ORAL ARGUMENT SCHEDULED FOR MAY 17, 2004

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IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 02-1287
(consolidated)

CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORP., *et al.*,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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WASHINGTON, D.C. 20426

DECEMBER 5, 2003
FINAL BRIEF: MARCH 2, 2004

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CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties before this Court are identified in the briefs of Petitioners.

B. Rulings Under Review

1. *Mirant Delta, LLC, et al*., 100 FERC ¶ 61,059 (2002); and

2. *Mirant Delta, LLC, et al*., 100 FERC ¶ 61,271 (2002).

C. Related Cases

This case has not previously been before this Court or any other court. A previous petition for review concerning the same subject matter, *Western Power Trading Forum, et al. v. FERC*, No. 99-1532, was dismissed by the Court on April 10, 2001 for mootness and lack of standing. Also, numerous parties petitioned in *Public Utilities Commission of the State of California, et al. v. FERC*, Nos. 01-71051, *et al*. (9th Cir.), for review of *San Diego Gas & Elec. Co., et al*., 93 FERC ¶ 61,294 (2000), which was also originally challenged in this proceeding, but petitioners now acknowledge that for purposes of this appeal the challenge to *San Diego* is moot.

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Dennis Lane
Solicitor

March 2, 2004

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GLOSSARY

ABX1 5	Assembly Bill 5 of the 2001-02 First Extraordinary Legislative Session of the California Legislature
Audit Report	Vantage Consulting, Inc. "Operational Audit of the California Independent System Operator" (January 25, 2002)
CAISO	California Independent System Operator Corp.
CAISO Br.	Brief of Petitioner California Independent System Operator Corp.
CPUC	California Public Utilities Commission
CPUC Br.	Brief for Petitioners Public Utilities Commission of the State of California and California Electricity Oversight Board
December 15, 2000 Order	*San Diego Gas & Electric Co. et al.*, 93 FERC ¶ 61,294 (2000)
DWR	Department of Water Resources
FERC	Federal Energy Regulatory Commission
ISO	Independent System Operator
July 17, 2002 Order	*Mirant Delta, LLC, et al*., 100 FERC ¶ 61,059 (2002)
MD02 Order	*California Independent System Operator Corp*., 100 FERC ¶ 61,060 (2002)
Oversight Board	California Electricity Oversight Board
PX	Power Exchange
RTO	regional transmission organization
SB 96	(California) Stats. 1999, Ch. 510
September 16, 2002 Order	*Mirant Delta, LLC, et al*., 100 FERC ¶ 61,271 (2002)
November 1, 2000 Order	*San Diego Gas & Electric Co.*, 93 FERC ¶ 61,121 (2000)

TAPS	*Transmission Access Policy Study Group, et al. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000)

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BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUE

Whether the Commission (1) properly determined that the governance structure for the CAISO's Governing Board established by ABX1 5 was unduly discriminatory or preferential because it did not provide for fair representation by all classes of market participants, and (2) properly set selection and other procedures designed to result in a just and reasonable governance structure.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutes are contained in the Addendum to this brief.

STATEMENT OF THE CASE

I. Nature of the Case, Course of Proceedings, and Disposition Below

The California Independent System Operator ("CAISO") is a public utility created to operate the California transmission grid in interstate commerce, and is therefore subject to FERC's jurisdiction under § 201 of the Federal Power Act ("FPA"), 16 U.S.C. § 824. The challenged orders, *Mirant Delta, LLC, et al. v. California Independent System Operator Corp*., 100 FERC ¶ 61,059 (2002) ("July 17, 2002 Order"), *on reh'g*, 100 FERC ¶ 61,271 (2002) ("September 16, 2002 Order"), under FPA §§ 205 and 206, 16 U.S.C. § 824d and § 824e, rejected the CAISO's governance structure set by ABX1 5 on the grounds that, *inter alia*, its domination by the State, then the largest purchaser in the California energy market: (1) prevented FERC from ensuring that CAISO's rates were just and reasonable and not unduly discriminatory or preferential; and (2) hindered growth and development of the California and Western energy markets. In accordance with FPA §§ 205 and 206, after making those findings, the Commission set a just and reasonable governance structure.

Petitioners contend that the Commission lacked the statutory authority to address CAISO's governance structure, and that the findings that the composition was unduly discriminatory and unjust and unreasonable were not based on substantial evidence.

II. Statement of Facts

A. ISO and RTO Development

Historically, vertically integrated public utilities sold generation, transmission and electric distribution services as part of a bundled package. Recently, significant technological advances and changes in the law led to increased entry into the wholesale electric power generation markets, and created a need for greater access to transmission services.

Because entry into the transmission market is difficult and restricted, utilities owning or controlling transmission facilities enjoy a natural monopoly that they can exploit to favor their own generation and exclude competitors from the market. *Transmission Access Policy Study Group, et al. v. FERC,* 225 F.3d 667, 683-84 (D.C. Cir. 2000) ("*TAPS*"), *aff'd sub nom., New York v. FERC*, 535 U.S. 1 (2002). FERC found that vertically integrated public utilities were using their monopoly control over interstate transmission facilities to gain advantage over potential competitors, and thus stymy competition. To remedy this situation, FERC Order No. 888 [1] fundamentally altered the

[1] *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities,* Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996)("Order No. 888"), *clarified,* 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996), *on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, *clarified,* 79 FERC & 61,182 (1997), *on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998); *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, FERC Stats. & Regs. ¶ 31,035 (1996)("Order No. 889"), *on reh'g*, Order No. 889-A, FERC Stats. & Regs. ¶ 31,049 (1997), *on reh'g*, Order No. 889-B, 81 FERC ¶ 61,253 (1997), *aff'd in part, remanded in part, Transmission Access Policy Study Group,*

wholesale electric power market, requiring all jurisdictional public utilities to unbundle wholesale electric power services and to file open access non-discriminatory transmission tariffs as a remedy for undue discrimination. This Court ruled FERC properly identified the "fundamental, systemic problem in the industry," *TAPS*, 225 F.3d at 683, and affirmed the imposition of open access as a generic remedy for that problem, *id*. at 684.

One means for public utilities to meet the non-discriminatory open access transmission tariff requirements was participation in a properly constituted ISO. Order No. 888 at 31,730. Because the "primary purpose of an ISO is to ensure fair and non-discriminatory access to transmission services and ancillary services for all users of the system," it is crucial that an ISO be independent of market participants, *id*., so that policies, operation, and dispute resolution can be conducted in a fair and nondiscriminatory manner, *id*. at 31,731. To accomplish this purpose, the ISO governance structure must prevent control and the appearance of control by any one class or group of market participants. *Id*.

Following Order No. 888, virtually all transmission-owning public utilities filed open access tariffs, thus facilitating increased interregional transfers of electricity. Divestiture by many integrated utilities of some or all of their generating assets, as part of States' efforts to introduce retail competition, led to increased merger activity and increased numbers of new participants (*e.g.*, power marketers, generators, and independent power exchanges).

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et al. v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub. nom, New York v. FERC*, 535 U.S. 1 (2002).

All these factors placed new and different demands on the transmission grid. Following an industry-wide consultative process, FERC Order No. 2000 [2] concluded that transmission-related impediments were hindering a fully competitive wholesale electric market, and that regional transmission organizations ("RTOs") could eliminate undue discrimination in transmission services through improved grid efficiency, reliability, and market performance. The Commission therefore required all public utilities that own, operate or control interstate transmission facilities either to file a proposal to participate in an RTO or to describe their efforts toward joining one. To assure non-discriminatory access to the transmission grid, the Commission established minimum characteristics for an RTO, including the "bedrock" principle that each RTO should be independent from market participants.

Independent grid operation minimizes discriminatory conduct that would lead to higher costs for customers.

