

Summary of Recent FERC Orders Re OATT Liability Limitation Provision

***Midwest Independent Transmission System Operator, Inc.*, Docket Nos. ER04-1160-000 and -001, “Order Accepting Notice of Withdrawal Conditionally Accepting Proposed Tariff Revisions and Directing Compliance Filing,” 110 FERC ¶ 61,164 (February 16, 2005)**

Key Issues:

- Whether proposed liability provisions provided MISO and Transmission Owners with too much protection from damage awards.

Brief Summary

In this filing, MISO and American Transmission Company LLC proposed revised MISO OATT language limiting the liability of the RTO, Transmission Owners (TOs), and generators acting in response to MISO or TO directives. Under the proposal, these entities would only be liable to transmission customers, users, or other third parties for gross negligence or intentional misconduct associated with service provided under the MISO OATT, thereby eliminating their liability for ordinary negligence. In addition, the applicants proposed that these entities would only be liable for “direct damages,” and further included a definition of that term to clarify what those damages would not include (*e.g.*, punitive, incidental, and consequential damages).

According to the applicants, there were many reasons to provide this liability protection. First, MISO and stand-alone transmission companies are regulated exclusively by FERC and are thus not protected by liability provisions available to state-regulated retail service providers.¹ Second, the applicants pointed out that the Commission had stated in the SMD NOPR and White Paper, as well as in the 2004 reliability policy statement, that it may be appropriate for ISOs and RTOs to incorporate these sorts of liability protections into their tariffs. The applicants also noted that FERC had approved similar protections in the RTO New England application. As a matter of policy, the applicants argued that TOs may not want to transfer control of their transmission assets to an RTO if it did not have sufficient liability protections shielding it from potentially excessive damage verdicts. Finally, the applicants raised the possibility of MISO having to file for bankruptcy protection if it was hit with an enormous damage award.²

¹ Responding to a FERC deficiency letter, the applicants submitted a chart detailing the state-level liability protections for these entities, finding that roughly half either expressly stated that the utility was not liable for ordinary negligence or were silent on the subject.

² The applicants initially included language that would have made similar modifications to the OATT’s indemnification provisions. However, the applicants later withdrew this aspect of the proposal, which the Commission accepted in its order.

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Although strongly supported by the MISO TOs, the proposal was protested by some transmission customers taking service under the MISO OATT. A coalition of Midwest industrial customers argued that the filing did not mention the fact that MISO TOs were provided an enhanced return on equity that appropriately accounted for risks associated with their duties. The customers argued, in essence, that they would be double-paying for these risks if the Commission accepted the proposal -- first, in the ROE paid to the TOs and second in the fact that their legal recourse would be greatly limited if MISO or the TOs acted negligently. Another customer argued that MISO did not properly vet the proposal through the stakeholder process. A number of entities generally supported the proposal, and only suggested some discrete clarifications. Consumers Energy Company (Consumers), for example, wanted the Commission to find that the proposal would not work to abrogate liability provisions in existing agreements. Finally, Wisconsin Public Service Company (WPS) asked FERC to clarify that the proposal would only apply to the currently effective MISO OATT and not the upcoming energy markets tariff.³

The Commission agreed with the applicants that state regulators have routinely allowed jurisdictional utilities to include gross negligence liability protections into their retail tariffs, and it was appropriate to allow this at the federal level as well. FERC also acknowledged the specter of excessive damage awards and their potential impact on the transmission system (*e.g.*, higher costs borne by customers).⁴ According to the Commission, therefore, strong liability provisions would help shield customers from bearing higher costs. FERC also rejected arguments suggesting that risk of TO liability was already accounted for in the higher ROEs TOs received. The Commission pointed out that such risk was only one component of the ROE. However, FERC directed the applicants to submit a compliance filing that eliminated the definition of “direct damages,” believing that the appropriate state court should be the one that decides what constitutes direct damages. In addition, FERC granted Consumers’ clarification that the new language should not apply to contracts executed before the effective date of the proposal, and thus required the applicants to insert language to that effect. With respect to WPS’ concerns regarding the inclusion of the language in the energy markets tariff, the Commission believed that the more appropriate time to raise the issue was when MISO actually filed to include the language in the new tariff. Finally, the Commission directed the applicants to allow generators acting in good faith to comply with MISO directives to

³ In answer to the protests and comments, MISO and ATCLLC responded that MISO stakeholders properly vetted the proposal, and it would apply to the energy markets tariff, and when that tariff went into effect.

