UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

OPINION NO. 493

The United Illuminating Company Docket No. EL05-76-001

v.

Dominion Energy Marketing, Inc.

ORDER AFFIRMING INITIAL DECISION

Issued: February 20, 2007

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.

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1. This case is before the Commission on exceptions to an Initial Decision issued on May 24, 2006.[1] The Initial Decision addressed whether the Power Supply Agreement (PSA), entered into on December 28, 2001, between Virginia Electric and Power Company (VEPCO), a subsidiary of Dominion Resources, Inc. and the United Illuminating Company (UI) allocates responsibility for reliability cost tracker charges to UI or to Dominion Energy Marketing, Inc. (DEMI).[2] The Initial Decision also addressed three sub-issues: (i) whether "reliability cost tracker" charges are "transmission congestion costs" within the meaning of section 1.9 of the PSA; (ii) whether "reliability cost tracker" charges are "associated with the delivery of Energy" within the meaning of section 2.1(c) of the PSA; and (iii) what is the proper allocation of reliability cost tracker charges between DEMI and UI if reliability cost tracker charges are found to be associated with the delivery of energy pursuant to section 2.1(c) of the PSA. In this order the Commission affirms the Initial Decision's finding that the PSA allocates reliability

[1] *United Illuminating Co. v. Dominion Energy Marketing, Inc.*, 115 FERC ¶ 63,044 (2006) (Initial Decision).

[2] In 2002, VEPCO assigned the PSA to Dominion Energy Marketing, Inc. UI and DEMI are collectively referred to as "Parties" in this order.

cost tracker charges to DEMI. Further, we affirm the Initial Decision's holding that reliability cost tracker charges are within the PSA's definition of "transmission congestion costs" as stated in section 1.90 of the PSA and that section 2.1(c) assigns responsibility for those costs to DEMI up to UI's system.

I. Background

2. The dispute between the Parties arose from conflicting interpretations of the terms of the December 28, 2001 PSA.[3] The issue is whether reliability cost tracker charges, which are fixed charges under reliability must run (RMR) agreements, should be allocated to UI or to DEMI. The Commission authorized ISO New England, Inc. (ISO-NE) to impose reliability cost tracker charges to compensate generation units deemed by ISO-NE to be needed for reliability in southwest Connecticut.[4] Subsequently, ISO-NE began billing UI for a share of ISO-NE's payments to the generation units.[5] UI, in turn, began deducting the reliability charges from DEMI's billing statements to UI beginning in early 2003; in December of 2004 DEMI contested the charges and demanded a refund of approximately $8.9 million.[6]

3. On February 11, 2005, DEMI filed a breach of contract suit in the United States District Court for the District of Connecticut, alleging that UI's deduction of reliability charges from payments to DEMI was a breach of UI's obligation to pay for all energy provided by DEMI under the contract. On March 14, 2005, UI filed a complaint with the Commission alleging that DEMI refused to abide by the terms of the PSA. UI specifically cited section 2.1(c) of the PSA which provides that DEMI is responsible for all costs or charges "associated with the delivery of Energy," including transmission congestion costs. Although DEMI had filed a lawsuit in federal district court, the Commission asserted jurisdiction over the matter, finding that the contract at issue is a Commission-jurisdictional contract that had been filed with and approved by the

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[3] The PSA was first executed on December 28, 2001, and subsequently amended and restated on January 28, 2002, with changes not at issue in this proceeding.

[4] *See Devon Power LLC*, 103 FERC ¶ 61,082 (*Devon*), *order on reh'g*, 104 FERC ¶ 61,123 (2003).

[5] Initial Decision, 115 FERC ¶ 63,044 at P 90. ISO-NE had imposed its first charge for fixed payments under an RMR agreement approved in 2002. *See Sithe New Boston, LLC*, 98 FERC ¶ 61,164 (2002).

[6] Initial Decision, 115 FERC ¶ 63,044 at P 91. *See The United Illuminating Co. v. Dominion Energy Marketing, Inc.*, 111 FERC ¶ 61,224, at P 6 (2005) (May 13, 2005 Order), *reh'g granted*, 112 FERC ¶ 61,279 (2005) (September 15, 2005 Order).

Commission.[7] The Commission further found that it had special expertise regarding the contested issues, that there is a need for consistent application and understanding of terminology, and that the matters raised in UI's complaint are important to the Commission's regulatory responsibilities.[8]

4. In its May 13, 2005 Order, the Commission granted UI's complaint. The Commission found that, while the contract is "understandably silent" with regard to which party bears responsibility for Reliability Cost Tracker charges, the language of the PSA is broad enough to indicate that the Parties intended to encompass costs beyond the specific language of section 2.1(c).[9] Specifically, the Commission found that the reliability cost tracker charges are costs "associated with the delivery of energy" within the meaning of section 2.1(c) of the PSA.[10] The Commission also found that DEMI failed to demonstrate that the Parties intended to exclude such fixed cost charges from the PSA's broad definition of "Transmission Congestion Costs" and concluded that DEMI must bear responsibility for the charges at issue.[11]

5. On June 13, 2005, DEMI filed a request for rehearing of the May 13, 2005 Order, arguing that since the Commission found the PSA "understandably silent" with regard to which party bears responsibility for reliability cost tracker charges, the Commission erred by summarily finding that the terms of the PSA allocate the charges to DEMI. DEMI asserted that the Commission failed to analyze the contract in its entirety as required by New York law, which governs the contract. On September 15, 2005, the Commission agreed that DEMI had raised credible arguments that the PSA is ambiguous as to which party bears responsibility for the Reliability Cost Tracker charges, granted rehearing, and instituted hearing procedures.[12] The Commission directed the designated presiding Administrative Law Judge (ALJ) to determine whether the Reliability Cost Tracker charges are "associated with the delivery of energy" or properly categorized as

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[7] *Virginia Elec. & Power Co.*, Docket No. ER02-932-000 (Mar. 8, 2002) (unpublished letter order).

