

94 FERC ¶ 61,019
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

New York Independent System Operator

v.

Docket No. EL01-17-000

New York State Electric & Gas Corporation

ORDER ON COMPLAINT

(Issued January 10, 2001)

On November 24, 2000, the New York Independent System Operator, Inc. (NYISO) filed a complaint under section 206 of the Federal Power Act (FPA) and Rule 206 of the Commission's Rules of Practice and Procedure against the New York State Electric & Gas Corporation (NYSEG). The NYISO's complaint requests that the Commission employ its fast-track procedures in the disposition of the subject filing, declare NYSEG's \$6.635 million set-off against the NYISO unlawful, and direct NYSEG to make payment in full (including interest) to the NYISO immediately. As discussed in the body of this order, the Commission grants the NYISO's requested relief and directs NYSEG to make payment in full, including interest, to the NYISO.

I. Background

By separate letters dated September 5, 2000, NYSEG informed the NYISO that as a result of various acts and omissions by the NYISO in its operation of the market for 10-minute reserves during the spring of 2000, the market-clearing prices and prices charged to NYSEG for 10-minute reserves increased dramatically. NYSEG claimed that it had paid approximately \$6.635 million more than it would have been charged if the NYISO had operated the market properly. Consequently, NYSEG informed the NYISO that NYSEG was seeking one of two forms of relief: (1) presentation of the dispute to senior representatives of the NYISO and NYSEG for resolution on an informal basis pursuant to section 11.1 of the ISO Services Tariff (Services Tariff) and section 12.1 of the ISO Open Access Transmission Tariff (OATT); or (2) indemnification of the \$6.635 million claim

pursuant to section 7.2 of the Asset Purchase and Sale Agreement (APA).¹ NYSEG stated that a detailed statement of the facts constituting the basis of its indemnification claim was contained in a complaint it had filed with the Supreme Court of the State of New York.

In a subsequent letter from NYSEG to the NYISO, dated November 16, 2000, NYSEG informed the NYISO that, because the NYISO failed to promptly satisfy NYSEG's \$6.635 claim for indemnification, pursuant to section 7.5 of the APA, NYSEG was entitled to accomplish the payment by setting it off against amounts owed by NYSEG to the NYISO.² Accordingly, the November 16, 2000 letter served as notice to the NYISO that NYSEG was setting-off the October 2000 invoice from the NYISO to NYSEG in the amount of \$6.635 million.

II. NYISO's Complaint

The NYISO states that its OATT requires that a customer pay all disputed amounts in full to the NYISO, subject to an after-the-fact billing adjustment once the underlying dispute is ultimately resolved. The NYISO contends that NYSEG's use of the set-off provisions under the indemnification provisions contained in the APA is an attempt to avoid paying the operating reserves charges it incurred under section 5 of NYISO's OATT, in violation of the NYISO OATT. Therefore, NYISO asks that the Commission order NYSEG to pay immediately.

NYISO points to two sections of its OATT for requiring that a customer pay its bill in full. First, the NYISO states that section 7.2A of its OATT provides that if a customer

¹The APA, dated December 1, 1999, is between the NYISO and the New York Power Pool (NYPP), of which NYSEG is a Member System. The APA pertains to the purchase of miscellaneous assets, e.g., equipment, machinery, furniture, computer source codes, programs and other software (ISO Software). Section 7.2 delineates the circumstances under which the NYISO is required to indemnify the NYPP.

