

110 FERC ¶ 61,177
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midwest Independent Transmission
System Operator, Inc.

Docket No. ER04-691-002

Public Utilities With Grandfathered Agreements
in the Midwest ISO Region

Docket No. EL04-104-002

ORDER APPROVING CONTESTED SETTLEMENT

(Issued February 18, 2005)

1. In an order dated August 6, 2004, the Commission approved the Midwest Independent Transmission System Operator, Inc.'s (Midwest ISO) proposed Transmission and Energy Markets Tariff (TEMT), which, when implemented, will allow the Midwest ISO to initiate Day 2 operations in its region.¹ The Midwest ISO's Day 2 operations will include, among other things, day-ahead and real-time energy markets, and a Financial Transmission Rights (FTR) market for transmission capacity.

¹ *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 (TEMT II Order), *order on reh'g*, 109 FERC ¶ 61,157 (2004). The TEMT specifies that all services provided under its terms and conditions will be provided by a Transmission Provider. In turn, the TEMT defines "Transmission Provider" as the Midwest ISO or any successor organization. See Module A, section 1.320, Original Sheet No. 133. For clarity, we will refer to the Midwest ISO wherever the TEMT or the Balancing Authority Agreement refers to the Transmission Provider.

2. As directed in the TEMT II Order,² the Midwest ISO and the transmission owners in the Midwest ISO region³ negotiated a resolution to the interrelated questions of how functional responsibilities, costs and liability associated with the Midwest ISO's new role in its region should be allocated among the Midwest ISO and the control areas within its footprint. This order approves a contested settlement between those parties, which benefits customers because it provides certainty as to how financial and operational responsibility for important Day 2 energy market functions will be divided.

I. Background

3. In a July 25, 2003 filing, the Midwest ISO filed a proposed TEMT pursuant to section 205 of the Federal Power Act (FPA).⁴ The July 25 Filing proposed to implement day-ahead and real-time energy markets, as well as an FTR market, within the Midwest ISO's 15-state region. The new energy markets would operate under the TEMT, which the Midwest ISO proposed as a replacement for its currently-effective Open Access Transmission Tariff (OATT). The July 25 Filing met with numerous protests, many of which alleged that the filing was incomplete and premature. Following a stakeholder vote, the Midwest ISO filed a motion to withdraw it.

² See TEMT II Order at P 138.

³ The transmission owners are: Ameren Services Company, as agent for Union Electric Company d/b/a Ameren UE, Central Illinois Public Service Company d/b/a AmerenCIPS, and Central Illinois Light Co. d/b/a Ameren Cilco; Aquila, Inc. d/b/a Aquila Networks (f/k/a Utilicorp United, Inc.); Cinergy Services, Inc. (for Cincinnati Gas & Electric Co., PSI Energy, Inc., and Union Light Heat & Power Co.); City Water, Light & Power (Springfield, Illinois); Hoosier Energy Rural Electric Cooperative, Inc.; Indianapolis Power & Light Company; LG&E Energy Corporation (for Louisville Gas and Electric Co. and Kentucky Utilities Co.); Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.; Northern Indiana Public Service Company; Northern States Power Company and Northern States Power Company (Wisconsin), subsidiaries of Xcel Energy Inc.; Northwestern Wisconsin Electric Company; Otter Tail Corporation d/b/a Otter Tail Power Company; Southern Illinois Power Cooperative; Southern Indiana Gas & Electric Company (d/b/a Vectren Energy Delivery of Indiana); and Wabash Valley Power Association, Inc.

⁴ 16 U.S.C. § 824d (2000).

4. The Commission granted the Midwest ISO's motion to withdraw the proposal. It also provided, on an advisory basis, guidance on a number of issues raised in the July 25 Filing in order to better enable the Midwest ISO to revise and re-file the TEMT.⁵ Among other things, the Commission advised the Midwest ISO and stakeholders to adopt the North American Electric Reliability Council (NERC) Reliability Functional Model (Functional Model) as a basis for discussions on the allocations of responsibilities for reliable market and power system operations.⁶ The Commission also advised that the revised TEMT "state clearly the current responsibilities under each of these categories and the proposed changes in those responsibilities."⁷

5. The Midwest ISO filed a revised TEMT proposal on March 31, 2003 (March 31 Filing). Section 38.6 of the proposed TEMT assigned responsibility to the Midwest ISO, control area operators, transmission owners, transmission operators and generation owners for three primary roles with authority to carry out reliability functions – Reliability Authority, Balancing Authority and Interchange Authority.⁸ Numerous intervenors filed protests that sought further clarification of the Midwest ISO's proposed division of functions between itself and other entities within its footprint.

⁵ See *Midwest Independent Transmission System Operator, Inc.*, 105 FERC ¶ 61,145, *reh'g dismissed*, 105 FERC ¶ 61,272 (2003).

⁶ See *id.* at P 46.

⁷ *Id.*

⁸ Reliability Authority refers to performing the functions of ensuring real-time operating reliability, performing transmission security analysis, approving generation and transmission outages, and performing regional and inter-regional coordination. The term "Balancing Authority" is used instead of "Control Area Operator" to reflect the new NERC Functional Model. The Balancing Authority maintains load-resource balance within the Balancing Authority Area. Interchange Authority relates among other things to the responsibility to serve as Scheduling Agent. The TEMT identifies the Midwest ISO as both transmission service provider and Interchange Scheduling Agent.

6. The Commission found that the proposed TEMT appropriately used the NERC Functional Model as a basis for defining roles and responsibilities within the Day 2 energy markets,⁹ and established settlement judge proceedings to address a number of unresolved issues surrounding the allocation of functions between the Midwest ISO and the control areas.¹⁰ The parties filed an Offer of Settlement on October 5, 2004.