[8] May 13, 2005 Order, 111 FERC ¶ 61,224 at P 24-25.

[9] May 13, 2005 Order, 111 FERC ¶ 61,224 at P 27 ("The PSA, which was originally executed in 2001, is understandably silent with regard to which party must pay for Reliability Cost Tracker charges, which were accepted by the Commission in 2003.").

[10] *Id*. P 27.

[11] *Id*. P 29.

[12] September 15, 2005 Order, 112 FERC ¶ 61,279 at P 12.

Transmission Congestion Costs as defined in the PSA, and whether DEMI is responsible for the Reliability Cost Tracker charges in the context of the PSA in its entirety.[13] The September 15, 2005 Order also directed the ALJ to examine the intent of the Parties when executing the contract.[14]

6. A hearing was held before the ALJ on February 28 and March 1, 2006. Initial briefs were filed on March 30, 2006, by both UI and DEMI. On April 13, 2006, reply briefs were filed by both Parties.

II. Initial Decision

7. Pursuant to the Commission's directives in the September 15, 2005 Order, the ALJ analyzed the PSA under the governing law agreed to by the Parties in the contract, namely, the law of New York.[15] Accordingly, the ALJ found that New York law requires a contract to be read as a whole, rather than by particular words or phrases; requires a contract to be enforced according to the expectations of the parties; allows extrinsic evidence, including the level of business savvy and sophistication of the parties, to be considered when contract terms are ambiguous; and considers course of performance under the contract the most persuasive evidence of the parties' intent.[16]

8. After analyzing the contract pursuant to New York law, the ALJ concluded that, in the context of the PSA in its entirety, reliability cost tracker charges are within the definition of "transmission congestion costs" as stated in section 1.90 of the PSA.[17] The ALJ also concluded that section 2.1(c) of the PSA assigns responsibility for those costs to

[13] *Id*. P 13.

[14] *Id*. P 14.

[15] Initial Decision, 115 FERC ¶ 63,044 at P 92.

[16] *Id.* P 92-93.

[17] *Id.* P 94.

DEMI up to UI's system.[18] Although DEMI contended that reliability cost tracker charges are not within the definition of transmission congestion costs because such charges did not exist at the time the PSA was negotiated and the then-existing market rules defined "transmission congestion costs" narrowly as "costs resulting from out-of-merit dispatch,"[19] the ALJ found DEMI's interpretation too narrow and concluded that the PSA was written broadly to include costs such as reliability cost tracker charges.[20] The ALJ found that the evidence demonstrated that the Parties' expectations at the time of the negotiation and execution of the PSA was that the entity providing electric capacity, energy, and ancillary services to UI would assume all costs associated with providing such capacity, energy, and services.[21]

9. The ALJ found that UI intended to shift the burden and risk of evaluating, anticipating, and quantifying future costs to DEMI under the PSA because of the uncertainty about the impact the growing congestion would have on the price of wholesale energy.[22] The ALJ characterized the PSA as an "all-in," fixed price, requirements contract for which UI paid a premium. The ALJ remarked that DEMI made a business decision to submit a bid and enter into the PSA.[23]

10. Further, the ALJ concluded that DEMI could reasonably be expected to know that RMR-type agreements were a distinct possibility, though not explicitly included in the PSA.[24] The ALJ noted the Commission's acceptance in 2003 of four RMR agreements

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[18] *Id.* The Judge noted that if the cost is imposed on, or associated with delivery of energy from UI's system to its retail customers, it is UI's responsibility. However, there was no allegation that UI is charging DEMI for costs from UI's system.

[19] *Id.* P 65.

[20] *Id.* P 95.

[21] *Id.*

[22] *Id.* P 96.

[23] *Id.*

[24] *Id.* P 97, 98. For example, the ALJ notes that in May 1997, NEPOOL submitted proposed Market Power Mitigation Principles and Market Power Mitigation procedures to the Commission, which permitted recovery of RMR fixed costs.

for generation units in southwest Connecticut.[25] By approving those RMR agreements, the ALJ explained, the Commission accepted the reliability cost tracker provisions of those agreements which provide a mechanism to compensate ISO-NE for maintaining generation units that must run at certain times to lessen transmission congestion.[26] Following the Commission's decision in *Devon*, ISO-NE began billing UI for a share of ISO-NE's payments to the generation units. Thus, the ALJ concludes that "[i]n addition to knowing that it was entering into an agreement in which it undertook the risks associated with congestions costs, DEMI also knew that the industry was changing and that what those costs would be was uncertain."[27]

11. In reviewing the course of performance by the Parties, the ALJ pointed out, *inter alia*, that between January 2002 and December 2004, UI deducted from DEMI's invoices to UI reliability cost tracker (labeled, "CT Reliability COS") charges imposed by ISO-NE on UI's load;[28] from January 2002 to December 2003 UI deducted all the charges, because DEMI was the sole supplier, and beginning January 2004, UI deducted only a portion, because there were other suppliers. However, DEMI did not contest the cost pass-through until December 16, 2004. Furthermore, the ALJ concluded that DEMI cannot reasonably claim ignorance when its employee, beginning in October 2002, prepared spreadsheets estimating future reliability cost tracker charges. The evidence also showed an internal DEMI e-mail dated April 10, 2003, with the subject line "Potential RMR Costs for UI deal" and gave an estimate of DEMI's exposure for such costs.[29]

III. Discussion

A. Brief on Exceptions

12. On July 13, 2006, DEMI filed its Brief on Exceptions. DEMI contends that the Initial Decision (1) fails to adequately address arguments and evidence presented by DEMI and issues set for hearing; (2) ignores PSA provisions and other evidence that disprove that the Parties intended for DEMI to be responsible for the reliability cost

[25] *Id.* P 90; *see Devon Power LLC*, 103 FERC ¶ 61,082, *order on reh'g*, 104 FERC ¶ 61,123 (2003).