²Section 7.5 of the APA provides, in relevant part, that:

The Indemnifying Party shall promptly pay the Indemnified Party any Claim amount due under this Article 4, which payment may be accomplished, in whole or in part, at the option of the Indemnified Party, by the Indemnified Party setting off any amount owed to the Indemnifying Party by the Indemnified Party.

wishes to challenge its settlement information³ for accuracy, it must first make payment in full, including amounts in dispute. If it is subsequently found that a customer has overpaid the NYISO, then the NYISO is required to make the customer whole by returning the overpayment with interest. Second, NYISO states that section 7.3 of its OATT ("Customer Default") deviates from the pro forma tariff because it does not contain provisions for customers to place disputed amounts in an escrow account. The NYISO states that when it filed its OATT, it argued against establishing escrow provisions because customers of other independent system operators ("ISO") had invoked escrow provisions, resulting in cash flow problems for the ISO. NYISO reasoned that from its financial perspective, the inability to use escrowed amounts was tantamount to not being paid at all. NYISO states that the Commission accepted the change.⁴

The NYISO states it has been financially harmed by the set-off and that the set-off will soon inflict financial harm on other market participants if NYSEG is not required to make payment. The NYISO states that it is a not-for-profit organization with no shareholders, retained earnings, or source of revenues except for customer payments to pay its suppliers. As a result, it is vulnerable to mismatches between the revenues it receives and the payments it must remit to suppliers. The NYISO has secured a modest revolving credit line to handle ordinary cash flow mismatches, but its credit line cannot handle \$6.635 million. The NYISO claims that while it has been forced to resort to this line of credit as an interim measure in order to maintain market stability and to avoid financial harm to other customers, the line of credit is limited in amount and duration and thus is not a viable long-term solution. If the provisions of NYISO's tariff are not enforced, the NYISO claims that it may have to reduce payments to suppliers and/or increase charges to customers in order to recover the amount withheld by NYSEG. Further, if NYSEG engages in future set-offs or if other members of the NYISO follow NYSEG's example, the NYISO fears that its credit could be severely restricted or cut off, forcing the NYISO to impose harsh financial reserve requirements on other market participants, or face possible insolvency.

The NYISO argues that NYSEG's interpretation of the relevant APA provisions is, at best, strained. The NYISO states that although the APA includes indemnification and set-off provisions, the APA has nothing to do with the administration of the 10-minute reserves markets. The APA governs the NYISO's purchase of miscellaneous assets of the NYPP and its assumption of certain contractual and permit rights and liabilities. The purchased

³Section 1.41A of the NYISO's OATT ("Definitions") defines "settlement" as the "process of determining the charges to be paid to, or by, a transmission customer to satisfy its obligations."

⁴New York Independent System Operator, Inc., 90 FERC 61,015 (2000).

assets do not include New York's bulk power transmission system, which the NYISO operates but does not own; rather, the assets consist largely of control room equipment and personal property located at NYISO's headquarters, NYISO's software, other intellectual property, and NYPP's files. In addition, the NYISO argues that although section 7.2 of the APA allows a member system to seek indemnification and set-off in connection with claims arising out of or resulting from the NYISO's ownership of miscellaneous NYPP assets or arising out of or related to the ISO Software, it is not reasonable to apply this language to disputes concerning the operation of the NYISO's 10-minute operating reserves markets. If the APA were interpreted this way, the NYISO claims it would confer a right on the member systems that other customers do not have – the right to set-off disputed payments.

The NYISO states that NYSEG's set-off claim is based on allegations that relate to the NYISO's tariff provisions and market rules, which are the subject of litigation before the Commission and have nothing to do with the APA. These allegations are that the NYISO: (1) failed to consider bids from western suppliers; (2) did not consider the Blenheim-Gilboa pumped storage facility as a source of reserves; (3) failed to reserve transmission capacity for reserves across the Central-East interface; (4) refused to use the Temporary Extraordinary Procedures as aggressively as NYSEG preferred; (5) encouraged a supplier to submit higher bids; (6) charged NYSEG a price higher than the clearing price for 10-minute spinning reserves when that price was lower than the clearing price for 10-minute non-spinning reserves; and (7) did not base its purchases of reserves on its actual contingency requirements.