> In other areas of the country, where markets do not have independent or regional grid operation, the lack of price transparency in the marketplace can mask problems and transmission operators can use their ability to control the transmission system to favor their own power sales. New competitors may be blocked or delayed because the transmission operator can favor its affiliated suppliers both in interconnecting to the grid and in allocated the costs of interconnection. The result of these problems is

[2] *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 (1999), *on reh'g*, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd, Public Utility Dist. No. 1 of Snohomish County v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

higher customer costs, making independence a critical element for protecting native load. [3]

Likewise, lack of market confidence resulting from the perception of discrimination is itself a significant impediment to competitive markets having real-world consequences for market participants and consumers. Order No. 2000 at 31,017. Among other things, lack of market confidence may deter generation expansion, leading to higher consumer prices. *Id*. Fears of discriminatory curtailment of transmission rights may deter existing or new sources of generation from seeking transmission access, with the result that those potential sources of additional power, that would otherwise mitigate price spikes, would not be available to end-users. *Id*.

B. California's Restructuring

In September 1996, the California legislature enacted AB 1890 to restructure the California electric industry. AB 1890 mandated the creation of the CAISO and a Power Exchange ("PX") by January 1998, and the creation of the California Electricity Oversight Board ("Oversight Board") with members appointed by the Governor and legislature. The CAISO would operate a single, state-wide transmission grid, and the PX would facilitate creation of a transparent, visible spot market for electric generation.

To implement this restructuring program, on April 29, 1996, California's three largest investor-owned utilities filed a joint application with FERC to transfer control of

[3] *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, Docket No. RM01-12-000, Notice of White Paper (April 28, 2003).

certain transmission facilities to the CAISO and to sell electricity to the PX. The applicants, the California Legislature, the California Public Utilities Commission ("CPUC") and the other parties all recognized that the CAISO and PX would be public utilities subject to FERC jurisdiction under the FPA.

AB 1890 proposed that the CAISO and PX would be governed by boards composed of California residents selected to represent various stakeholder classes (*i.e.*, transmission owners, municipal entities, sellers, end-users, etc.), with each class having a specified number of voting representatives. An Oversight Board was proposed: (1) to establish nominating/qualification procedures for the ISO and PX Governing Boards, to determine the composition of Board representation, and to select Board members both initially (start-up function) and in the future; and (2) to serve as a permanent appeal board for reviewing ISO Governing Board decisions.

The Commission conditionally granted the applications on a preliminary basis, approving the proposed Governing Boards as consistent with the ISO principles of Order No. 888, except for the proposed California residency requirement which was unduly discriminatory. *Pacific Gas & Electric Co.*, 77 FERC ¶ 61,204 (1996). The Commission approved the start-up function for the Oversight Board, but rejected its having a permanent role in the governance or operations of the CAISO because those matters are within FERC's exclusive jurisdiction, and because its governance structure conflicted with open access independence principles.

In 1999, the Oversight Board sought advance FERC approval of a bill pending before the California Senate, SB 96, which made several changes to the California

restructuring law. Whereas formerly the Oversight Board was authorized to appoint all members to the ISO and PX stakeholder boards, SB 96 gave it only veto power over certain categories of proposed board members. The California residency requirement was changed to a requirement that board members be electricity customers in the area served by the ISO or PX. The previously very broad appellate jurisdiction was confined to matters outside FERC's authority pertaining to retail electric service or sales. The Commission approved the changes proposed in SB 96 in light of the unique circumstances involved. *California Electricity Oversight Board*, 88 FERC ¶ 61,172 (1999), *reh'g denied*, 89 FERC ¶ 61,134 (1999).

C. Events Concerning the CAISO Board Following the Summer of 2000

Beginning in the summer of 2000, the California bulk wholesale market experienced serious dysfunctions and pricing abnormalities. Following its investigation into those difficulties, the Commission proposed in *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,121 (2000) ("November 1, 2000 Order"), specific remedies to correct identified flaws. One flaw was the ineffectiveness of the then-existing ISO Governing Board in reaching decisions, due both to its inability to reach consensus on important issues and to its susceptibility to influence by market participants, including the State of California, creating conflicts of interest. Unless the CAISO Board could resolve matters independently and timely, the Commission could not be assured that the CAISO's rates, terms and conditions for jurisdictional services would be just and reasonable, and not unduly discriminatory or preferential. To remedy this situation, the Commission proposed replacing that Board with an independent, non-stakeholder Board within 90

days. In addition to an independent selection process, the Commission specified that the Board should include members with experience in corporate leadership, professional expertise in either finance, accounting, engineering or utility law and regulation, and experience in the operation and planning of transmission systems.

San Diego Gas & Elec. Co., 93 FERC ¶ 61,294 (2000) ("December 15, 2000 Order"), addressed comments regarding the proposed new, non-stakeholder CAISO Board. To allow California an appropriate role in board selection, the Commission proposed an on-the-record consultative procedure between it and the State. The existing Board was required to turn over decision-making power and operating control to the CAISO management by January 29, 2001, but could continue functioning as members of a stakeholder advisory committee. If no consensus were reached regarding board selection within 90 days of the December 15, 2000 Order, the procedures proposed in the November 1, 2000 Order would apply.

On January 18, 2001, the California legislature passed a statute (ABX1 5) that replaced the existing CAISO Board with a five-member Board appointed by the Governor, subject only to confirmation by the Oversight Board. See July 17, 2002 Order at ¶ 10, JA 51. The law stated that new Board members should not be affiliated with actual or potential market participants, purported to give the Board authority to determine what filings the CAISO could submit to FERC, and precluded CAISO's entry into a multistate entity or a regional organization under Order No. 2000 unless approved by the Oversight Board. *Id.*

The Governor nominated five California residents to the Board: the California Secretary of Business, Transportation, and Housing; the Director of Policy and Senior Advisor to the Governor; a senior attorney for The Utility Reform Network, a consumer advocacy group; a former chair of the Oversight Board; and the President and CEO of the Silicon Valley Manufacturing Group, another advocacy group. *See id*. at ¶ 11, JA 51. On January 23, 2001, the Oversight Board confirmed the Governor's nominees, and the California Attorney General filed suit to compel the then-existing Board members to resign immediately. *Id*. Resignations occurred on January 25, 2001, when the new members assumed control of the Board. *Id*. An executive order (E.O. D-23-01) directed the new Board to revise the CAISO's FERC tariff to reflect those changes. *Id*.

On January 17, 2001, the Governor issued an emergency proclamation giving the California Department of Water Resources ("DWR") (which reports directly to the Governor) authority to purchase power. *Id*. at ¶ 12, JA 51-52. DWR became the largest purchaser of energy in the California wholesale electricity market. *Id*.

In response to a Commission directive, the CAISO filed a Comprehensive Market Redesign Proposal ("MD02") to address deficiencies in the existing market design. In *California Independent System Operator Corp*., 100 FERC ¶ 61,060 (2002) (the "MD02 Order"), the Commission accepted, rejected and modified in part the MD02 proposal. The Commission found that the dysfunctional California wholesale market and extremely high prices during certain time periods were due, in part, to California's heavy reliance on imports (20 percent of load), without sufficient new bulk transmission being built to assure access. Concerns were also expressed over the growing loads and reduced reserve

margins for several Western States, which undercut continued reliance on imports to supply reliability and low electric prices. To alleviate potential problems, several long-term structural reforms were offered to maintain sufficient incentives to sell into California and to build necessary generation and transmission facilities. One structural reform calls for the establishment of an independent, non-stakeholder CAISO Board to avoid unduly discriminatory or preferential treatment or the appearance of such bias.

D. The July 17, 2002 Order

The July 17, 2002 Order found that the composition of the CAISO Board under ABX1 5 poses a barrier to implementation of the MD02 market redesign and conflicts with the November 1, 2000 and December 15, 2000 Orders as well as with Order Nos. 888 and 2000. 100 FERC ¶ 61,059 at ¶ 1, JA 48.

