

**PERSPECTIVES ON RTO WEST
TRANSCONNECT: WILL THE MARRIAGE
HOLD?**

PRESENTED TO:

SEVENTH ANNUAL CONFERENCE ON BUYING AND SELLING POWER IN
THE WEST
JANUARY 17-18, 2002
SEATTLE, WASHINGTON

BY
GARY A. DAHLKE

PAINE, HAMBLEN, COFFIN, BROOKE & MILLER LLP
717 WEST SPRAGUE, SUITE 1200
SPOKANE, WASHINGTON 99201
gdahlke@paineamblen.com

TABLE OF CONTENTS

I. Six Major Obstacles to Success

- A. Liability – Blackouts
- B. Credit – Default Imbalance Supplier
- C. Planning – Control and Jurisdiction
- D. Costs – Benefits – Rewards
- E. Real-Time Markets and Price Mitigation
- F. Must Run, Must RAS, Must Buy, Must Shed

II. Comments on TransConnect’s Filing

- A. Comments by Intervenors
- B. TransConnect’s Response

III. Recent Developments

- A. FERC Staff Vision and RTO Market Design NOPR
- B. Alliance Order

I. Six Major Obstacles to Success

There are six major obstacles to development of a Regional Transmission Organization (“RTO”) in the RTO West geographic area that must be removed before the promise of blending the investor-owned transmission systems and the publicly-owned transmission systems can be achieved successfully.

A. Liability

The RTO West proposal for a limitation on outage liability to be included in the RTO West tariff was rejected by the Federal Energy Regulatory Commission (“FERC”) on rehearing in an Order issued on July 12, 2001.¹ Thus, the issue remains unresolved for transmission owners being asked to divest control of their transmission assets to a non-profit RTO. The need for legislative or tariff protection, before implementation of the RTO, is detailed in the attached position summary prepared for Avista Corporation (Appendix). This issue, perhaps more than other RTO design issues, is a “lawyers” issue and it has not been at the forefront the debate among economists about the proper method of restructuring the industry to achieve a seamless, competitive market. The point that is being missed and, which some lawyers are now attempting to point out, is that shifting the tariff and contract relationships away from the vertically integrated utility model actually changes the risk of liability from outage events.

The key elements of change are:

1. Service is being moved from state tariffs where liability limitation is common, to FERC tariffs where liability limitations have been rejected.²
2. In acting as an umbrella organization for both publicly-owned entities and investor-owned transmission owners where some entities enjoy sovereign immunity and Federal Tort Claims Act protections and others do not, an RTO imposes the risk of joint liability on an inequitable basis.
3. The industry is moving towards mandatory reliability standards, either legislatively or through the Western Electricity Coordinating Council (“WECC”), which increases the risk that under state law a legal duty is being created for the benefit of third parties, whereas most prior cases in the vertically integrated model held that utility systems did not owe any duty to the customers of other utility systems.
4. Class action certifications have recently occurred in outage liability lawsuits and, although others have been denied, the risk of class action certification and the possibility of large damage awards in a post-RTO environment remains.

¹ *Avista Corporation, et al.*, 96 FERC ¶ 61,058, at pp. 61,181-182 (2001).

² Since Order 888, FERC has consistently rejected attempts to limit liability as part of an open access tariff, but has allowed parties to contractually limit liability on a bilateral basis. *Compare Avista Corporation, et al.*, 96 FERC ¶ 61,058, at pp. 61,181-182 (2001) (rejecting a proposed liability limitation provision in an open access tariff) *with Pennsylvania-New Jersey-Maryland Interconnection, et al.*, 92 FERC ¶ 61,282, at pp. 61,959-960 (2000) (accepting a provision in PJM Interconnection’s Operating Agreement that limited liability to claims of gross negligence) and *Central Hudson Gas & Electric Corp., et al.*, 88 FERC ¶ 61,138, at pp. 61,384 (1999) (accepting a gross negligence standard in the New York ISO’s Services Tariff).

5. The very essence of the RTO is that the transmission owner gives complete control of its transmission assets to the RTO. Thus, the assets are put at liability risk even though the transmission owner does not control the actions that would mitigate that risk.

The outage liability risks are significant enough that, absent liability protection, there is a likelihood that at least some of the transmission owners will not voluntarily move ahead with RTO West or TransConnect until the necessary protections are put in place.

B. Credit Default and Imbalance Energy

Another difficult issue for RTO formation is the question of how to handle the default of a large energy supplier in the market. Under the requirements of Order 2000, the RTO must serve as the supplier of last resort for ancillary services.³ One of the ancillary services that the RTO will provide, where it operates a single control area as contemplated by RTO West, is the balancing of loads and resources on an instantaneous basis (imbalance energy). This obligation means that if an energy supplier in the market within the geographic area of RTO West were to default, and no other stand in default supplier immediately picks up the supply responsibility, the RTO itself will either have to enter the market to purchase balancing power, or it will have to obtain the reduction of load equivalent to the default. As is demonstrated in the table below, the cost of supplying imbalance energy can, under adverse market conditions, rapidly escalate.⁴

MW of Load Served By Imbalance Energy (IE)	IE Price	\$ Exposure for 1 Hour	\$ Exposure for 12 Days	\$ Exposure for 60 days
5	\$50	\$250	\$72,000	\$360,000
5	\$300	\$1,500	\$432,000	\$2,160,000
5	\$750	\$3,750		
25	\$50	\$1,250	\$360,000	\$1,800,000
25	\$300	\$7,500	\$2,160,000	\$10,800,000
25	\$750	\$18,750		
100	\$50	\$5,000	\$1,440,000	\$7,200,000
100	\$300	\$30,000	\$8,640,000	\$43,200,000
100	\$750	\$75,000		
500	\$50	\$25,000	\$7,200,000	\$36,000,000
500	\$300	\$150,000	\$43,200,000	\$216,000,000
500	\$750	\$375,000		
1000	\$50	\$50,000	\$14,400,000	\$72,000,000
1000	\$300	\$300,000	\$86,400,000	\$432,000,000
1000	\$750	\$750,000		
2000	\$50	\$100,000	\$28,800,000	\$144,000,000
2000	\$300	\$600,000	\$172,800,000	\$864,000,000
2000	\$750	\$1,500,000		

³ *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089, at p. 31,140 (1999) (“Order No. 2000”), *order on reh’g*, Order 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs. ¶ 31,092 (2000) (Order No. 2000-A), *aff’d*, *Public Util. Dist. No. 1 of Snohomish County, Washington v. FERC*, Nos. 00-1174, *et al.* (D.C. Cir. Dec. 11, 2001).