III. Notice of Filings, Interventions and Comments

Notice of NYISO's complaint was published in the Federal Register, 65 Fed. Reg. 75,688 (2000), with comments, protests, and interventions due on or before December 6, 2000. On December 6, 2000, NYSEG filed an answer contending that NYISO's filing should be rejected. In addition, on December 21, 2000, NYSEG filed an answer to the comments submitted in this proceeding. Timely motions to intervene raising no substantive issues were filed by Enron Power Marketing, Inc.; 1st Rochdale Cooperative Group, Ltd. and Coordinated Housing Services, Inc. (jointly); The Long Island Power Authority and LIPA (jointly); PG&E National Energy Group, Orion Power New York GP, Inc.; TransCanada Power Marketing, Ltd.; Midwest Independent Transmission System Operator, Inc.; ISO New England Inc.; Keyspan-Ravenswood, Inc.; and the Members of the Transmission Owners Committee of the Energy Association of New York State. On December 7, 2000, a late motion to intervene was filed by Niagara Mohawk Energy Marketing, Inc. (NMEM).

Timely motions to intervene and comments in support of the complaint were filed by Independent Power Producers of New York, Inc. (IPP); NRG and Affiliated Companies (NRG); Aquila Energy Marketing Corporation (Aquila); Southern Bowline, L.L.C., Southern Energy Lovett, L.L.C., Southern Energy NY Gen, L.L.C., and Sithe Power Marketing, L.P. (jointly referred to as "Southern"); and PG&E National Energy Group, PG&E Generating and PG&E Energy Trading-Power (collectively "PG&E").

A. Comments in Support of the NYISO's Complaint

IPP, NRG, Aquila, Southern, and PG&E (collectively "Supporters") all concur with the assertions and requested relief in the NYISO's complaint. The Supporters contend that NYSEG's attempted set-off amounts to nothing less than an unlawful withholding of payment for services rendered, which cannot be allowed with impunity. According to the Supporters, the NYISO does not have any source of money for market suppliers other than the money it collects from other market participants, so if NYSEG's conduct is permitted to stand, the financial stability of the NYISO and its suppliers will be compromised. Furthermore, the Supporters contend that because NYSEG's claim against the NYISO is predicated upon the NYISO's administration of its reserves markets, which is governed by the NYISO's OATT and Services Tariff, the provisions of the foregoing tariffs should dictate the disposition of this proceeding, not the set-off provisions of the unrelated APA.

B. NYSEG's Answer

NYSEG requests that the Commission reject the NYISO's complaint. It disagrees that the APA is unrelated to the dispute over the NYISO's reserves markets. NYSEG argues that under the APA, the NYISO assumed liabilities relating to the NYISO Software, including liability for defects and for failures to correct defects or take other corrective action, and the APA provides that the NYISO is obligated to indemnify NYSEG against liabilities or claims arising out of or related to the NYISO Software, including defects or failure to correct defects or take other corrective actions.

NYSEG states that Article 7 of the APA provides a mechanism for exercising indemnity rights; an indemnifying party must promptly pay the indemnified party any claimed amount due under this section. Indemnification, adds NYSEG, may be accomplished in whole or in part, at the option of the indemnified party, by setting-off any amount owed to the indemnifying party. NYSEG asserts that the APA provisions are clearly relevant to the operating reserves markets because these markets "incorporate" the NYISO Software, which is covered by the indemnification provisions. Furthermore, NYSEG avers that the failures causing high operating reserves prices are software failures and failures to make changes to the NYISO Software or take other

corrective action. Consequently, NYSEG contends that based upon the plain language of the APA, NYSEG has a right to indemnification from the NYISO for liabilities associated with defects in the NYISO Software and other NYISO actions and inactions.

NYSEG claims that the APA is an independent contractual obligation. It was negotiated at arm's length after market participants and the NYISO had begun operations under the new tariffs. In fact, the APA was executed after the NYISO and Member Systems submitted a joint filing regarding section 7.3 of the OATT, whereby OATT section 7.3 was modified to disallow disputed payments into escrow accounts pending resolution of a claim. NYSEG states that the foregoing chronology indicates that the NYISO was fully cognizant of the different provisions – the APA allowing set-off and the OATT requiring payment of disputed amounts.