Since passage of ABX1 5, after which all Board members were selected by the Governor, the CAISO decision-making process has been heavily influenced, if not completely dictated, by the State, who, through DWR, was also the largest purchaser of electricity in California. *Id*. at ¶ 50, JA 57. Without a board independent of dominance by one market participant, the Commission could not be assured that the rates, terms or conditions of the CAISO's jurisdictional service would be just, reasonable, and not unduly discriminatory or preferential. *Id*. at ¶ 58, JA 58. Further, State dominance of the CAISO, whose transmission grid is central to the Western energy market, impedes creation of a well-functioning Western energy market by making it difficult, if not impossible, to develop needed, reasonably-priced infrastructure. *Id*. at ¶¶ 51-52, JA 57. The State's dominance of the board, coupled with the State's role through DWR as a

market participant, has led to the perception that the CAISO is biased, which perception, by itself, can prevent proper market forces from working in the Western market. *Id*. at ¶ 53, JA 57.

State control also raises jurisdictional issues related to conflicts with or obstacles to the Commission's exclusive jurisdiction over, in particular, the rates, terms, and conditions of the CAISO's transmission service in interstate commerce. *Id*. at ¶ 54, JA 57-58. State control of the CAISO Board conflicts with the independence requirements for ISOs under Order Nos. 888 and 2000, as well as with the December 15, 2000 Order regarding CAISO. *Id*. at ¶ 56, JA 58. Dominance of the CAISO by any one market participant (here, the State), threatens the CAISO's ability to treat in-state and out-of-state transmission users on a non-discriminatory basis as required under the FPA. *Id*. at ¶ 57, JA 58.

The Commission also found that the composition of the CAISO Board violated the December 15, 2000 Order's non-stakeholder requirement because two members are associated with organizations (The Utility Reform Network and Silicon Valley Manufacturing Group) that represent end-user stakeholders. *Id*. at ¶ 59, JA 58. Also violated was the requirement that Board members have appropriate expertise in corporate leadership, professional expertise in finance, accounting, engineering or utility law and regulation and experience in the operation and planning of transmission systems. *Id*. at ¶ 60, JA 58-59. No Board member had prior utility experience in the operation and planning of transmission systems. *Id*.

Based on these enumerated inadequacies under federal law, the July 17, 2002 Order directed that by January 1, 2003, the Board must be replaced with an expert, non-stakeholder Board composed of nine voting members who are independent of market participants. *Id*. at ¶ 62, JA 59. To effectuate this goal, the Commission ordered a board selection process designed to assure representation for each member-class of ISO stakeholders, *id*. at ¶ 63, JA 59-60; revised bylaws to reflect the governance structure and board selection process ordered, *id*. at ¶ 69, JA 61; a stakeholder advisory committee from all stakeholders other than the State, as well as a separate advisory committee composed of the Oversight Board, to serve as the State's and its agencies' representative in advising the Board, *id*. at ¶ 68, JA 60.

E. Events Following the July 17, 2002 Order

On August 6, 2002, California's Attorney General wrote to the CAISO and opined that the CAISO could not comply with the July 17, 2002 Order without violating California law because, in his view, the July 17, 2002 Order exceeded "any possible jurisdiction FERC has under the Federal Power Act," and that "there is no legal authority to permit FERC to dictate the governance of a corporation organized under state law." *See* CAISO August 13, 2002 Request for Rehearing and Motion for Stay, R. 58, Exhibit 1, at 1-2, JA 103-05.

The CAISO's Request for Rehearing and Motion for Stay of the July 17, 2002 Order acknowledged that it is a "public utility" as defined in FPA § 201. R. 58 at 6, JA 69. Nevertheless, the CAISO asserted that compliance with the July 17, 2002 Order would create a "clear conflict with corporate requirements and state law" and would

"expose the ISO to enforcement actions against the ISO, its officers and directors, including exposure to criminal prosecution under Sections 2210 and 2211 of the California Public Utilities Code." *Id*. at 33, JA 96. The California Electricity Oversight Board and the CPUC also sought rehearing, challenging the Commission's authority and alleging a lack of substantial evidence for its FPA §§ 205 and 206 findings. R. 61, JA 1-106-26; R. 63, JA 172-91.

F. The September 16, 2002 Order

The September 16, 2002 Order denied the requests for rehearing. 100 FERC ¶ 61,271. Under its FPA §§205 and 206 authority, the Commission reaffirmed its findings that the current CAISO Board was not independent, and that its lack of independence has an unduly discriminatory effect on Western energy markets. *Id*. at ¶18, JA 197. The State's position as a market participant in the CAISO's markets (through DWR's purchases) while simultaneously choosing all Board members makes the Board's composition inherently non-independent, and precludes other market participants from being fairly represented. *Id*. at ¶19, JA 197-98. Further, a State-controlled Board leads to the perception that the CAISO is predisposed to favor the State to the detriment of other participants. *Id*. at ¶20, JA 198. As even the perception of bias can prevent proper market forces from working properly, market reliability and efficiency are hindered by the Board's composition. *Id*. Further, the State's pervasive control over the CAISO interferes with FERC's exclusive jurisdiction by allowing the State to dictate what filings the CAISO would make with the Commission. *Id*. at ¶18, JA 197. The Commission also relied on specific examples of the Board's discriminatory practices, as well as on

independent reports detailing unduly discriminatory behavior on the part of the Board. *Id*. at ¶ 22, JA 198-99.

The Commission further found that § 337 of the California Public Utilities Code regarding the composition of the Board was inconsistent with, and therefore preempted by, the July 17, 2002 Order. *Id*. at ¶ 27, JA 199. Although the FPA does not require a particular type of public utility governance structure, § 337 frustrates the designs and objectives of federal statutes (FPA §§ 205 and 206), federal regulations (Order Nos. 888 and 2000) and agency orders (the November 1, 2000, December 15, 2000 and July 17, 2002 Orders), and § 337 is therefore preempted. *Id*. at ¶¶ 28-29, JA 199-200. Further, State control over the CAISO's corporate governance adversely impacts regional energy markets and therefore § 337 is a direct burden on interstate commerce. *Id*. at ¶¶ 30-31, JA 200-01. The fact that the State has inappropriately attempted to assert control over the CAISO does not, however, make the CAISO an instrumentality of the State exempt from Commission regulation under FPA § 201(f). *Id.* at ¶¶ 35-36, JA 202-03.

SUMMARY OF ARGUMENT

Petitioners contend that FPA §§ 205 and 206 do not provide authority to reject and to modify the CAISO corporate governance. As CAISO is a public utility as defined in FPA § 201(e), it falls under the Commission's exclusive jurisdiction. The CAISO therefore is subject to the requirements of FPA §§ 205 and 206, which give the Commission the authority to review any rule, regulation, practice, or contract affecting rates, terms and conditions of service, and if found to be not just and reasonable, to determine the just and reasonable practice to be observed.

Here, the Commission found that the CAISO Board's lack of independence had an unduly discriminatory effect on the Western market. Pervasive state control over the public utility interferes with the Commission's exclusive jurisdiction to assure just and reasonable rates. Further, the State-controlled Board led to the perception of discrimination, which in itself is enough to impede the functioning of market forces. Under those circumstances, the Commission found the CAISO governance structure unjust and unreasonable and unduly discriminatory, and properly determined the just and reasonable and non-discriminatory practice to be followed.

Petitioners contend that "practice" under § 206 refers only to non-price terms and conditions of electric service. FERC's authority under the statute is not so limited, given that, as this Court has recognized, there is an infinitude of practices affecting rates and services. The Commission has broad discretion to determine what rates and practices affect jurisdictional service. Although petitioners assert that FERC has "consistently" defined "practices" as referring only to non-price terms and conditions of electric service,

the Commission has exercised its FPA §§ 205 and 206 authority over practices or contracts that do not reflect non-price terms and conditions of service, where regulation was necessary to assure just and reasonable jurisdictional rates or remedy undue discrimination. The Interstate Commerce Act cases cited by petitioners support regulatory authority over a broad range of "practices" where necessary to regulate jurisdictional rates or remedy undue discrimination.

