

DISCUSSION PAPER FROM LIABILITY/INSURANCE

SUBGROUP A OF LEGAL WORKSHOP

RTO WEST

SUMMARY

SubGroup A of the Legal Work Group drafted a White Paper that discusses Issue 18 of the RRG approved list of issues addressing the potential liabilities of the RTO and of the participating transmission owners and the liability of the RTO, if any, for its violations of the tariff.

SubGroup A makes the following three recommendations:

1. **The IndeGO proposal for liability provisions between a Transmission Owner and the regional transmission organization should not be carried over to RTO West.**

The proposal selected for IndeGO was to amend the Agreement Limiting Liability Among Western Interconnected Electric Systems (“WIS” or “WIES” Agreement) to permit the RTO to join in the program as an electric system. The essential elements of the IndeGO proposal were: (1) a release of liability between signatories to WEIS, except for willful actions; and (2) an insurance program for limited third-party claims.

Subsequent to the IndeGO proposal, the Region formed the Pacific Northwest Security Coordinator (“PNSC”) to perform security coordination. PNSC had different liability provisions including: (1) a requirement to obtain liability insurance for third-party claims and waiver of subrogation; (2) indemnity between PNCS and member systems for negligent acts or omissions; (3) no assumption of any duty by member systems to other systems or third-parties and no third-party beneficiaries; (4) mutual release of first party claims similar to WIS; and (5) ability to terminate the PNSC arrangement on thirty (30) days’ notice.

RTO West has several significant differences from IndeGO and PNSC including: (1) RTO West is a permanent relationship which cannot be terminated on short notice; (2) unlike IndeGO, RTO West may not have multiple control areas. Transmission Owners may have only naked legal title to bulk transmission facilities and no day-to-day operational control; (3) insurance may not always be available during the life of RTO West; (4) RTO West will assume new legal duties to manage the bulk power system for the benefit of a broad range of customers and stakeholders. To the extent Bonneville currently performs similar duties, it enjoys sovereign immunity defenses which will not be applicable to RTO West; and (5) FERC has indicated that the RTO may not limit its liability for ordinary negligence in its tariffs, but it may include the

cost of insurance in its rates. Due to these significant differences, the SubGroup could not recommend the IndeGO model because it was felt that the transfer of control to the RTO required protection against the potential risk that the assets could be subject to large class action liability claims for system-wide blackouts.

2. Legislation is required for a fully workable solution to the liability issue.

The Subgroup could not identify a liability/insurance contract form that was fully workable without legislation. The SubGroup's preference for legislation is a grant of immunity for RTOs and Transmission Owners who become subject to a system of fines and penalties (such as RMS) for failure to implement measures designed to maintain interconnected system reliability. An opportunity to obtain such legislation may exist by amendment of Senator Gorton's reliability legislation now pending before Congress. If this legislation were passed with recommended amendments, we would recommend that the remaining liability issue, system property damage, be handled with a mutual release of liability similar to WIS coupled with a waiver of subrogation.

In the absence of legislation, the SubGroup favored a mutual indemnity and insurance provision similar to the New York ISO provision. However, the SubGroup believes that this approach remains fundamentally flawed for the Northwest because: (1) it is not clear that all public agencies and BPA have authority to offer indemnity for third-party claims; (2) a one-way indemnity provision may not be enforceable; (3) insurance may not always be available to support the indemnity undertaking; (4) self-insurance may not be accepted by FERC as a cost includable in RTO tariff rates; and (5) even if self-insurance is included in RTO rates, there is no way to recover from a single catastrophic event in the event of an adverse determination of liability.

3. A funding mechanism for responding to replacement power costs in the event RTO West errors in failing to provide transmission service is desirable, and should be included in the RTO West filing, however, liability should be limited to amounts in the fund. No liability for consequential damages should be assumed. The SubGroup is researching alternatives for this issue, and will report later on this subject.

Issue 18 also raises the question of loss caused by the RTO not following its tariff, for example, the RTO causes loss by cutting the wrong schedule. This type of liability is insurable and not of too great a concern. However, liability should be limited to the cost of replacement power and not consequential

damages, such as business interruption. There is an existing insurance product to cover these kinds of claims and it is reasonably affordable--the RTO should purchase it.

INTRODUCTION

The first issue assigned to SubGroup A of the Legal Work Group is Issue 18 of the RRG approved list of issues, which reads as follows:

18. Risk Management – Finance and Insurance: The issues of potential liabilities of the RTO and of the participating transmission owners was explored extensively during the IndeGO effort. However, these issues need to be revisited in light of ongoing market development and in light of the development of enhanced transmission security arrangements, to determine if the previous resolutions remain adequate. The liability of the RTO, if any, for its violations of the tariff should be addressed.

SubGroup A met on June 14, 2000 and discussed this issue. We have the following recommendations for the Legal Work Group.

1. The IndeGO proposal for liability provisions between a Transmission Owner and the regional transmission organization should not be carried over to RTO West.
2. Legislation is required for a fully workable solution to the liability issue.
3. A funding mechanism for responding to replacement power costs in the event RTO West errors in failing to provide transmission service is desirable, and should be included in the RTO West filing, however, liability should be limited to amounts in the fund. No liability for consequential damages should be assumed. The SubGroup is researching alternatives for this issue, and will report later on this subject.

DISCUSSION

The proposal selected for IndeGO was to amend the Agreement Limiting Liability Among Western Interconnected Electric Systems (“WIS” or “WIES” Agreement) to permit the RTO to join in the program as an electric system. The IndeGo proposal is attached as Exhibit “A”. The WIS program embodies:

1. A release of liability between electric systems for system damages, except for willful actions as defined in that Agreement; and
2. An insurance program for third-party claims limited to instances where two or more insured electric systems are involved.

Subsequent to the IndeGO proposal, the Region formed Pacific Northwest Security Coordinator, a Washington non-profit corporation to perform security coordination. Security coordination is one of the functions assigned to RTO’s under Order 2000. In the context of security coordination, and subject to the Agreement, transfer of control of a member’s system occurs under emergency situations. The Region selected a different liability alternative for PNSC. (See Exhibit “B” attached) That alternative was:

1. Requirement for PNSC to obtain \$75 million of liability insurance for third-party claims and waiver of subrogation;
2. Indemnity between PNCS and member systems for negligent acts or omissions;
3. No assumption of any duty by member systems to other systems or third-parties and no third-party beneficiaries;
4. Mutual release of first party claims similar to WIS; and

5. Ability to terminate the PNSC arrangement on thirty (30) days' notice.

The RTO West formulation poses several significant differences from IndeGO and PNSC. We have identified the following considerations:

1. RTO West is a permanent relationship which cannot be made terminable on short notice;
2. Unlike IndeGO, with its retention of local control area responsibilities (nested control areas), RTO West may not have multiple control areas. Transmission Owners may have only naked legal title to bulk transmission facilities and no day-to-day operational control;
3. While insurance was available for PNSC at the limits indicated above, we were advised by our PNSC broker, Marsh (Joe Phillips) that we cannot assume that insurance will always be available during the life of RTO West. Multi-year insurance contracts would not likely be written at the inception of RTO West;
4. RTO West will assume new legal duties to manage the bulk power system for the benefit of a broad range of customers and stakeholders. These duties are **NOT** currently assumed by local electric systems. To the extent Bonneville currently performs similar duties, it enjoys sovereign immunity defenses which will not be applicable to RTO West; and
5. FERC has ruled in the New York ISO case that the RTO may not limit its liability for ordinary negligence in its tariffs, but it may include the cost of insurance in its rates. Even if a limitation of liability were permitted in the tariff, it would not limit liability to persons who were not in privity of contract.

Consequently, we could not identify a liability/insurance contract form that was fully workable without legislation. The SubGroup's preference for legislation is a grant of immunity for RTO's and Transmission Owners who become subject to a system of fines and penalties (such as RMS) for failure to implement measures designed to maintain interconnected system reliability. An opportunity to obtain such legislation may exist by amendment of Senator Gorton's reliability legislation now pending before Congress, if that legislation proceeds on a stand alone basis. One proposed amendment is attached as Exhibit "E".

If amendments to this legislation were passed, covering third-party claims, we would recommend that the remaining liability issue, system property damage, be handled with a mutual release of liability similar to what is presently in WIS together with a waiver of subrogation. So, for example, the Transmission Control Agreement would contain a provision similar to the following WIS provision:

No Party (First Party), its directors, officers and employees, shall be liable to any other Party (Second Party) for any loss or damage to the electric system of any Second Party whether or not resulting from the negligent, grossly negligent, or wrongful act or omission of any Party, its directors, officers or employees, whether its or their own or imputed, in the design, construction, operation, maintenance, use or ownership of First Party's electric system, or the performance or nonperformance of the obligations of any Party under Section 2 of this Agreement. Each Second Party releases each other first Party, its directors, officers, and employees, from any such liability.