II. Details of the Settlement

A. General Information

7. The Offer of Settlement's principal component is the Balancing Authority Agreement (Agreement), a contract among the Midwest ISO and the various Balancing Authorities in its region, which divides among the parties the tasks related to TEMT implementation. The Agreement includes attachments containing tariff language that: (1) waives the ability of customers under the TEMT to sue the Balancing Authorities in certain circumstances; (2) revises TEMT section 38.6 to describe the allocation of functions agreed to in the settlement proceeding; (3) allows the Balancing Authorities to collect the actual, accounted-for costs of implementing the TEMT; and (4) moves a provision of the original section 38.6 that no longer fits in the revised section. The Offer of Settlement and the attachments comprise an integrated agreement. The Offer of Settlement states that if the Commission does not accept the entire agreement, including attachments, without modification or condition unacceptable to the parties, then the Offer of Settlement is null and void.

8. The terms of the Offer of Settlement provide that the Offer of Settlement will become effective on the date of this order. The Agreement and the tariff language in the attachments thereto will become effective at the same time as the remainder of the TEMT. The Offer of Settlement notes that the Midwest ISO will file tariff sheets with the Commission in accordance with the Offer of Settlement after the Offer of Settlement has been accepted.

⁹ See TEMT II Order at P 120-21.

¹⁰ See *id.* at P 137-38.

9. Section 1 of the Agreement recites the procedural history leading up to the signing of the agreement and states that the parties believe that the Agreement is in the public interest. Section 2 defines various terms used in the body of the Agreement. Section 3 indicates that the Agreement is separate from, and not intended to modify, the Midwest ISO Transmission Owners Agreement or any other agreement. Conflicts between agreements are to be resolved in favor of the Transmission Owners Agreement.

B. Allocation of Operational Responsibilities

10. Section 4 of the Agreement divides operational responsibilities between the Midwest ISO and the Balancing Authorities. As a general matter, section 4 specifies that in carrying out obligations under the Agreement, the Balancing Authorities and the Midwest ISO shall: (1) follow Good Utility Practice; (2) comply with applicable NERC and regional reliability council policies; and (3) comply with applicable laws and regulations. Section 4 also provides for the allocation of specific functions. It specifies that the Midwest ISO shall be responsible for a host of tasks relating to: (1) external scheduled interchange; (2) internal scheduled interchange; (3) net scheduled interchange calculations (except with respect to dynamic schedules, as described below); (4) NERC reporting requirements for the area interchange error report; (5) inadvertent interchange, and inadvertent interchange accounts; (6) providing each Balancing Authority with dispatch instructions for each generating resource within its balancing authority area, as determined on a 5-minute basis, and resource commitment through the Reliability Assessment Commitment process; (7) subject to confidentiality requirements, exchanging data with the Balancing Authorities; (8) providing information to the Balancing Authorities necessary to allow deployment of regulation and operating reserves; and (9) declaring energy emergency alerts and documenting each emergency procedure that a Balancing Authority will be expected to perform as directed by the Midwest ISO.

11. As specified in section 4, the Balancing Authorities will: (1) continue to implement scheduled interchange requirements for dynamic schedules (including confirmation) and approve and confirm interchange schedules for start and stop time with regard to dynamic schedules; (2) collect, calculate and verify actual interchange values for each interconnection with one another or with external balancing authorities, and provide hourly data to the Midwest ISO; (3) retain their pre-TEMT inadvertent interchange accounts and implement inadvertent energy payback procedures; (4) maintain their responsibilities concerning Area Control Error, frequency bias value and time error corrections; (5) comply with NERC and regional reliability council control performance requirements; (6) subject to confidentiality requirements, provide the Midwest ISO with hourly seven-day load forecasts, available real-time operational information and the identities of generating units subject to reserve sharing;

(7) coordinate deployment of regulation and operating reserves with the Midwest ISO; (8) comply with the Reliability Authority's directives, in accordance with NERC policy, including implementing emergency procedures; and (9) negotiate with the Midwest ISO amendments to the Agreement necessary to address grandfathered agreements (GFAs).

12. The Agreement also proposes limitations on the Midwest ISO's actions. It specifies that the Midwest ISO may not issue any orders to Balancing Authorities or take any actions that it knows or should have known would damage any of the Balancing Authorities' facilities, cause injury to any person or violate applicable law.

C. Liability and Indemnification

13. Section 6 of the Agreement contains provisions related to indemnification, liabilities and insurance. With respect to indemnification, the Agreement requires that:

The Midwest ISO shall at all times indemnify, defend, and save harmless each Balancing Authority and its officers, shareholders, directors, agents, contractors, employees and members . . . from and against any and all damages, losses, claims . . . and all other obligations by or to third parties or other Balancing Authorities, arising out of or resulting from the Balancing Authority's performance of its obligations under this Agreement or the Midwest ISO's performance of its obligations under this Agreement, except in cases of gross negligence or intentional misconduct by the Balancing Authority.¹¹

Attachment B to the Agreement proposes a new tariff provision to be included in the TEMT. That provision states that control area operators, their representatives, and the Midwest ISO shall not be liable to any transmission customer or market participant or any of their representatives – including, without limitation, direct, incidental, consequential, punitive, special, multiple, exemplary or indirect damages, including attorney's fees – arising or resulting from any act or omission associated with the TEMT, except to the extent that the control area operator or the Midwest ISO is found liable for gross negligence or intentional misconduct, in which case they shall not be liable for incidental, consequential, punitive, special, multiple, exemplary or indirect damages. In addition, the control area operator, its representatives and the Midwest ISO shall not be liable for damages arising out of actions under the TEMT, including any act or omission that results in an interruption, deficiency or imperfection of service, occurring as a result of conditions beyond the control area operator's or the Midwest ISO's control or

¹¹ Balancing Authority Agreement at section 6.2.

resulting from electric system design or operations practices common to the domestic electric utility industry. The section also applies to entities that take responsive action to implement or comply with directives or needs of the Midwest ISO or control area operator relating to the performance of the Agreement.