Petitioners next contend the Commission defines "practice" as a "consistent and predictable course of conduct of the supplier that affects [the utility's] financial relationship with the consumer." While this definition was not raised on rehearing for Commission consideration, it in any event fails to support petitioners' attempt to limit the scope of "practices." The definition is applied as a rule of reason, and the finding that the CAISO governance structure had an adverse impact upon rates and the functioning of the California and Western markets shows that the structure "affects [CAISO's] financial relationship with the consumer."

The Commission properly rejected the argument that the limited authority over corporate governance conferred in FPA § 305, 16 U.S.C. § 825d, or the express authority conferred on other agencies by other statutes, indicated a Congressional intent to preclude Commission authority over corporate governance under FPA § 206. FPA § 206 is not a grant of power specifically tailored to apply only in limited factual circumstances, but rather is a broad grant of authority to remedy all unduly discriminatory rules, regulations, practices, and contracts that affect Commission-jurisdictional rates and services. Thus,

even if the Commission's authority to act in certain cases is otherwise limited, the FPA makes an exception to that rule where FERC finds undue discrimination.

The Commission's authority under FPA § 206 is sufficiently broad to impose requirements on ISO governance even though ISOs are a relatively new creation established in response to the changes in the electric market since the FPA was enacted. The Commission has authority to fill in gaps so that the statutory objectives are met. Indeed, ISO governance, central to the proper functioning of interstate transmission, is precisely the type of issue properly subject to federal regulation.

The CPUC contends that the appropriate remedy for an unacceptable governance structure is simply to rule that the CAISO is no longer an ISO for Order No. 888 purposes. FPA § 206 does not require such a drastic step, but authorizes the Commission to replace an unjust, unreasonable, unduly discriminatory or preferential practice with a just and reasonable one. Because the CAISO's bylaws, which include its governance provisions, affect the rates, terms and conditions of jurisdictional services and are on file with the Commission, they are subject to the Commission's authority under § 206.

Similarly, the Commission is not limited to disallowing rate recovery of costs associated with unjust and unreasonable practice or contracts. The Commission is free to make pragmatic adjustments, as required by the particular circumstances. Here, the institutionalization of discriminatory bias in the governance of a jurisdictional public utility directly affects the proper functioning of the California and Western markets.

The Commission modified the CAISO corporate governance for the express purpose of alleviating unjust and unreasonable rates and discriminatory practices in the

interstate energy markets resulting from the Board's lack of independence. This remedy is necessary and fully justified in the context of remedying adverse effects on the market-based rate regime in the California and Western markets.

The claim that FPA § 201(a) does not allow FERC to assert authority over the governance structure of CAISO has no legal basis. The portion of FPA § 201(a) used in support is a general policy declaration, which the Supreme Court has repeatedly stated cannot nullify a clear and specific grant of jurisdiction in the statute. Even if § 201(a) were applicable, CAISO's business is the transmission of electricity in interstate commerce, an area that has never been subject to State regulation, and thus would not fit within the jurisdiction left to the States under the Act. While States do have jurisdiction over corporate governance, that jurisdiction must yield to federal law where the State law conflicts with federal objectives. Here, FERC found that CAISO's governance structure, set by State law (ABX1 5) conflicts with the FPA's goals as implemented through FERC's open access policies, and in particular its independence principle for ISOs.

The pervasive control that the State exerts over CAISO does not transform CAISO into a state instrumentality exempt from FERC jurisdiction under FPA § 201(f). Contrary to Petitioner's claims, the extent to which government controls an entity is not determinative of whether that entity is a state instrumentality. Rather, the test requires a showing that the entity performs an inherent governmental function or becomes so assimilated into government to become one of its constituent parts. CAISO meets neither criterion. In addition, FERC rejected this argument on grounds that the State's inappropriate attempt to exert control did not convert CAISO into a state instrumentality,

and that CAISO is a public utility whose operation, including its governance structure, has been subject to FERC authority and approval since inception.

Petitioners' assertions of a lack of substantial evidence and reasoned decisionmaking to support FERC findings and conclusions rest on a view that FERC must play a reactive, rather than a proactive, role in seeking to redress undue discrimination. In their view, FERC can only respond to overt discriminatory conduct by CAISO's board, and cannot address the board governance and composition as sources of undue discriminatory or preferential treatment. Petitioners' preferred approach is undermined by the history of open access generally and as applied to CAISO specifically, where the Commission has focused at each turn on board composition and governance, not on board conduct, as possible sources of unduly discriminatory or preferential practices affecting rates.

The transmission grid operated by CAISO forms a crucial part of the Western transmission grid through which considerable amounts of energy are exported out of and imported into California. CAISO's obligation to assure reliable service at reasonable prices thus has direct and substantial effects on customers throughout the Western States. To fulfill this obligation, CAISO must operate fairly for the benefit of all its market participants, not just for those in California or just for the State of California. At CAISO's inception, its board was proposed to consist of all California residents. FERC rejected that composition as not open to all regional market participants in CAISO, the same reason the current board composition was rejected. Absent fair representation on the board, the Commission was properly concerned that non-Californian market

participants would be subject to undue discrimination (or Californian participants would receive preferential treatment), both of which would result in unlawful rates.

Next, FERC, responding to a declaratory order request, indicated that a board composition set by SB96 was acceptable in those unique circumstances. When that board proved ineffective in dealing with the problems experienced during 2000-01, the Commission moved to replace it with an independent, non-stakeholder board. California passed new legislation, ABX1 5, however, that set the current board, consisting of five members selected by the Governor, all of whom are California residents. At that time, California, through DWR, also became the largest energy purchaser in the California wholesale market.

The challenged orders address the ABX1 5 board composition, consistent with the Order No. 888 independence principle for ISOs and prior FERC orders dealing with CAISO's board, all of which addressed composition, not conduct, of ISO boards. The rulings here are also consistent with the underlying concerns of those prior orders: that a board dominated by one market participant would not allow fair representation by all market participants, and would create a perception that CAISO's operations would be biased in favor of that dominant participant, both of which would lead to unlawful rates for transmission service. Undue discrimination results from the ABX1 5 board composition because similarly situated parties, all CAISO market participants, are unjustifiably excluded from participation in the board that controls how service will be provided to them.

The challenged orders satisfy the FPA § 206 requirements for replacing an existing practice that has been found unlawful. First, the orders demonstrate that the current board composition results in undue discriminatory or preferential treatment that leads to unjust and unreasonable rates in the Western energy market. Second, the Commission found that the prior board composition under SB 96 was no longer effective. Third, the orders set a selection process for an independent, expert, non-stakeholder board that would allow fair representation by all market participants and that would solve the problems found with the SB 96 board.

Petitioners' lack of substantial evidence assertions rest on carefully selected snippets from the record that, in isolation, appear to undermine criticisms of the board. A fair reading of the sources for the snippets shows, however, substantial evidence exists for the criticisms. For example, as to the criticism that the Board is disinclined to address long-range planning, CAISO points to a sentence fragment that it had presented a plan that includes some elements necessary to develop a robust long-term market. But review of the whole paragraph as well as contiguous paragraphs shows that the elements would not be implemented for some time, that the interim proposals were designed to mitigate prices, not market power, and that the long-term proposals contained no incentives for new generation or demand response markets. Other evidence showed that the board delayed or narrowed proposals presented by management, and stated in open meeting a lack of interest in providing long-term incentives.

CPUC's challenge that the perception of discrimination in the board's composition cannot meet FPA § 206 standards similarly rests on incomplete record evidence. The

whole record shows that, except for State employees, virtually every market participant and CAISO officer interviewed shared the view that the board was not independent because of its composition. In addition, the shareholder input process was an exercise in futility because input was ignored by the board. While the board members may have had the best intentions, the lack of independence from the board composition has led to a series of major problems. The record as a whole supports a conclusion that unless the governance issue is resolved, there is no hope for a comprehensive solution for the problems in California.