⁴ The information in the table is from a paper entitled “Revised Discussion Draft RTO West Credit Issues Overview,” presented to the RTO West Liability and Risk Management Work Group on September 14, 2001. The full text of the paper may be accessed on the RTO West website at (<<http://www.rtowest.org/>>).

We sometimes refer to this situation as the “California” problem because the default by investor-owned utilities within the California market resulted in the California ISO having to purchase balancing power to maintain reliability either directly or through another state agency, the California Department of Water Resources (“CDWR”). This is not to suggest, however, that this is exclusively a California issue. Late last year, when Enron declared bankruptcy, a similar result occurred in another deregulated state, Montana. The Montana Power Company, as transmission owner and control area operator, had to enter the market to purchase balancing power and power supplies for industries that had been supplied by Enron in order to maintain reliability and balance loads and resources.

Currently, there is no overarching requirement of federal law that would prescribe how back up supply must be handled. Thus, as the situation now stands, the RTO could find itself with any number of different state forms of regulation or deregulation including both the traditional obligation to serve vertically integrated model (such as the case in Washington and Idaho), and various other forms of deregulation such as those adopted in Montana and Oregon or some other model not yet proposed. One major issue for the RTO and state regulators will be to find a way to prevent imbalance energy costs incurred due to a default by a supplier in a high priced market like that Western market of 2000-2001 from spreading outside the bounds of that state and becoming a socialized cost of all states through RTO rates. Vertically integrated, non-deregulated states would then be exposed to paying twice, once for the cost of surplus resources under their least cost obligation to serve acquisitions, and a second time to pay a share of the default of a supplier in a deregulated state.

There are various proposals pending that attempt to address this issue. The California ISO has proposed an excess capacity requirement for all market participants as a means of mitigating risk during periods of price spikes due to relative shortages of supply.⁵ The RTO West content group working on the credit issue identified the possibility of a state agency being the default back up supplier as a means of containing the costs within the deregulated state. This proposal is in conjunction with a number of other mitigation measures.

C. Planning and State Jurisdiction

FERC’s initiative to restructure the industry was predicated on the position that states would retain jurisdiction over transmission used for bundled service in states that did not deregulate and unbundle the transmission, generation and distribution functions. Some (such as Enron) argued that FERC should have claimed jurisdiction over bundled and unbundled service. However, in the briefs filed with the U.S. Supreme Court on this issue, FERC has clearly conceded jurisdiction over bundled service to the states as a legal matter.⁶

⁵ *Electricity Market Design and Structure*, FERC Docket No. RM01-12-000, Comments of the California Independent System Operator Corporation on the Commission’s RTO Workshop at p.7 (filed Nov. 9, 2001).

⁶ Brief for the Federal Energy Regulatory Commission at 22-23, *State of New York, et al. v. Federal Energy Regulatory Comm’n, et al.*, (U.S. Supreme Court Nos. 00-568 and 00-809) (filed May 2000).

Nevertheless, as a matter of policy and rulemaking, FERC has acted more recently in a manner that suggests it is rethinking this position. The Commission issued a Notice of Proposed Rulemaking (“NOPR”) on September 27, 2001⁷ regarding Standards of Conduct in which it seeks to require the separation of transmission personnel from distribution services. Many states, such as Washington and Idaho protested that this was in conflict with the authority of the states over bundled transmission service.⁸

This issue has particular application to planning. In states that retain bundled service, the planning of delivery services, including both transmission and distribution is a single function that is not separated into state and federal segments. States retain acts and practices jurisdiction over this planning function, in addition to specific siting authority. In order for an RTO to develop and provide a planning function that enables deregulated states to purchase from a seamless competitive market, it will be necessary for some accommodation to be made regarding the jurisdiction of the planning function for bundled service as well as unbundled service.

The Washington Utilities and Transportation Commission has proposed an interstate compact for this purpose. Until some solution is developed which will allow for the simultaneous planning of transmission for both bundled and unbundled service, the investor-owned utilities that are under both state jurisdiction and federal jurisdiction will have difficulty working out a planning function in the RTO that includes all of the elements necessary to arrive at an efficient model and which is acceptable to both state and federal regulators.

D. Costs-Benefits-Rewards

There is every expectation that state regulators for the investor-owned utilities will require a demonstration that the RTO will provide benefits for consumers. RTO West has a cost benefit study underway as a part of the development process, and individual investor-owned utilities are expected to prepare their own demonstration of the benefits of an RTO in connection with state filings for approval to transfer control of their transmission systems. In addition, there is the related issue of whether there are incentive rates available at the federal level for transfers of control that achieve complete independence or complete unbundling. TransConnect has a filing pending that seeks to obtain FERC approval of incentive rates. (See p.7, *infra*.)

E. Real Time Markets and Price Mitigation

The operation of balancing markets and control of price mitigation measures (does this mean price caps?) were not originally a significant part of Order 2000. However, the litigation in California over price caps seems to have caused FERC to conclude that runaway markets can be prevented by a system of imposing price mitigation upon the balancing market. The theory would be that if a potential seller cannot obtain high sales prices in the real time market by

⁷ *Notice of Proposed Rulemaking - Standards of Conduct for Transmission Providers*, Docket No. RM01-10-000, 66 Fed. Reg. 50,919 (Oct. 5, 2001).

⁸ *Standards of Conduct for Transmission Providers*, Comments of the Washington Utilities and Transportation Commission Opposing Separation of Transmission Functions from Bundled Retail Sale of Electricity, (filed Nov. 19, 2001); Comments of the Idaho Public Utilities Commission Opposing Separation of Transmission Functions from Bundled Retail Sale of Electricity, (filed Dec. 20, 2001).

withholding its supply, it will elect to sell into the forward market and thereby lower prices. As noted by FERC:

Applying mitigation to spot market transactions will also result in mitigation of generation market power in longer term (forward) markets by creating a kind of competitive “standard offer” service for customers. If sellers attempt to charge excessive, non-competitive prices in forward markets, customers can avoid them by waiting to purchase in the real-time market. This puts market pressure on sellers to offer competitive prices in the forward markets. And when sellers offer competitive forward prices, many buyers will prefer to purchase in the forward markets in order to gain price certainty.⁹

FERC has issued another new policy initiative in which it is seeking comment upon its intent to adopt a new market rate test for parties seeking or renewing market rate authority. One of the stated exceptions to this test, however, is the instance where sales are being made into an RTO that runs a balancing market with appropriate FERC approved price mitigation. In the *AEP Power* Order, FERC describes the exception as follows:

All sales, including bilateral sales, into an ISO or RTO with Commission-approved market monitoring and mitigation will be exempt from the [market rate screen] and, instead, will be governed by the specific thresholds and mitigation provisions approved for the particular markets.¹⁰

Thus, if RTO West elected to proceed without adopting a model under which it would provide a balancing market and FERC-approved price mitigation measures, the participants within the RTO West market would be subject to the new market rate pricing screen. The only balancing market experience that we have in the West with price mitigation is the California ISO market, and the experience there, for many, has been less than satisfactory judging from the amount of litigation that has ensued both at FERC and in the courts. The challenge for RTO West will be to design something that will work better. Indeed, California has recently announced that it will engage in a redesign process for the California ISO.¹¹

F. Must Run, Must RAS, Must Buy, Must Shed

One of the issues that was not addressed in Stage 1 for RTO West and, which will become more important as we move towards conclusion of the filing, is the question of what conditions the RTO may place upon the operation of the distribution function and the generation function of the transferring transmission owners in order to meet its obligations and maintain

⁹ *AEP Power Marketing, Inc., et al.*, Docket No. ER96-2495-015, Order on Triennial Market Power Updates and Announcing New, Interim Generation Market Power Screen and Mitigation Policy, at p. 12 (Nov. 20,2001).