[26] Initial Decision, 115 FERC ¶ 63,044 at P 90.

[27] *Id.* P 99.

[28] *Id.* P 91.

[29] *Id.* P 101.

tracker charges when the PSA was negotiated; (3) fails to account for the context in which the PSA was negotiated or the material changes to the NEPOOL market rules after the PSA was executed; (4) erroneously concludes that there was a "meeting of the minds" with regard to these charges; (5) erroneously assigns to DEMI the burden of proof with regard to whether the PSA defines transmission congestion costs to mean something materially different from the NEPOOL market rules' definition; (6) incorrectly attributes to DEMI knowledge that RMR agreements containing fixed monthly payments were forthcoming; (7) erroneously concludes that DEMI received a premium in exchange for agreeing to pay such charges; (8) does not analyze and ignores evidence concerning whether the reliability cost tracker charges are "associated with the delivery of energy"; and (9) misapplies the legal standard with respect to DEMI's course of performance and ignores the fact that DEMI objected to paying these charges within the time period allowed by the PSA.

13. DEMI first posits that the Initial Decision inadequately addressed the relevance and operation of PSA section 17.2, which DEMI characterizes as a "re-opener" to address future, unanticipated regulatory changes not addressed by the agreement. Similarly, DEMI argues that the Initial Decision does not address whether the reliability cost tracker charges at issue are "associated with the delivery of energy" (under PSA section 2.1(c)). Likewise, DEMI states that there is no discussion of or reference to article XVI and its two-year audit provision.

14. Second, DEMI argues that the Initial Decision ignores PSA provisions and other extrinsic evidence that disprove that the Parties intended for DEMI to be responsible for the reliability cost tracker charges when the PSA was negotiated. According to DEMI, the ALJ concluded that the PSA was an "all-in," fixed price agreement under which DEMI agreed to assume all costs and that the Parties were aware of the potential for future regulatory changes generally, and DEMI, therefore, agreed to be responsible for new costs that resulted from such changes after the PSA was executed.[30] DEMI specifically contends that the Initial Decision ignores section 17.2 of the PSA, which was a critical element of the bargain negotiated by DEMI and UI, even though the September 15, 2005 Order directed the ALJ to address that provision. Section 17.2, DEMI explains, provides that the Parties must negotiate any prospective "amendment" to the NEPOOL market rules that would be "reasonably likely to have a material adverse effect on the rights or responsibilities of either Party."[31] DEMI maintains that DEMI and UI knew that they were operating in a regulatory environment that was, and would

[30] Brief on Exceptions at 20 (citing Initial Decision, 115 FERC ¶ 63,044 at P 95-96).

[31] PSA § 17.2(b), Ex. UI-4 at 62.

continue to be, subject to change.[32] DEMI cites testimony of its witness, Ronald Armstrong, that section 17.2 was included in the PSA because DEMI "did not agree to accept the unbounded risk of unknown future regulatory changes or ISO-initiated changes to market or operation rules that would have a material impact on the parties' obligations."[33] DEMI states that this aspect of the testimony was not challenged by UI. Further, DEMI asserts that UI witness Dennis Hrabchak confirmed that the risks allocated to DEMI were limited by section 17.2(b).[34]

15. Furthermore, DEMI argues that UI's suggestion that section 17.2 be ignored when determining the Parties' intent distorts the plain meaning of the provision, whose fundamental purpose is to shield both Parties from the consequences of future material changes to the regulatory environment and which requires that disputes about who pays any newly-imposed costs or charges be addressed by the negotiation process in section 17.2. DEMI takes issue with UI's contention that section 17.2 creates no exceptions to or carve-outs from cost responsibility under the PSA. DEMI also argues that UI, not DEMI, was obliged to invoke section 17.2 because UI was the party adversely affected; instead, UI chose to engage in self-help by silently passing the charges through to DEMI.[35] Moreover, even if DEMI was required to invoke section 17.2 but failed to do so, DEMI contends that its conduct would not constitute a waiver.

16. Thirdly, DEMI addresses the context in which the PSA was negotiated. At that time, as DEMI recalls, the NEPOOL market rules did not provide for the types of RMR agreements that later gave rise to the reliability cost tracker charges. DEMI explains that under the market rules in place in 2001 (when the PSA was negotiated), there was no separate, fixed monthly payment that compensated generators needed for reliability for costs not recovered through the single-part energy price. Therefore, the introduction of RMR agreements (*i.e.*, arrangements compensating generators for costs that are not recovered through the energy charge) required changes to the NEPOOL market rules. DEMI cites various sources that address the need for changes in the NEPOOL market

[32] Brief on Exceptions at 22 (citing Initial Decision, 115 FERC ¶ 63,044 at P 96, 98-99; Ex. DOM-18 at 18:23 to 19:4 (Armstrong); Ex. UI-1 at 22:22-26 (Coretto); Ex. UI-37 at 7:14 to 8:2 (Coretto)).

[33] Brief on Exceptions at 23; Ex. DOM-18 at 17:18-20.

[34] Brief on Exceptions at 24 (citing Tr. at 25:6-16 (Hrabchak)).

[35] Brief on Exceptions at 34 (citing Tr. at 48:20 to 49:11 (Gagliardi)).

rules to authorize RMR agreements.[36] DEMI further remarks that the record shows that two of the three regional markets with RMR agreements referenced in the Initial Decision (viz., New York and Ontario) did not include the form or type at issue here,[37] and the Commission specifically had rejected application of the third mechanism (*i.e.*, the one used in California) in New England. Finally, DEMI points out that UI's witness Hamal admitted that the cost-of-service RMR Agreement proposed by Sithe New England Holdings, LLC in December 1998, which included a separate fixed monthly payment to compensate Sithe for unit-specific costs, had been rejected by the Commission.[38] In sum, DEMI states that if the Parties were aware of this proposal, they also would have been on notice that the Commission found that such an agreement would first require changes to the market rules.