The Commission properly found that State dominance of the board meant that the State controlled filings CAISO makes at FERC in contravention of the FPA's plan. The FPA leaves ratemaking authority solely in the hands of public utilities, subject exclusively to FERC's authority to modify or to set aside rates that it finds unjust and unreasonable. Just as FERC cannot compel a utility to file a specific rate proposal (absent a finding that the existing rate is unlawful), so, too, the State may not compel CAISO to make specific filings related to its transmission or wholesale sales services.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under that standard, the Commission must demonstrate that it has reached a reasoned decision based upon substantial evidence in the record. The Commission's factual findings are conclusive if supported by substantial evidence. FPA §313(b), 16 U.S.C. § 825*l*(b).

II. THE CAISO GOVERNANCE STRUCTURE PROPERLY FALLS WITHIN THE COMMISSION'S FPA § § 205 AND 206 AUTHORITY.

The CAISO is a public utility as defined in FPA § 201(e), and its transmission services and sales for resale of electric energy in interstate commerce (*e.g*., its operation of imbalance energy markets) are within FERC's exclusive jurisdiction and subject to the requirements of FPA §§ 205 and 206. September 16, 2002 Order at ¶ 15, JA 196-97. "Sections 205 and 206 of the FPA give the Commission the authority to review any rule, regulation, *practice*, or contract affecting rates, terms and conditions of service, and if found to be not just and reasonable, the Commission under Section 206 can determine the just and reasonable practice to be observed." *Id*. at ¶ 17, JA 197 (emphasis in original). The CAISO Board's lack of independence has an unduly discriminatory effect on the Western market and interferes with the Commission's exclusive jurisdiction to assure rates are just and reasonable. *Id*. at ¶ 18. Further, the State-controlled Board leads to the perception of discrimination, which impedes the proper functioning of market forces. *Id*.

at ¶ 20, JA 198. Those findings led the Commission to conclude that the CAISO governance structure was unjust and unreasonable and unduly discriminatory, and to determine the just and reasonable and non-discriminatory practices to be followed.

Petitioners contend that the CAISO governance structure cannot be a "practice" affecting a rate because "practice" under the FPA refers only to "non-price terms and conditions of electric service." *See* Brief of Petitioner California Independent System Operator Corp. ("CAISO Br.") at 22-23; Brief for Petitioners Public Utilities Commission of the State of California and California Electricity Oversight Board ("CPUC Br.") at 13 n. 11 (adopting argument). FERC's FPA authority is not so limited. As "there is an infinitude of practices affecting rates and services," it is "obviously left to the Commission, within broad bounds of discretion, to give concrete application to this amorphous directive." *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985). The Commission therefore "has considerable flexibility" to identify what practices "affect" jurisdictional service. *Prior Notice and Filing Requirements Under Part II of the Federal Power Act*, 64 FERC ¶ 61,139 at 61,988 n.3 (1993).

Although petitioners assert that FERC has "consistently treated 'practices' as limited to the non-price terms and conditions of electric service," CAISO Br. at 23, the Commission has exercised -- and has been affirmed in exercising -- its FPA §§ 205 and 206 authority over practices or contracts that do not reflect "non-price terms and conditions of electric service," where regulation of such practices was necessary to regulate jurisdictional rates or remedy undue discrimination.

For example, "practices" subject to FPA §§ 205 and 206 include the organization and structure of power pooling arrangements. In *Central Iowa Power v. FERC*, 606 F.2d 1156, 1167 (D.C. Cir. 1979), the Court upheld the conclusion that a voluntary power pooling agreement was "an FPC tariff which must pass muster under Sections 205 and 206 of the Federal Power Act." The Commission therefore had authority under § 206 to modify the agreement "if, in the absence of such modifications, the Agreement presented 'any rule, regulation, practice or contract [that was] unjust, unreasonable, unduly discriminatory or preferential.'" *Id*. at 1168. Because certain membership criteria under the Agreement were found discriminatory, *id*. at 1170, the Commission had authority to require modification of the criteria as redress of a discriminatory practice, *id*. at 1171. *See also Pennsylvania Power Co. v. FPC*, 343 U.S. 414, 421-22 (1951) (although contract requiring coordinated operations between utilities was unenforceable, FPA § 206 gave the Commission "ample statutory power to order [the utilities] to continue their long-existing operational 'practice' of integrating their power output"); *see also Northern Natural Gas Co. v. FERC*, 929 F.2d 1261, 1272 (8th Cir. 1991) (Commission properly regulated nonjurisdictional gathering charges under its NGA "in connection with" authority where "essential to prevent discrimination against third-party gas in interstate transportation and sales.") [4]

[4] *See, e.g., Policy Statement Regarding Regional Transmission Groups*, 64 FERC ¶ 61,138 (1993) (regional transmission group governing agreements must provide for fair and non-discriminatory governance and decisionmaking procedures); *Ohio Edison Co*., 14 FERC ¶ 63,054 (1981) (political expenditures to defeat state constitutional amendment creating municipal power agency, even though not treated as operating expenses for cost-of-service ratemaking, were nonetheless practices affecting

The Interstate Commerce Act cases cited by petitioners support the Commission's authority over "practices" where necessary to regulate jurisdictional rates or remedy undue discrimination. *See* CAISO Br. at 22 (citing *United States v. Pennsylvania Railroad Co.*, 242 U.S. 208 (1916) and *Missouri Pac. R. Co. v. Norwood*, 283 U.S. 249 (1931)). While *Pennsylvania Railroad* rejected reading "practices" so broadly as to give the ICC authority over a carrier's refusal to furnish tank cars in the absence of discrimination, it acknowledged that ICC regulation had been upheld over "practices" that "favored the large shipper and oppressed the small one." 242 U.S. at 229. *Missouri Pacific* rejected the argument that ICA regulation of "practices" preempted Arkansas safety laws based on the lack of connection between Arkansas safety laws and fixing rates or prescribing service to be rendered by the carriers. 283 U.S. at 257. It does not preclude ICC regulation of a practice where such a connection exists.

Petitioners contend that the Commission has defined "practice" as a "consistent and predictable course of conduct of the supplier that *affects [the utility's] financial relationship with the consumer.*" *See* CAISO Br. at 22-23 (quoting *Michigan-Wisconsin Pipeline Co.*, 34 F.P.C. 621, 626 (1965)); CPUC Br. at 13 n. 11 (adopting argument). While this was not argued on rehearing, and thus the Commission did not address it, nor

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jurisdictional rates because the payments have some effect on the company's equity component, and the defeat of the amendment may adversely affect cash flow, increase construction budget and require a higher rate of return).

does this Court have jurisdiction to hear it under FPA § 313(b), [5] it, in any event, fails to support petitioners' theory that "practices" is limited to non-price terms and conditions. In *Michigan-Wisconsin*, the Commission *rejected* a determination that the term "practices" was confined to "things of the general class, such as 'schedules,' 'classifications,' 'regulations, and 'contracts,'" that directly affect the financial relationship with consumers, and, instead, required a utility to file its policy regarding building lateral lines. 34 FPC 621, 1965 FPC LEXIS 64 at * 17. Rather than limiting "practices" to non-price terms and conditions, *Michigan-Wisconsin* employs a rule of reason. *Village of Winnetka*, 678 F.2d at 357 (*Michigan-Wisconsin* standard includes "standard practices or procedures in a tariff" subject to a "rule of reason," case-by-case approach); *Transwestern Pipeline*, 26 FERC ¶ 63,008 at 65,018 (what constitutes an agreement or contract affecting a rate "'must be judged by the rule of reason.'") (quoting *Pacific Gas and Electric Co.*, 5 FERC ¶ 61,305 at 61,658 (1978)). Here, the Commission met the *Michigan-Wisconsin* standard. The finding that the CAISO governance structure had an adverse impact upon rates and the functioning of the California and Western markets shows that the structure "affects [CAISO's] financial relationship with the consumer."

