This is of particular importance here, according to ConEd, because this type of transformer is uncommon. In addition, ConEd claims that because it is required to maintain a spare PAR under the contracts (because of the lengthy replacement times), this fact reflects the parties' understanding that the outage times for critical transmission facilities should be minimized, including the purchase and maintenance of back-up spares for major pieces of equipment.

Brief Opposing Exceptions

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[45] Exh. No. CE-5 at 2.

[46] Item I.B lists the equipment that PSE&G agreed to provide for the second Hudson-Farragut interconnection. Sub-item 1.b states, "Two 345/230 autotransformers each equipped with a +/- 10% tap changing under load at Hudson Generating Station, one for replacing the autotransformer in the existing Hudson-Farragut interconnection, which will be retained as a non-operating spare."

45. In its brief opposing ConEd's exceptions, PSE&G highlights that § 4 of the May 9, 1978 amendment deleted the expressed requirement of § 5.2 of the 1975 contract to maintain a spare transformer .[47] PSE&G states that it has met its contractual obligations under the 1978 contract, which required it to construct the two transformers at the Hudson Station, and to keep the replaced transformer as a non-operating spare. PSE&G emphasizes that the 1978 contract did not require PSE&G, in the event that the replaced transformer was no longer usable, to obtain another transformer for use as a spare or any other purpose.

[47] See n.46, supra.

46. In addition, PSE&G states that § 6.4 of the 1975 contract is inapplicable because it applies only if a catastrophe or condemnation has occurred.[48] Moreover, according to PSE&G, § 6.4 applies only to interconnection facilities, while the spare transformer ceased to be among facilities of any interconnection once PSE&G had completed construction of the two transformers at the Hudson Station, as required by the 1978 contract. PSE&G also highlights the fact that if ConEd had intended PSE&G to maintain a spare transformer, it knew how to do so, since the 1975 contract had such a provision.

Commission Decision

47. The Commission will postpone making a final determination concerning this issue. However, we will provide a preliminary indication of how we think this issue should be analyzed, based on the record developed thus far. We believe that, in addition to contract construction, good utility practice also governs the matter. As discussed below, in light of the Commission's preliminary analysis of this issue, we will direct the parties to further address, in Phase II, the issue of whether a spare transformer is required and how its cost would be recovered.

48. The Commission agrees with the presiding judge that interpreting these 1970s era contracts is a difficult and close question. We find support for the view that the 1975 and 1978 contracts, read together, require PSE&G to maintain a spare transformer, despite the absence of express language ascribing responsibility to PSE&G for spare transformer on hand at all times. These contracts were executed in an era of cooperation, when utilities willingly assisted one another to meet load. They should be interpreted in the same spirit in which they were written. Also, the Commission agrees with ConEd that § 5.2 of the 1975 contract, and its deletion by § 4 of the May 9, 1978 amendment, are not germane to the discussion, PSE&G never having provided the additional transformer at the Waldwick Station that § 5.2 required.

49. Besides, the arguments and interpretations about the contracts already presented, we observe that additional contract provisions may bear on the issue of the spare transformer. In § 7 of the May 9, 1978 amendment, the parties addressed the subject of what equipment should be deleted from Schedule I of the 1975 contract after completion of the equipment required by the 1978 contract, and did not cite the transformer described

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[48] See n.44, supra.

in Item 2 of Schedule I, in the 1975 contract, the transformer at issue here.[49] The May 9, 1978 amendment also continued unamended sections of 1975 contract in full force.[50] In § 6.2(a) of the 1975 contract, the parties discussed the subject of replacing equipment (as opposed to

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[49]Section 7 of the May 9, 1978 amendment states, in pertinent part, "effective when all of the PS facilities defined in Item I-B of the Second Hudson-Farragut Agreement [1978 contract] have been completed and placed in commercial operation, the phrase, 'including a spare pipe in the underwater section" shall be deleted from Item 1 of Schedules I and II of the Two-Party Agreement [1975 contract]." The remainder of the section discusses subtraction from the facilities' book costs of the deleted pipe.