14. Section 6.3 of the Agreement provides that a Balancing Authority “shall not be liable to the Midwest ISO for any damages whatsoever,” including damages that arise out of or result from acts or omissions associated with the Balancing Authority’s responsibilities under the Agreement. There is an exception to the extent that the Balancing Authority is found liable for gross negligence or intentional misconduct. The Midwest ISO must obtain adequate insurance to cover the indemnifications and liabilities under the Agreement.

D. Cost Recovery

15. Section 7.1 of the Agreement specifies that Attachment D to the Settlement Agreement sets forth a tariff provision providing for the recovery of costs incurred by Balancing Authorities in the implementation of the Agreement. The parties state that this tariff language is an essential term of the Agreement.

16. The tariff language, in turn, defines “Control Area Operator” to mean all entities (except the Midwest ISO) directly or indirectly performing the balancing functions enumerated in the Agreement, and that are signatories to the Agreement. It states that all Control Area Operators shall recover costs incurred as a result of implementing the energy markets and services pursuant to the TEMT, including: (1) daily operation and maintenance costs; (2) administrative and general costs; (3) capital costs; and (4) costs for systems-in-place, training, and from the performance of obligations imposed by the TEMT. All costs to be recovered must relate to control area actions in implementing, or performing obligations under, the TEMT and cannot include costs recovered under the TEMT or otherwise reimbursed by the Midwest ISO. Control Area Operator Costs are to be recovered together with, and in the same manner as, schedule 17 costs, and must be accounted for by each Control Area Operator. Finally, the tariff language indicates that the Midwest ISO shall bill appropriate entities under this schedule, and that the billing and payment provisions of schedule 7 of the TEMT shall apply. To the extent that there is an issue with regard to payment, the Midwest ISO has the right to enforce obligations under this schedule; once the Midwest ISO has received payment, it must remit it to the appropriate Control Area Operator.

17. Section 7.2 of the Agreement provides that the Midwest ISO may reimburse a Balancing Authority for costs the Balancing Authority incurs to implement the TEMT. To the extent that the Balancing Authority is reimbursed, it shall not recover costs through the new tariff mechanism. Section 7.3 indicates that if a Midwest ISO action or

inaction causes a Balancing Authority to incur a penalty, the Midwest ISO shall reimburse penalty costs. Finally, section 7.4 provides that the Midwest ISO shall not knowingly take action under the Agreement that would cause a Balancing Authority to incur or face costs relating to fulfilling its functions under the Agreement that are not recoverable pursuant to the new tariff provision or otherwise reimbursed.

E. Confidentiality, Dispute Resolution and Default

18. Section 8 provides that Balancing Authority personnel performing functions under the Agreement must keep confidential all information received from the Midwest ISO or other entities relating to its performance under the Agreement, and shall not disclose such information to market participants (even marketing personnel that are part of the same company). The sole exception to this rule is for entities with personnel who perform both Balancing Authority and marketing functions, and did so at the time the entity executed the Agreement. In such cases, the Midwest ISO has authority to limit the information provided to that Balancing Authority, unless no other entity controls generation in the Balancing Authority's area. The Midwest ISO and its personnel must adhere to the Standards of Conduct attached to the Transmission Owners Agreement with respect to all activities related to the Agreement.

19. Section 9 of the Agreement specifies that disputes arising under the Agreement shall be resolved by binding arbitration, using procedures specified in the section. Section 10 provides inspection and auditing procedures, including a requirement that the Midwest ISO and the Balancing Authorities make their books, records and facilities available to one another for purposes of determining compliance with the Agreement.

20. Section 11 states that any failure to carry out any term of the Agreement shall constitute non-performance and specifies procedures for notice and cure of non-performance. If non-performance is not disputed or cannot be cured, or a party is found to be non-performing through the dispute resolution procedures of section 9 and does not take corrective measures, then that party shall be considered to be in default. Parties may seek appropriate remedies in court in the event of another party's default.

F. Effectiveness, Termination and Modification of Agreement

21. Under section 12, the Agreement shall become effective on the date that the entire TEMT becomes effective (unless the Commission modifies or conditions any term of the Settlement Agreement in a way that is unacceptable to the parties). The Agreement shall remain effective for five years from the effective date, and from year to year thereafter unless either the Midwest ISO or three-quarters of the Balancing Authorities then subject to the Agreement give a year's written notice that they wish to terminate it.

22. Section 12.2 provides that a Balancing Authority may withdraw from the Agreement if: (1) there are no transmission facilities or there will no longer be transmission facilities subject to the Midwest ISO's functional control located within the Balancing Authority Area that that entity operates; (2) the Balancing Authority ceases, or will cease, to be a Balancing Authority; (3) the Commission materially modifies or conditions the tariff provisions detailed in sections 6.2 or 7.1 of the Agreement; or (4) a regulatory authority with jurisdiction over an entity orders that entity to withdraw from the Midwest ISO. A withdrawing Balancing Authority must provide written notice at least 180 days prior to withdrawal, except in limited circumstances, and withdrawal may not be effective before the condition set forth in this section is satisfied. Sections 12.3 and 12.4 state that the Balancing Authority and the Midwest ISO shall be subject to rights and responsibilities for actions or inactions occurring prior to termination of the Agreement or a Balancing Authority's withdrawal. The provisions of the Agreement related to indemnification survive termination or withdrawal to the extent necessary to enforce them. In the case of a Balancing Authority's withdrawal, any action or claim against the withdrawing entity related to the Agreement must commence within three years of the effective date of the withdrawal.