⁴ The Commission observed that MISO and the TOs are obligated to provide transmission service to all eligible customers and cannot deny service based on what they see as the risk of potentially high damage awards if service to those customers was interrupted for some reason -- thus, all customers would bear the costs associated with that risk.

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be covered by not only the limitation of liability provisions, but also the OATT's indemnification provisions.

Commissioner Kelly dissented from the order, stating that while there may be some cases where limiting liability was appropriate (*e.g.*, service interruptions), there were others where it would not be proper (*e.g.*, loss of human life). In a similar vein, Kelly feared that there would be an overly broad application of that language, even though the majority of the Commission only spoke of service interruptions. Kelly was not impressed by the list of retail tariff liability provisions, finding that silence in those tariffs concerning liability should not automatically lead to the conclusion that liability protections are therefore as strong as the applicants suggest they are.

PJM Interconnection, LLC Docket No. ER05-1209-000 “Order Accepting Tariff Provisions,” 112 FERC ¶ 61,264 (September 9, 2005)

Key Issues:

- Whether PJM's proposal to introduce a gross negligence standard in its tariff was acceptable to the Commission.

Brief Summary

In July 2005, PJM proposed to amend its OATT to add limitation of liability provisions that would add a layer of protection to PJM, Transmission Owners, and generators acting in good faith in responding PJM instructions. Specifically, the proposal would protect these entities from liability against any transmission customer or third party for direct damages arising out of *ordinary* negligence associated with services provided under the OATT. Instead, the liability would be limited to direct damages resulting from *gross* negligence or willful misconduct.

The Commission accepted PJM's filing, observing that PJM must provide service to *all* eligible customers, and cannot deny service to particular customers based on the risk of potential damages associated with interruption of service to those customers.⁵ Moreover, FERC found that PJM is not in a position to easily quantify the potential risk associated with service to customers and price that service accordingly. Therefore, all customers would ultimately bear the cost associated with the risk of such service, including those customers that do not have special reliability needs. FERC explained that PJM and the transmission owners were subject to federal jurisdiction, and thus did not have the state liability protections often afforded to other entities. The Commission also believed that the potential exposure to excessive damage awards would lead to higher insurance premiums and higher cost of capital -- which would be borne by all customers.

⁵ FERC cited to its order approving MISO's similar changes to its tariff regarding liability limitations.

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Commissioner Kelly dissented, stating that the proposal struck the appropriate balance between reasonable customer rates and the rights of parties to seek appropriate remedies if they are harmed by jurisdictional utilities' negligent actions.

Southwest Power Pool, Inc., Docket No. ER05-666-000, “Order on Proposed Tariff Revisions,” 112 FERC ¶ 61,100 (July 21, 2005)

Key Issue:

- Proposed revisions to SPP's OATT to include, among other things, provisions relating to liability limitation.

Factual Context

FERC authorized SPP as an RTO on Oct. 1, 2004. On March 1, 2005, SPP submitted a series of proposed changes to its OATT, all of which were approved by SPP's Regional Transmission Working Group, Markets and Operations Policy Committee and the Board of Directors. Specifically, SPP proposed, among other things, to revise Section 10 to add a gross negligence standard to the liability and indemnification sections.