The corresponding PNSC provision reads as follows:

Neither Party, its directors, commissioners, officers, nor employees shall be liable to the other Party for any loss or damage to the electric system or equipment of such other

Party, or any loss or damages for bodily injury (including death) that such other party or its employees may incur arising out of this Agreement or its performance.

In the absence of legislation, the SubGroup favored a mutual indemnity and insurance provision similar to the New York ISO provision. That provision is attached (Exhibit “C”). The PNSC indemnity provision, Section 9.4(5) is attached (Exhibit “B”) for comparison.

However, the SubGroup believes that this approach remains fundamentally flawed for the Northwest because:

1. It is not clear that all public agencies and BPA have authority to offer indemnity for third-party claims and the question of what law applies is complicated (for purposes of PNSC, this issue was tabled);
2. A one-way indemnity provision (RTO to TO) may not be enforceable;
3. Insurance may not always be available to support the indemnity undertaking;
4. Self-insurance (or a form of captive self-insurance) may not be accepted by FERC as a cost includable in RTO tariff rates given that the NY ISO order appears to only allow third-party insurance costs. (See New York ISO, Inc. Orders attached as Exhibit “D”).
5. Even if self-insurance is included in RTO rates, there is no way to recover from a single catastrophic event in the event of an adverse determination of liability. The only alternative for the RTO is to delay payment of judgments while rates are raised to recover costs of third-party losses. Unlike BPA, or other public agencies, however, RTO assets would not be immune from post-judgment execution procedures.

The SubGroup could not recommend the WIS alternative used in IndeGO because it was felt that the transfer of control to the RTO required protection against the potential risk that the assets could be subject to large class action liability claims for system-wide blackouts. Separation of control and ownership potentially exposes both parties to risk of liability. Note that the New Jersey Appellate Division is reported in Restructuring Today, Tuesday, June 15, 2000 as allowing a class action suit against GPU Energy from 1999 summer outages. The assumption of new duties by the RTO means that the controlling party (the RTO) must offer protection similar to the PNSC solution for security coordination.

Liability insurance at an acceptable level is essential to RTO formation. It is recommended that TO's attempt to be named as broad form "additional insureds" under liability coverage, that the RTO's coverage be "primary", and that the RTO's and TO's agree to waiver of subrogation claims. Insurance for other operations, to include, directors and officers (D&O), errors and omissions (E&O), etc. will be reviewed by Joe Phillips of Marsh, however, care must be taken by other working groups of the need to incorporate insurance requirements into planning, operation, and maintenance activities of the RTO..

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EXHIBIT “A”

20. Limitation of Liability and Insurance.

20.1 Liability - Interconnected System Operation.

20.1.1 Limitation of Liability for Loss to Electric Systems. Notwithstanding the provisions of Section 20.3, except as set forth in Sections 20.1.4. and 20.1.5., neither IndeGO, nor its trustees, officers or employees, shall be liable to the Executing Transmission Owner for any Loss to the Electric System of the Executing Transmission Owner caused by or arising out of an Electric Disturbance, whether or not such Electric Disturbance results from the negligent, grossly negligent or wrongful act or omission of IndeGO or its trustees, officers or employees (whether its or their own or imputed) in the performance or nonperformance of any obligation under this Agreement; and the Executing Transmission Owner hereby releases IndeGO and its trustees, officers and employees, from any such liability.

20.1.2 Limitation of Liability for WIS Parties. Notwithstanding the provisions of Section 20.3, except as set forth in Sections 20.1.4. and 20.1.5., if the Executing Transmission Owner is a party to the Agreement Limiting Liability Among Western Interconnected Systems (“WIS Agreement”), then neither the Executing Transmission Owner nor its directors, commissioners, officers or employees, shall be liable to IndeGO for any Loss to IndeGO caused by or arising out of an Electric Disturbance, whether or not such Electric Disturbance results from the negligent, grossly negligent or wrongful act or omission of the Executing Transmission Owner or its directors, commissioners, officers or employees, (whether its or their own or imputed) in the design, construction, operation, maintenance, use or ownership of the Executing Transmission Owner’s Electric System, or the performance or nonperformance of any obligation under this Agreement; and IndeGO hereby releases the Executing Transmission Owner and its directors, commissioners, officers and employees from any such liability.

20.1.3 Consistency With Insurance Policies. In the event that a Party holds or obtains any insurance policy that is inconsistent with the provisions of Sections 20.1.1 and 20.1.2, such Party shall, to the extent not prohibited by applicable law, indemnify and hold harmless the other Party from all costs and damages to the other Party resulting from such inconsistency, including but not necessarily limited to the other Party’s costs of defending against subrogated claims.

20.1.4 Not Applicable to Willful Action. The provisions of Sections 20.1.1 and 20.1.2 do not apply to Losses resulting from Willful Action.

20.1.5 Effect of Prior Arbitration Awards. The provisions of Sections 20.1.1. and 20.1.2. do not apply to Losses resulting from an action taken or not taken by a Party which action or non-action (1) has been determined by arbitration award to be a violation of Section 20.3.1. of this Agreement and (2) occurs or continues beyond the period specified in such arbitration award for curing such violation or, if no cure period is specified, occurs or continues beyond a reasonable period to cure such violation.

Each Party agrees to pay for Losses that both (1) occur while such Party is a party to this Agreement and (2) result from violation by such Party that occurs or continues beyond the period specified in such arbitration award for curing such violation or, if no cure period is specified, occurs or continues beyond a reasonable period to cure such violation.

20.2 Relationship to Agreement Limiting Liability Among Western Interconnected Systems.

20.2.1 Executing Transmission Owner as WIS Agreement Party. The Parties recognize that the Executing Transmission Owner is or may become a party to the WIS Agreement.

20.2.2 IndeGO as a WIS Agreement Party. IndeGO agrees to become a party to the WIS Agreement and the insurance program associated therewith (the “WIS Insurance”), subject to amendment of the WIS Agreement and the WIS Insurance to permit IndeGO to become a named insured of the WIS Insurance.

20.2.3 Amendments to WIS Agreement. If the Executing Transmission Owner is a party or becomes a party to the WIS Agreement, it agrees to cooperate in all reasonable respects in effecting any amendments which may be necessary or appropriate to the WIS Agreement and WIS Insurance, including but not limited to amendments assessing appropriate premiums against IndeGO, to enable coverage of the “Ultimate Net Loss” (as defined in the WIS Insurance Insuring Form) arising out of an Electrical Disturbance in or on the Electric System of any party participating in WIS Insurance, subject to reasonable limits.

20.2.4 WIS Agreement Exclusions. The Parties agree that the WIS Insurance, as amended, shall have reasonable exclusions, including but not necessarily limited to the following:

(a) The WIS Insurance shall not apply to physical injury to the Electric System of any WIS insured party or any property of IndeGO, or to loss of revenue resulting therefrom.

(b) Unless an Electric Disturbance is caused in whole or in part, directly, indirectly or concurrently, by the actions or inactions of IndeGO, the WIS Insurance shall not apply to damage resulting from an Electric Disturbance, if such damage occurs solely on and is confined to: (1) the Electric System of the WIS insured party upon whose system the Electric Disturbance originated, and (2) the customers of such Electric System, except wholesale for resale customers.

20.3 Responsibility - Interconnected System Design and Operation.

20.3.1 Operation to Minimize Electric Disturbances.

20.3.1.1 The Executing Transmission Owner's Operation of its Electric System to Minimize Electric Disturbances. The Executing Transmission Owner shall design, construct, operate, maintain, and use its Electric System and perform its other obligations under this Agreement in conformance with Good Utility Practice to minimize:

(a) Electric Disturbances originating on the Executing Transmission Owner's Electric System;

(b) The effect on the Executing Transmission Owner's Electric System of any Electric Disturbance that originates on the Executing Transmission Owner's Electric System or another party's Electric System; and

(c) The effect on any other party's Electric System of any Electric Disturbance that: (i) originates on the Executing Transmission Owner's Electric System or (ii) although not originating on the Executing Transmission Owner's Electric System, reaches or could reach the Electric System of the other party through the Executing Transmission Owner's Electric System.