23. Under section 13, if the Commission modifies or conditions any term of the Agreement, the agreement shall become null, void, and without legal effect except as specified in section 12.1. However, the parties agree to negotiate to determine if the Commission's proposed modifications or conditions can be accommodated. Section 13.2 states that the parties do not intend that the Agreement will be further modified absent their agreement (with limited exceptions); therefore, the *Mobile-Sierra* "public interest" standard will apply to both Commission-proposed and party-proposed modifications or conditions to the agreement. The parties agree to negotiate changes in good faith in the event of NERC, Commission, regional reliability council or TEMT requirements that materially affect the Agreement, and to use the dispute resolution procedures if they cannot reach agreement. Section 13.3 states that absent the parties' agreement, the standard of review for changes or conditions to the Agreement, whether proposed by a party, a non-party, or the Commission, shall be the *Mobile-Sierra* "public interest" standard.¹² Finally, section 13.4 provides that the Agreement may be modified or conditioned by a three-fourth affirmative vote of the Balancing Authorities, provided that no such modification or condition may be imposed on a dissenting party to the extent that that modification will cause the party to be out of compliance with NERC or regional reliability council requirements.

¹² See *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

G. Miscellaneous Provisions

24. Section 14 of the Agreement contains miscellaneous provisions. Most significantly, section 14.3 states that by entering into the Agreement, the Balancing Authorities are not agreeing that their activities under the agreement are subject to Commission jurisdiction, and that nothing in the Agreement shall be construed to confer jurisdiction over Balancing Authorities that are non-public utilities or to cause a non-public utility to take action that would subject them to Commission jurisdiction. Section 14.5 provides for the formation of a Balancing Authorities committee to review performance under the Agreement and to propose amendments. Section 14.6 indicates that consolidation of Balancing Authorities shall be accommodated under this Agreement, and section 14.7 permits Balancing Authorities that are not signatories to the Agreement to become so. Section 14.15 states that performing functions described in the Agreement shall not cause a party to become a market participant.

III. Protests and Comments

25. As detailed below, four parties filed comments on the Agreement: the Coalition of Midwest Transmission Customers (Coalition MTC), the Michigan Public Power Agency and the Michigan South Central Power Agency (collectively, Michigan Parties), the Dominion Companies¹³ and ALCOA Power Generating Inc. (Alcoa). The Midwest ISO Transmission Owners (Midwest ISO TOs)¹⁴ filed reply comments urging the

¹³ Dominion Energy Marketing, Inc., Dominion Retail, Inc., and Troy Energy LLC.

¹⁴ The Midwest ISO TOs are: Ameren Services Company, as agent for Union Electric Company d/b/a AmerenUE, Central Illinois Power Service Company d/b/a AmerenCIPS, and Central Illinois Light Co. d/b/a AmerenCilco; Aquila, Inc. d/b/a Aquila Networks (f/k/a Utilicorp United, Inc.); Cinergy Services, Inc. (for Cincinnati Gas & Electric Co., PSI Energy, Inc., and Union Light Heat & Power Co.); City Water, Light & Power (Springfield, Illinois); Hoosier Energy Rural Electric Cooperative, Inc.; Indianapolis Power & Light Company; LG&E Energy Corporation (for Louisville Gas and Electric Company and Kentucky Utilities Company); Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.; Northern Indiana Public Service Co.; Northern States Power Company and Northern States Power Company (Wisconsin), subsidiaries of Xcel Energy Inc.; Northwestern Wisconsin Electric Company; Otter Tail Corporation d/b/a Otter Tail Power Company; Southern Illinois Power Cooperative; Southern Indiana Gas & Electric Company (d/b/a Vectren Energy Delivery of Indiana); and Wabash Valley Power Association, Inc.

Commission to disregard opposing comments and approve the Agreement. The Settlement Judge issued a report on the contested settlement on November 10, 2004, and a supplement to that report on November 17, 2004.

IV. Discussion

A. Procedural Issues

1. Comments

26. Dominion claims that by accepting the Agreement, the Commission would be effectively abrogating its responsibility under the FPA to ensure that the rates and terms of service are just and reasonable. Dominion states that any future changes would have to meet the much higher *Mobile-Sierra* “public interest” standard. Dominion claims that by styling the Agreement as a separate contract the separate arrangements could hinder system reliability. As a result, these alternative arrangements should be filed with the Commission.

27. Dominion requests rejection or conditional acceptance of the Agreement, arguing that acceptance would undermine the Midwest ISO stakeholder process and unreasonably restrict the Commission’s ability to prospectively approve changes to the market design. Michigan Parties claim that the Agreement has not been adequately justified or examined under the stakeholder process although it impacts the rights and obligations of all market participants under the Midwest ISO OATT. Accordingly, these protestors request that the Commission defer making a decision about the Agreement until the Midwest ISO conducts a more reasoned and thorough examination of the issues.

28. The Midwest ISO TOs argue that the protesting parties should have raised their objections to the Agreement during the negotiations and not at this late stage. According to the Midwest ISO TOs, the Agreement is an extraordinary achievement due to the consensus reached by numerous parties in a short time frame. A critical element of the Agreement is that it must be accepted in its entirety. The discussions were open to all parties and the objecting parties had a chance to voice their concerns during the settlement process. Their failure to timely voice their concerns should not inure to their

benefit.¹⁵ As an example, the Midwest ISO TOs state that the Michigan Parties appeared at the Agreement discussions and that concessions were made to accommodate their concerns. The Midwest ISO TOs maintain that the Agreement is in the public interest, since it addresses all the issues that the Commission set for settlement, including delineating responsibilities between the Balancing Authorities and the Midwest ISO. Thus the Agreement provides the Midwest ISO the authority required to initiate the markets. Any delays will result in delays in the implementation of the Day 2 markets.