SPP proposed several changes to its OATT regarding the liability limitation and indemnification provisions, including: (1) a new Section 10.2 to exempt SPP and TOs from liability to transmission customers or users for any act or omission in performing obligations under the OATT, except in cases of gross negligence or intentional wrongdoing; (2) a provision precluding recovery in all cases of incidental and consequential-type damages; (3) to the extent customers or users have claims against SPP or a TO, limiting such claims to the value of the assets transferred to the functional control of the SPP; (4) barring claims against individuals, by reason of their status as SPP's directors, members, shareholder, officers, etc.; (5) modifying Section 10.3 to require the transmission customer to at all times indemnify SPP and TOs for all damages arising out of their performance of obligations under the OATT on behalf of the customers, except in cases of gross negligence or intentional wrongdoing; (6) proposing to spread indemnification costs amongst all of its customers through a Schedule 1 charge; (7) a new Section 10.4 exempting SPP and TOs from liability for damages arising out of services provided under the OATT, including acts or omissions resulting in interruption, deficiency or imperfection of service or resulting from commonly used electric system design, operation practices, or commonly occurring conditions; (8) providing that TOs would not be liable for good faith attempts to comply with SPP directives; and (9) a new Section 10.5 providing that to the extent SPP is required to pay damages due to its indemnification of any other party, it will be allowed to recover such amounts (minus any insurance coverage) through Schedule 1.

The Commission accepted SPP's proposed liability limitation provisions in Sections 10.2 through 10.5, subject to certain conditions.

FERC's Holdings/Actions

- **Gross negligence standard for liability limitation accepted.** Intervenors raised the same old objections regarding SPP's proposed liability limitation provisions, arguing that a gross negligence standard provides no incentive for SPP and TOs to maintain system reliability or execute their responsibilities under the OATT. Intervenors argued that the state tariff liability provisions in the SPP region do not demonstrate that the gross negligence is predominantly used (as was the case in MISO). Intervenors further argued that the cap on liability (up to the value of the assets transferred) is unworkable if there are competing claims. The Commission found the proposed gross negligence standard to be just and reasonable, citing all the same policy reasons that formed the basis of the Commission's acceptance of a gross negligence provision in MISO. The Commission found that "several" state commissions in SPP's footprint allow utilities to limit liability to gross negligence (as opposed to a "predominantly" used in the MISO footprint).
- **Gross Negligence standard for indemnification accepted.** Intervenors argued that transmission customers cannot control the actions of SPP and TOs, and therefore transmission customers should not be insurers of SPP and TO conduct (especially when SPP and TOs seek to have no direct liability for such conduct). The Commission accepted the gross negligence standard for the indemnification provision. According to the Commission, even though the proposed liability provision relieves SPP and TOs from liability from ordinary negligence, that provision applies only to transmission customers and users under SPP's tariff.⁶ According to the Commission, there are other entities that could sue SPP and TOs for providing transmission service. In addition, the Commission found SPP's proposal to spread the cost of indemnification to all customers under Schedule 1 to be appropriate and will minimize the burden on all transmission customers.
- **Liability cap rejected.** The Commission rejected the proposed limit on the total value of claims for gross negligence to the value of SPP's assets or a TO's transmission assets transferred to SPP's operational control. According to the Commission, no other RTO has such a limit on liability, SPP has not supported this particular cap, and SPP has not been clear on whether the cap applies to "all claims from all incidents" or "all claims from a specific incident."
- **SPP not required to extend protections to generators and market participants.** Intervenors argued that market participants and generators should all be protected from acts or omissions done in compliance with good faith efforts to comply with SPP directives. The Commission did not require that SPP extend the liability limitation protections to market participants and generators. According to the Commission, it has found such provisions appropriate when proposed. SPP, however, has not proposed to include such entities.

⁶ MISO's tariff does not include the higher gross negligence standard in the indemnification section. MISO's limitation provision, however, applies to a broader group -- transmission customers, market participants, users, interconnection customer, interconnecting transmission owner or *any third party or any person...* (Section 10.3(a) (emphasis added)).

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- Recovery of damages under Schedule 1 is appropriate. The Commission accepted SPP's proposal to recover damages paid as part of its administrative charges under Schedule 1 as consistent with a similar mechanism in RTO-NE.
- Commissioner Kelly dissents again. As with MISO liability order, Commissioner Kelly dissented on the broad application of the SPP liability limitation provision. While she stated that she agrees some liability limitation is appropriate for economic damages that result from service provided under the tariff, she objects to the provision to the extent it insults a utility from claims for personal injury or death directly caused by the utility's negligent acts. She stated that she was not convinced that state tariffs in the SPP region supported FERC's adoption of a gross negligence standard. According to Commissioner Kelly, "rather than accomplishing the apparent goal of eliminating disparity between the federal and state regulated tariffs, this order merely replaces the existing disparity between the federal tariff and a different set of retail tariffs (with which the federal tariff was formerly consistent). She objected to the Commission's decision to allow the gross negligence standard to apply to indemnification, which she characterized as an unsupported departure from the Commission's "long-standing" indemnification precedent.