20.3.1.2 IndeGO's Operation of IndeGO Controlled Transmission Facilities to Minimize Electric Disturbances. IndeGO shall operate the IndeGO Controlled Transmission Facilities and perform its other obligations under this Agreement in conformance with Good Utility Practice to minimize:

(a) Electric Disturbances originating on the IndeGO Controlled Transmission Facilities;

(b) The effect on the IndeGO Controlled Transmission Facilities of any Electric Disturbance that originates on the IndeGO Controlled Transmission Facilities or another party's Electric System; and

(c) The effect on any other party's Electric System of any Electric Disturbance that: (i) originates on the IndeGO Controlled Transmission Facilities or (ii) although not originating on the IndeGO Controlled Transmission Facilities, reaches or could reach the Electric System of the other party through the IndeGO Controlled Transmission Facilities.

20.3.2 No Duties Created to Non-Party. Nothing in this Agreement shall be construed to create any duty to, any standard of care with reference to, or any liability to any person other than IndeGO and the Executing Transmission Owner.

20.3.3 Resolution of Differences. Should differences arise between the Parties regarding the implementation of Section 20.3.1, they shall seek an equitable solution and shall perform

necessary technical studies which shall not be unreasonably delayed. In the event agreement cannot be reached, and if in the judgement of either Party to the disagreement the necessary technical studies have been performed, such Party may demand the matter be resolved in accordance with Dispute Resolution provisions of Section 21. This provision shall not be used to resolve differences among or with persons or entities who are not Parties.

20.3.4 Covenants Independent. Except as and to the extent set forth in Section 20.1.5, the mutual releases and covenants of Sections 20.1.1 and 20.1.2 are independent of and divisible from the covenants of Section 20.3.1 and are not affected by nonperformance under Section 20.3.1. It is the intent of this Agreement that the obligations of Section 20.3.1 shall be enforceable only by a Party assuming the risk of liability for Loss resulting from a failure to comply with an arbitration award as provided in Section 20.1.5.

EXHIBIT “B”

SECURITY COORDINATION AGREEMENT - PNSC

9. INSURANCE, INDEMNIFICATION, AND LIMITATIONS OF LIABILITY.

To promote cooperation between the Parties, to avoid duplication of costs, and to carry out the purposes of this Agreement, the Parties agree to the following provisions for insurance, indemnification, and limited liability.

9.1 Insurance; Waiver of Subrogation Rights.

9.1.1 PNSC Insurance Coverage Requirements. Throughout the term of this Agreement, the PNSC shall maintain insurance coverage that at a minimum:

- (1) provides general liability and errors and omissions insurance with respect to PNSC’s performance under this Agreement;
- (2) provides for maximum per-occurrence self-insured retention of not more than \$4 million;
- (3) provides general liability coverage limits of not less than \$75 million and separate errors and omission coverage limits of not less than \$50 million;
- (4) provides an agreement or endorsement under which the insurance cannot be terminated, canceled, allowed to expire, or materially altered without 90 days’ prior written notice to PNSC and provides that such policy is primary over any other insurance; and
- (5) provides that PNSC’s insurer shall be bound by any waivers of the insurer’s rights of subrogation granted by PNSC.

9.1.2 Waiver of Subrogation Rights. PNSC hereby waives all rights of subrogation its insurer(s) may have against CAO.

9.2 PNSC’s Obligation to Notify CAO with Respect to Insurance. PNSC shall not consent to or allow the insurance required under Section 9.1.1 above to be terminated, canceled, allowed to expire, or materially altered without providing at least 60 days’ advance notice to CAO.

9.3 First Party Claims. Neither Party, its directors, commissioners, officers, nor employees shall be liable to the other Party for any loss or damage to the electric system or equipment of such other

Party, or any loss or damages for bodily injury (including death) that such other party or its employees may incur arising out of this Agreement or its performance.

9.4 Third-Party Claims. In the event third-party claims are made against either Party arising out of this Agreement or its performance, the Parties agree that:

- (1) In the event of any such claim, the Party against which the third-party claim is made shall provide immediate notice to the other Party pursuant to Section 13.1 below; shall make such immediate efforts as necessary to preserve evidence and/or protect against default judgment; and shall provide notice to the Claims Committee at the address designated for such purpose with a copy of the broker of record with respect to the insurance policy described in Section 9.1.1 above. PNSC shall provide notice to all Other NWPP CAO(s), notice as necessary to its insurance carrier, and refer such matter to the Claims Committee.
- (2) The Parties anticipate that the Claims Committee shall (a) consist of widely respected risk or claims managers of Western Interconnection utilities; and (b) have responsibility to review any such claims; take action as necessary to properly investigate, evaluate, and defend such claims; and make recommendations regarding payment, rejection, or compromise of such claims.
- (3) In the event of legal action resulting from the denial of any such claim, the parties anticipate that the Claims Committee shall recommend suitably qualified legal counsel to defend such claims. Subject to Section 13.7 below and to the extent permitted by law, the Parties agree, except where there is an irreconcilable conflict of interest, (a) to consent to joint representation in defense of such legal action and (b) to make good faith efforts to enter into a mutually acceptable joint representation agreement to facilitate cooperation, information-sharing, and protection of attorney-client privilege and work product in connection with the joint defense. If joint representation is precluded by an irreconcilable conflict of interest or for any other reason, the Party unable to participate in joint representation shall provide legal counsel of its own choice, at its own expense, to defend such legal action.
- (4) Where the claim or legal action arises in whole or in part from allegedly negligent actions or inactions of PNSC in performance of obligations of this Agreement, the self-insured retention and the policy coverage described in Section 9.1.1 above shall be regarded as primary with respect to payments or judgments resulting from any such claim or legal action. Payments shall include reasonable attorney fees and costs of investigation and defense.
- (5) To the extent of insurance coverage, PNSC shall indemnify, defend, and hold CAO harmless from and against all Damages based upon or arising out of bodily injuries or damages to third Person(s) or parties, including without limitation death result therefrom, or physical damages to or losses of property caused by, arising out of or sustained, in

connection with performance of this Agreement to the extent attributable to the negligence of PNSC or its employees, agents, suppliers and subcontractors (including suppliers and subcontractors or subcontractors; hereafter “Subcontractors”), specifically including, without limitation, where CAO has acted in response to a directive of PNSC issued under Section 6.1 of this Agreement.

- (6) Other than where CAO has acted in response to a directive of PNSC issued under Section 6.1 of this Agreement, subject to Section 13.7 below and to the extent permitted by law, CAO shall indemnify, defend, and hold PNSC harmless from and against Damages based upon or arising out of bodily injuries or damages to third Person(s) or parties, including without limitation death resulting therefrom, or physical damages to or losses of property caused by, arising out of or sustained, in connection with performance of this Agreement to the extent attributable to the negligence of CAO or its employees, agents, suppliers and Subcontractors.
- (7) Notwithstanding Section 9.4(4) above, in the event that any such Damage is caused by the negligence of CAO and PNSC, including their employees, agents, suppliers and Subcontractors, the Damage shall be borne by CAO and PNSC in the proportion that their respective negligence bears to the total negligence causing the Damage.

9.5 Inaccurate or Incomplete Data or Information. Liability as between the Parties for incomplete or inaccurate data or information shall be limited as set forth in Sections 4.1(8), 4.2(10), and 4.2(2) above and shall also be subject to the limitations set forth in Section 9.6 below.

9.6 Limitation of Damages. As against the other Party (including its directors, commissioners, officers, and employees), each party waives all claims, and covenants not to sue or otherwise pursue any claim or remedy arising out of or in connection with this Agreement (whether based on contract, tort, or any other legal theory), except for:

- (1) claims arising under Section 9.4 of this Agreement with respect to third-party actions; and
- (2) claims for actual, direct damages only, which shall under no circumstances include any lost profits, lost data, or any indirect, incidental, consequential, special, exemplary, or punitive damages.

EXHIBIT “C”

Article 23: INDEMNIFICATION

23.01 Indemnification

The ISO shall indemnify, save harmless and defend a Transmission Owner including its directors, officers, employees, trustees, and agents, or each of them, from and against all claims, demands, losses, liabilities, judgments, damages (including, without limitation, any consequential, incidental, direct, special, indirect, exemplary or punitive damages and economic costs) and related costs and expenses (including, without limitation, reasonable attorney and expert fees, and disbursements incurred by a Transmission Owner in any actions or proceedings between a Transmission Owner and another Transmission Owner, a third party, Market Participant, the ISO, or any other party) arising out of or related to the Transmission Owner's or the ISO's acts or omissions related in any way to the Transmission Owner's ownership or operation of its transmission facilities when such acts or omissions are either (1) pursuant to or consistent with ISO Procedures or direction; or (2) in any way related to the Transmission Owner's or the ISO's performance under the ISO OATT, except to the extent that a Transmission Owner is found liable for negligence or intentional misconduct, and under the ISO Services Tariff, the ISO/TO Agreement, the NYSRC Agreement, the ISO/NYSRC Agreement, or this Agreement, except to the extent a Transmission Owner is found liable for gross negligence or intentional misconduct.

