

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
Nora Mead Brownell, Joseph T. Kelliher,  
and Suedeen G. Kelly.

USGen New England, Inc.

Docket No. ER04-841-000

ORDER ACCEPTING RELIABILITY AGREEMENT  
AND ESTABLISHING HEARING AND  
SETTLEMENT JUDGE PROCEDURES

(Issued July 7, 2004)

1. In this order, the Commission accepts for filing the unexecuted Reliability Agreement between USGen New England, Inc. (USGenNE) and the Independent System Operator New England, Inc. (ISO-NE), concerning USGenNE's 763 megawatt Salem Harbor generating station (Station) located in Salem, Massachusetts. The order also sets this matter for hearing, but holds the hearing in abeyance so that the parties may engage in settlement discussions. This order benefits customers because it accepts the necessary Reliability Agreement while encouraging the parties to resolve issues through direct settlement negotiations.

**I. Background**

2. In May 2001, the Massachusetts Department of Environmental Protection (DEP) adopted regulations requiring the Station to reduce air emissions. USGenNE determined that the capital costs of the required environmental improvements were uneconomical and made an application to the ISO-NE to retire the Station.<sup>1</sup> Soon thereafter,<sup>2</sup> USGenNE was (and still is) in Chapter 11 bankruptcy.

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<sup>1</sup> This application was submitted pursuant to section 18.4 of the Restated NEPOOL Agreement.

<sup>2</sup> USGenNE applied to retire the Station on April 25, 2003 and filed for bankruptcy protection on July 8, 2003.

3. On July 22, 2003, the ISO-NE, in consultation with its Reliability Committee, rejected USGenNE's section 18.4 application based upon a determination that the retirement of the Station would have a significant adverse impact on the reliable operation of the New England Power Pool (NEPOOL) system in the North Shore and Greater Boston areas (NEMA/Boston) of Massachusetts. In response to this determination, USGenNE entered into an Administrative Consent Order (ACO) with the DEP that identified the environmental upgrade equipment that would be necessary to keep the Station in operation and in compliance with the DEP regulations (Compliance Equipment). According to USGenNE, the ACO contemplates that USGenNE would seek funding for the costs of the Compliance Equipment from ISO-NE.

## **II. The Filing**

4. On May 14, 2004, pursuant to section 205 of the Federal Power Act (FPA) and Part 35 of our regulations, USGenNE filed an unexecuted Reliability Agreement between itself and ISO-NE concerning USGenNE's Station located in Salem, Massachusetts. USGenNE states that it filed the Reliability Agreement to comply with the DEP's air quality emissions requirements, consistent with USGenNE's understanding of the conditions of the ACO. USGenNE states that the Reliability Agreement was negotiated with ISO-NE to establish the mechanism by which ISO-NE will initially fund the estimated \$85 million cost of constructing the Compliance Equipment.

5. The Reliability Agreement includes a complex funding mechanism by which USGenNE will, subject to certain conditions and exclusions, pay to the ISO-NE defined percentages of its gross margin from the Station on both a monthly and a yearly basis until USGenNE has repaid, with interest at five percent, the costs for the Compliance Equipment. In addition, the Reliability Agreement provides for the collection of funds from the responsible NEPOOL participants.

6. USGenNE requests that the Reliability Agreement become effective on the latter of the date on which: (1) a final Commission order is issued accepting the Reliability Agreement; or (2) approval of the Reliability Agreement is obtained from the Bankruptcy Court, if such approval is necessary.

7. USGenNE states that the term of the Reliability Agreement shall run from the effective date and shall terminate upon the earlier of the following: (1) the repayment completion date; or (2) the date on which termination is permitted pursuant to either section 7.2 (Termination for Default) or section 9.4 (Effect of Invalidation, Modification, or Condition) of the Reliability Agreement; or (3) the date prior to the compliance

funding initiation date on which the funding cancellation date for all of the units occurs pursuant to section 3.10.2<sup>3</sup> of the Reliability Agreement; or (4) the date on which all of the units are permanently retired pursuant to section 3.11.2<sup>4</sup> of the Reliability Agreement.

8. USGenNE states that the Reliability Agreement is not a Reliability Must Run (RMR) agreement, but rather only a funding mechanism for environmental upgrades. USGenNE claims that the Reliability Agreement does not restrict or distort the Station's participation in the markets. Thus, according to USGenNE, the Reliability Agreement does not interfere with market outcomes to the same extent as typical RMR contracts might and, therefore, is consistent with the Commission's market-oriented approach to generating resources that are needed for reliability purposes. USGenNE requests that the Commission consider and approve the Reliability Agreement on an expedited basis.