¹⁰ *Id.* at 8.

¹¹ See *Preliminary Report on Project Approach and Key Market Design Elements Under Consideration* (December 21, 2001), which can be found on the California Independent System Operator web page at (<<http://www.caiso.com/docs/2001/12/21/2001122108490719681.html>>).

system reliability. These conditions may arise either in conjunction with congestion management where pre-existing contracts are not converted and a “package” of rights has to be given to the RTO in order to perform those contracts, or in connection with overall reliability requirements.

On September 7, 2001, Duke Energy filed a complaint with FERC¹² alleging that the California ISO arbitrarily ordered units with long start-up times to comply with the must offer condition of the Commission’s April 26 Order, notwithstanding that the units had previously been granted waivers or exemptions. The complaint asserts that the California ISO was attempting to convert the must offer obligation into a must run obligation. At issue was the ISO’s July 10 compliance filing containing proposed tariff revisions required by the Commission’s June 19 Order setting forth the formula for price mitigation in the Western Markets.

On December 19, 2001, FERC issued an Order that responds to Duke’s complaint.¹³ In this Order, the Commission rejects the ISO’s proposal to retain discretion over the declaration of a Stage 1 emergency. Further, the Commission endorsed an exemption process for some generation to be free of the must offer obligation, but required that the exemption procedures be specified in the tariff, and be transparent and non-discriminatory.

This dispute was one of a number of disputes that occurred last year concerning must offer or must run conditions in the California market. If it is possible for the ISO, or an RTO, to impose must offer, must run or similar conditions in its tariff (rather than in a bilaterally negotiated Generation Interconnection Agreement or Load Integration Agreement), subject only to obtaining FERC’s approval, then the generation function and distribution function of a transmission owner transferring control of transmission to RTO West has only one opportunity to pin down the conditions which limit the operation of its generation or distribution, and that is in the Transmission Owners Agreement that it signs to make the transfer. Otherwise, the transferring owner will be subject only to the tariff and will be limited to a comment and protest process.

As an example, on December 5, 2001, the Midwest Independent Transmission System Operator filed with FERC its “operating protocols” for existing generators.¹⁴ The Midwest ISO seeks FERC’s confirmation that, as a proposed RTO, it has the “authority to implement the operating protocols.” The protocols are stated to be at its “stakeholder’s request,” in lieu of renegotiation of the numerous operating agreements presently held by existing generators. The filing states that “no formal operating agreement will be negotiated with already existing Generators.”

¹² Docket Nos. EL00-95-040 and EL00-98-038.

¹³ *San Diego Gas & Elec. Co.*, 97 FERC ¶ 61,293, slip. Op. at 9 (Dec. 19, 2001)

¹⁴ Docket No. ER02-488-000.

II. Comments on TransConnect's Filing

A. Comments by Intervenors

On November 13, 2001, TransConnect, LLC filed with FERC an Application for preliminary approval of transmission rates, including innovative transmission rate treatment, planning and expansion protocol, preliminary compliance filing and a modified governance proposal.¹⁵ In response to TransConnect's filing, numerous intervenors filed comments. These comments are briefly summarized as follows:

1. **Commentor:** Public Utility Commission of Oregon
Oregon Office of Energy
Public Power Council
PNGC Group
Bonneville Power Administration
PacifiCorp
Northwest IPPs/Marketers Group
Duke Energy North America, LLC and Duke Energy Trading and Marketing, LLC
TransAlta Corp.
Electric Power Supply Association
Public Utilities Commission of Nevada
Edison Mission Energy; Edison Mission Marketing and Trading, Inc.
PPL Montana, LLC
PPL Energy Plus, LLC
Cogeneration Coalition of Washington
Nevada Independent Energy Coalition
Northwest Requirements Utilities
Northwest IPPs/Marketers Group
Electric Power Supply Association

Brief Description of Comments/Protests: Requested an extension of time to submit comments regarding the TransConnect filing; requests that planning protocol be held in abeyance or in the alternative, substantially revised; and that any decision on the TransConnect filing should be deferred until FERC acts on RTO West and determines which RTO functions can properly be performed by a for-profit entity until after the RTO West filing that is scheduled for March 1, 2002.

2. **Commentor:** Idaho Public Utilities Commission

Brief Description of Comments/Protests: States that it is premature to examine the ultimate question whether authorizing the transfer of ownership or control of utility assets to an RTO is consistent with public policy.

¹⁵ *Avista Corp., et al.*, FERC Docket No. RT01-15 (filed Oct. 16, 2000).

3. **Commentor:** Transmission Agency of Northern CA
Cities of Redding and Santa Clara, CA & the M-S-R Power Agency

Brief Description of Comments/Protests: Requests withholding of final approval until all interested parties have sufficient opportunity to comment on and, if appropriate, protest the proposal once it is flushed out and filed in final form.

4. **Commentor:** Industrial Customers of Northwest Utilities
Truckee Donner Public Utility District
Utah Associated Municipal Power Systems
Deseret Generation & Transmission Cooperative
Bonneville Power Administration

Brief Description of Comments/Protests: Protest proposed cost/benefit analysis was overstating purported benefits and understating costs; or that TransConnect should not be able to determine which studies and analyses will be provided to the RTO for review.

5. **Commentor:** Public Utility Commission of Oregon
Oregon Office of Energy
Industrial Customers of Northwest Utilities
Truckee Donner Public Utility District
Cogeneration Coalition of Washington
Nevada Independent Energy Coalition
Utah Associated Municipal Power Systems
Deseret Generation & Transmission Co-Op
Affiliated Tribes of Northwest Indians

Brief Description of Comments/Protests: A high proposed rate of return on equity of 14.5% needs to be reviewed.