23.02 Survival.

The provisions of this Article 23 shall survive the termination of this ISO Agreement.

ARTICLE 25: LIMITATION OF LIABILITY

25.01 Limitation of Liability of ISO.

For the purpose of this Section, the term Market Participant shall not include a Transmission Owner with respect to acts or omissions related in any way to the Transmission Owner's ownership or operation of its transmission facilities when such acts or omissions are either (1) pursuant to or consistent with ISO Procedures or direction; or (2) in any way related to the Transmission Owner's or the ISO's performance under the ISO OATT, the ISO Services Tariff, the ISO/TO Agreement, the ISO/NYSRC Agreement or this Agreement. Subject to the provisions of Article 23, the ISO shall not be liable (whether based on contract, indemnification, warranty, tort, strict liability or otherwise) to any Market Participant or any third party for any damages whatsoever, including without limitation, direct, incidental, consequential, punitive, special, exemplary or indirect damages resulting from any act or omission in any way associated with this Agreement, except in the event that the ISO is found liable for gross negligence or intentional misconduct, in which case the ISO will not be liable for any incidental, consequential, punitive, special, exemplary, or

indirect damages; provided, however, that the liability of the ISO related services provided under the ISO OATT shall be governed by the provisions of the ISO OATT.

25.02 Limitations of Liability of Transmission Owners.

A Transmission Owner shall not be liable (whether based on contract, indemnification, warranty, tort, strict liability or otherwise) to the ISO, any Market Participant, any third party, or any other Party, for any damages whatsoever, including without limitation, direct, incidental, consequential, punitive, special, exemplary or indirect damages resulting from any act or omission in any way associated with this Agreement, except to the extent that the Transmission Owner is found liable for gross negligence or intentional misconduct, in which case the Transmission Owner shall not be liable for any incidental, consequential, punitive, special, exemplary, or indirect damages; provided, however, that the liability of a Transmission Owner related to services provided under the ISO OATT shall be governed by the provisions of the ISO OATT.

EXHIBIT “D”

UNITED STATES OF AMERICA 90 FERC ¶ 61,015
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James J. Hoecker, Chairman;
Vicky A. Bailey, William L. Massey,
Linda Breathitt, and Curt Hébert, Jr.

New York Independent System Operator, Inc.

Central Hudson Gas & Electric
Corporation

Consolidated Edison Company of
New York, Inc.

New York State Electric & Gas
Corporation

Niagara Mohawk Power Corporation
Orange and Rockland Utilities, Inc.

Rochester Gas and Electric
Corporation

Docket Nos. ER00-550-000
and ER00-556-000

ORDER ACCEPTING PROPOSED TARIFF REVISIONS FOR FILING, AS MODIFIED

(Issued January 12, 2000)

This order addresses proposed revisions to the New York Independent System Operator's (New York ISO or ISO) Open Access Transmission Tariff (ISO Transmission Tariff), the New York ISO Services Tariff (ISO Services Tariff) and various related agreements submitted by the New York ISO and the Member Systems of the New York Power Pool (Member Systems) (together, Applicants). With the modifications discussed below, we accept the proposed changes.

Background

In Docket No. ER00-550-000, the ISO and the Member Systems have proposed revisions to the tariffs "to memorialize the outcome of negotiations between the Member Systems and the New York ISO with respect to proposed changes to the Commission-approved ISO Tariffs and ISO related

Agreements." ¹ The Applicants assert that the filing addresses certain issues which must be resolved for the orderly functioning of New York ISO operations and to provide for greater consistency between the ISO Tariffs and agreements. It includes proposed revisions to the ISO Transmission Tariff, ISO Services Tariff, ISO/Transmission Owner Agreement, ISO Agreement, and the ISO/New York State Reliability Council (NYSRC) Agreement and addresses indemnification, liability limitation, ISO obligations with respect to Transmission Owners, ISO tariff and agreement amendment procedures, identification of Transmission Owner rights under ISO operation, and procedures for the Transmission Owners to withdraw from participation in the ISO/Transmission Owner agreement.

With one exception as noted below, Member Systems and the New York ISO request waiver of notice to allow an effective date of November 18, 1999, the date the New York ISO commenced operations.

In Docket No. ER00-556-000, the Applicants seek to revise the ISO Transmission Tariff, and the ISO Services Tariff to address certain revisions that Member Systems and the New York ISO characterize as essential to the commencement of ISO operations. The application contains revisions which modify certain provisions of the tariffs, as well as numerous non-substantive clarifying, typographical, grammatical and stylistic changes. The Applicants note that some of the proposed revisions were previously rejected without prejudice by the Commission because they were included in a compliance filing. ²

The Member Systems and the New York ISO request waiver of notice to allow an effective date of November 18, 1999, the commencement date of New York ISO operations.

II. Notice of Filings and Interventions

Notice of the Applicants' filing in Docket No. ER00-550-000 was published in the Federal Register, 64 Fed. Reg. 66,621 (1999), with protests and interventions due on or before November 30, 1999. ³ Notice of the Applicants' filing in Docket No. ER00-556-000 was published in the Federal

¹Transmittal letter at 2.

²See Central Hudson Gas & Electric Corp., et al., 89 FERC ¶ 61,110 (1999).

³ Under ordinary circumstances, the last date of Commission action on this filing would be January 9, 2000. At the Commission's request, the Applicants submitted a letter to allow the Commission to extend the time to act on the filing so it can be acted on at the regularly scheduled January 12, 2000 meeting.

Register, 64 Fed. Reg. 66,623 (1999), as amended 64 Fed. Reg. 69,244 (1999), with protests and interventions due on or before December 13, 1999.

Parties filing motions to intervene and/or protests are listed in Appendix A of this order.

On December 15, 1999, in Docket No. ER00-550-000, the Applicants filed a response to the protests and comments filed by the intervenors. On December 17, 1999, in Docket No. ER00-556-000, the Applicants filed a response to the protests and comments filed by the intervenors. In addition, on December 27, 1999, the New York ISO filed an additional answer in Docket No. ER00-556-000.

III. Discussion

A. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (1999), the timely, unopposed motions to intervene of those parties listed in the Appendix serve to make them parties to this proceeding.

Although the Commission's Rules of Practice and Procedure do not permit answers to protests,⁴ given the complex nature of this proceeding, and given that the answers help in clarifying certain issues, we will accept the answers filed by the Applicants.

B. Docket No. ER00-550-000

Unilateral Modification of Tariffs by ISO Board

Currently, all revisions to New York ISO tariffs and agreements require the ISO Board to obtain the concurrence of the Management Committee, which is comprised of ISO participants. Applicants propose to revise this authority to permit the ISO Board to unilaterally file to revise any ISO tariff or agreement without concurrence of the Management Committee when necessary to "address exigent circumstances" related to the New York ISO market or the transmission grid. The provision states that any such proposed revisions would terminate within 120 days after the date of filing with the Commission.

PG&E Generating and PG&E Energy Trading-Power L.P.(PG&E Gen) and Sithe/Independence Power Partners, L.P. (Sithe) state that this provision is open ended and ill defined. They claim that since there are no criteria for invoking this authority other than that a situation requires

⁴See 18 C.F.R. § 385.213(a)(2) (1999).

immediate aid or action, the ISO Board is vested with the authority to make changes of any kind for any reason. PG&E Gen requests rejection of the revisions. Sithe requests rejection of the provision as it relates to energy markets, and that revisions terminate in 60 days rather than 120 days.

It is reasonable for an ISO to have the ability to file a unilateral amendment with the Commission when the ISO believes that immediate action is necessary to protect the integrity of an energy market or the transmission grid.⁵ We reject Sithe's request to require the revisions to terminate in 60 days and will accept the Applicants' proposal in this regard.

Indemnification and Liability

The Applicants have added a provision to the ISO Transmission Tariff that would limit their liability except in circumstances of negligence or willful misconduct.

While the ISO Transmission Tariff retains the pro forma tariff's indemnification language, the Applicants have added language to Section 10.2 that provides that the ISO will procure insurance or other alternative risk financing arrangements to cover the risks associated with carrying out its responsibilities under the ISO Transmission Tariff. The added language further provides that proceeds from such insurance would be used by the ISO before it exercises its right to seek indemnification. Finally, the language provides that, unless indemnification is required directly from a particular transmission customer, indemnification costs would be recovered under the existing Schedule 1 charge under the ISO Transmission Tariff.