### **III. Notice of Filing and Responsive Pleadings**

9. Notice of USGenNE's filing was published in the Federal Register, 69 Fed. Reg. 29,527 (2004), with interventions, comments and protests due on June 4, 2004. Eight protests and four comments were filed.<sup>5</sup> Various protestors requested a stay of the proceedings, an evidentiary hearing, and/or rejection of the filing. Mirant Corporation filed a motion to intervene out-of-time. ISO-NE and USGenNE filed answers to the protests. The protestors raise a myriad of issues and concerns which, among other things, include the following, summarized below.

10. Protestors contend that the Reliability Agreement amounts to a loan at a five percent interest rate, which is below market, especially considering that USGenNE is in bankruptcy, and no collateral is being provided. They argue that USGenNE's bankruptcy protection compounds the uncertainties surrounding the scope, cost and scale of the

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<sup>3</sup> Cancellation of the Compliance Funding Mechanism by the ISO-NE.

<sup>4</sup> USGenNE's Right to Retire or Deactivate any Unit.

<sup>5</sup> Protests were filed by: Massachusetts Office of Attorney General; Reading Municipal Light Department, Wellesley Municipal Light Plant, Concord Municipal Light Plant, and Danvers Electric Division (jointly); Massachusetts Municipal Wholesale Electric Company; The Conservation Law Foundation, on its own behalf and on behalf of Clean Water Action, Healthlink, MASSPIRG and Wenham Lake Watershed Assn.; The PSEG Companies; NSTAR Electric & Gas Corporation; Calpine Corporation and Calpine Energy Services, L.P.; and ANP Funding LLC. Comments were filed by ISO-NE; the City of Salem, Massachusetts; the Massachusetts Division of Energy Resources/Department of Environmental Protection/Department of Telecommunications and Energy (jointly); and Northeast Utilities Service Company on behalf of the NU Operating Companies and Select Energy, Inc.

compliance project. Protestors claim that the Bankruptcy Court might modify the terms of the proposed repayment mechanism in a manner that could harm ratepayer interests. They also state that USGenNE's obligation to repay any amounts received would cease if USGenNE decides to permanently retire the Station.

11. Protestors claim that the Reliability Agreement would adversely affect competitive markets in New England because the agreement would effectively subsidize the cost of power generated by the Station, to the detriment of ISO-NE's competitive markets. They argue that cleaner and more efficient generators in ISO-NE would not be able to fairly compete with USGenNE, because the price of the electricity generated by the Station would not reflect the true costs of operating the units and generating energy.

12. Protestors claim that the Reliability Agreement was not entered into pursuant to the NEPOOL tariff. They assert that the filing fails to describe which NEPOOL market participants would be responsible for the compliance funding mechanism. Also, they claim that there is no indication of how the interest payments made by USGenNE would flow back to responsible NEPOOL participants, if at all. Protestors also contend that the Reliability Agreement circumvents the NEPOOL agreement and exceeds ISO-NE's authority.

13. The Massachusetts Attorney General (Mass AG) argues that a decision now would be premature. The Mass AG points out that new owners (as a result of the bankruptcy) may not need participant funding. Also the Mass AG states that National Grid and NSTAR have proposals for transmission line upgrades that may make reliability upgrades for the Station unnecessary. The Mass AG points out that the filing indicates that the upgrades would take 32 months to complete. The Mass AG argues that by the time the upgrades are complete, the reliability provided by the Station may not be necessary because of potential events occurring during that time, such as new ownership or the National Grid/NSTAR proposals. In this regard, the Mass AG points out that National Grid and NSTAR have proposed transmission line upgrades for completion in 2005 and 2006 that may make the Station unnecessary to ensure reliability on the North Shore and in Boston. The Mass AG also claims that there is no precedent for ordering participant funding of capital improvements for reliability units.

14. In their answers, the ISO-NE and USGenNE explain that the Reliability Agreement is not a loan, contrary to protestor's claims. Instead, according to the ISO-NE, the Reliability Agreement is similar to a RMR agreement in that the repayment scheme set forth in the Reliability Agreement is simply a cost reimbursement mechanism which is similar to the revenue off-set mechanism of a traditional RMR agreement. The ISO-NE claims that the Reliability Agreement does not include an absolute obligation for repayment.

15. The ISO-NE further contends that the Reliability Agreement is reasonable because, among other things, it includes provisions that are not necessarily in the interest of USGenNE. The ISO-NE claims that such provisions seek to provide reasonable protections for the responsible participants. Such provisions include: (1) a repayment or cost reimbursement provision; (2) oversight of the construction contracting and building processes by an independent engineer; (3) the ability of the ISO-NE to terminate funding as to any and all units if the reliability need no longer exists; and (4) the right of set-off against amounts owed to USGenNE if USGenNE fails to remit a required repayment amount.