17. DEMI's fourth point is that the PSA can only be read consistently with the established usage of "transmission congestion costs" in late 2001, but that the Initial Decision contains a superficial analysis of the regulatory context in which the PSA was negotiated. DEMI maintains that the common industry usage of the term did not apply to fixed costs such as reliability cost tracker charges. DEMI concludes that it would be a notable exception to the rule for parties to a bilateral wholesale power sales agreement to deviate from the terminology of the governing market rules;[39] it would be highly unusual for those parties to intend for the specific terms to have a different meaning from the standard, recognized definition.[40] DEMI maintains, therefore, that the Initial Decision erroneously concludes that there was a "meeting of the minds" with regard to these charges; DEMI states that "transmission congestion costs" should be interpreted consistently with the market rules in place at the time the PSA was negotiated, which referred solely to costs resulting from out-of-merit dispatch (and which do not include reliability cost tracker charges), while UI proposes a "unique" meaning to this term.[41]

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[36] Brief on Exceptions at 27-28 (citing Ex. Dom-1 at 23:16 to 24:32 (Philip Hanser); Ex. DOM-12 at 5-6 (same); Ex. Dom-13 at 5-8 (same) and quoting Ex. DOM-12 at 5; Ex. DOM-13 at 5-6; Initial Decision, 115 FERC ¶ 63,044 at P 97).

[37] Brief on Exceptions at 28 (citing Tr. at 211:4 to 212:5 (Cliff Hamal)).

[38] Brief on Exceptions at 29 (citing Tr. at 129:18 to 132:22 (Hamal)).

[39] Brief on Exceptions at 37 (citing DOM-1 at 16:16-23); *see also id.* at 38-40.

[40] Brief on Exceptions at 40 & n.126.

[41] Brief on Exceptions at 40, 41 & n.129.

18. Fifth, DEMI contends that UI, as complainant, bears the burden of proof to show that the Parties (1) specifically intended to depart from the definition of "transmission congestion costs" contained in the NEPOOL market rules and widely accepted in the industry, and (2) specifically agreed to a materially different definition.[42] DEMI characterizes the Initial Decision's apparent reversal of this burden as clear error.[43]

19. In its sixth argument, DEMI contends that the ALJ incorrectly attributes to DEMI knowledge that RMR agreements containing fixed monthly payments were forthcoming. DEMI argues that this finding is expressly refuted by the testimony of each of the witnesses that negotiated the PSA, including UI's three witnesses.[44] Moreover, the ALJ's conclusion from this finding—that DEMI agreed to be responsible for costs resulting from NEPOOL market rule changes—is wrong. For even if DEMI knew about the impending imposition of fixed cost RMR agreements and reliability cost tracker charges, which it did not, section 17.2 of the PSA would instruct the Parties as to how to address the risk of any change in the NEPOOL market rules.

20. DEMI maintains that the PSA does not assign broad, categorical responsibility to DEMI for future costs associated with changes to market rules, such as reliability cost tracker charges. DEMI contends that the Initial Decision errs by construing the PSA as "an 'all-in,' fixed price requirements contract,"[45] by relying on testimony that UI intended to shift all risk to DEMI, and by accepting that DEMI was paid a "premium" to assume such risk.[46] With respect to the term "all-in," DEMI notes that UI introduced this term in its pre-filed testimony without contemporaneous evidence that this view of the PSA had been communicated to DEMI in 2001. DEMI posits that contemporaneous

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[42] Brief on Exceptions at 35 (citing 5 U.S.C. § 556(d); *Arkansas Elec. Coop. Corp. v. Entergy Arkansas, Inc.*, 114 FERC ¶ 63,015 (2006) (applying burden to complainant)); *see also id.* at 35 n.102.

[43] DEMI also contends that the record evidence demonstrates that during negotiation of the PSA, the Parties used and understood "transmission congestion costs" to mean the costs of out-of-merit dispatches and nothing more. Brief on Exceptions at 42-45.

[44] Brief on Exceptions at 46 (citing Ex. DOM-18 at 14:13-14 (Ronald Armstrong); Tr. at 69:20-23 (Coretto); Tr. at 41:13-17 (Gagliardi); Tr. at 21:12-15 (Hrabchak)).

[45] Brief on Exceptions at 48 (citing Initial Decision, 115 FERC ¶ 63,044 at P 104).

[46] Brief on Exceptions at 48 (citing Initial Decision, 115 FERC ¶ 63,044 at P 96, 99).

statements are more compelling than such unilateral *post hoc* rationalizations.[47] Furthermore, DEMI states that the bid documents and other communications exchanged by the Parties during the negotiations of the PSA refute this "all-in" characterization; leading up to the PSA, the Parties always spoke in terms of specific costs.[48]

21. DEMI next contends that the term "all-in" is contradicted by sections 1.90 and 17.2 of the PSA. DEMI remarks that the Initial Decision appears to rely exclusively on the first clause of section 1.90, which refers to "all costs resulting from insufficient transmission capacity, without regard to the cause of such congestion or how such costs are allocated or assessed." DEMI points out that the rest of section 1.90 provides examples of such costs, and each of the examples refers only to out-of-merit dispatch of generation resources—and none of the examples relates to reliability cost tracker charges or other fixed monthly payments made under RMR agreements.[49] DEMI concedes that this list is not exclusive, but argues that this does not mean that section 1.90 may be made "an empty vessel" into which any meaning may be poured.[50] Further, applying the legal doctrines of *ejusdem generis*, *expressio unius est exclusio alterius*, and *nascitur a sociis*, DEMI argues that the context in which a general term (like "all costs resulting from insufficient transmission capacity") is placed will determine the scope of its reach. The Initial Decision's overly broad interpretation of section 1.90 would make DEMI responsible for a virtually unlimited range of costs.