Dynergy Power Marketing, Inc. (Dynergy) and Connecticut Municipal Electric Energy Cooperative note that the Applicants seek to place inappropriate limits on their liability. Dynergy claims such a limitation would be inconsistent with prior Commission rulings.⁶ Moreover, 1st Rochdale Cooperative Group, Ltd. and Coordinated Housing Services, Inc. (1st Rochdale) contends that Applicants have set up a framework in which New York ISO depends on Member Systems to shield it from risk of operating the ISO, but where a Member System at fault cannot be required to provide indemnification. 1st Rochdale argues that this proposal should be rejected, as it appears to be biased in favor of the Member Systems, who would not bear the full responsibility for their actions. Moreover, 1st Rochdale notes that New York ISO has provided neither a detailed formula nor specific cost

⁵In fact, a substantively similar provision was accepted for the PJM ISO. Pennsylvania-New Jersey-Maryland Interconnection, et al., 81 FERC ¶ 61,257 (1997), order on reh'g, 82 FERC ¶ 61,047 (1998).

⁶See Central Hudson Gas & Electric Corp, et al., 83 FERC ¶ 61,352 at 62,412 (1998); Dynergy Protest at 3.

support for the recovery of indemnification costs under Schedule 1 and requests rejection of the Applicants' proposal in this regard.

We will reject the additional liability provision to the ISO Transmission Tariff. The pro forma tariff does not address (and was not intended to address) liability issues, for the reasons discussed in Order No. 888.⁷ Instead, the Applicants should pursue any legal remedies they may have with respect to liability in the appropriate forum.⁸

We will accept the proposed language added to Section 10.2, regarding insurance, as consistent with or superior to the pro forma tariff, only to the extent that, as provided by the pro forma tariff, transmission customers are not required to indemnify (in any manner, including through the payment of insurance premiums) the ISO or the Transmission Owner in cases of negligence or intentional wrongdoing.⁹ We direct the Applicants to refile this proposed language to clearly reflect the requirements of the pro forma tariff and this determination.

In addition, while we will allow the ISO Transmission Tariff to be amended to allow the addition of costs to the Schedule 1 charge, before Applicants may recover any such costs they must file pursuant to section 205 of the FPA to do so, with appropriate justification and cost support.

Cost Shifting

⁷See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540, FERC Stats. & Regs. ¶ 31,036 (1996), order on reh'g, Order No. 888-A, 62 Fed. Reg. 12,274 (1997), FERC Stats. & Regs. ¶ 31,048 at 30,301-02 (1997), order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 at 62,080-81 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998). See also, Pacific Gas and Electric Company, et al., 81 FERC ¶ 61,122 (1997); Delmarva Power & Light Company, 88 FERC ¶ 61,247 (1999).

⁸See Order No. 888-B at 62,080-81.

⁹ See Order No. 888-A at 30,514. Payment by transmission customers of insurance premiums for insurance that covers negligence or intentional wrongdoing is effectively the same as transmission customers directly indemnifying against negligence or intentional wrongdoing, which we consistently have not allowed. See, e.g., Rochester Gas and Electric Corp., 78 FERC ¶ 61,262 at 62,122 & nn.10-11 (1997), reh'g denied, 82 FERC ¶ 61,250 (1998).

The Applicants propose to revise the New York ISO/Transmission Owner Agreement to add a new section 6.15 which would require New York ISO and Member Systems to work together in good faith to resolve any cost shifting that may occur as a result of litigation in Docket No. ER97-1523-011, et al., dealing with third party grandfathered agreements. PG&E Gen notes that it is unclear whether this refers to cost shifts solely among the Member Systems. To the extent the provision may bind third parties, PG&E Gen requests rejection. The Applicants answer that the provision is not intended to be binding on third parties or the Commission.

As clarified by the Applicants, the provision merely requires New York ISO and Member Systems to work in good faith to resolve cost shifts and would not bind third parties. Moreover, any attempt to reallocate cost shifts resulting from litigation would require a section 205 filing. Therefore, we will accept this proposed change.

Amortization of Start-up Costs

The Applicants propose to reduce the period for amortizing New York ISO start-up costs from ten to five years. Municipal Electric Utilities Association of New York State (MEUA) notes that the Commission set for hearing New York ISO's recovery of start-up costs,¹⁰ including the ten-year amortization period, and Applicants should not be permitted to end-run the hearing. The Applicants respond that they have proposed the same change in the ongoing hearing proceeding. Accordingly, we will accept these revisions subject to the outcome of the hearing in that proceeding.

Recovery of NYPA Transmission Adjustment Charges (NTAC)

The Applicants propose to revise section 3.06 of the New York ISO/Transmission Owner Agreement to state that the agreement is conditioned on the Transmission Owners being "authorized" to recover the NTAC, as opposed to being "able" to recover NTAC costs.

MEUA objects to the revision, noting that recovery of NTAC charges is at issue in the hearing in Docket No. ER97-1523-000, et al. The Applicants respond that the change is merely a clarification since the Commission has already approved recovery of the NTAC charges. The Applicants add that the issue at hearing is limited to the extent to which the NTAC can be recovered from grandfathered customers.

¹⁰ Central Hudson Gas & Electric Corp., et al., 89 FERC ¶ 61,032 (1999).

We find that the hearing is unaffected by Applicants' proposed revision, which merely clarifies that recovery of the NTAC must be authorized by the Commission. Accordingly, we will accept this revision.

C. Docket No. ER00-556-000

Scheduling of Transmission Service in the Balancing Market Evaluation

The New York ISO Transmission Tariff currently provides that a generator within the New York ISO control area is deemed to have supplied into the market 100 percent of the power it scheduled, regardless of whether the generator actually delivers the power. Under that provision, a generator is deemed to have purchased any shortfall between the scheduled and delivered amounts from the New York ISO and resold it to the third party purchaser. This provision was accepted and set for hearing along with amendments to existing Qualifying Facility (QF) power purchase agreements, in Docket No. ER97-1523-011, et al.¹¹

To prevent a QF from having to make any purchases from the New York ISO, the Applicants propose to revise the ISO Transmission Tariff and ISO Services Tariff to retroactively adjust: (1) the scheduled output for certain generators pursuant to existing must-take QF power purchase contracts so that the scheduled output of the QF is adjusted to equal the actual output in each hour; and (2) transmission service from these generators so that the amount of transmission service scheduled in the hour-ahead Balancing Market Evaluation (BME) is adjusted to equal the generator's actual output in the hour.

Selkirk Cogen Partners, L.P. (Selkirk) asserts that the proposal, while a step in the right direction, is incomplete. Specifically, Selkirk states that the adjustment mechanism addresses only sales under the Public Utility Regulatory Policies Act (PURPA)¹² and does not include merchant sales made by a QF. It argues that if the tariff does not treat merchant sales by the QF in the same fashion as PURPA sales, the QF may be required to purchase and resell power from New York ISO, thereby facing risk of loss of QF status. Selkirk also requests that the provision be expanded to include all merchant sales by QFs, not just sales under existing contracts. Otherwise, Selkirk asserts it may be required to take transmission service under the New York ISO transmission tariff rather than use its transmission rights under its existing grandfathered transmission service agreements. Finally, Selkirk notes that issues concerning grandfathered contracts are currently being litigated in Docket No. ER97-

¹¹ Central Hudson Gas & Electric Corp., et al., 88 FERC ¶ 61,306 (1999).

¹²16 U.S.C. § 824 a-3 (1994).

1523-011, et al., and that acceptance of the revisions without modification would adversely affect ongoing litigation.

We conclude that the treatment of merchant sales by QFs is an issue in the ongoing litigated proceeding; any resolution from that proceeding will require a revision to the filed tariff provisions. Accordingly, we will accept the proposed revisions subject to the outcome of Docket No. ER97-1523-011, et al.

Payment Obligations of Transmission Owners in Transmission Congestion Contract (TCC) Auctions

Available TCCs are acquired by market participants through an auction at the market clearing price. The market clearing price can be positive or negative; a positive price requires a payment to the seller, while a negative price requires a payment to the purchaser. Auction revenues are then distributed to the transmission owners through the New York ISO. In order to encourage the release of additional transmission capacity by transmission owners into the auction, Applicants propose to revise the ISO Transmission Tariff and the ISO Services Tariff such that transmission owners releasing residual TCCs or existing transmission capacity for native load into the auction will not incur a payment obligation to the other transmission owners if the ultimate purchaser acquires the TCC at a negative market clearing price. Instead, it proposes that all transmission owners will proportionately bear the cost of the negatively-valued TCC through the auction revenues distribution process which is already in place.