29. The Midwest ISO TOs argue that no additional stakeholder process is necessary because the parties followed the process that the Commission provided in the TEMT II Order. The Midwest ISO TOs also state that substantial stakeholder process has taken place in the negotiation of the Reliability Charter which formed the basis for much of the Agreement. Furthermore, in October, the Midwest ISO Advisory Committee rejected a motion to direct the Midwest ISO to seek stakeholder input on the Offer of Agreement.

2. Discussion

30. As the Commission noted in both the TEMT I Order and the TEMT II Order, it is important that the Midwest ISO clearly delineate the division of reliability functions between itself and the Balancing Authorities.¹⁶ Issues of costs and liability – which have a bearing on rates – are related to the question of the proper allocation of functional responsibilities.¹⁷

¹⁵ The Midwest ISO TOs argue that Coalition MTC, Dominion and Alcoa did not appear and raise objections at the settlement conference, so the Commission should not indulge their objections now. The Midwest ISO TOs cite 18 C.F.R. § 385.601(b)(3) (2004) (“If any party fails to attend the conference such failure will constitute a waiver of all objections to any order or ruling arising out of, or any agreement reached at, the conference.”); and *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,106 at n.1 (2004) (party who failed to appear at settlement conference waived objections to unanimous settlement). Reply Comments of the Midwest ISO Transmission Owners at 3.

¹⁶ TEMT II Order at P 97; TEMT I Order at P 49.

¹⁷ See TEMT II Order at P 137.

31. It has been evident to the Commission throughout the process of considering the July 25 Filing and the March 31 Filing that market participants have strong opinions about the issue of functional allocation. The portion of the July 25 Filing that addressed control area responsibilities met with at least a dozen protests that raised arguments ranging from the Midwest ISO's authority to reallocate control area functions to practical operational and financial issues.¹⁸ And although the Midwest ISO heeded the Commission's instruction in the TEMT I Order to continue to work on this issue with its stakeholders,¹⁹ the protests to the March 31 Filing indicated that a diverse range of interrelated issues remained unresolved.²⁰ It was evident to the Commission that negotiation would be a faster, more efficient way to resolve the difficult issues of how Day 2 energy market functions would be provided than a paper hearing might be.²¹ The advent of the Agreement (especially within a short time after the TEMT II Order was issued), and the number of Balancing Authorities who have executed it, validates our reasoning.

32. We disagree with Dominion's argument that by accepting the Agreement, we are abrogating our responsibility under the FPA to ensure that rates and terms of service are just and reasonable.²² The heart of Dominion's argument seems to be that it is irresponsible for the Commission to accept the Agreement's *Mobile-Sierra* clause, which

¹⁸ See TEMT I Order at P 31-39.

¹⁹ *Id.* at P 49-52. See also Testimony of Joe Gardner at 11-12, 15-16, Docket No. ER04-691-000 (March 31, 2004) (describing efforts to divide functional responsibilities in accordance with NERC Functional Model); Testimony of Richard Doying, Docket No. ER04-691-000 at Exhibit RD-1 (March 31, 2004) (identifying dates and subject matter of key stakeholder and Control Area Working Group meetings at which control area roles and responsibilities were discussed).

²⁰ See TEMT II Order at P 129-34, 137 ("There are, however, a number of unresolved issues surrounding the proposal. It is unclear precisely what the functional responsibilities of the Midwest ISO and the control areas will be, and how they will work together to effectuate the new arrangements.").

²¹ See TEMT II Order at P 137-38.

²² See 16 U.S.C. § 824d (2000).

would subject future changes – whether initiated by a party to the Agreement, a non-party, or the Commission – to the “public interest” standard of review.²³ Dominion notes that both the Commission and the stakeholders, through the stakeholder process, will be restricted in their ability to make changes to the Agreement going forward. We agree with Dominion and Michigan Parties that this change will not be easy to effect, but we do not agree that the restriction is unacceptable. The Agreement provides more than one means for modification. The parties may negotiate (or pursue through dispute resolution) appropriate changes to the Agreement under certain conditions, including changes in Commission requirements, and the parties also may vote to modify the Agreement. Changing the agreement via section 206 of the FPA (which would require the party requesting the change to demonstrate that the *Mobile-Sierra* “public interest” standard is satisfied) appears to be a second-choice means of resolving issues that require the modification of the Agreement. And if the public interest “imperatively demands” change, the Commission can make amendments.²⁴

33. Dominion’s and Michigan Parties’ concerns that the Agreement will undermine the stakeholder process, or should have been approved through the stakeholder process, are similarly misplaced. The Agreement is a negotiated resolution to issues pending in a contested Commission case. While the Commission may refer issues back to the stakeholder process for resolution, in this case the Commission elected to require the parties to negotiate before a settlement judge.²⁵ The Midwest ISO TOs are therefore correct that no additional stakeholder process is necessary for the Commission to approve the settlement. Parties to this docket who were not part of the negotiations had an opportunity to comment on the settlement and to express their objections.

34. We agree with the Midwest ISO TOs to the extent that they argue that it is appropriate for protesting parties to raise their objections during settlement discussions. However, as the Commission was not privy to those discussions, we cannot discern with certainty who attended the settlement conference and raised what objections.²⁶ Alcoa, Dominion and Coalition MTC are not Midwest ISO transmission owners, and therefore

²³ Balancing Authority Agreement at section 13.3.

²⁴ *Metropolitan Edison Co. v. FERC*, 595 F.2d 851, 856 n.29 (D.C. Cir. 1979).

²⁵ See TEMT II Order at P 138.

²⁶ The ALJ indicated only that it “appears [Coalition MTC], Dominion and Alcoa may not have been present at the settlement discussions.” ALJ Report at P 24 n.10.

the Commission did not order them to attend the settlement conference. And while the Midwest ISO TOs indicate that the settlement proceedings were “open to all parties,” we are unsure from the record the extent to which these parties would have been permitted to participate.²⁷ We will therefore afford these parties the benefit of the doubt and address the arguments raised in their comments.