6. **Commentor:** Public Utility Commission of Oregon
Oregon Office of Energy

Brief Description of Comments/Protests: Whether the rate proposal would eliminate volumetric rate “pancaking” needs to be reviewed.

7. **Commentor:** Public Utility Commission of Oregon
Oregon Office of Energy
Industrial Customers of Northwest Utilities
Truckee Donner Public Utility District
Utah Associated Municipal Power Systems
Deseret Generation & Transmission Co-Op
PNGC Group
Affiliated Tribes of Northwest Indians
Public Utilities Commission of Nevada
Pacific Northwest Generating Cooperative

Brief Description of Comments/Protests: Implied accounting treatment and incentive mechanisms need to be reviewed; Protest performance based ratemaking proposal.

8. **Commentor:** Utah Associated Municipal Power Systems
Deseret Generation & Transmission Cooperative

Brief Description of Comments/Protests: The adjustable rate cap is not an appropriate incentive to cut costs and the cap cannot be justified as an incentive to form TransConnect

9. **Commentor:** Puget Sound Energy
PacifiCorp
Mirant Companies
Utah Associated Municipal Power Systems
Affiliated Tribes of Northwest Indians
PacifiCorp

Brief Description of Comments/Protests: RTO West pricing proposal should control the methodology for establishing Company Rates and for allocating RTO costs and revenues, or in the alternative, set the rate proposals for a full evidentiary hearing.

10. **Commentor:** Mirant Companies
Bonneville Power Administration
Northwest IPPs/Marketers Group

Brief Description of Comments/Protests: The November 13 filing does not provide for a meaningful least cost planning process.

11. **Commentor:** Puget Sound Energy
PacifiCorp
Industrial Customers of Northwest Utilities
Utah Associated Municipal Power Systems
Deseret Generation & Transmission Cooperative
PNGC Group
Bonneville Power Administration
Pacific Northwest Generating Cooperative

Brief Description of Comments/Protests: RTO West should retain the same authority over TransConnect's expansion projects as it retains over expansion projects of other participating TOs within RTO West; no limits on RTO West's ultimate planning authority.

12. **Commentor:** Duke Energy North America, LLC
Truckee Donner Public Utility District

Brief Description of Comments/Protests: Planning protocol improperly limits the RTOs' authority over interconnection and transmission service requests.

13. **Commentor:** Puget Sound Energy
PacifiCorp

Brief Description of Comments/Protests: FERC should consider RTO West's proposal on how it intends to share responsibilities with its participating TOs with regard to interconnections before ruling on TransConnect's proposal.

14. **Commentor:** Puget Sound Energy
PacifiCorp
Northwest IPPs/Marketers Group
Northwest Energy Coalition
Renewable Northwest Project
Natural Resources Defense Council
Project for Sustainable FERC Energy Policy
American Wind Energy Association
Wyoming Industrial Energy Consumers

Brief Description of Comments/Protests: FERC should review the relationship between RTO West's and TransConnect's planning protocols together after RTO West makes its Stage 2 filing.

15. **Commentor:** Duke Energy North America, LLC
Cogeneration Coalition of Washington
Nevada Independent Energy Coalition

Brief Description of Comments/Protests: TransConnect planning and expansion protocol is still deficient in that it will not objectively consider non-wires solutions and load serving entities retain too much control over local planning.

16. **Commentor:** Truckee Donner Public Utility District

Brief Description of Comments/Protests: Requests rejection of proposed planning protocol because FERC lacks sufficient context to approve it.

17. **Commentor:** Public Power Council
Industrial Customers of Northwest Utilities
Truckee Donner Public Utility District
Affiliated Tribes of Northwest Indians

Brief Description of Comments/Protests: Requests rejection of rate proposal as either premature or unjustified.

18. **Commentor:** Mirant Companies
Northwest Requirements Utilities

Brief Description of Comments/Protests: Because FERC's tests for independence do not mandate that an ITC be completely independent of market participants, an ITC should not be permitted to perform certain market-related functions, including transmission planning and expansion.

19. **Commentor:** Public Power Council
Utah Associated Municipal Power Systems
PNGC Group
Bonneville Power Administration

Brief Description of Comments/Protests: Protests that no collaborative public process was initiated in the development of the TransConnect proposals.

20. **Commentor:** Truckee Donner Public Utility District
Utah Associated Municipal Power Systems
Deseret Generation & Transmission Cooperative
PNGC Group
Bonneville Power Administration
Pacific Northwest Generating Cooperative

Brief Description of Comments/Protests: Protests that TransConnect is not truly independent of market participants.

21. **Commentor:** Truckee Donner Public Utility District

Brief Description of Comments/Protests: Proposed membership option would convert TransConnect from a true Transco to a middleman ISO

22. **Commentor:** Utah Associated Municipal Power Systems
Deseret Generation & Transmission Cooperative
Bonneville Power Administration
Affiliated Tribes of Northwest Indians
Northwest IPPs/Marketers Group

Brief Description of Comments/Protests: Proposal would preempt resolution of facilities inclusion issues.

23. **Commentor:** American Forest & Paper Association

Brief Description of Comments/Protests: Questions proper level of RTO operational authority over cogeneration and customer-owned generation facilities.

24. **Commentor:** PNGC Group

Brief Description of Comments/Protests: TransConnect's relationship to existing native load and existing contract obligations is unclear.

25. **Commentor:** Bonneville Power Administration

Brief Description of Comments/Protests: No need for TransConnect to limit the disclosure of confidential data to the RTO as part of the coordinated planning process.

B. TransConnect's Response

TransConnect LLC is in the process of preparing a reply to these comments which is expected to be filed prior to the date of the conference.

III. Recent Developments

A. FERC Staff Vision and Market Design NOPR

On September 28, 2001 FERC initiated a rulemaking proceeding concerning market design.¹⁶ On November 20, 2001, a Notice Inviting Comments on Wholesale Market Activities¹⁷ was issued in which the Commission invites specific comments on a number of market design issues and states as follows:

Parties have proposed the development of a separate organization to perform some wholesale market activities, some of which were specified as RTO functions under Order No. 2000, and some of which have been raised as additional activities to enable vibrant and efficient wholesale markets. These wholesale market activities include: (1) congestion management; (2) ancillary services; (3) administration of a balancing market; (4) OASIS administration, including total transmission capacity and available transmission capacity calculations; (5) security coordination; (6) market monitoring; (7) regional transmission facility planning; and (8) tariff administration and design. (Emphasis added.)¹⁸

As noted here, the Commission may expand the functions that were delineated in Order 2000 to include a market balancing and price mitigation function, and may further consider a different allocation of the functions of Order 2000 to other entities, and not be limited to the RTO itself.

In conjunction with the rulemaking, FERC Commission Staff presented a discussion paper setting forth its vision of the market and the rulemaking.¹⁹ The Staff paper clearly contemplates that real time and day ahead markets will be independently operated and controlled.