1st Rochdale contends that this policy contradicts the price signals that are sent by the market regarding the value of congested transmission paths.

Participants that are awarded TCCs with negative value (that is, they are paid to take the TCC) will receive payments for taking those negatively valued TCCs. The proposed amendment simply sets forth a system by which auction revenues are distributed among the transmission owners. Because the proposed revision only impacts revenue sharing between the transmission owners and does not change the payments made to the TCC holder, this policy will have no effect on price signals sent by the market for TCCs. Given that no transmission owner has any objections to this revenue distribution mechanism, we will accept this provision.

Congestion Revenues

The Applicants have added minor clarifications indicating that congestion revenues from the real-time market which do not flow through to TCC holders will be used to offset the Scheduling, System Control, and Dispatch Service (Schedule 1) costs. Excess congestion revenues from the day-ahead market, where TCCs apply, will revert back to the transmission owners.

1st Rochdale believes that this provision requires considerable clarification. It contends that it is unclear how the Schedule 1 offset for real-time congestion rents will be applied. It suggests that such rents be refunded back to the transmission customers that paid the congestion revenues. Similarly, 1st Rochdale objects to the refund of excess day-ahead congestion revenues to transmission providers, claiming that this fails to provide transmission providers (the primary holders of TCCs) the incentive to alleviate congestion, but rather grants them an opportunity for profit.

We disagree with 1st Rochdale's concerns and find that the Applicants' revisions merely clarify the difference between congestion revenues in the day-ahead market and congestion revenues in the real-time market. The Commission has already approved the use of excess congestion rents to offset Schedule 1 charges as well as the payment of excess rents to transmission owners. Moreover, 1st Rochdale's request to refund real-time excess congestion rents back to those transmission customers who paid them would render the New York ISO's congestion management system meaningless; under 1st Rochdale's proposal, transmission customers would effectively not pay any congestion in real-time, and hence would receive the wrong price signals regarding the allocation of transmission capacity. 1st Rochdale's concern that transmission owners will have a disincentive to relieve congestion due to excess rent payments is without merit. Therefore, we will approve the Applicants' proposed clarifications.

Installed Capacity

The Applicants propose to calculate a Load Serving Entities' (LSE) installed capacity requirements annually rather than seasonally--equal to the greater of: (1) the amount of energy consumed by an LSE's customers during the peak hour for the time period containing that capability period, or the immediately preceding capability period, whenever the load was greater; or (2) the average amount of energy consumed by that LSE's customers over the duration of the capability period in which the highest peak load occurred. Applicants explain that LSEs will have the same requirement for the winter and summer periods, assuming no customers switch LSEs.

1st Rochdale complains that the "greater of" change increases costs for LSEs and dilutes seasonal market signals and realities. It suggests that installed capacity requirements be computed more frequently so that the amount of installed capacity required during lower peak load periods is lower, and hence imposes lower costs on LSEs.

1st Rochdale's arguments mirror those rejected in the January 27 and July 29 orders, where the Commission approved the New York ISO's installed capacity requirements on an annual basis and

rejected comments calling for more frequent changes of installed capacity requirements. Accordingly, we will accept the Applicants' proposed change.

Regulation Penalties

The Applicants propose to exempt from the regulation penalty: (1) generators providing power under existing contracts, including PURPA contracts, in which the power purchaser does not have control over the operation of the supply source; (2) certain turbine generators that provide steam within New York City; and (3) existing intermittent generators.

The Public Service Commission of the State of New York (New York Commission) states that the costs associated with the proposed exemptions cannot be accurately ascertained at this time. Therefore, it requests the Commission to order the ISO to revisit, through a collaborative process six months from the start-up of the New York ISO, how such costs will be allocated among market participants.

1st Rochdale argues that the proposed exemptions may be unduly discriminatory due to the fact that other parties, such as LSEs, will be called upon to make up the difference. It also argues that adequate support is not provided for the modification.

We agree with the intervenors that these exemptions are inappropriate at this time. The Applicants have provided no rationale for exempting any class of participants from regulation charges. Accordingly, we will reject this provision without prejudice to refiling the proposal in a separate docket including appropriate justification and cost support.

Additional Working Capital

The Applicants propose to revise the Schedule 1 (scheduling, cost recovery) formula to specify that the line item "capital requirements" specifically includes working capital. The Applicants note that it must have sufficient funds available to balance receipts and payments on a monthly basis.

1st Rochdale argues that the proposed revision should be rejected because the Applicants have neither supported the addition of working capital costs to the scheduling charge nor the components of the existing scheduling charge.

We disagree with 1st Rochdale that the revision proposed here should be rejected since the New York ISO requires working capital to operate. Moreover, the Applicants have not added costs, but rather, have added greater specificity to their existing formula. This does not require support since it recovers only New York ISO's actual costs. Accordingly, we accept this provision.

D. Effective Date and Waiver of Notice

The Applicants request the filings to become effective on the date the New York ISO commences operations. With respect to the effective date for changing the amortization period for the recovery of start-up costs, the New York ISO requests an effective date of January 1, 2000. In addition, the Applicants request waiver of the Commission's notice requirement because that date is likely to be less than 60 days from the date of the filings.

We find good cause to grant the Applicants' request for waiver of the 60-day prior notice requirement and we will allow the accepted tariff revisions to become effective, as requested, on the date the New York ISO commenced operations.¹³ Moreover, we will allow the January 1, 2000 effective date for changing the amortization period as requested.

The Commission orders:

(A) The Applicants' filings are hereby accepted, as modified, to become effective as discussed in the body of this order.

(B) The Applicants are hereby directed to make a revised filing, with the modifications directed herein, within 30 days of the date of this order.

(C) The Applicants will be informed of rate schedule designations at a later date.

By the Commission.

(S E A L)

Linwood A. Watson, Jr.,
Acting Secretary.

¹³ See Central Hudson Gas & Electric Corp., et al., 60 FERC ¶ 61,106, reh'g denied, 61 FERC ¶ 61,089 (1992).

Docket No. ER00-550-000

1st Rochdale Cooperative Group, Ltd. and Coordinated Housing Services, Inc. *
AES, NY, L.L.C.
Connecticut Municipal Electric Energy Cooperative *
Dynegy Power Marketing, Inc. *
Municipal Electric Utilities Association of New York State *
PG&E Generating and PG&E Trading-Power, L.P. *
Sithe/Independence Power Partners, L.P. *
Southern Energy Bowline, L.L.C., Southern Energy Lovett, L.L.C. and
Southern Energy NY-Gen, L.L.C.

Docket No. ER00-556-000

1st Rochdale Cooperative Group, Ltd. and Coordinated Housing Services, Inc. *
AES, NY, L.L.C.
Connecticut Municipal Electric Energy Cooperative
Dynegy Power Marketing, Inc.
Orion Power New York GP, Inc.
Public Service Commission of the State of New York **
Selkirk Cogen Partners, L.P. *
Sithe/Independence Power Partners, L.P.
Southern Energy Bowline, L.L.C., Southern Energy Lovett, L.L.C. and
Southern Energy NY-Gen, L.L.C.

* Parties also filing comments or protests

** Parties filing comments only

UNITED STATES OF AMERICA 91 FERC ¶ 61,012
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James J. Hoecker, Chairman;
William L. Massey, Linda Breathitt,
and Curt Hébert, Jr.

New York Independent System Operator, Inc.

Central Hudson Gas & Electric
Corporation
Consolidated Edison Company of
New York, Inc.

New York State Electric & Gas
Corporation
Niagara Mohawk Power Corporation
Orange and Rockland Utilities, Inc.
Rochester Gas and Electric
Corporation

Docket Nos. ER00-550-001
and ER00-556-001

ORDER ON REHEARING
(Issued April 4, 2000)

On January 12, 2000, the Commission issued an order ¹⁴ accepting with certain modifications proposed revisions to the New York Independent System Operator's (New York ISO or ISO) Open Access Transmission Tariff (ISO OATT), the New York ISO Services Tariff (ISO Services Tariff) and various related agreements submitted by the New York ISO and Members of the Transmission Owners Committee of the Energy Association of New York State (Member Systems). ¹⁵ As discussed below, we grant rehearing on the issue of recovery of liability insurance costs and deny rehearing on all other issues.

Background

¹⁴ New York Independent System Operator, Inc. *et al.*, 90 FERC ¶ 61,015 (2000) (January 12 Order).

¹⁵ The Member Systems were formerly known as the member systems of the New York Power Pool.