[50]Section 8 of the May 9, 1978 amendment provides, "Except as expressly amended hereby, the Two-Party Agreement [1975 contract] shall continue in full force and effect."

repairing, restoring, or reconstructing it), as well as betterments, reinforcements, or additions to the facilities, and leave payment for such equipment to the mutual agreement of each party.[51]

50. The presiding judge stated that ConEd had not provided ample evidence that good utility practice dictates an obligation on PSE&G's part to replace the spare transformer.[52] However, because a primary transformer outage may take 12 months or more to repair, we believe that it would be difficult to argue reasonably that "firm" service (or the service at issue here) could be maintained without a spare transformer, unless there were alternative transmission paths (as ConEd asserts it maintains for the circumstance in which it does not have a spare) or other means to ensure service.

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[51] Section 6.2(a) of the 1975 contract states, in pertinent part, "If at any time during the Agreement, capital improvements, betterments, replacements, reinforcements or additions to either interconnection for any reason are, in the opinion of either party, required or appropriate, such party shall submit to the other party proposals in sufficient detail to permit an informed judgment with respect to the necessity or desirability of such capital improvements, betterments, replacements, reinforcements or additions, and upon the approval of the other party such proposals shall be authorized and any sharing of the adjusted investment costs of the said interconnection facilities shall be determined by mutual agreement of the parties." The section also permits either party to make capital improvements, etc., at its own expense.

[52] 99 FERC ¶ 63,028 at P 73.

51. Accordingly, while deferring our decisions on whether or not the contracts, when read together, or good utility practice require PSE&G to maintain a spare transformer to ensure good utility practice, we direct that, in fashioning the remedies in this case, the parties address the question of what is a reasonable, economic means, of ensuring service, either with or without requiring a spare transformer, consistent with the meaning of good utility practice.[53]

The Interim Remedy

Initial Decision

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[53] As defined in the Commission's pro forma tariff, good utility practice means:

> Any of the practices, methods and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period, or any of the practices, methods and acts which, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety and expedition. Good Utility Practice is not intended to be limited to the optimum practice, method, or act to the exclusion of all others, but rather to be acceptable practices, methods, or acts generally accepted in the region. Order No. 888, ¶ 31,036 at 31,931.

52. Because the Commission had expressed a desire to act in time to afford ConEd some relief before the summer peak period,[54] the presiding judge ordered an interim remedy, pending agreement of the parties on a permanent solution. The presiding judge found that for an interim period, based on his findings regarding the firmness of the transmission service, it would be unfair for ConEd to pay any additional charge for the service for which PSE&G was already being compensated.[55] In determining the interim remedy, the presiding judge recognized the difficulties in administering the contracts, since both parties no longer have complete control over their respective transmission systems. The presiding judge reflected on the fact that once electrical energy is on an interconnected grid, its flows cannot be tracked, and noted the difficulty of assuring that ConEd receives what it contracted for under the contracts.

[54] 99 FERC at 61,123 and 61,128.

[55] 99 FERC ¶ 63,028 at P 83.

53. The presiding judge directed the parties to treat the transactions as an injection into the PJM grid at Waldwick and a withdrawal at the "A" line at Linden Goethals and the "B" and "C" interconnections at Hudson-Farragut. The presiding judge asserted that this, according to the testimony of PJM's Executive Director for Operations, Michael J. Kormos, would "reproduce the effect of the service" under the 1975 and 1978 contracts. In addition, ConEd could schedule the service and receive basically the same service as an OATT point-to-point customer. Any resulting redispatch or congestion costs would then be assigned to PSE&G.[56] The presiding judge then directed the parties to:

> [p]romptly meet and negotiate in good faith for the development of a protocol under which the obligations of PSE&G to Con Edison under the 1975 and 1978 contracts can be satisfied as nearly as possible pursuant to the open access transmission tariffs of both regional organizations. Such protocol shall be filed with the Commission for review and approval as promptly as possible and in no event later than December 31, 2002.[57]

54. Because of the parties' July 19, 2002 request to the Commission to delay acting on Phase I issues, we neither placed into effect nor addressed the presiding judge's proposed interim remedy for the 2002 summer peak period. Although that peak period has ended, we will address the matters raised by the parties to guide the parties in their Phase II discussions.