35. The Commission may accept a contested settlement such as this one if it can make an “independent finding supported by substantial evidence on the record as a whole, that the proposal will establish just and reasonable rates.”²⁸

B. Liability and Indemnification

1. Comments

36. Coalition MTC believes that the limited liability provisions are unreasonably broad since eligible control area operators, their representatives and the Midwest ISO, as transmission provider, are shielded from the consequences of faulty provision of transmission service in all but egregious instances (gross negligence and intentional misconduct). Coalition MTC maintains that the proposed limitation of liability is not in the public interest. These protestors maintain that the liability provision insulates the Midwest ISO and the control area operators from too much responsibility. Protestors also ask the Commission to wait to rule on the liability provisions until it has issued an order in Docket No. ER04-1160-000.

37. Protestors claim that the indemnity obligation should be in the Midwest ISO’s OATT, and should also apply to entities required to respond to directives that the Midwest ISO issues in the course of its performance under the Agreement. They argue that generators and other market participants should be provided with comparable protections or limitations of liability and indemnification rights since they are required to act at the direction of the Midwest ISO and Balancing Authorities.

38. Coalition MTC states that the Balancing Authority Agreement allows for the double recovery of costs related to the risk of transmission ownership and Regional Transmission Organization participation. This is so because customers already pay a 12.88 percent return on equity which was based on the risk assessment of the enterprise.

²⁷ Midwest ISO TOs at 3.

²⁸ *Mobil Oil Corp. v. FERC*, 417 U.S. 283, 314 (1974).

The proposed limited liability provision would force customers paying a 12.88 percent return on equity to face additional costs associated with hedging against the risk that a Midwest transmission provider's negligence will inflict damage.

39. According to the Midwest ISO TOs, the liability and indemnity provisions were critical to the Agreement. The Midwest ISO TOs also state that the liability provisions in the Agreement are consistent with Commission precedent. Similar liability and indemnity provisions were approved by the Commission for ISO New England and were not considered overly broad.²⁹

40. The Midwest ISO TOs counter that the 12.88 percent return on equity does not apply to the functions covered by the Agreement that relate to Day 2 energy market operations. Moreover, the Midwest ISO TOs also claim that the market will reduce the transmission revenues recovered by the transmission owners (the market may eliminate current internal point-to-point transmission revenues). Therefore, there will not be "additional" costs as Coalition MTC alleges.

41. Furthermore, the Midwest ISO TOs assert that the protestors' request that the Commission hold its decision in abeyance until it concludes Docket No. ER04-1160-000 is unreasonable because the Commission specifically ordered that liability issues be resolved in this proceeding. The legal structure, including waiver of liability, needs to be in place for the Balancing Authorities to move forward with market start-up.

42. The Midwest ISO TOs state that the request that indemnification and liability provisions should be expanded to cover the Michigan Companies and Dominion, who will not operate as Balancing Authorities, is beyond the scope of the proceeding because the TEMT II Order speaks in terms of the responsibilities and obligations of the Midwest ISO and Balancing Authorities.

²⁹ See *ISO New England Inc.*, 106 FERC ¶ 61,280 at P 229 (2004) (accepting provisions that provided: (1) that tariff customers waived ability to sue ISO New England or the transmission owners except in case of gross negligence or willful misconduct and (2) for ISO New England to indemnify the transmission owner).

2. Discussion

43. Taken together, the proposed limitation of liability provisions in section 6 of the Agreement and in the new tariff language the parties to the Agreement propose have the following implications:

- The Midwest ISO and the Balancing Authorities will not be liable to transmission customers or market participants for acts or omissions arising from the TEMT, except to the extent that one of them is found liable for gross negligence or intentional misconduct. The Midwest ISO waives its right to sue the Balancing Authorities for, and must indemnify the Balancing Authorities against, damages stemming from the Balancing Authority's performance of its obligations, except in cases of gross negligence or intentional misconduct by the Balancing Authority.
- Neither the Balancing Authorities nor the Midwest ISO will be liable for damages arising out of actions under the TEMT that occur as a result of conditions beyond the Balancing Authorities' or the Midwest ISO's control.
- The Balancing Authorities shall not be liable for attempting to comply with the Midwest ISO's directions.
- With limited exceptions, the Balancing Authorities shall not be liable to the Midwest ISO for damages. The Midwest ISO's liability to the Balancing Authorities is limited.

44. Coalition MTC alleges that the limited liability provisions are overbroad, while the Midwest ISO TOs argue that they are appropriate because they are similar to those approved for ISO-NE. In approving ISO-NE as a Regional Transmission Organization, the Commission directed it to include in the liability section of its tariff "a cross indemnification provision requiring RTO-NE and the Transmission Owners to be responsible for all third party liabilities attributable to their own acts and omissions."³⁰ Earlier precedent accepted reciprocal assumption of liability and release of responsibility between contracting parties when that contract did not limit the rights of transmission customers and other third parties.³¹

³⁰ *ISO New England Inc.*, 106 FERC ¶ 61,280 at P 229 (2004).

³¹ See *TRANSLink Development Company, LLC*, 102 FERC ¶ 61,033 at P 39 (2003).