The Commission properly rejected the argument, *see* CPUC Br. at 11-12; CAISO Br. at 20, that the limited authority over corporate governance conferred in FPA § 305

[5] CAISO cites for this proposition *Michigan-Wisconsin Pipeline*, 34 F.P.C. 621; *Transwestern Pipeline Co.*, 26 FERC ¶ 63,008 (1984); and *Village of Winnetka v. FERC*, 678 F.2d 354, 357 (D.C. Cir. 1982), which were not cited to the Commission on rehearing. Thus, the Commission had no opportunity to address their applicability here.

demonstrates a Congressional intent to preclude Commission authority over corporate governance under other FPA provisions. September 16, 2002 Order at ¶ 32, JA 201-02. Rather, FPA § 206 authority, unlike that under FPA § 305, was not specifically tailored to apply only in limited factual circumstances, but was fashioned broadly to remedy all unduly discriminatory rules, regulations, practices, and contracts that affect FERC-jurisdictional rates and services. *Id*. Thus, even if FERC's authority to undertake an action would otherwise be limited, the FPA "makes an exception to that rule where FERC finds undue discrimination." *TAPS*, 225 F.3d at 686-87. *See also Associated Gas Distributors v. FERC*, 824 F.2d 981, 999 (D.C. Cir. 1987). In *TAPS*, the Court found that, although FPA § 211, 16 U.S.C. § 824j, limits FERC's authority to order wheeling, the Commission nevertheless had authority to order open access as a remedy for undue discrimination. 225 F.3d at 686-87. Likewise, here, any general limitations on Commission authority over corporate governance do not limit its authority to alter the CAISO governance structure to remedy undue discrimination or unjust and unreasonable practices.

The Commission's authority under FPA § 206 is sufficiently broad to impose requirements on the CAISO governance structure even though ISOs were established in response to the changes in electric markets since the FPA was enacted. *Id*. The Commission has authority to fill in gaps left by the FPA to assure that its objectives are met. *Id*. (citing FPA § 309, 16 U.S.C. § 825h). Indeed, the issue of CAISO governance, central to the proper functioning of Western energy markets, is precisely the type of issue properly subject to federal regulation. "The very nature of the present problem, entailing

as it does considerations that overstep the bounds of any one State, illustrates the improbability that state commissions could or would attempt to deal with it; it seems clear that considerations of this sort are uniquely fitted for federal scrutiny." *FPC v. Transcontinental Gas Corp*., 365 U.S. 1, 27 (1960). "Therefore, when we are presented with an attempt by a federal authority to control a problem that is not, by its very nature, one with which state regulatory commissions can be expected to deal, the conclusion is irresistible that Congress desired regulation by federal authority rather than nonregulation." *Id*. at 28.

As to petitioners' arguments regarding authority over corporate governance conferred in other statutes, *see* CPUC Br. at 12 (citing 15 U.S.C. § 79 et seq.); CAISO Br. at 21 (same), the Commission properly concluded that those statutes have no relevance for interpreting Congress' intent with respect to FPA §§ 205 and 206. September 16, 2002 Order at 62,038-39, n. 65, JA 201-02. As with FPA § 305, whether or not, in other contexts, a different statutory provision would limit FERC's authority to regulate public utility governance, or whether other agencies are elsewhere afforded authority to regulate the corporate governance of utilities, FPA §§ 205 and 206 provide ample authority for FERC to do so where necessary to remedy systemic conditions leading to undue discrimination or unjust and unreasonable practices in the interstate transmission of electric energy. Thus, while the Commission may lack authority to remedy discriminatory employment practices, *see* CAISO Br. at 24 (citing *NAACP v. FPC*, 425 U.S. 662 (1976)), the Commission is nonetheless required "to promote the orderly

production of plentiful supplies of electric energy and natural gas at just and reasonable rates," 425 U.S. at 670, a goal impeded by CAISO's governance structure.

Atlantic City Electric Co. v. FERC, 295 F.3d 1 (D.C. Cir. 2002) is not to the contrary. *See* CPUC Br. at 13-15; CAISO Br. at 17. In *Atlantic City*, the Court held that the Commission could not review utility withdrawals from ISOs under FPA § 203, 16 U.S.C. § 824b, because joining or withdrawing from an ISO did not constitute a "disposition" of jurisdictional facilities. *Id*. at 12. That holding, however, "does not mean that FERC is prohibited from reviewing entry to or exit from an ISO" or ISO agreements under FPA § 205 to decide whether those agreements are just and reasonable, or to review a specific entry or withdrawal. *Id*.

The CPUC contends that, if the Board's governance structure is unacceptable, the Commission's remedy is "simply to rule that the ISO is no longer an Independent System Operator for Order No. 888 purposes." CPUC Br. at 15. [6] The Commission rejected this all-or-nothing approach, finding instead that FPA § 206 provides authority to modify specific rates, rules, or practices of a public utility whenever it determines that an existing rate, rule or practice is unjust, unreasonable, unduly discriminatory or preferential. July 17, 2002 Order at ¶ 70, JA 61. Because the CAISO's bylaws, including the governance provisions, affect the rates, terms and conditions of jurisdictional services and are on file with the Commission, the bylaws and their governance provisions are subject to the Commission's authority under § 206. *Id*.

[6] Of course, even if the CAISO were no longer an ISO, it would still be a public utility subject to FERC's jurisdiction.

Similarly, petitioners argue that the Commission is restricted to remedying unjust and unreasonable practices or contracts by disallowing rate recovery of associated costs, *see* CAISO Br. at 24-25, and that the Commission lacks authority to modify the terms of non-jurisdictional contracts, *id*. at 25-26 (citing *American Gas Ass'n v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990)). That argument is inapplicable, however, as the "practice" at issue does not involve a non-jurisdictional contract but rather the institutionalization of discriminatory bias in the operational governance of a jurisdictional public utility. Just and reasonable market-based rates and non-discriminatory practices depend directly upon the proper functioning of the California and Western markets, and those markets cannot function properly with a State-dominated CAISO Board. While petitioners contend that FERC's "proper power" does not extend beyond its open-access remedy in Order No. 888, CAISO Br. at 27, experience following Order No. 888 showed that remedy did not eradicate the problems of undue discrimination inherent where transmission service is controlled by a single market participant. Among the further remedies necessary to eradicate that problem was further insistence on the independence of ISO transmission operations.

Thus, the Commission undertook to modify the CAISO corporate governance for the express purpose of alleviating unjust and unreasonable rates and discriminatory practices in the Western energy market resulting from the Board's lack of independence. Such modification is necessary and fully justified to remedy adverse effects on the market-based rate regime in those markets. As the Ninth Circuit found, in rejecting arguments that would limit FERC's authority to impose remedies in the same markets:

> FERC's authority under § 206(a) to remedy rules and structures adversely affecting market-based rate regimes cannot be read so narrowly. Indeed, as the Supreme Court has held in the context of the Natural Gas Act, the counterpart to the FPA, "agencies created to protect the public interest must be free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. . . . Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority."

California Power Exchange Corp. v. FERC, 245 F.3d 1110, 1120-21 (9th Cir. 2001) (quoting *FPC v. La. Power & Light Co.*, 406 U.S. 621, 642 (1972)).

III. FERC'S AUTHORITY OVER THE CAISO'S GOVERNANCE STRUCTURE IS NOT LIMITED BY FPA § 201(a).

CPUC charges that no "provision of the FPA can fairly be read to grant FERC the authority to affect the internal structure of a corporation created under state law." CPUC Br. at 10. This charge rests on an impermissible reading of FPA § 201(a) along with a failure to recognize that the state law at issue conflicts with federal law, and is therefore preempted. *Id*. at 8-10. The Commission has authority to redress CAISO's governance structure because that structure affects the rates for the interstate transmission of electricity, and thus falls within FERC's exclusive jurisdiction. To the extent that the ABX1 5 governance structure conflicts with and creates an obstacle to the fulfillment of federal law, it is preempted. Accordingly, FERC not only possesses the statutory authority to address CAISO's governance structure, but also properly required its revision in furtherance of legitimate federal law objectives.

CPUC charges that FPA § 201(a)'s language – "such federal regulation, however, to extend only to those matters which are not subject to regulation by the States" – precludes FERC action here because the States "were engaged, as they continue to be, in

regulating the governance of corporations that are incorporated under the laws of the states," thus placing governance outside FERC's regulation. CPUC Br. at 9-10.