22. DEMI adds that section 17.2 of the PSA limits the types of costs that may be passed on to DEMI. This section makes clear that the Parties neither intended nor agreed to a broad categorical approach of shifting responsibility to DEMI for all costs that could

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[47] Brief on Exceptions at 49 & n.153 (citing precedent).

[48] DEMI cites to references in an e-mail exchange of specific allocations, as well as to UI's Term Sheet, which stated that "pricing for other contract provisions other [sic] than those stated … above, will also be considered[;] however, a price should be included that comports to items 1-11 above." Brief on Exceptions at 50 (citing Ex. UI-74 at 32, 33).

[49] Section 1.90 further explains that "all costs" …"includ[es] the difference in the clearing price for Energy between the point of injection and point of receipt of Energy, and redispatch costs resulting from Reliability Must Run (as such term is defined in the Restated NEPOOL Agreement) requirements *or other out of merit order generation dispatch directed by the ISO-NE pursuant to the NEPOOL Rules*, the interconnection of a generator or the maintenance or upgrade of the PTF." Brief on Exceptions at 52 (quoting PSA § 1.90, Ex. UI-4 at 18-19) (emphasis in brief).

[50] Brief on Exceptions at 52-53.

potentially arise from insufficient transmission capacity. Moreover, UI witness Hrabchak disavowed UI's "categorical approach" argument when he conceded that the risks and costs of future regulatory changes were limited by section 17.2(b).[51]

23. DEMI's seventh contention is that, contrary to the Initial Decision's conclusion, there is no evidence that DEMI received a "premium" in exchange for agreeing to be responsible for the reliability cost tracker charges. Further, section 17.2, discussed above, makes clear that DEMI is not responsible for costs or charges arising from changes in the market rules that occurred after the PSA was executed, which applies to the reliability cost tracker charges.

24. DEMI's eighth argument is that reliability cost tracker charges have nothing to do with "the delivery of energy," within the meaning of section 2.1(c) of the PSA. DEMI states that, even assuming that the PSA is an all-in, fixed-price requirements agreement, the Initial Decision nonetheless avoids determining whether the reliability cost tracker charges are "associated with the delivery of Energy," a determination specifically directed by the Commission. DEMI argues that the ALJ had no basis on the record to find that classifying reliability cost tracker charges as transmission congestion costs effectively ends the analysis. DEMI asserts that the plain language of section 1.90 (Transmission Congestion Costs) does not make one party or another responsible for such costs; rather, costs that are DEMI's responsibility are those that are "associated with the delivery of Energy."[52]

25. Next, DEMI contends that the reliability cost tracker charges are too attenuated from the "delivery of Energy" to be allocable to DEMI. First, DEMI contends that UI, as complainant, has not borne its burden of proof. DEMI maintains that its evidence supports the position that such charges are not "associated with the delivery of Energy," as that phrase is understood in the market and used in the PSA. DEMI argues that RMR agreements are revenue sufficiency agreements and that, as such, they have no connection with DEMI's supply of energy to UI; the costs incurred under RMR agreements are unrelated to the performance of wholesale power supply agreements such as the PSA. DEMI further argues that UI's interpretation of section 2.1(c)—that the PSA assigns all costs related to transmission system reliability to DEMI—would render meaningless the clause that assigns to DEMI certain costs that are "associated with the delivery of Energy." "Delivery," DEMI defines, describes *action*, such as the physical transfer of Energy by DEMI to UI. Here, however, there is no relationship between performance under the PSA and the disputed costs. Furthermore, although section 2.3(a)

[51] Brief on Exceptions at 56 (citing Tr. at 25:6:16 (Hrabchak)).

[52] Brief on Exceptions at 61 (citing Ex. DOM-18 at 15:12-21).

of the PSA does not go so far as to excuse DEMI's obligation to provide Energy supply in the event that a particular generating resource is not available, this section does not impose a separate obligation on DEMI to ensure the reliability of the transmission system.[53] Finally, DEMI contends that even if costs are "imposed on" rather than "associated with" the delivery of Energy, as section 2.1(c) alternatively provides, such costs are connected to the actual "delivery" of Energy, clarified by another phrase in section 2.1(c), "each [transmission congestion cost, uplift charge, etc.] relating to the transmission of Energy."

26. DEMI lastly argues that the Initial Decision's reliance on DEMI's course of performance misapprehends the legal standard and ignores the fact that DEMI objected to paying these charges within the time period allowed by the PSA. While the Initial Decision's conclusion "suggests a systematic pattern of conduct," DEMI maintains that the ALJ misapprehends both the law as well as the facts with respect to DEMI's course of performance. First, a party's course of performance can only explain and interpret the contract; it cannot alter the contract's terms.[54] And the rules of contract interpretation mandate that DEMI's course of performance be read consistently with the express terms of the PSA, so long as such a reading is possible.[55] Here, DEMI maintains, its course of performance (*i.e.*, apparent acquiescence to the RMR agreement charges) is irrelevant because the audit provision in article XVI of the PSA provided DEMI a two-year right to audit the other party's records and because DEMI exercised this right within that timeframe.

27. DEMI explains that it did not immediately challenge the charges because it did not know the true nature of the charges. Thus, DEMI points out in its second argument, that no interpretation of a contract (e.g., through DEMI's course of performance) can read out of the contract terms to which the parties agreed. Moreover, DEMI questions the use of such course-of-performance evidence when, as DEMI contends, it did not know the true nature of the charges until the fall of 2003; its conduct prior to that time cannot, therefore, be deemed a knowing concurrence.

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[53] Brief on Exceptions at 65 (quoting section 1.33 of the PSA (Force Majeure), which is referenced in section 2.3(a); citing Ex. UI-43 at 33:23-33 (Hamal)); *see also infra* note 60.