The January 12 Order addressed two dockets. In Docket No. ER00-550-000, the New York ISO and the Member Systems proposed revisions to the tariffs to memorialize the outcome of negotiations between the Member Systems and the New York ISO with respect to proposed changes to the Commission-approved ISO Tariffs as well as ISO- related Agreements intended to, inter alia, provide for greater consistency between these documents. In Docket No. ER00-556-000, they sought certain revisions in the ISO OATT and the ISO Services Tariff which they characterized as essential to the commencement of ISO operations. We will address only those issues raised by the parties on rehearing.

The applicants proposed a provision to the ISO OATT that would limit their liability except in circumstances of negligence or willful misconduct. Additionally, they proposed adding language to Section 10.2 of the OATT governing indemnification which provided that the ISO will procure insurance or other alternative risk financing arrangements to cover the risks associated with carrying out its responsibilities under the tariff. The proposed language also provided that any proceeds from such insurance would be used by the ISO before it exercises its right to seek indemnification, and that unless indemnification is required directly from a particular transmission customer, indemnification costs would be recovered under the existing Schedule 1 charge under the ISO Transmission Tariff.

The January 12 Order rejected these proposals. First, the Commission rejected the proposed liability provision because "the pro forma tariff did not and was not intended to address liability issues," and held that the parties "should pursue any legal remedies they may have with respect to liability in the appropriate forum." ¹⁶ Concerning the proposed addition to Section 10.2, the Commission accepted the proposed language regarding insurance, as consistent with or superior to the pro forma tariff, "only to the extent that, as provided by the pro forma tariff, transmission customers are not required to indemnify (in any manner, including through the payment of insurance premiums) the ISO or the Transmission Owner in cases of negligence or intentional wrongdoing." The Commission noted in this regard that "payment by transmission customers of insurance premiums for insurance that covers negligence or intentional wrongdoing" was "effectively the same as transmission customers directly indemnifying against negligence or intentional wrongdoing." ¹⁷

¹⁶ 90 FERC at 61,034 (footnote omitted). The Commission relied on language in Order No. 888 and particularly Order No. 888-B in this regard. See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540, FERC Stats. & Regs. ¶ 31,036 (1996), order on reh'g, Order No. 888-A, 62 Fed. Reg. 12,274 (1997), FERC Stats. & Regs. ¶ 31,048 at 30,301-02 (1997), order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 at 62,080-81(1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

¹⁷ 90 FERC at 61,035 & n.9, citing Rochester Gas and Electric Corp., 78 FERC ¶ 61,262 at 62,122 & nn.10-11 (1997), reh'g denied, 82 FERC ¶ 61,250 (1998) .

Finally, while the Commission permitted the ISO OATT to be amended to allow the addition of indemnification costs to the Schedule 1 charge, it held that before the New York ISO or the Member Systems "may recover any such costs they must file pursuant to section 205 of the [Federal Power Act (FPA)] to do so, with appropriate justification and cost support." ¹⁸

The January 12 Order additionally addressed the applicants' proposed exemption from regulatory penalty for certain classes of generators. ¹⁹ Responding to the concerns of the New York Public Service Commission (New York Commission) that the costs associated with the proposed exemptions could not be accurately ascertained, and of 1st Cooperative Group, Ltd. and Coordinated Housing Services, Inc. (1st Rochdale) that the exemption could result in discriminatory cost shifting and was not adequately supported, the Commission rejected the exemption as "inappropriate at this time" because the applicants had "provided no rationale for exempting any class of participants from regulation charges." ²⁰ However, this rejection was without prejudice to the parties refiling the proposal in a new docket with appropriate justification and cost support.

Finally, as relevant here, the January 12 Order accepted a proposal by the applicants to permit the ISO Board to unilaterally file to revise any ISO tariff or agreement without concurrence of the Management Committee when necessary to address exigent circumstances related to the New York ISO market or the reliability of the transmission grid, which revision would be effective for up to 120 days. The Commission concluded that it was reasonable "for an ISO to have the ability to file a unilateral amendment with the Commission when the ISO believes that immediate action is necessary to protect the integrity of an energy market or the transmission grid." ²¹

Timely requests for rehearing were filed by the New York ISO, the Member Systems, the New York Commission, AES, NY, L.L.C. (AES), PG&E Generating, Selkirk Cogen Partners, L.P. and PG&E Energy Trading-Power, L.P. (PG&E Companies), Sithe/Independence Power Partners, L.P.

¹⁸ 90 FERC at 61,035 (footnote omitted)

¹⁹ The classes of generators are: (1) generators providing power under existing contracts, including contracts under the Public Utility Regulatory Policies Act (PURPA), 16 U.S.C. § 824 a-3 (1994), in which the power purchaser does not have control over the operation of the supply source; (2) certain turbine generators that provide steam within New York City; and (3) existing generators whose electric output is intermittent because it is subject to environmental elements or actions taken by public authorities.

²⁰ 90 FERC at 61,037.

²¹ 90 FERC at 61,034 (footnote omitted). The Commission further noted that it had accepted a substantively similar provision. 90 FERC at 61,034 n.5, citing Pennsylvania-New Jersey-Maryland Interconnection, *et al.*, 81 FERC ¶ 61,257 (1997), *order on reh'g*, 82 FERC ¶ 61,047 (1998).

(Sithe), and 1st Rochdale. On February 11, 2000, the Independent Power Producers of New York, Inc. (IPPNY) filed a motion to intervene out of time in these proceedings, and a request for rehearing. Also, on March 3, 2000, Indeck Energy Services of Corinth, Inc. (Indeck) filed a motion to intervene in these proceedings.²²

The New York ISO, the Member Systems, the New York Commission, Sithe, AES and 1st Rochdale all assert that the Commission erred in denying the New York ISO the ability to recover the cost of insurance from transmission customers. The New York ISO explains that because Section 10.2 of its OATT (following the pro forma tariff) does not provide for indemnification in cases of negligence or intentional wrongdoing either by the New York ISO or the Member Systems, the New York ISO "has no alternative to acquiring liability insurance," and indeed must do so as a matter of "Good Utility Practice."²³ The Commission's decision, the New York ISO states, imposing a requirement

that would deny the [New York] ISO the opportunity to recover the costs of insurance from its customers would effectively deny [it] the ability to purchase insurance

[T]he [New York] ISO has no other sources from which it could pay insurance premiums. It will not be paying dividends to shareholders, nor will it have any retained earnings. It cannot operate under such circumstances. [²⁴]

The New York ISO further observes that the Commission has routinely permitted utilities to recover the costs of insurance as part of their cost of service, and that insurance expenses have thus always been included in Section 4 of Schedule 1 of its OATT.

The New York ISO additionally argues the Commission erred by requiring a section 205 filing with appropriate justification and cost support before it may recover the costs of indemnification. Because it has no alternative to recover such costs except through its OATT, the New York ISO observes that a section 205 filing "would serve no useful purpose, [as] [a]ny denial of recovery by the Commission would require [it] either to sell the very assets it needs to operate or to declare bankruptcy."²⁵

²² On March 20, 2000, the Member Systems filed an answer to Indeck's motion.

²³ New York ISO Request for Rehearing at 4.

²⁴ Id. at 6.

²⁵ Id. at 7. The other parties seeking rehearing on this issue essentially agree with the New York ISO's analysis.

1st Rochdale argues with respect to the January 12 Order's resolution of the indemnity provision issues that the Commission ignored its view that certain provisions of the ISO/Transmission Owners Agreement unfairly shield the New York ISO and the Member Systems from indemnification obligations and place such obligations on the users of the ISO. According to 1st Rochdale, these indemnity provisions render the New York ISO beholden to the transmission owners for the risks of establishment and operation of the ISO, while the owners have "no clear responsibility" to the ISO, "and the Transmission Owner at fault cannot be called upon to provide indemnity." ²⁶

PG&E Companies, Sithe and the Member Systems seek rehearing of the portion of the January 12 Order rejecting the regulatory penalty exemption.²⁷ The Member Systems assert that the regulation charge was crafted to provide an incentive to generators to comply with regulation requirements, but that the classes of generators for which the exemption was proposed "are not capable of accurately following an output schedule and therefore not capable of complying with the [r]egulation requirements." ²⁸ They state that qualifying facilities (QFs) operating under PURPA contracts which do not require QF plants to be designed or built to follow regulation requirements are in this position, as are steam/electric generating units which cannot accurately follow the New York ISO's basepoint signals and still meet their customer demand, and intermittent renewable resource generators whose output is dictated by environmental and regulatory factors beyond their control. Thus, the Member Systems contend that it is reasonable to exempt these classes of generators from the regulation charge, because the regulation charge cannot serve as an incentive to comply with requirements that are beyond the operational capabilities of the generators.