This argument falls for several reasons. First, the statutory language on which CPUC relies does not delineate the scope of FERC authority. "The policy declaration that federal regulation is 'to extend only to those matters which are not subject to regulation by the States' is one of great generality. It cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose." *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 527 (1945); *see United States v. Pub. Utilities Comm'n*, 345 U.S. 295, 311 (1953)("To conceive of [FPA § 201(a)] as a bench mark of the Commission's power or an affirmation of state authority over any interstate sales for resale would be to speculate about congressional purpose for which there is no support.").

Second, CAISO was created to facilitate the transmission of electric energy in interstate commerce. *E.g., Pacific Gas & Electric*, 77 FERC at 61,795. Such transmission was ruled outside the jurisdiction of the States in *Public Utilities Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83, 86 (1927): "The transmission of electric current from one State to another * * * is interstate commerce." Accordingly, FPA § 201(b) included a specific grant of jurisdiction to FERC over "the transmission of electric energy in interstate commerce." *New York v. FERC*, 535 U.S. 1, 19-20 (2002). Thus, even if the language of FPA § 201(a) were applicable, as CPUC claims, the transmission

of electric energy in interstate commerce has never been subject to regulation by the States, and thus is not an area that Congress intended to leave to State regulation.[7]

Third, regulation of corporate governance, while primarily a matter of state law (CPUC Br. at 10), remains subject to preemption where necessary to fulfill federal objectives. *See. e.g., Cort v. Ash*, 422 U.S. 66, 84 (1975)(recognizing that state law governs internal affairs of a corporation, "except where federal law expressly requires certain responsibilities")[8]; *American Airways Charters, Inc. v. Regan*, 746 F.2d 865, 875 (D.C.Cir. 1984)(recognizing that state law governs corporate structure absent "a concrete showing that state law in fact conflicts with federal purposes and objectives"). Here, the existing governance structure of the CAISO Board conflicts with the FPA and the purposes and objectives of FERC's open access transmission policies. *See, e.g.*, July 17, 2002 Order at ¶ 49, JA 56-57 ("With regard to the composition of the current Board, the Commission concludes that the CAISO is not sufficiently independent to operate its interstate transmission facilities in a non-discriminatory basis . . . [and] poses a barrier to the implementation of market redesigns that are necessary to rehabilitate the CAISO and Western markets.").

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[7] *Pacific Gas & Elec. Co. v. State Energy Res. Conservation and Dev. Comm'n*, 461 U.S. 190, 205-06 (1983), cited CPUC Br. at 9-10, is not to the contrary. That case addressed the "economic aspects of electrical generation [that] have been regulated for many years in great detail by the States," *id*., not transmission of electricity, which is at issue here.

[8] Although *Cort* speaks of "federal law [that] expressly requires certain responsibilities of directors with respect to stockholders," *id*, that statement addresses the facts of the case and does not indicate that federal law may restrict state governance of internal corporate affairs only with respect to directors' responsibilities to stockholders.

To the extent the California law setting the CAISO's governance structure conflicts with FERC regulation, it is preempted. "[T]he correct focus is on the federal agency that seeks to displace state law and on the proper bounds of its lawful authority to undertake such action. The statutorily authorized regulations of an agency will pre-empt any state or local law that conflicts with such regulations or frustrates the purposes thereof." *City of New York v. FCC*, 486 U.S. 57, 64 (1988); *Fidelity Federal S&L Ass'n v. Cuesta*, 458 U.S 141, 153 (1982)("Federal regulations have no less pre-emptive effect than federal statutes"); *see* CAISO Br. at 31 ("FERC's rulings and directives on matters within FERC's jurisdiction are controlling, and of course trump any contrary state directives"). Order No. 888 policies were upheld "in nearly all respects" on appeal, *TAPS*, 225 F.2d at 681, and thus FERC acted within the lawful bounds of its authority in establishing the independence and other ISO principles.

The independence principle for ISOs was promulgated "to ensure fair and non-discriminatory access to transmission services and ancillary services for all users of the system." Order No. 888 at 31,730. Representation of all types of users in an ISO governance structure "would help ensure that the ISO formulates policies, operates the system, and resolves disputes in a fair and non-discriminatory manner." *Id*. at 31,731. CAISO's original governance structure was guided by "overriding principles" adopted so that a class of users "will not be able to dominate the Governing Boards." *Pacific Gas and Electric*, 77 FERC at 61,817.[9] Consistent with its effort to assure independence of

[9] Indeed, the CPUC indicated "that the ISO's independence is critical." *Id*. at 61,810.

CAISO's board, FERC has "required substantive modification of ISO proposals, and [has] rejected others . . . based on [its] independence review." *California Elec. Oversight Bd.*, 89 FERC ¶ 61,134 at 61,382 (1999).

In short, the Commission properly established the independence principle for ISO governance as part of its open access tariff implementation, and has sought to have CAISO's board selected in accordance with that principle. As ABX1 5 is inconsistent with and frustrates the purposes behind that principle, FERC properly acted to remove that obstacle to fulfilling federal goals.

IV. THE CAISO IS NOT A STATE INSTRUMENTALITY EXEMPT FROM FERC JURISDICTION UNDER FPA § 201(f).

CPUC makes the related argument that the "state's 'pervasive control' over CAISO since enactment of ABX1 5 . . . takes the CAISO out of FERC's jurisdiction" as a state instrumentality exempt under FPA § 201(f). CPUC Br. at 20-21, 24. According to CPUC, whether CAISO is a state instrumentality turns on whether "it was organized pursuant to state law, and is subject to extensive state oversight and control." *Id*. at 23. The generality of CPUC's test would subsume most, if not all, public utilities, which are organized under state law and subject to extensive state oversight and control for their retail distribution, within its definition of state instrumentalities.

CPUC asserts that "the critical factor in the § 201(f) analysis is the extent to which the government controls the subject entity." *Id*., relying on *City of Paris, Kentucky v. FPC*, 399 F.2d 983, 986 (D.C. Cir. 1968). This Court did not look to control as determinative, but, rather, considered whether an entity "perform[s] an inherent

governmental function [or] ha[s] . . . become so assimilated or incorporated into government as to become one of its constituent parts." 399 F.2d at 986 (footnote omitted). That type of assimilation was necessary because "[a]ll sorts of privately owned government authorized business serve the public interest but are not, for most purposes at least, thereby considered governmental instrumentalities." *Id*. at n. 6. No showing has been made that CAISO performs a governmental function or has been assimilated into the State government.

The Commission "found no merit" to CPUC's claim that the Board's "pervasive" control (*see* CPUC Br. at 20, 23) over CAISO made CAISO a state instrumentality exempt from FERC jurisdiction. September 16, 2002 Order at ¶ 35, JA 202. Two grounds support that finding: (1) "the State['s] . . . inappropriate[] attempt[] to assert its control over the CAISO is not enough to make it an instrumentality of the State under Section 201(f)" and (2) CAISO's operation, including governance proposals, are within FERC's exclusive jurisdiction. *Id*. at ¶ 36, JA 203; *see generally California Electricity Oversight Board*, 88 FERC ¶ 61,172 (describing FERC involvement with CAISO governance). [10] Contrary to CPUC's assertion (Br. at 24), this answer responded directly to its claims by indicating that FERC jurisdiction does not depend on whether ABX1 5 was enacted before FERC-mandated changes could be implemented. *E.g.*, *Capital Cities Cable, Inc. v.*

[10] Similarly, FERC's statement (July 17, 2002 Order at 61,227 n. 60, JA 57) that "the Board is akin to an executive agency in the State government" does not stand up to the weight CPUC would give it. CPUC Br. at 23. The entire footnote addresses Board selection, which the Commission found to be similar to how executive agency members are selected, not, as CPUC implies, that the selection process somehow transforms the CAISO into a California executive agency.