The Commission further appears to intend that price mitigation or price caps will be a component of the independently controlled market. In *AEP Power Marketing, Inc., et al.*,²⁰ the Commission announced a New Interim Generation Market Power Screen and Mitigation Policy

¹⁶ *Electricity Market Design and Structure*, Docket No. RM01-12-000, Notice of Workshops (Sept. 28, 2001).

¹⁷ *Electricity Market Design and Structure*, Docket No. RM01-12-000, Notice Inviting Comments on Wholesale Market Activities (Nov. 20, 2001).

¹⁸ *Id.* at 1. In Order No. 2000, FERC listed eight “minimum functions of an RTO” that is very similar to the cited list. The main difference is that “parallel path flow” has been deleted and replaced by “administration of a balancing market.” The Commission did address operation of a balancing market in Order No. 2000, but discussed balancing markets under the ancillary services function and not as a separately listed RTO function.

¹⁹ Concept Discussion Paper for an Electric Industry Transmission and Market Rule, (Dec. 17, 2001).

²⁰ *AEP Power Marketing, Inc., et al.*, Docket No. ER96-2495-015, Order on Triennial Market Power Updates and Announcing New, Interim Generation Market Power Screen and Mitigation Policy, at p. 12 (Nov. 20, 2001).

to take the place of the hub and spoke market power test heretofore used to determine market power for purposes of granting market rate authority. Regarding RTOs, the *AEP Power* Order states:

All sales, including bilateral sales, into an ISO or RTO with Commission-approved market monitoring and mitigation will be exempt from the [market rate screen] and, instead, will be governed by the specific thresholds and mitigation provisions approved for the particular markets.²¹

On December 20, 2001, FERC entered a Notice delaying the effective date of the new Interim Generation Market Power Screen until a technical conference can be scheduled.²² There are a number of questions concerning whether the proposed methodology can be used in the Northwest, and comments regarding this methodology recently were filed by Puget Sound Energy, Avista Corporation and Avista Energy, Inc. in Petitions to Intervene and Requests for Rehearing in the *AEP Power Marketing* docket.

In any case, for purposes of RTO consideration, the required functions have been expanded beyond Order 2000 functions to include: running a balancing market and implementing price mitigation or price thresholds as a part of the market monitoring process.

B. Alliance Order

Included among a flurry of orders issued on December 20, 2001, the Commission abruptly changed direction and ordered the Alliance RTO to join the Midwest ISO.²³ Since the issuance of Order 2000 on January 6, 2000, the electric industry in the Midwestern United States had proceeded with the formation of an RTO with both the Midwest ISO and Alliance RTO. The Commission, in numerous orders, had addressed the Alliance RTO and found that it met most of the requirements of Order 2000 and, among other things, ordered Alliance to work with the Midwest ISO to develop a seamless market in the region. As noted by Commissioner Breathitt in her dissent, Alliance proceeded in good faith to meet the requirements of Order 2000 and spent over \$75 million in the process. Despite seemingly approving the formation of multiple RTOs in a region in its December 20, 2001 Order, the Commission abruptly changed direction, rejected the Alliance RTO as an RTO and directed Alliance “to explore membership” in the Midwest ISO.

In reaching its conclusion, the Commission found that the Alliance RTO lacked “sufficient scope” to be a stand alone RTO. Among the factors the Commission considered was: lack of progress on the implementation of the Inter-RTO Cooperation Agreement between Alliance RTO and the Midwest ISO, failure to resolve seams issues such as standardized ATC calculations, energy imbalance markets and procedures to implement one-stop shopping. The

²¹ *Id.* at 8.

²² *AEP Power Marketing, Inc., et al.*, Notice Delaying Effective Date of Mitigation and Announcing Technical Conference, FERC Docket No. ER96-2495-016, et al. (Dec. 20, 2001)

²³ *Alliance Companies, et al.*, 97 FERC ¶ 61,237, Order on Requests for Rehearing (December 20, 2001).

Commission also noted the recent withdrawal of International Transmission from the Alliance RTO. Additionally, the Commission noted that a majority of the state commissions supported the notion of a single RTO in the Midwest and that the surviving RTO should be the Midwest RTO. While the Commission rejected the Alliance RTO as a stand-alone RTO, it did direct Alliance to explore how it could operate as a Transco under the Midwest ISO.

I:\energy\00005178.doc v.4

APPENDIX

The Need for Outage Liability Protection

December 28, 2001

Avista Corporation (formerly The Washington Water Power Company) is a comparatively small, vertically integrated investor-owned electric utility serving customers over a large geographic area in Eastern Washington and Northern Idaho. Avista's generation resources are predominantly hydro-based, supplemented by jointly-owned and operated coal and gas-fired generation facilities. It owns and operates transmission and distribution lines which have provided reliable and economic service to its customers. Historically, Avista has been an active participant with other regional power companies, the Bonneville Power Administration (BPA), Public Utility Districts (PUDs), and Municipalities in power pooling and interconnection agreements to coordinate operations, promote reliability, and minimize damage from electrical disturbances when they occurred, while conserving resources and controlling costs.

Throughout its existence, Avista has had the benefit of protection from liability for service interruptions through continuity of service tariff limitations established by state utility commissions as a term and condition of approved retail rates. Duties were owed to Avista's own customers only and contracts governed interconnection relationships with other utility systems.

With respect to Avista's interconnected transmission system, liability to other system owners has been limited by operation of the Western Interconnected Systems (WIS) Agreement. Under the WIS Agreement, which is voluntary and terminable at any time, each utility system or generation owner agrees to be responsible for damages occurring to its own system, except for "willful misconduct." An alternative dispute resolution process exists under the WIS agreement to address and correct any failure to conform to accepted electric utility practices in design, operation and maintenance of its system. The WIS Agreement further provides for joint purchase of a \$10 million insurance policy to cover costs of actual property damage occurring to retail customers from multiple system transmission outages.

Following the occurrence of two wide scale western outages in the Summer of 1996, which did not significantly impact Avista's service area, Avista participated with other control

area transmission operators as a member of the Western Systems Coordinating Council (WSCC), a regional council of the North American Electric Reliability Council (NERC), in the investigation of measures to improve the reliability of interconnected transmission systems in the western United States.

Undertaken initially on a voluntary basis, a development from this WSCC process was a proposal by WSCC Staff and certain participants, to require implementation of mandatory Reliability Management System (RMS) “criteria” as a condition of connection to a participating Control Area. These RMS “criteria” are analogous to “rules of the road” for operation of the interconnected transmission system. Enforcement measures included requirements for extensive record keeping, self-reporting of alleged violations, policing by WSCC staff, the issuance of “citations” for violations, and the assessment of monetary sanctions following an adjudicatory process. Avista voiced concerns at the time that while well intended, the RMS process increased the risk that legal duties were being created for the benefit of third parties, while at the same time creating a ready method for determination of civil liability.