45. The Agreement and the new tariff language accompanying it strike a balance between *ISO New England* and *TRANSLink*. While it includes reciprocal assumption of liability and release of responsibility as to one another, it waives the Midwest ISO's and the Balancing Authorities' liability to third parties except under limited circumstances. In providing third parties with a right to sue in those limited circumstances, however, the Agreement appropriately assigns liability to the party most responsible for the damages.³²

46. We further note that the Commission has already required the Midwest ISO to file additional tariff provisions that limit the liability of generators and market participants. The Commission found in the TEMT II Rehearing Order that it had erred in limiting the settlement discussions to the Midwest ISO and the Midwest ISO TOs, foreclosing the possibility that the settlement process would produce a provision regarding limitation of liability for generators and market participants.³³ The Commission instructed the Midwest ISO to provide the limitation of liability for generators and market participants that is lacking from the Agreement.³⁴ We continue to expect that within 30 days of the date of this order, the Midwest ISO will make a filing to propose such provisions. We will therefore accept the proposed indemnification and limitation of liability provisions proposed here subject to the outcome of that compliance filing.

47. We agree with the Midwest ISO TOs that the indemnification and liability provisions of the Agreement should not be expanded to cover Michigan Companies and Dominion, who will not operate as Balancing Authorities. Should either of those entities eventually become Balancing Authorities, they will have the option, in accordance with the terms of the Agreement, to become a signatory and thus to avail themselves of these provisions. Moreover, we expect that Dominion and Michigan Companies, as market participants, will be covered under the liability provisions that the Midwest ISO must propose in its upcoming compliance filing.

³² See *ISO New England*, 106 FERC ¶ 61,280 at P 230 (contrasting new tariff proposal, which proposed to make ISO-NE liable for third-party claims relating to its exercise of authority over its transmission system, with current situation, in which risk of liability for third party claims of ordinary negligence are spread among all market participants).

³³ TEMT II Rehearing Order at P 476.

³⁴ See *id.* at P 476-77.

48. Protestors' concern that Commission action in the instant proceeding would potentially adversely affect the outcome of Docket No. ER04-1160-000 is without merit. The issue before the Commission in Docket No. ER04-1160-000 concerns liability limitation under the Midwest ISO's OATT. The issue here is liability limitation for Balancing Authorities under the TEMT, *i.e.*, after markets have started in the Midwest region.

49. As for protestors' arguments that the indemnity obligation should be in the Midwest ISO's tariff, we agree. We will require the Midwest ISO to designate the pages of the Agreements in compliance with Order No. 614, as it has with the Transmission Owner Agreement, thus placing them in the tariff.

50. Finally, the Commission has approved a 12.88 percent return on common equity for the Midwest ISO TOs providing transmission services;³⁵ the 12.88 percent figure is used in the formula calculation of transmission service rates. While Coalition MTC and other customers may face additional costs related to limitation of liability for the Midwest ISOs, it is impossible at this point to determine whether such costs will arise, or to predict their magnitude. It is also impossible to predict the precise circumstances under which the limitation of liability for the Midwest ISO TOs may apply, and whether the result will be a double recovery of costs.

C. Cost Recovery

1. Comments

51. According to Alcoa, the proposed cost recovery does not account for payments for control area services currently being made by customers under GFAs and may result in the duplication of charges already paid by GFA customers to transmission owners. Additionally, Alcoa claims that if new charges result from the Agreement, such new charges cannot be assessed on the Alcoa GFA No. 343 under the *Mobile-Sierra* doctrine.³⁶ Further, such charges would most likely disadvantage Alcoa *vis a vis* international aluminum producers. As a result, Alcoa requests that the recovery mechanism be changed so that GFA parties already paying for control area services not

³⁵ See *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2002), *reh'g denied*, 102 FERC ¶ 61,143 (2002), *order on remand*, 106 FERC ¶ 61,302 (2004).

³⁶ GFA No. 343 is an Electric Power Balancing Authority Agreement with Southern Indiana Gas and Electric Company.

pay any additional charges for such services. In addition, the Commission should hold that any additional control area charges arising under the Agreement should not apply to service under GFA No. 343.

52. In response, the Midwest ISO TOs explain that under the Agreement, Alcoa's rights will not be impacted because any potential costs that may be imposed on GFAs will require a separate filing and can be contested at that time. Moreover, amendments to the Agreement dealing with GFAs are in the process of negotiations.

53. Additionally, Coalition MTC states that there is no language on how the costs are to be monitored, enforced or audited. Dominion maintains that section 4.13.6 of the Agreement (which allows the Midwest ISO and any Balancing Authority to modify the division of responsibilities through contract) could subject market participants active in more than one control area to additional costs by being forced to adapt their operations to comport with alternative arrangements.

54. The Midwest ISO TOs assert that the recovery of Balancing Authority costs is an essential and critical element of the Agreement. It argues that the cost recovery mechanism affords customers the same protections as those in schedule 1 and costs will be accounted for in a specific account and available for audit. Improperly collected costs can be refunded. Additionally, were the Commission to require additional accounting detail, the Midwest ISO TOs will provide it, as long as it is clear that identifiable costs not otherwise recovered, relating to the implementation of the Agreement, are recoverable. Moreover, the tariff already addresses "double recovery" issues since it provides that costs otherwise recovered under the Midwest ISO tariff or reimbursed by the Midwest ISO will not be recovered. Any duplication of cost recovery involving retail customers can be addressed if and when a transmission owner seeks to pass through these costs at the state level. Finally, the Midwest ISO TOs reiterate that Coalition MTC waived its right to assert these objections since it failed to assert them during the Agreement conferences.

55. Dominion states that the Agreement should be modified to allow the Commission to order consolidation of control areas. Dominion further states that section 8.1(c) must be removed in order to safeguard the sharing of information under this Agreement to ensure that market participants are not placed at a competitive disadvantage by the

Balancing Authorities' access to information. The information exchange should be subject to the Code of Conduct for Transmission Providers.³⁷ Finally, this entity asserts that certain definitions in the Agreement are inconsistent with the definitions of the TEMT.