Finally, NYSEG argues that since the NYISO is required to carry liability insurance, the NYISO can use the proceeds to cover its obligation to indemnify NYSEG. Moreover, the set-off is less than five percent of the payments NYSEG has made to the NYISO in ten months this year. Therefore, the set-off should not threaten the NYISO's financial integrity.

IV. Discussion

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2000), the timely, unopposed motions to intervene listed above serve to make the filing entities parties to this proceeding.

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (1999), we will grant the late motion to intervene of NMEM, given its interest in the proceeding, the early stage of the proceeding and the absence of any undue prejudice or delay.

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 213 (2000), NYSEG's Answer of December 21, 2000 is denied.

It is undisputed that NYSEG's \$6.635 million set-off claim is based on the NYISO's administration of the market for operating reserves. Schedule 5 of the NYISO's OATT requires transmission owners to purchase operating reserves to serve load within the New York Control Area, and the NYISO has the authority to charge for providing such reserves. Moreover, NYISO's OATT requires customers to pay disputed amounts in full to the NYISO, subject to appropriate after-the-fact adjustments once the underlying dispute is ultimately resolved. Specifically, section 7.2A of the NYISO OATT ("Billing Disputes") states that when a customer "wishes to challenge the Settlement information for accuracy"

it must "first make payment in full including any amounts in dispute." If the customer is subsequently found to have overpaid, the NYISO is required to repay the customer with interest. Similarly, section 7.3 of the NYISO's OATT ("Customer Default") requires customers to pay disputed amounts while a dispute is pending. Thus, under the NYISO's OATT, customers, such as NYSEG, who dispute a charge are required to remit the disputed amount in full, and if the customer is subsequently found to have overpaid, the NYISO will refund the disputed amount with interest.

Although the NYISO's OATT contains explicit provisions regarding the handling of billing disputes, NYSEG seeks to avoid the billing dispute provisions of the NYISO's OATT and Services Tariff by invoking the indemnification and set-off provisions contained in the APA. The APA, however, governs the transfer of certain assets, *e.g.*, equipment, machinery, furniture, computer source codes, programs and ISO Software, from the NYPP (of which NYSEG is a Member System) to the NYISO. Furthermore, the nexus that NYSEG is trying to establish between the APA and the NYISO's operation of its reserves markets is indirect, at best. In fact, the reasons offered by NYSEG as justification for its set-off claim⁵ solely pertain to the NYISO's OATT and Service Tariff, not the NYISO's ownership of former NYPP assets or the ISO Software.

The Commission finds that the disputed claim is based on a service that is governed by the NYISO's OATT. The billing dispute provisions of the NYISO's OATT require customers, such as NYSEG, who dispute a charge to pay the disputed amount in full, subject to refund. Accordingly, the Commission finds that NYSEG's \$6.635 million set-off violates the NYISO's OATT. NYSEG is hereby directed to pay, subject to any appropriate after-the-fact adjustments once the underlying dispute is ultimately resolved, \$6.635 million, plus interest, to the NYISO within 15 days of this order's issuance.

The Commission's rejection of the NYSEG set-off still leaves the company with possible recourse. If the Commission subsequently determines that the NYISO has over-charged customers for operating reserves, the NYISO will be liable for a refund of the over-charged amount, including interest, to the affected customers.

⁵In NYSEG's September 5, 2000 letter to the NYISO, apprizing the NYISO of NYSEG's claim for indemnification and set-off, NYSEG alleged that several acts and omissions by the NYISO resulted in the improper operation of the NYISO's market for operating reserves. *See supra* p. 4.

The Commission orders:

NYSEG is hereby directed to pay, subject to any appropriate after-the-fact adjustments once the underlying dispute is ultimately resolved, \$6.635 million, plus interest, to the NYISO within 15 days of this order's issuance.

By the Commission.

(S E A L)

David P. Boergers,
Secretary.