WSCC RMS developments occurred at a time when two Washington court decisions had suggested the potential that electric utilities in Washington State could be subjected to increased liability for outage events, or for negligence in failing to timely restore service in the aftermath of service interruptions. See Employco v. City of Seattle, 117 Wn.2d 606, 817 P.2d 1373 (1991); National Union v. Puget Sound Energy, 94 Wn.App. 163, 972 P.2d 481 (Div. I, 1999). At the same time, electric utilities nationwide were being exposed to litigation, to include class action litigation, from outage events. The Federal Energy Regulatory Commission (FERC) in Order 888 had further ordered transmission utilities to permit “open access” to effectively become a “common carrier” of electricity owned by third parties and potentially destined for customers in distant locations.¹ Notably, FERC’s order occurred without any protection from

¹ See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 FERC ¶ 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996)(Order No. 888), order on reh’g, Order No. 888-A, 62 FERC ¶ 12,274 (march 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997)(Order No. 888-A), order on reh’g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), order on reh’g, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

liability for a “cargo,” the value of which, in the increasingly volatile western utility market, placed the transporting utility at unprecedented risk.²

Avista actively participated in the development of voluntary RMS standards, even though it felt constrained not to enter into a WSCC RMS Agreement because of liability concerns. It also had objection to the enforcement methods adopted by WSCC for the RMS program, but it continued with voluntary implementation. A large majority of Washington Control Area Operators also declined to enter RMS Agreements. However, attorneys attempted to work with the WSCC to explore ways to improve system reliability without increasing liability risk. Avista further prepared draft legislation for incorporation in draft national energy legislation to either confine liability to RMS sanctions, limit liability to the equivalent of state protective tariffs or in a manner consistent with the WIS Agreement, or to limit liability altogether, depending upon the preference of policy makers.

Avista’s efforts also did not stop at the WSCC. A presentation was made by Avista’s attorneys at the first Regional Transmission Organization (RTO) workshop held in the Northwest on February 9, 2000, following the adoption of FERC Order 2000. Explanation was provided concerning the need for protection from outage liability risk for RTOs and participating transmission owners. Avista reviewed existing measures to protect against outage liability and attempted to explain why FERC’s refusal to limit liability for continuity of service as a term and condition of rates established by FERC for open access transmission service was necessary and consistent with pre-Order 888 FERC practice. Avista further offered explanation of why states would no longer have authority to limit liability for wholesale transmission service under Orders 888 or 2000. In so doing, it specifically challenged the wisdom, logic and consequences inherent in a then recent FERC decision denying the New York Independent System Operator (ISO)

² For a more complete discussion of these cases in the context of developments at FERC, see Attachment 1 from a presentation to the Edison Electric Institute Claims Conference November 1, 2000, and Attachment 2, a July 31, 2001, legal memorandum prepared by attorney Kathryn Kavanagh Baran to former FERC Commissioner Mike Naeve, both of the law firm of Skadden, Arps, Slate, Meagher and Flom LLP.

authority to insure against its own negligence, while including the cost of such insurance as a component of recovered rates. Shortly thereafter FERC reversed itself on the issue of insurance.³

Previous to submission to FERC of the proposal to form a non-profit RTO West pursuant to the requirements of FERC Order 2000, regional transmission owners, to include Avista, participated in a collaborative process with power marketers and direct service customers in proposing an agreement to limit liability in a manner consistent with the WIS Agreement, the language of existing state tariff protections, pre-Order 888 precedents and available liability insurance limits.⁴ This approach was rejected outright by FERC, which chose to distinguish all previous instances of FERC limitations on liability as “pre-Order 888” and allegedly contrary to a requirement that RTO customers be compensated for “lost opportunity costs” for generators given “wrongful dispatch orders.”⁵

On May 24, 2001, at RTO West’s request, a FERC Technical Conference was convened with FERC staff in Washington, D.C. To an overflow hearing room attended by representatives of other forming RTOs and existing ISOs, an attempt was made to address the background, basis, and need for liability protection.⁶ RTO West further timely filed a Petition for Rehearing and Clarification, which FERC granted in part, but in which FERC again refused any limitation of liability for transmission customers and third parties, reiterating that any relief from liability would have to be addressed by individual states. FERC did provide authority for participating transmission owners of RTO West to allocate risk among themselves and the RTO by agreement,

³ Compare *New York Independent System Operator, Inc.*, ER 00-550-000 (Jan. 12, 2000) [90 FERC ¶ 61,015] (citing to Order No. 888-B at 62,080-81) with Order on Rehearing, *New York System Operator, Inc., et al.*, p.8 (April 4, 2000)[citing by example to *Alabama Tennessee Natural Gas Company*, 48 FPC 774, 780 (1972)]. The Northwest RTO workshop presentation occurred in Portland on February 9, 2000.

⁴ See *Avista Corp., et al.*, FERC Docket No. RT01-35, Supplemental Compliance Filing and Request for Declaratory Order Pursuant to Order No. 2000, Attachment Y (Oct. 24, 2000).

⁵ See *Avista Corp., et al.*, 95 FERC ¶61,114 (April 26, 2001).

⁶ A copy of RTO West’s presentation is attached as Attachment 3. Note that Slide 24, p.8, included specific reference to the potential impact of RMS reliability standards impacting liability of the RTO.

and left open how potential Canadian participants in RTO West would be addressed until later proceedings.⁷

With these FERC pronouncements, RTO West and participating transmission owners, to include Avista, were left to go to individual states to obtain any permitted protection from liability. This was despite the fact that typical state tariff limitations on liability would not prove effective due to the fact that FERC was setting wholesale transmission tariffs and state utility commissions had no clear authority to set terms and conditions of such service. Based upon prior FERC Orders, RTO West could also seek to insure against risks of outage liability and include such costs as an approved expense. It could also seek to assign business risk for RTO West (a non-profit entity having few assets other than any potentially available insurance) by agreement among participating transmission owners transferring control of their systems to RTO West.

The practical limitations of these FERC options became readily apparent. The prospect of going to each individual western state to attempt to obtain the equivalent of present continuity of service tariff limitations on liability would take time; could lead to different provisions in each state, and was of questionable authority, at least as a function of regulation at the state utility commission level given that states would not be setting wholesale transmission rates. If state limits were not the same, RTO development could lead to different rights and remedies for interruptions of transmission service in a given state, inviting forum shopping, and producing complex conflict of law issues in the application of the tort law of individual states.