56. In response to Dominion's arguments, the Midwest ISO TOs assert that any Agreements between the Balancing Authorities and the Midwest ISO modifying the division of responsibilities would be filed with the Commission. The Midwest ISO TOs also state that nothing in the Agreement precludes the Commission from ordering the consolidation of control areas. Finally, the Midwest ISO TOs claim that the confidentiality language of section 8.1 is not intended to have broad impact but it protects smaller utilities which do not have separate Balancing Authority personnel and marketing personnel and that although there are some differences between the definitions in the Agreement and the TEMT, all definitions used in the Agreement are clearly defined.

2. Discussion

57. Attachment D to the Agreement reads:

Control Area Operators shall recover their costs incurred as a result of implementing the Midwest ISO Markets and Services pursuant to this Tariff. These Control Area Operator Costs included daily operation and maintenance costs, administrative and general costs, capital costs, costs for systems-in-place, training of personnel and any costs that result from the performance of obligations imposed by this Tariff on Control Area Operators; provided however, that all costs to be recovered under this Schedule must be related to Control Area actions in performing obligations under this Tariff and in implementing this Tariff and shall not include any other costs reimbursed by the Transmission Provider to Control Areas or costs otherwise recovered in this Tariff.

³⁷ *Standards of Conduct for Transmission Providers*, Order No. 2004, FERC Statutes and Regulations ¶ 31,155 (2003), *order on reh'g*, Order No. 2004-A, 107 FERC ¶ 61,032 (2004), *further reh'g*, 108 FERC ¶ 61,118 (2004).

58. In reply comments, the Midwest ISO TOs add that all costs will be accounted for in a specific account available for audit. If the Commission requires additional accounting detail, the Midwest ISO TOs say that they will provide it, as long as there is no question that identifiable costs that are not otherwise recovered, relating to the implementation of the Agreement, are recoverable.³⁸

59. We find the concept of recovery of costs incurred by the transmission owners as a result of the Agreement is reasonable. Therefore we accept this provision. However, we are concerned that there is not enough transparency in the Agreement and hence the proposed TEMT language. Therefore, we accept the Midwest ISO TOs' offer to submit additional detail regarding the treatment of these costs. That detail should provide assurance that there are mechanisms in place to prevent double recovery and to allow for these amounts to be clearly identifiable and available for audit. The Midwest ISO TOs are directed to provide this information within 30 days of the date of this order.

60. We accept the Midwest ISO TOs' explanation of the effect of the Balancing Authority Agreement on Alcoa's GFA. Section 4.13.5 of the Balancing Authority Agreement states that the Midwest ISO TOs commit to negotiate within forty days after the execution of the Balancing Authority Agreement amendments to address the GFAs.

61. We also find that any transmission owner seeking to recover additional costs under a GFA must make a section 205 filing with the Commission. This should alleviate the concerns expressed by Alcoa.

62. Dominion requests the Commission require the Midwest ISO TOs include a provision expressly not precluding the Commission from ordering the consolidation of control areas. In reply comments, the Midwest ISO TOs point to section 14.6 of the agreement which directly accommodates such consolidation. Therefore Dominion's concern has already been addressed.

63. Dominion also has expressed concern over the language contained in section 8.1 regarding confidentiality. The language states that no Balancing Authority shall be obligated to restructure its operations (in place at the time of its execution of this Agreement) to separate Balancing Authority personnel from marketing personnel. In its reply comments, the Midwest ISO TOs state that this language was included to protect certain small utilities that do not have separate Balancing Authority personnel and marketing personnel, and is not intended to have broad impact. Each party that has personnel that perform both the Balancing Authority function and the marketing function

³⁸ Reply Comments of Midwest ISO TOs at 10.

must notify the Midwest ISO. The Midwest ISO may limit the information provided to each such party. We find that this is a reasonable solution to this issue. We also find that the provision does not affect any party currently covered by Order No. 889 and only parties that were already performing both functions may continue to do so. We are also comforted by the fact that Midwest ISO has also placed limits on what information each Balancing Authority with personnel performing dual functions may share with third parties or potential third parties.

64. Dominion also expresses concern that the definitions used in the Balancing Authority Settlement do not always conform to the definitions used in the TEMT. As long as the terms used in the Agreement are clearly defined we are satisfied. Dominion also does not raise an issue that a particular term is unclear, and the fact that there are some minor differences in the definitions of some terms between the TEMT and the Agreement is not a concern. However, we remind the Midwest ISO and the Balancing Authorities that any amendments made to the TEMT as a result of the Agreement must be consistent with the definitions contained in the TEMT.

D. Disposition of Filing and Compliance Requirement

65. The Agreement constitutes a just and reasonable resolution of the issues that the Commission set for hearing in the TEMT II Order, and we approve it.

66. We will require the Midwest ISO to file, within 30 days of the date of this order, the tariff language appended to the Agreement as Attachments C, D and E. We also accept the offer of the Midwest ISO to provide more details regarding the treatment of costs as discussed above. The Midwest ISO must also submit amendments or a status report on negotiations regarding the GFAs. As noted above, the Midwest ISO must also submit language concerning limitation of liability and indemnification as discussed herein and in the TEMT II Rehearing Order. Further, in its compliance filing the Midwest ISO is directed to refile the Agreement as a rate schedule consistent with Order No. 614.³⁹

³⁹ *Designation of Electric Rate Schedule Sheets*, Order No. 614, 65 Fed. Reg. 18,221, FERC Stats. & Regs. ¶ 31,096 (2000).

The Commission orders:

(A) The Settlement is in the public interest and is hereby approved, subject to the outcome of the Midwest ISO's filing to provide limitation of liability protection for generators and market participants, as discussed in the body of this order.

(B) The Midwest ISO is directed to make compliance filings as described in the body of this order.

By the Commission. Commissioner Kelly dissenting with a separate statement to be issued later.

(S E A L)

Magalie R. Salas,
Secretary.