[54] Brief on Exceptions at 68 (citing *Century Power Corp.*, 53 FERC ¶ 61,240, at 61,993 (1990), *on reh'g*, 56 FERC ¶ 61,083 (1991)).

[55] Brief on Exceptions at 68 (citing New York Uniform Commercial Code § 1-205; *Arkansas Elec. Coop. Corp. v. Entergy Arkansas, Inc.*, 114 FERC ¶ 63,015, at P 47 (2006)).

28. Even if such evidence is relevant, DEMI states that the Initial Decision misconstrues DEMI's "course of performance" conduct. As an initial matter, DEMI's participation in the "load" group is not correctly viewed as its "course of performance," because no aspect of "delivering Energy or Market Products" under the PSA obligated DEMI to attend the mediation proceedings. Moreover, no statement or action by DEMI in the course of those proceedings evidences an obligation to assume the reliability cost tracker charges now at issue. Furthermore, the ALJ's rejection of witness Armstrong's testimony (that statements by DEMI's agents during the mediation were based on a belief that DEMI was responsible only for RMR costs that existed at the time the PSA was negotiated) reflects a lack of understanding of the nature of RMR charges. DEMI states that witness Armstrong did not know that the charges reflected both variable and fixed RMR costs (*i.e.*, costs beyond those directly related to out-of-merit dispatches) until UI proposed a draft power supply agreement in the fall of 2003.

29. DEMI further asserts that its acceptance of UI's invoices and its delay in challenging them is meaningless in light of the two-year review (*i.e.*, audit) provision under article XVI; witness Armstrong educated himself on the nature of the charges, conferred with his colleagues, and concluded that DEMI should avail itself of the audit provision. With respect to the other communications involving the Parties, DEMI maintains that the discussions from DEMI's side are not inconsistent with its view that the costs associated with the RMR agreements arose from out-of-merit dispatch and thus could fairly be allocated to DEMI under the PSA.

B. Brief Opposing Exceptions

30. UI opposes all of the exceptions that DEMI raises. In summary, UI states that the PSA is an "all-in," fixed-price requirements agreement, with fixed prices based on the amount of Energy DEMI delivered. UI maintains that the PSA expressly allocates responsibility to DEMI for transmission congestion costs incurred prior to the delivery of energy to UI's system. According to UI, the term "transmission congestion costs" used in the PSA is broader than the contemporaneous, customary, or usual industry definitions of such costs. UI contends that the Initial Decision is supported by the language of the PSA, by evidence regarding the Parties' knowledge and intentions during negotiations, and by the Parties' course of performance.

31. UI first examines the language of the PSA. UI states that under New York law the best evidence of the Parties' intent is the language of the contract itself, and New York law requires that all contract provisions be considered.[56] UI contends that when read together the PSA cost-allocation provisions are clear: DEMI is responsible for the

[56] Brief Opposing Exceptions at 19 and nn.81-82 (providing New York case law).

disputed costs. UI maintains that where the Parties envisioned narrow exceptions, the PSA expressly identifies those exceptions.[57]

32. UI criticizes DEMI's use of interpretive aids "to minimize the facially inclusive language of the defined term 'Transmission Congestion Costs'" and notes that DEMI's application of *ejusdem generis* is at odds with New York law, which allows the aid to be applied where general words follow particular terms—not the reverse, as here.[58] UI examines DEMI's argument that out-of-merit dispatch costs are "included" within the term "Transmission Congestion Costs," but remarks that PSA article XIX expressly defines the term "without limitation."[59] UI further criticizes DEMI's "alternative definitions" of "Transmission Congestion Costs," stating that DEMI relies upon tariff terms and definitions that are patently different in wording and scope from the definition that the Parties included in the PSA.[60] Finally, UI dismisses DEMI's "slippery slope scenarios" of responsibility for any and all transmission upgrades linked to insufficient transmission capacity as a *reductio ad absurdum* for which DEMI provides no support.

33. UI next examines evidence regarding the Parties' knowledge and intentions at the time of contracting. UI notes that DEMI's primary fact witness, one of the principal negotiators of the PSA, agreed during cross-examination with the characterization of the PSA as an "all-in" contract.[61] UI contends that if RMR charges were allocated to neither DEMI nor UI under the PSA, they would be the only generator charges not addressed in the contract.[62] Although DEMI relies on a UI term sheet to show that the PSA was not an

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[57] Brief Opposing Exceptions at 21 (citing, for example, to Ex. UI-4 at 23 (PSA § 2.3(a)), which provides limited exceptions to DEMI's supply obligations for force majeure or buyer default, and *id.* at 10 (PSA § 1.33), which provides that "an economic hardship … shall not be deemed a Force Majeure."); *see id.* at 23.

[58] Brief Opposing Exceptions at 23, 24-26 (citing New York case law and distinguishing Commission orders DEMI cited in support).

[59] Brief Opposing Exceptions at 25-26; Ex. UI-4 at 68 (PSA art. XIX).

[60] Brief Opposing Exceptions at 27 and n.117 (alleging introduction of definition at hearing). "[I]ndustry usage cannot be used to contradict or vary a term of the contract; it may only be used to explain the meaning of the term." Brief Opposing Exceptions at 34.

[61] Brief Opposing Exceptions at 29 (citing Tr. 327:25 to 328:3 (Armstrong); 384:18-25).

[62] Brief Opposing Exceptions at 30 (citing Ex. UI-43 at 39:5-6).

all-in contract, UI contends that the fact that the term sheet expressed a willingness to consider alternative pricing proposals indicates only that DEMI could have proposed a different and more narrow bid scope, as other bidders did—but DEMI did not. Moreover, quoting witness Armstrong's testimony, UI contends that DEMI built a risk premium into its bid.[63] UI criticizes DEMI's qualification of this premium; if DEMI only charged a risk premium where it could anticipate every cost, it would not be charging a "risk premium" at all: there would be no risk left in the calculation. Furthermore, with respect to the Parties' knowledge and intentions, UI agrees with the ALJ that DEMI reasonably could be expected to know that RMR-type agreements were a distinct possibility.