Exceptions

55. On exception, PSE&G argues that the interim remedy inappropriately expands PSE&G's obligations and ConEd's rights in a way that is inconsistent with the finding that ConEd is not entitled to service equivalent to firm transmission service under the OATT. In addition, PSE&G continues, the interim remedy would require PJM to operate in a manner inconsistent with good utility practice because it would mandate that PJM redispatch generation to support power transfers to ConEd, regardless of whether the NYISO could deliver the power without redispatch. PSE&G points out that it is not good utility practice for one control area to operate generation uneconomically to provide a parallel path where the other control area is not redispatching due to internal transmission limitations. PSE&G also contends that this is a substantial change in the parties' course of performance under the agreements since each utility

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[56] Id. at PP 82-83.

[57] Id. at Ordering Paragraph D.

understood that the power transfer service would enable them to make more efficient use of their systems, not for one party to operate inefficiently for the benefit of the other. Furthermore, if required, the interim remedy would give ConEd priority access to the capability of the interconnections with PJM and would grant ConEd service superior to firm OATT service. Lastly, PSE&G asserts, the interim remedy is incomplete because it fails to reflect ConEd's acknowledgment that conditions on ConEd's system sometimes impair PSE&G's ability to deliver power.

56. PJM, while taking no position on the interpretation of the agreements, excepts to the Initial Decision because the presiding judge imposed an interim remedy that no party sponsored, that does not resolve the dispute, and that creates market problems and opportunities for "gaming" by third parties. PJM explains that, unlike transmission services that involve scheduled deliveries of energy between control areas, these agreements involve circulation of energy from one control area to another. In that context, PJM asserts that the basic question then is determining which flows satisfy the circulation contemplated by the agreements. PJM disputes the presiding judge’s observation that PJM and PSE&G disagree with NYISO over whether counter-flows of power necessarily make meter readings at the interconnections unreliable so that it is not possible to monitor compliance with PSE&G’s contractual obligations and to determine whether ConEd is getting its entitled service[58] To resolve this issue, PJM suggests that the ISOs could develop a "desired flow" calculation similar to the "desired flow" calculation used by NYISO and PJM regarding the 500 kV "5018" line to recognize the expected distribution of flows across that line from various transactions.

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[58] 99 FERC 63,028 at PP 78-79.

57. In addition, asserts PJM, because the practical implementation of the circulation contemplated by the agreements is more a matter of flow management than service scheduling, the disputes over the agreements turn on when, and to what extent, the settings on the PARs should be adjusted to effectuate the particular flows within the transmission system.[59] The dispute, however, occurs when one or both ISOs is forced to dispatch its generation out of merit as a consequence of a PAR adjustment. PJM adds that a scheduling procedure will result in day-ahead nominations that do not correspond with real-time actions since it is unresolved how to manage the service. Other market participants could be expected to exploit this mismatch between the day-ahead and real-time markets. Moreover, alleges PJM, because Con Ed incurs no incremental costs as a result of the bids, there is no discipline on its bids. Con Ed could nominate 1000 MW all the time and PJM could be forced to redispatch when there is no reliability reason or economic reason to do so, i.e., even when Con Ed is being served and NYISO does not have to redispatch. PSE&G could then nullify the nominations by submitting its own offsetting withdrawals and injections. Since the presiding judge ordered PSE&G to bear any costs from ConEd's nominations, this would be a rational response by PSE&G because it could eliminate the need to redispatch. Therefore, PJM states that the ISOs could use guidance from the Commission on where to strike the balance between effectuating this circulation and avoiding adverse impacts, i.e., increased costs to PJM market participants.