16. In its answer, USGenNE claims that no Commission-approved Reliability Agreement requires a generator to repay any amounts that are funded in order to ensure reliability. USGenNE contends that the gross margin thresholds in the Reliability Agreement do not reduce the amounts that USGenNE will repay to the ISO-NE, but rather only impact the rate at which USGenNE makes such payments.

17. USGenNE states that, contrary to protestors' claims, the Reliability Agreement will not impact NEPOOL markets because the funding provided is for capital costs only and does not include any variable costs. Thus, USGenNE contends that the only impact that the Reliability Agreement could have on the markets is that the Station will continue to participate in the markets (since it is needed for reliability) rather than being retired.

#### **IV. Discussion**

##### **A. Procedural Matters**

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the timely, unopposed motions to intervene serve to make them parties to this proceeding. Motions to intervene filed out-of-time prior to the issuance of this order will not delay or disrupt the proceeding, and thus will be granted. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (a)(2) (2003), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the answers because they provide information that assisted us in our decision-making process.

##### **B. The Commission's Determination**

19. The protestors' and commentors' concerns raise factual questions concerning the Reliability Agreement that we cannot summarily decide on the record before us. These concerns are best addressed in the hearing and settlement judge procedures that we order herein. In addition, based on our preliminary review of the Reliability Agreement, we find that it may be unjust, unreasonable, unduly discriminatory or preferential, or

otherwise unlawful. Accordingly, we will accept the proposed Reliability Agreement for filing and set it for hearing, to become effective on a date to be determined by the Commission in a subsequent order in this proceeding.

20. While we are setting this proceeding for a trial-type, evidentiary hearing, we will hold the hearing in abeyance and direct settlement judge procedures, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, in order to assist the parties in resolving this matter. If the parties desire, they may, by mutual agreement, request a specific judge as a settlement judge in this proceeding; otherwise, the Chief Administrative Law Judge will select a judge for this purpose.<sup>6</sup> The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of this order concerning the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

21. We encourage the parties to make every effort to settle their disputes before hearing procedures are commenced. We are hopeful that USGenNE and the parties will negotiate a revised agreement and that USGenNE will file the revised agreement together with necessary supporting data. To expedite the settlement process, and to put the parties onto the right track, the Commission will point out concerns that it has with the filing and provide further guidance.

22. We are concerned that there is no data to support the Reliability Agreement's proposed terms and conditions and that the Reliability Agreement could lead to distortions in the ISO-NE markets. We are also concerned that the Reliability Agreement's terms will endure long after the Station is needed for reliability purposes or, if the Station is sold, long after it would be appropriate for any subsequent Station owner to receive such terms.

23. We are also concerned that the Reliability Agreement is fundamentally at odds with our stated policy on reliability compensation issues. The Reliability Agreement imposes terms and conditions which could be in place for over a decade. But in Devon Power LLC,<sup>7</sup> we found that reliability compensation appears to be more of a short-term issue in NEMA/Boston and contemplated that a locational installed capacity (LICAP)

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<sup>6</sup> If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a listing of Commission Judges and a summary of their background and experience. ([www.ferc.gov](http://www.ferc.gov) - click on Office of Administrative Law Judges.)

<sup>7</sup> Devon Power LLC, 107 FERC ¶ 61,240 at P 35 (2004).

mechanism would be implemented by January 1, 2006. The proposed Reliability Agreement would extend well beyond the January 1, 2006 implementation date for the ISO-NE LICAP mechanism, but does not take the LICAP mechanism into account.

The Commission orders:

(A) USGenNE's Reliability Agreement is hereby accepted for filing, to become effective on a date to be determined by the Commission in a subsequent order in this proceeding.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held in Docket No. ER04-841-000, concerning the justness and reasonableness of the Reliability Agreement. As discussed in the body of this order, the hearing shall be held in abeyance to provide time for the parties to resolve the issues through settlement judge procedures.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2003), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge within 15 days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge.

(D) Within 60 days of the date of this order, the settlement judge shall file a report with the Chief Judge and the Commission on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their efforts, or if appropriate, provide for a formal hearing by assigning the case to a presiding judge. If the parties are given additional time to continue their efforts, they shall file a report at least every 30 days thereafter informing the Commission and the Chief Judge of their progress toward resolving the outstanding issues.

(E) If the discussions between the parties fail, and a formal hearing is to be held, a presiding judge to be designated by the Chief Judge shall convene a conference in this proceeding to be held within approximately 15 days of the date the Chief Judge designates the presiding judge, in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

( S E A L )

Linda Mitry,  
Acting Secretary.