34. UI next examines evidence of the Parties' course of performance. At the outset, UI underscores the strength of course-of-performance evidence of contracting parties' intentions, especially where the parties continue with a practical interpretation for a long period of time prior to a dispute. UI concludes that DEMI's conduct prior to December 16, 2004, demonstrates DEMI's understanding that, under the terms of the PSA, DEMI was responsible for fixed-payment RMR charges, including the reliability cost tracker charges at issue here. In support of DEMI's awareness of and acceptance of the liability for the reliability cost tracker charges, UI discusses DEMI's billing history, waiting almost three years to challenge the charges UI passed through to DEMI; DEMI's participation in the "load group" mediation, which was related to the proposed RMR agreements that eventually gave rise to the charges at issue; statements by DEMI to the Commission and the Circuit Court of Appeals for the District of Columbia that reflect DEMI's understanding that it was responsible for RMR charges; DEMI's internal accounting and planning documents and communications; and discussions about extending the Standard Offer Service portion of the PSA, which indicate that DEMI knew it was liable for the reliability cost tracker charges. Faced with the "inconvenient truth of its repeated admissions," DEMI rejects the course-of-performance evidence as irrelevant. But UI argues that witness Armstrong's assertion that he first learned of the nature of the RMR charges through communications with UI in the fall of 2003 is at odds with the internal communications and outward conduct that demonstrate DEMI's understanding of the nature of the fixed-payment RMR charges, with DEMI's awareness that UI was passing through those charges to DEMI, and with DEMI's recognition that it was responsible for them.[64]

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[63] Brief Opposing Exceptions at 31 (citing Tr. 325:3-9).

[64] Brief Opposing Exceptions at 43. UI agrees with the ALJ, who stated, "It is difficult to believe that DEMI was as unknowing about its business dealings as it claims here to be." Initial Decision, 115 FERC ¶ 63,044 at P 100.

35. UI states that DEMI confuses UI's use of course-of-performance evidence as an aid to contract interpretation with waiver of DEMI's right to request an audit under article XVI of the PSA. UI notes that the ALJ did not hold that DEMI had waived its rights under the PSA to challenge the pass-through of the RMR charges; rather, DEMI's failure to dispute the charges for nearly two years was considered evidence of DEMI's understanding regarding its responsibility for the invoiced charges. Moreover, UI contends that DEMI misstated the nature of the audit provision, which permits the Parties to verify the accuracy of statements, charges, or computations, but which does not mention the right to challenge a contract interpretation or the allocation of a particular type of charge. Furthermore, by the time DEMI requested the audit, DEMI already knew that UI was allocating the reliability cost tracker charges to DEMI, making the audit "a sham."[65] UI also contends, however, that even if article XVI permitted DEMI to challenge the contract interpretation as it does, UI points out that DEMI had an obligation to make accurate representations in its communications with federal government bodies.

36. Additionally, UI discusses DEMI's arguments regarding section 17.2 of the PSA as well as DEMI's contention that the ALJ failed to consider whether the reliability cost tracker charges are "associated with the delivery of Energy." With respect to the former, UI states that section 17.2 is a remedial provision designed to address major changes to the regulatory environment in which the Parties operate. This provision comes into play only where the NEPOOL Agreement is terminated or amended in a way that would eliminate or materially change a rule, and where such a change appears likely to materially alter the rights or responsibilities and obligations of a party—and where a party seeks to avail itself of the protections afforded by section 17.2. First, UI recites the instances where the ALJ addressed section 17.2 in the Initial Decision.[66] Second, UI argues that, in any event, DEMI's reliance on section 17.2 is misplaced because, *inter alia*, section 17.2 is a remedial provision that easily can be harmonized with the language of sections 1.90 and 2.1(c); DEMI has not show that the change in cost allocation necessarily materially affects the overall responsibilities of the Parties, nor has DEMI shown that it has been materially adversely affected as a result of ISO-NE's change to Market Rule 17; under the PSA UI prepares invoices, so DEMI was responsible for invoking section 17.2; although DEMI's delay in invoking section 17.2 may not constitute a waiver, DEMI's behavior has significant evidentiary value (to show that DEMI did not consider this provision applicable); and finally, under New York law DEMI did waive its right to invoke section 17.2, which includes an obligation to arbitrate, when DEMI filed suit against UI in federal court.

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[65] Brief Opposing Exceptions at 46 (citing Tr. 374:10-18 (Armstrong)).

[66] Brief Opposing Exceptions at 49-50 (citing Initial Decision, 115 FERC ¶ 63,044 at P 50, 86, 88).

37. With respect to whether the reliability cost tracker charges are "associated with the delivery of Energy," UI contends that there was no need for the ALJ to separately address the issue. In any event, UI maintains that the ALJ did discuss the positions of both Parties.[67] UI states that by concluding the reliability cost tracker charges are transmission congestion costs arising prior to the Delivery Points, the ALJ necessarily concluded that those charges are "associated with the delivery of Energy."[68] UI also states that there is no functional difference between fixed RMR agreement payments and the higher energy bids that critically-needed units were permitted to make and were making at the time the PSA was negotiated.[69] Further, regardless of the source of the electricity, UI contends that DEMI had to use the transmission system operated by ISO-NE—facilities known to be subject to costs arising from insufficient transmission capacity—to deliver Energy to UI's Delivery Points. Moreover, since the disputed costs are allocated on the basis of network load, UI explains, a market participant incurs only a portion of the fixed-payment RMR costs for a given month if it uses the network to deliver Energy during that month. Finally, if the reliability cost tracker charges are not "associated with the delivery of Energy," they would be "imposed on" the delivery of Energy, and thus be DEMI's responsibility.[70]

C. Commission Determination

38. Having reviewed the Initial Decision and the record as a whole, including the Parties' briefs, the Commission finds that all issues were properly resolved by the Initial Decision. Therefore, we deny the exceptions and summarily affirm and adopt the Initial Decision as our own decision. Specifically, after analyzing the contract in its entirety pursuant to New York law, we affirm the ALJ's Initial Decision that the PSA allocates reliability cost tracker charges to DEMI for the reasons provided in the Initial Decision. We further affirm that reliability cost tracker charges are within the PSA's definition of "transmission congestion costs" as stated in section 1.90 of the PSA and that section 2.1(c) assigns responsibility for those costs to DEMI up to UI's system, as discussed below.