Southwest Power Pool, Inc. Docket No. ER05-666-003, "Order Denying Rehearing," 113 FERC ¶ 61,287 (December 19, 2005)

Key Issue:

- Whether SPP's proposed limitation of liability provisions improperly shifted risk to transmission customers.

Brief Summary

In March 2005, SPP filed revisions to its OATT to address limited liability and indemnification provisions. In particular, SPP sought to limit liability of itself, its transmission owners, and generators acting at its direction to instances of gross negligence or willful misconduct for service provided under the SPP OATT. In July 2005, the Commission issued an order conditionally approving SPP's proposed revisions to the limited liability and indemnification sections of its OATT, and directed a further compliance filing.⁷ That compliance filing was accepted in November 2005.

Golden Spread Electric Cooperative (Golden Spread) requested rehearing of the July order, claiming that the proposed liability provisions insulated SPP and its transmission owners from the economic consequences that arise from ordinary negligence. Golden Spread claimed that the provisions shifted the burden to transmission customers who are not responsible for the damaging activity (or inactivity) and who are not suited to mitigate the risk of that burden. Moreover, Golden Spread contended that the provisions

⁷ The July 2005 order is summarized in the 9/30/05 edition of *ATC FERC Summaries*.

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removed any incentive for SPP and its transmission owners to avoid negligent conduct and to exercise the appropriate level of care in the course of conducting their affairs.

The Commission denied Golden Spread's request for rehearing, concluding that the request raised no new arguments or presented new evidence. It also concluded that SPP's proposed liability and indemnification provisions did not conflict with FERC precedent. Moreover, FERC pointed out that, in the RTO/ISO context, similar broad provisions were contained in OATTs that are already approved and on file. By contrast, in cases where it had rejected similar provisions, the Commission had concluded that the non-ISO/RTO transmission providers seeking the protections were not solely regulated by FERC -- those transmission providers were also regulated by state agencies.⁸

Southern Company Services, Inc., Docket No. ER06-10-000 “Order Rejecting Tariff Amendments” 113 FERC ¶ 61,239 (December 2, 2005)

Key Issue:

- Whether a non-independent transmission provider could adopt limitation of liability provisions similar to those approved for ISOs and RTOs.

Brief Summary

In October 2005, Southern Company Services, Inc., on behalf of its operating companies (collectively, Southern Companies), submitted amendments to the Southern Companies' OATT to include limited liability provisions to protect and/or indemnify the operating companies in the event of service interruptions, except in cases of gross negligence or intentional misconduct. Southern Companies argued that the risk of potential damages associated with interruption of service is no different than that in RTOs and ISOs, like MISO and SPP where FERC had approved similar proposals. Southern Companies reasoned that limitations on liability provided by the states in which Southern Companies operate may not extend to service provided under Southern Companies' OATT, which is regulated solely by FERC.⁹

The Commission ruled that Southern Companies did not show that they were similarly situated to the ISOs and RTOs cited in the filing -- as those entities were regulated only by FERC -- and offered no evidence that Southern Companies are unable to rely on state laws for adequate liability protections.¹⁰ The Commission therefore rejected Southern Companies' request to add limited liability provisions to its OATT.

⁸ Commissioner Kelly issued a brief dissent, noting her objection to the broad liability protections afforded to SPP in the underlying order.

⁹ Interestingly, no party protested or otherwise commented on Southern Companies' filing.

¹⁰ FERC also noted that, other than for ISOs and RTOs, it has rejected attempts to revise transmission providers' indemnification provisions.

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Commissioner Kelly concurred with the order; however, she noted her opposition to the orders in which FERC approved similar limited liability provisions for ISOs and RTOs.