58. Specifically, PJM asks the Commission to address the following implementation questions:

> 1. How should PJM measure whether the desired circulation is occurring; specifically, should the measure of performance be solely the metered level of flows on the A, B, and C lines and the J and K lines, or can PJM add and subtract from the metered flows any other flows that are calculated as a result of other transactions, and add any circulating flows from other parallel lines to and from New York, such as the 5018 line, to determine whether the desired circulation has occurred?
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> 2. To what extent are flows from PJM and New York ISO tariff transactions permitted to use the A, B, and C lines and the J and K lines? If ISO tariff flows on those lines prevent PJM from physically receiving or delivering the amount

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[59] PJM explains that when energy is transmitted from PJM to a location outside of PJM as a scheduled service versus the circulation contemplated by the agreements, generation and load in affected control areas must be brought out of balance for the flow to occur. For all transactions between PJM and NYISO, a schedule is created so that the generation in each control area is sufficient for internal load plus transmission out. Based on a control algorithm called Area Control Error (ACE), it dispatches generation to achieve a balance between its own generation and load and the net of all its transactions with all other control areas.

requested by ConEd, is PJM required to curtail its tariff services and, if so, under what priority standard relative to ConEd's requested use?

3. Under what circumstances is PJM required to redispatch PJM generation out of merit order to effectuate the circulation? Specifically, must PJM agree to a PAR move that is requested to facilitate the circulation only if such a move is needed to prevent the New York ISO from going off-cost? And even if needed to prevent the New York ISO from going off-cost, may PJM nonetheless deny the requested PAR move if it would force PJM to go off-cost?

4. If PJM is required to redispatch off-cost to effectuate the circulation, who must bear the costs of such redispatch: ConEd? PSE&G? or all PJM market participants?[60]

59. PJM contends that with answers to these questions, it will have a framework for implementing the agreements with the NYISO.

Briefs Opposing Exceptions

60. NYISO states that the Initial Decision has provided the predicate for the parties to work out the details of performing and tracking the service since the presiding judge indicated the rights and obligations he believes the parties to have.[61] NYISO also states that it excepts to certain of PJM's exceptions. These are: (1) PJM's contentions that the loop flow circulation cannot be scheduled as a transaction; (2) that the Initial Decision ignored PJM's questions in forming the interim remedy; and (3) the Initial Decision erroneously imposed an interim remedy that no party sponsored, that does not resolve the dispute, and creates market problems and opportunities for "gaming" by third parties. However, NYISO also agrees with PJM that they should work together to develop an implementation protocol.

61. ConEd states that PJM's and PSE&G's exceptions are without merit, and that the interim remedy is feasible and reasonable. ConEd asserts that PSE&G, not PJM, currently controls the transmission service, and asks the Commission to require PJM and NYISO to

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[60]PJM Brief on Exceptions at 6.

[61]NYISO Brief Opposing Exceptions at 4.

develop protocols and procedures for scheduling and monitoring PSE&G's service to ConEd. ConEd maintains that the service under the two contracts can be scheduled and monitored like other transactions between NYISO and PJM using firm transmission service. ConEd says that the essential steps are coordination of the day-ahead scheduling by PJM and NYISO, and administration of the PARs so that actual flows are commensurate with the scheduled flows. ConEd urges that PJM's economic considerations, such as the policy of not changing PAR settings if this would increase generation costs in the PJM control area, are extra-contract issues that should neither affect nor delay resolution of the terms of the contracts. Lastly, ConEd argues that although reliability or economic considerations sometimes cause it to use less than the full 1,000 MW, these requests for reduced service do not affect PSE&G's contractual obligation nor justify an amendment to permanently reduce the contracts' service obligations.

Commission Decision

62. We agree with PSE&G and PJM that the presiding judge's interim remedy presents certain problems. However, we believe that the presiding judge has correctly identified the general direction that any remedy, interim or permanent, must follow, and has identified additional issues that need to be examined. In particular, we believe that the presiding judge correctly found that PSE&G must redispatch to support the service provided under the 600 MW contract.

63. We will direct the parties to address the question of what protocol is appropriate to implement the contracts given the guidance outlined below. We are concerned about the ramifications of allowing the service in question, as the presiding judge proposes, to become a scheduled transaction. We are not certain how parties could game this arrangement or why real time actions could inappropriately match day-ahead nominations as PJM alleges, but we believe that these issues should be examined in Phase II of this hearing proceeding. Nor is it evident how PSE&G could legitimately nominate off-setting flows to avoid redispatch, as PJM has hypothesized, and not be in clear violation of the contracts, or why this would be difficult to prevent. In addition, we find that the presiding judge has overlooked the fact that ConEd has impaired service, and that this issue must be part of any remedy as discussed further below.