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[67] Brief Opposing Exceptions at 59-60 (citing Initial Decision, 115 FERC ¶ 63,044 at P 57, 58, 59, 62, 65).

[68] *See* Brief Opposing Exceptions at 60-62 (discussing UI's and DEMI's positions).

[69] Brief Opposing Exceptions at 62 (citing Initial Decision, 115 FERC ¶ 63,044 at P 106-07).

[70] Brief Opposing Exceptions at 64 (stating that "the PSA's use of the term "imposed" adds greater meaning and scope to section 2.1(c)).

39. Although DEMI contended that reliability cost tracker charges are not within the definition of transmission congestion costs because such charges did not exist at the time the PSA was negotiated and the then-existing market rules defined "transmission congestion costs" narrowly as "costs resulting from out-of-merit dispatch," we affirm the ALJ's finding that DEMI's interpretation was too narrow and agree with the ALJ that the PSA was written broadly to include costs such as reliability cost tracker charges. We also affirm the ALJ's finding that the evidence demonstrated that the Parties' expectations at the time of the negotiation and execution of the PSA was that the entity providing electric capacity, energy, and ancillary services to UI would assume all costs associated with providing such capacity, energy, and services.

40. With respect to "costs resulting from insufficient transmission capacity" and costs "imposed on or associated with the delivery of Energy,"[71] we agree that the PSA is an "all-in," fixed-price requirements contract. In addition to the other reasons set forth in the Initial Decision by the ALJ, we find compelling DEMI witness Armstrong's admission that DEMI's price for the PSA was an all-in price, "a full requirements deal."[72] Thus, as a fixed-price requirements agreement, with fixed prices based on the amount of Energy DEMI delivers, DEMI is responsible generally for RMR costs under the terms of

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[71] Section 1.90 of the PSA defines transmission congestion costs as

> all *costs resulting from insufficient transmission capacity*, without regard to the cause of such congestion or how such costs are allocated or assessed, including the difference in the clearing price for Energy between the point of injection and point of receipt of Energy, and redispatch costs resulting from Reliability Must Run (as such term is defined in the Restated NEPOOL Agreement) requirements or other out of merit order generation dispatch directed by the ISO-NE pursuant to the NEPOOL Rules, the interconnection of a generator or the maintenance or upgrade of the PTF.

(Emphasis added.) And section 2.1(c) of the PSA states that DEMI

> shall be responsible for all costs or charges … *imposed on or associated with the delivery of Energy* and … Market Products, delivered, or caused to be delivered, by Seller to UI to the Delivery Point(s), including Transmission Congestion Costs, settlement uplift charges, control area services, inadvertent energy flows, losses and loss charges, each relating to the transmission of Energy, if any, to the Delivery Point(s)….

(Emphasis added.)

[72] Tr. 327:25 to 328:3 (Armstrong); *see also* Tr. 384:18 to 385:3.

the PSA, including the reliability cost tracker charges at issue here. Further, we agree with the ALJ finding that "in addition to knowing that it was entering into an agreement in which it undertook the risks associated with congestion costs, DEMI also knew that the industry was changing and that the costs would be uncertain."[73]

41. DEMI maintains *inter alia* that the PSA's assignment of cost responsibility is limited by section 17.2, the negotiation provision for material changes to a market rule that would result in a material adverse effect.[74] DEMI explains that section 17.2 makes clear that the Parties neither intended nor agreed to a broad categorical approach of shifting responsibility to DEMI for all costs that could potentially arise from insufficient transmission capacity. We agree that DEMI's delay in referring to the section 17.2 negotiation requirement to address the claimed material adverse effect (due to the reliability cost tracker charges) does not constitute a waiver by DEMI, even though such a delay may have evidentiary value. Regardless of the delay, however, DEMI waived its right to negotiate under this provision by commencing an action in federal court prior to calling for good faith negotiation under section 17.2.[75] Accordingly, in this particular case DEMI does not have recourse to section 17.2 of the PSA.[76]

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[73] *Id*. P 99.

[74] Section 17.2 of the PSA states:

> If, during the Term, the Restated NEPOOL Agreement is terminated or amended, in a manner that would eliminate or materially alter a NEPOOL Rule and any such aforementioned termination or amendment would be reasonably likely to have a material adverse effect on the rights or responsibilities of either Party under this Agreement, the Parties agree to negotiate in good faith in an attempt to amend this Agreement to incorporate such changes as they deem necessary to eliminate, to the extent possible, the effect of such termination or amendment.

[75] *Dominion Energy Mktg., Inc. v. United Illuminating Co.*, No. 305CV267 (D. Conn. filed Feb. 11, 2005); *see also, e.g.*, *Rusch Factors, Inc. v. Fairview Mfg. Co., Inc.*, 309 N.Y.S.2d 610, 611-12 (N.Y. App. Div. 1970) (waiving arbitration provision by commencing action); *Zimmerman v. Cohen*, 139 N.E. 764, 765 (N.Y. 1923) (same).

[76] The Commission is not here making a determination as to whether any change in cost responsibility has resulted in a material adverse effect as DEMI claims; however, assuming *arguendo* that DEMI has suffered such an adverse effect, section 17.2 would not apply due to DEMI's waiver.

The Commission orders:

We hereby affirm the Initial Decision as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.