Liability insurance, while still in the process of investigation, appears also to be a limited remedy in that the largest available liability limit presently acknowledged is in the amount of \$300 million. By comparison, losses associated with the 1996 western states transmission outages were estimated to have been in the billions of dollars. Moreover, as documented in a study for the Electric Power Research Institute (EPRI) released June 29, 2001, the estimate of annual outage of between \$104 billion and \$164 billion with annual power quality losses

⁷ Avista Corp., et al., 96 FERC, ¶ 61, 058, pp. 21-22 (July 12, 2001) *modified by* Order Granting Clarification of Prior Order, 96 FERC ¶ 61, 265 (September 12, 2001).

estimated at an additional \$15 Billion to \$24 billion. Annual power outage and power quality losses in California alone were estimated as between \$13.2 and 20.7 billion.⁸ Even if available, the cost of insuring against liability for such events can only increase rates substantially, and far beyond present costs of transmission service.

The ability of RTO West transmission owners to allocate costs among themselves also appears to be problematic. BPA, which accounts for over 75% of available transmission service in the Northwest, has the benefit of limitations on liability afforded by the Federal Tort Claims Act, and under the applicable principles of discretionary immunity. Even its ability to provide indemnification for its own negligent acts is questionable. Equally understandable is BPA's reluctance to give up the protections of such governmental immunity. Of monumental concern to small transmission utilities such as Avista, is the potential that it, or its assets, would be left exposed either for causing, contributing to, or for failing to exercise due care in responding to a cascading outage event, even not of its own creation. If left exposed to liability for even a single outage event, it could be held legally responsible for damages in excess of its assets and available insurance. Avista simply cannot prudently place its investor's assets, and its ability to serve its existing ratepayers at risk through any system that would create legal duties to third parties without protection from liability for power quality and outage events.

Incidental to the recent FERC RTO Workshop completed in October, 2001, Professor Richard J. Pierce, Jr., noted professor and legal scholar at George Washington University, submitted a "white paper" to FERC addressing the need for federal limitations on the tort liability of RTOs and their participants. The White Paper validates and substantiates the concerns raised years ago by Northwest participants and their attorneys, and distinguishes the limited case law proffered by FERC as the alleged basis for their inability to act to limit liability for outage events. A copy is attached as Attachment 4 to this summary.

It was also against the backdrop of these events, and this unresolved outage liability issue, that the WSCC proposed, and the FERC approved, merger of the WSCC with other

⁸ Primen, "The Cost of Power Disturbances to Industrial and Digital Economy Companies", p. ES-3 (June 29, 2001) [Submitted to EPRI's Consortium for Electric Infrastructure for a Digital Society (CEIDS)].

entities to form the WECC. *Western Systems Coordinating Council, et al.*, Order Granting Request to Transfer Programs and Directing Additional Filings, 96 FERC ¶ 61,348 (Sept. 27, 2001) Noteworthy in the merger proposal were By-laws that eliminated Article IX, Section 2 of the WSCC Agreement which had stated:

Each Member shall retain sole control of its own facilities and the use thereof, and nothing in this Agreement shall require a Members to construct or dedicate facilities for the benefit of any other Member or be deemed to impair its ability to take such actions as it deems necessary to maintain reliable service to its own customers or to fulfill its obligations to others.”

This represented a significant change from current WSCC By-law’s under which the right to operate a utility system for local needs would be preserved ahead of any duty to comply with regional transmission standards. Substantial questions were also raised as to whether the elimination of this provision, coupled with other changes to the By-laws, would effectively convert the WSCC RMS from voluntary to a mandatory system. Most notable was the requirement in Section 4.6.9 to:

... abide by these By-laws, decisions resulting from the dispute resolution process and all standards, or decisions of the WECC. . . .”⁹

This raised specific concern that RMS “criteria” could effectively become “standards” or “decisions of the WECC” which a member was obligated to follow or risk expulsion or suspension from the WECC, irrespective of whether any RMS Agreement had been entered into between the member and the WECC. In its Order approving the merger, FERC concluded that the WECC RMS would not become “mandatory” in this manner. While FERC’s express

⁹ Additional expansive provisions of the WECC By-laws included incorporation of “backstop authority” (i.e., which gives the WECC the ability to address an issue when the regional entity with primary authority for the issue has not acted), introduction of appeal and amendment procedures to overturn decisions of the Board of Directors given authority to adopt reliability measures, and repeated suggestion that the WSCC could implement authority delegated by regulatory authorities to mandate compliance by RMS members. This was in addition to imposition of “Good Utility Practice” for scheduled interchange with other Control Areas under Section 3.8. [“Good Utility Practice being defined to mean “Any of the practices, methods and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period, or any of the practices, methods and acts which, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety and expedition.” WECC By-laws, Section 3.13].

rationale is footnoted below,¹⁰ FERC's rationale is dependent upon the assessment that only membership in the WECC is voluntary (not the requirement to comply with "standards" or WECC decision, based upon the requirement to comply with the by-laws) and is further flawed in that its summary of the "exception" of Section 4.7 does not accurately reflect the actual language of the exception in the WECC By-laws.¹¹

Elimination of the priority on ability to serve local needs above any duty to comply with western region transmission standards, and the potential impact of mandatory standards have prevented Avista from becoming a signatory to RMS. However, it also has concerns about the rigidity of the RMS. It is, however, the increased liability risk associated with the RMS reporting, "citation" and "adjudication" process, and the impact that such system has on creating

¹⁰ FERC, in its approval of the WSCC merger into the WECC concluded that By-law changes did not make RMS mandatory because (in pertinent part):

... While compliance with the WECC's Bylaws and standards may be mandatory, membership in the organization is voluntary. Furthermore, Section 4.7 of the Bylaws specifically prohibits the WECC from requiring any action by a member that would create a risk to its system or to public health and safety, or to violate any law, regulation, rule or order. Moreover, we have required the Bylaws, and any changes, to be filed with this Commission. We also note that Section 11 and Appendix C of the Bylaws provide that any arbitration decisions that affect the provision of Commission jurisdictional service may be appealed to the Commission. With these protections in place, we do not believe that the WECC can summarily or unfairly terminate a member's membership. Further, we see nothing in the WECC's "Backstop Authority" that would allow it to prevent a member from accessing the transmission grid.