64. We agree with PJM that guidance from the Commission would aid the parties in developing an appropriate remedy. However, the record concerning possible answers to PJM's questions was not extensively developed before the presiding judge. Therefore, the guidance provided by the Commission below concerning these questions must be viewed as preliminary, pending further consideration in Phase II of this proceeding. With regard to PJM's proposal, that the parties develop an operational protocol, no party opposed the principle of developing a protocol to effectuate the loop flow. We believe that this will provide the necessary operational flexibility to administer the unusual nature of the contracts, as long as ConEd receives the service it is due.

65. In response to PJM's first question, the Commission finds that PJM should be permitted to add or subtract other circulating flows to determine whether the desired flow has

occurred. PJM and NYISO currently manage a "desired flow" calculation for the 5018 line, and PJM asserts that a like protocol could be used to ensure service. In the absence of evidence that this would not provide service to ConEd consistent with our finding, we believe this to be a reasonable solution.

66. Second, we find it appropriate that third party tariff transactions be allowed to flow on the tielines. NYISO's witness testified that flows on the A, B, and C lines are tightly controlled by PAR settings to only allow circulation under the contracts. However, as PJM points out, flows on the these lines include other flows, and PJM has never been asked to make a PAR adjustment for the purpose of preventing other flows from occurring on those lines.[62] Further, ConEd's revenue requirement for those facilities is included in the NYISO's transmission tariff.[63] Therefore, it would be inappropriate to disallow tariff transactions and any resulting counterflows on the interconnections when calculating performance under the contracts.

67. PJM also requests guidance regarding the relative priority of the transmission service to tariff services and whether it is required to curtail tariff services if tariff flows prevent it from receiving or delivering the amounts from ConEd. The Commission would ordinarily expect the parties to follow the existing North American Electric Reliability Council (NERC) Transmission Line Loading Relief (TLR) procedures. The parties should explore the question of under what circumstances such procedures are applicable, and why and under what circumstances the TLR procedures, or the unique nature of the contracts, may cause operational or reliability problems.

68. Third, while we find that PJM must redispatch its generation under the 600 MW contract to ensure service to ConEd as long there are no outages to PSE&G's bulk power facilities that make it impossible to maintain the service, we cannot at this time determine all circumstances that would require either PJM or NYISO to redispatch. We do not want PJM to be in a position where it would operate contrary to good utility practice or incur additional costs where there may be some other alternatives to ensure service. Accordingly, we shall allow PJM and NYISO, in Phase II, to incorporate such alternatives into the proposed permanent remedy as appropriate.

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[62] PJM Brief on Exceptions at 23-24.

[63] Id. at 24, citing transcript.

69. Lastly, when redispatch is required, we believe that the record needs to be supplemented before we can make a decision concerning how redispatch costs should be recovered, as discussed above.

70. In addition, the parties must account for what appear to be impairments to deliveries to ConEd because of new generator interconnections on ConEd's system. These considerations must be addressed in the protocols developed by the parties. Specifically, evidence was presented that one of ConEd's interconnection studies shows that in 2003 ". . .the contractual 1000 MW wheel through PSE&G system from Ramapo to New York City must be reduced to approximately 650 MW." The study also stated that with the addition of an additional project, the wheel would be reduced by another 150 MW.[64] This and like impairments must be studied and accounted for. Accordingly, as a part of the protocol to be developed and filed with the Commission, all known and projected impairments should be listed with a brief, descriptive narrative.

71. In regard to the spare transformer issue, the remedy must also consider whether good utility practice requires PSE&G to maintain a spare transformer for the A, B, and C lines of the Hudson-Farragut interconnection. Accordingly, consistent with our belief that the service must be supported by actions providing essentially firm service, we direct the parties to address the question of whether there are alternatives to maintaining a spare transformer, taking into consideration the principles within the Commission's definition of good utility practice of reliability and reasonable cost.

72. Pending the development of detailed remedy procedures, the Commission directs PSE&G and PJM to provide, to the extent possible, service consistent with this opinion.

<u>The Commission orders</u>:

The initial decision is affirmed in part, and modified in part, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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[64] PSE&G Answer, Exh. No. PS-6 at 9.