The Member Systems also assert that the New York ISO's proposal merely provided a mechanism to maintain the regulatory status quo in New York, where such regulation service costs have always been borne by load rather than these categories of generators, so that the proposed exemption will not result in cost shifting. Finally, the Member Systems allege that the Commission's decision is contrary to federal policy to encourage such classes of generators. ²⁹

²⁶ 1st Rochdale Request for Rehearing at 7.

²⁷ The New York Commission asserts that its comments on this issue may have been misinterpreted by the Commission. It notes that it "supported the exemptions on an interim basis," but "ask[ed] for a collaborative process" to ascertain the costs at issue and how they should be allocated among market participants. Request for Rehearing of New York Commission at 1 n.2.

²⁸ Member Systems Request for Rehearing at 4 (Docket No. ER00-556-001).

²⁹ PG&E Companies further claim that the Commission's decision on this issue runs counter as well to the policy of the State of New York, designed to foster development of "more efficient and environmentally compatible generators," such as those to whom the exemption would apply. PG&E Companies Request for Rehearing at 6-7.

PG&E Companies and Sithe additionally argue that the January 12 Order's rejection of the exemption of these generator categories from regulation charges is inconsistent with the Commission's policy of not permitting generic abrogation of existing contracts, in that removal of the exemption would result in such generators paying a charge for service under the ISO OATT even though the service is covered under their existing transmission agreements.³⁰

1st Rochdale also seeks rehearing of the January 12 Order on the ground that it failed to address what it terms "the fundamental question" of the New York ISO's independence, in light of the proposed tariff amendment being made as a joint filing by the New York ISO and the Member Systems, which presents "at least the appearance of control of the decisionmaking process by one class of participants, *i.e.*, the Transmission Owners."³¹ 1st Rochdale alleges that the Commission's acceptance of this joint filing is inconsistent with both precedent governing filings by Independent System Operators as well as principles espoused by the Commission in the course of promulgating Order No. 2000.³²

Finally, Sithe maintains that the January 12 Order erred in accepting the New York ISO's proposal permitting its board to file unilateral amendments which may be effective up to 120 days from the filing date if the board certifies that exigent circumstances exist with regard to matters of reliability or market integrity. According to Sithe, such tariff amendments, which do not have Management Committee approval, should expire no later than 60 days after their effective date, and be limited to addressing an exigent circumstance related to reliability.

Discussion

We will deny the late motions to intervene of IPPNY and Indeck. As the Commission recently stated: "[O]ur regulations require prospective parties to intervene in a timely manner or to demonstrate

³⁰ On March 3, 2000, the New York ISO filed in Docket No. ER00-556-000 a so-called "status report" and request for deferral of action by the Commission on the regulation charge exemption issue. The New York ISO states that proposed exemption was based "at least in part, on assumptions that schedules would be provided to the [New York] ISO that would fairly accurately predict the actual operation of such generating units," which has not occurred. New York ISO March 3 Letter at 1. The New York ISO further states that it has discussed these issues with affected parties and will continue to do so "to achieve a consensus." *Id.* at 2.

³¹ 1st Rochdale Request for Rehearing at 3.

³² *Id.* at 3-4, citing Pacific Gas & Electric Co., 77 FERC ¶ 61,204 at 61,816 (1996); Regional Transmission Organizations, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,541 at 33,718 (1999).

good cause for intervening out of time." ³³ Neither IPPNY or Indeck attempt to explain why they are filing at this late stage of the proceedings, after the issuance of the January 12 Order, and they both raise issues that were raised by other parties and have been fully addressed by the Commission. We therefore find no good cause for their late interventions and deny the motions. It follows that, because IPPNY and Indeck are not parties to these proceedings, they cannot request rehearing of the January 12 Order. ³⁴

The Commission will grant rehearing on the January 12 Order's determination that the New York ISO not be permitted to recover the cost of liability insurance from its transmission customers. We agree that such insurance is a cost of doing business, and, as we have recognized in the past, a recoverable cost of service. ³⁵ We also find, upon fuller consideration, that payment for insurance premiums is not the same as directly indemnifying the actual costs of negligence or wrongdoing, which is the reason, as just noted, that payment of insurance premiums has been a permissible cost of doing business recoverable in rates. Accordingly, we grant rehearing, and we will allow the New York ISO to recover the cost of liability insurance in its rates. It follows that we grant rehearing on our decision that a section 205 filing is required to recover the costs of liability insurance in rates; such costs are recoverable through Schedule 1 of the New York ISO OATT.

In all other respects, however, we reaffirm the January 12 Order on the issues of indemnification and liability. ³⁶ Furthermore, we reject 1st Rochdale's argument that the contested language governing the relationship between the ISO and the transmission owners in the ISO/Transmission Owners Agreement is unfair. Nothing in this language is inconsistent with the provisions governing indemnification contained in the pro forma tariff.

³³ New York State Electric & Gas Corporation, et al., 87 FERC ¶ 61,342 at 62,323 (1999).

³⁴ E.g., PJM Interconnection, L.L.C., 88 FERC ¶ 61,039 at 61,091 & n.11 (1999). In view of our disposition of Indeck's motion, we dismiss the Member Systems' answer to the motion as moot.

³⁵ See, e.g., Alabama Tennessee Natural Gas Company, 48 FPC 774, 780 (1972).

³⁶ In arguing that the January 12 Order erred in rejecting the proposed liability clause, the Member Systems cite Pacific Gas & Electric Co., et al., 81 FERC ¶ 61,122 at 61,519-20 (1997), order on reh'g, 82 FERC ¶ 61,223 (1998) (PG&E), in which the Commission permitted such a liability limitation provision. However, to the extent the cited decision authorized such a provision, it is inconsistent with the other precedent cited on this issue by the January 12 Order, see 90 FERC at 61,034 n.7. Also, the Commission is considering the issue on rehearing in that proceeding, see, e.g., Initial Brief of the California Independent System Operator Corporation, Docket No. ER98-3760-000, et al., at 13-25. We therefore decline to follow PG&E on this issue.

Concerning the regulation charge exemption, we observe that, in their initial filing, the New York ISO and the Member Systems provided no rationale and that we rejected it on this basis. Additionally, we advised the parties that they could refile their proposal in a separate docket with appropriate justification and cost support. Instead, they have chosen to renew their proposal in this proceeding with new justification. The Commission has often held that it looks with disfavor on new justifications advanced on rehearing.³⁷ We therefore deny the requests for rehearing on this issue.³⁸

We deny 1st Rochdale's request for rehearing that the January 12 Order failed to address the alleged unfairness of the New York ISO and the Member Systems jointly filing the tariff revisions at issue. As the New York ISO and the Member Systems have previously explained, the joint filing was the product of their negotiations to resolve issues necessary to allow the start-up of ISO operations.³⁹ Under these circumstances, we do not believe that the joint filing by the parties is vulnerable to 1st Rochdale's rather vague charge of "unfairness," or contradicts our views expressed in any other proceedings.

Finally, the Commission rejects Sithe's objection to our permitting unilateral amendments by the New York ISO Board on reliability or market integrity matters to be effective for 120 days (rather than Sithe's proposed 60 days) as conclusory and unsupported. We therefore reject Sithe's request for rehearing on this issue.

The Commission orders:

(A) The motions to intervene of IPPNY and Indeck are hereby denied.

(B) The requests for rehearing of the New York ISO, the Member Systems, the New York Commission, AES, Sithe and 1st Rochdale are hereby granted on the issue of liability insurance, as explained in the body of this opinion.

(C) In all other respects, the requests for rehearing of all parties are hereby denied.

³⁷ E.g., Northern States Power Company (Minnesota), et al., 64 FERC ¶ 61,172 at 62,522 (1993) (citations omitted); Public Service Company of Colorado, 62 FERC ¶ 61,013 at 61,059-60 (1993).

³⁸ We are constrained to reject the New York ISO's request that we defer a decision on this issue, because the parties who requested rehearing on this issue (the New York ISO did not) have not sought any such delay.

³⁹ See Response of the Member Systems and the New York ISO at 3-4 (Docket No. ER00-550-000 December 15, 1999).

By the Commission.

(S E A L)

Linwood A. Watson, Jr.,
Acting Secretary.

EXHIBIT “E”

New Section

No Bulk-power System User, Regional Transmission Organization or Transmission Utility shall be liable for any loss or damages sustained to wholesale or retail customers, to the customers of another Transmission Utility or Bulk-power System User, to each other, or to third parties with the event of an interruption of electrical supply or service. Bulk-power System Users, Regional Transmission Organizations or Transmission Utilities' liability is limited to the amount of any fine or penalty as may be imposed by an Electric Reliability Organization under this act for violation of an Electric Reliability Organization Standard.