Order Granting Request To Transfer Programs and Directing Additional Filings 96 FERC ¶ 61,348 (Issued September 27, 2001)

¹¹ Section 4.7 actually reads:

Limitations on Member Obligations. The obligation of Members pursuant to Section 4.6.9 will not require any Member to take any action which the Member in good faith determines: 1) would exceed the physical capabilities of the Member's electric system (or any part of another's electric system that the Member has the legal right to cause to comply with a WECC action governed by Section 4.6.9); 2) would create serious and immediate risks to public health or safety (**provided, however, that the shedding of load shall not in and of itself be deemed a serious and immediate risk to public health and safety for the purpose of this section**); 3) would create an immediate risk of serious damage to facilities or equipment within its electric system or cause it to operate any of its electric facilities or equipment in an unsafe manner; 4) would cause the Member to violate or improperly implement an applicable law, regulation, rule, order, FERC license provision or other legal obligation; or 5) would conflict with any non-power requirement applicable to the Member (including without limitation any obligation under environmental laws, regulations, court and administrative decisions or biological opinions).

a means and mechanism for proving civil liability coupled with no clear limitation of such liability which is most troubling.

Efforts by RTO West participants to obtain WSCC/WECC support for legislative remedy to limit liability for RMS “citations” to the amount of any imposed sanction, without further liability has all but been ignored by WSCC/WECC. In response to a request for inquiry to the WECC, Avista was advised that liability under state law for violation of WECC standards and policies is not precluded by the current form of WECC Agreement (By-Laws).

It also has to be appreciated that the outage liability risk, as enhanced by the RMS citation and adjudication process, is not a business risk that Avista or other participating utilities presently have anyway. The significant difference is that with RTO formation, participating transmission utilities will be coming out from under the umbrella of present state tariff protection. Moreover, tort law specific to electric utility operations is replete with examples where the duty of care has not been satisfied as a matter of law by compliance with regulations or electric safety codes. While compliance with RMS standards may have persuasive appeal to a jury, it is not likely to be dispositive of negligence issues in most jurisdictions. It is also naive to conclude that violations will not occur, as evidenced by the hundreds of assessed violations occurring with implementation of RMS standards on a test basis. No investor-owned utility can responsibly put its assets at risk for uninsurable, catastrophic risk-of-loss from outage events. Certain limitations on outage liability is the only solution to this risk, will serve as encouragement to participation, and will be to the ultimate benefit of all concerned with the development, implementation and enforcement of RMS criteria.

The net result to Avista is that it is being placed in the impossible position of being potentially accountable to a process that could lead to the imposition of legal liability for outage events without commensurate consideration of the need to limit its liability as a condition for participating in an RTO, or as a member the WECC RMS program.

- If Avista chooses not to participate in an RTO it faces loss of market rate authority while being compelled to purchase power at market-based rates to

service its own customers at significantly lower rates still fixed and regulated by the state commissions within its service area.

- If Avista submits its assets to control of the RTO without commensurate protection from outage liability risks, it faces potential loss of those assets, if not more, in the aftermath of damage litigation for outage events that cannot be fully insured, and which are not necessarily even subject to its control.

- If Avista voluntarily establishes for itself the RMS standards on reliability, and is determined to have violated those standards, it also leaves itself open to tort litigation to those determined to be owed a legal duty under the circumstances. The WECC RMS enforcement process is also likely to be the primary process for identifying potentially responsible parties, and for adjudicating civil liability.

- In forming an RTO, Avista is also being forced into relationships with governmental entities which have the benefit of application of various forms of governmental immunity in an entity that has few assets.

As a regulated utility, any decision on Avista's part that could jeopardize its assets or its future ability to service its native load customers and ratepayers could be determined to be imprudent in the eyes of regulators and/or investors.

Present Avista management views it as irresponsible to place Avista's assets at risk without certain limitations on liability for outage events when they occur. It is not acceptable to suggest, as counsel for WECC have indicated, that compliance with WECC RMS standards will be protection enough, or that Avista experiences some of the same risks under the existing transmission infrastructure. The need to address the liability issue has been validated by one of this country's most preeminent legal scholars, one of its most prestigious national law firms, and by analysis of attorneys for electric utilities throughout the Northwest and in Washington State.

All that needs to be done to deal with the outage liability issue is to limit liability in the same way that every common carrier's liability is limited where the value of its cargo, or its loss, significantly exceeds the value of the common carrier's assets and the amount it can charge for its services. Precedent exists not only within the existing electric and gas industry, but in industries as varied and diverse as the telegraph, telephone, airline, transportation and nuclear industries.¹²

In Texas, the only state in the contiguous 48 states that has an independent, electrically isolated transmission grid, and which has used an RTO type model to restructure its electricity market, the issue was felt to be significant enough for the Texas Public Utility Commission in February, 2001, to adopt the same protection on liability for Texas Transmission as it previously did for Texas utilities. It also had authority to do so because, unlike the other 48 states, Texas continues to have the authority to set terms and conditions, as well as rates for transmission services in Texas.¹³

Selecting the desired mechanism for limitation of liability for interruptions in transmission service may be an appropriate policy choice, but ignoring the issue altogether, or forcing investor-owned utilities to accept the risk of catastrophic loss for outage events on terms different from its public counterparts is not. Agreement to abide by a set of reliability standards that create duties which may be breached and be a proximate cause of damages will only lead to liability assessments in the aftermath of an outage event and is irresponsible absent clear immunity from civil liability for such outage events.

Throughout the RMS and RTO process Avista has been responsible in seeking to have the issue of outage liability addressed, and in providing a range of potential solutions to be

¹² Telephone: see e.g., Act of 1910, 36 Stat.539, 545 (1910); Western Union v. Priester, 276 U.S. 252, 260 (1928); Federal Communications Act of 1934, 47 U.S.C. § 332 as amended for cell phones in 1995 (11 F.C.C.R. 796); L.A. Cellular Telephone Company v. Superior Court of L.A., 65 Cal. App. 4th 1013 (1998). Airlines: Warsaw Convention Treaty of 1934, 49 Stat. 3000 (1934) as later modified by Montreal Agreement; *see also*, In re Aircrash in Bali, 684 F. 2d 1301 (9th Cir 1982) and Hill Construction v. American Airlines, 996 F. 2d 1315 (1st Cir 1993). Motor Carriers: 49 U.S.C. § 14706. Shipping: United States Carriage of Goods by Sea Act of 1936, 46 U.S.C. Section 1304. Nuclear: Price-Anderson Act, 42 U.S.C. § 2210; *See* Duke Power v. Carolina Environmental Study Group, 438, U.S. 59, 64-65 (1978).

¹³ See 26 Texas Register 1310, 13-15-1319 (February 9, 2001) and the discussion of Professor Richard Pierce, p. 5-13. Attachment 4 hereto.

addressed in Congress, in FERC, and in the WSCC/WECC. The need for protection from outage liability risk must be addressed as a condition of RMS or RTO development.

ATTACHMENTS
TO
APPENDIX

Attachment 1, 2, 3 and 4 may be found at the RTO West website at the following address:

http://www.rtoWest.org/OutageLiabilityIssues_SuppDocs.htm