Crisp, 467 U.S. 691, 708 (1984)("as we have repeatedly explained, when federal officials determine . . . that restrictive regulation of a particular area is not in the public interest, 'States are not permitted to use their police power to enact such a regulation.'")(citation omitted); *see Pacific Gas and Electric*, 77 FERC at 61,818 (noting that an earlier CAISO governance provision "would conflict with [FERC's] statutory duties under the FPA and should not remain as part of the ISO's structure, governance, and operation proposal").

V. SUBSTANIAL EVIDENCE SUPPORTS FERC'S REASONED DECISION.

CPUC (Br. at 15-20) and CAISO (Br. at 27-30) argue that the challenged orders lack substantial evidence and do not provide adequate reasoning to support the conclusion that the proposed amendment to CAISO's by-laws to implement the governance structure required by ABX1 5 "is unjust and unreasonable, unduly discriminatory, and preferential." July 17, 2002 Order at ¶ 61, JA 59. Their preferred approach (CPUC Br. at 19 and CAISO Br. at 28) would be for FERC to be reactive, not proactive, and simply wait until the CAISO engages in overtly discriminatory conduct before "requiring the filing and observance of appropriate tariffs." CAISO Br. at 28. They also implicitly ask this Court to pretend that the challenged orders were issued in a vacuum without the general history of FERC's efforts to establish open access transmission or the specific history related to FERC's prior efforts to assure the CAISO's independence through an appropriate governance structure. That history informs the challenged FERC actions, however, by highlighting the need for a proactive response so as to minimize the possibility for unduly discriminatory or preferential action.

CAISO was "charged with running a single statewide transmission grid." *Western Power Trading Forum v. FERC*, 245 F.3d 798, 799 (D.C. Cir. 2001). The CAISO's operation of the state-wide grid affects electric markets throughout the West. *See, e.g.*, November 1, 2000 Order, 93 FERC at 61,364 ("The transmission assets that the [CA]ISO operates are a critical part of the interstate transmission grid located in the Western Interconnection which provide essential support to the electric market. Any failings by the ISO in its obligation to ensure reliable operation of the transmission grid would have grave consequences for the residents and business[es] in the Western states."). Thus, CAISO must operate fairly for the benefit of all participants, not just to benefit Californians. When the initial proposal for creation of a CAISO oversight board was submitted, FERC rejected some of its arrangements as "conflict[ing] with the Commission's responsibilities under the [FPA] and with the 'independence principle'" adopted in Order No. 888. *Id*. [11]

On the latter point, the Commission rejected as unduly discriminatory a proposal that would have required all Board members to be California residents.

> The residency requirement is inconsistent with the Commission's goal of ensuring broad-based transmission and will act to discourage participation in the ISO by out-of-state entities by denying them meaningful representation. If a board is not open to broad representation, it has the potential to result in undue discrimination and undue preference by favoring certain sellers or

[11] In particular, FERC found that the proposed board "would [be] involve[d in] . . . structure, governance, regional coordination, and dispute resolution functions of a public utility that operates interstate transmission facilities. Indeed, they would involve the very matters that we specifically addressed in Order No. 888. The actions of the Oversight Board therefore may delay or conflict with our ability to perform our statutory duty, as well as our stated intention, to regulate ISOs." *Pacific Gas and Electric*, 77 FERC at 61,818.

> buyers to the exclusion of others. . . . [T]o establish any measure of regional coordination, the governing structures of the ISO and PX must be open and accessible to all regional participants. In addition, the California-only residency requirement is at odds with the intention to allow and encourage non-discriminatory participation of non-California buyers and sellers in the ISO and PX.

Pacific Gas and Electric, 77 FERC at 61,819. Contrary to the claim here that "FERC would evidently prefer to turn CAISO into a multi-state regional transmission organization," CAISO Br. at 28, the concerns about the composition of the current board, like the concerns about composition of the originally-proposed board, do not address the type of organization, but seek representation for all types of market participants, specifically for non-California buyers and sellers that are actively engaged in the CAISO's market. *See Pacific Gas and Electric Co.*, 81 FERC ¶ 61,122 at 61,453 n. 97 (1997) ("The Oversight Board is unacceptable . . . because it appears to be designed to favor California interests rather than all users of the ISO and PX.").

In response to FERC's initial concerns, California passed legislation (SB 96) that established a CAISO stakeholder board with changed duties. *See Western Power*, 245 F.3d at 799-800 (outlining changes). This stakeholder board was in place during the 2000 California energy problems. Part of FERC's response after investigation required replacement of that board "with a non-stakeholder Board whose member are 'independent of market participants.'" July 17, 2002 Order at ¶ 9, JA 51; *Western Power*, 245 F.3d at 801. FERC called for "'on-the-record procedures to discuss with California representatives the selection process for the new ISO Board.'" *Id*. In the interim,

decisionmaking was to be turned over to CAISO management. *Western Power*, 245 F.3d at 801.

Prior to such meetings, ABX1 5 was enacted and five California residents were nominated, confirmed, and put in place, while the existing stakeholder board was displaced. July 17, 2002 Order at ¶¶ 10-11, JA 51; *Western Power*, 245 F.3d at 802. Contemporaneously, DWR was authorized to purchase power and became "the largest purchaser of energy in the California wholesale market" at that time. July 17, 2002 Order at ¶ 12, JA 52.

The challenged orders arose in the context of how the CAISO Board would be composed.[12] Despite this context, petitioners insist that only conduct, not composition, of the board could provide valid grounds for making an FPA § 206 finding of unlawfulness. *E.g.*, CPUC Br. at 19 ("There is simply no basis for FERC to tamper with CAISO's corporate structure, since FERC can regulate the activities of jurisdictional entities."); CAISO Br. at 29 n. 17 and accompanying text. Such insistence overlooks the entire thrust of the independence principle for ISOs in general, and CAISO in particular, with its focus on board composition:

> an ISO should be independent of any individual market participant or any one class of participants (e.g., transmission owners or end-users). A governance

[12] Both CAISO (Br. at 28 n. 15) and CPUC (Br. at 18) downplay the current significance of DWR's purchasing because, on January 1, 2003, DWR's authority to enter purchased power contracts lapsed. As the orders under review were issued prior to January 1, 2003, DWR's purchasing authority after that date was not the context in which FERC acted. Neither petitioner challenges that, during the relevant period, DWR was the largest purchaser of power in the State, and thus this finding is conclusive for this appeal. FPA § 313(b). In any event, DWR entered into many long-term contracts whose effects will be felt beyond January 1, 2003.

> structure that includes fair representation of all types of users of the system would help ensure that the ISO formulates policies, operates the system, and resolves disputes in a fair and non-discriminatory manner. The ISO's rules of governance, however, should prevent control, and appearance of control, of decision-making by any class of participants.

Order No. 888 at 31,730-31 (emphasis added).

The importance of independent board composition was reiterated in the order addressing the original CAISO governance proposal:

> we agree with the Companies that the voting structure should be guided by two overriding principles: (1) no one class should be able to block or veto action; and (2) no two classes should together be able to form a sufficient majority to make decisions. Moreover, as noted earlier the Companies' proposal provides that an entity (including all affiliates and subsidiaries) may participate in only one class. Accordingly, with these restrictions and voting principles in place, we believe that with balanced representation, the Companies or any other class will not be able to dominate the Governing Boards.

Pacific Gas and Electric, 77 FERC at 61,817; *see id*. at 61,796 (same). Clearly, FERC was concerned at that time about composition, not conduct, as the CAISO was not yet operational.

As changes in governance structure required State legislative approval, the independence issue did not come before FERC again for awhile, but when it did, the context was a request for declaratory ruling about a proposed governing structure, not a ruling on CAISO's conduct. *See Western Power*, 245 F.3d at 799 ("the Oversight Board sought the Commission's advance approval of provisions in a bill pending before the California Senate, SB 96."). In ruling on that proposed bill, FERC focused on the composition, not the conduct, of the proposed board. *See California Electricity Oversight*

Board, 89 FERC at 61,382 (FERC "found that the governance structure in the proposed legislation would not infringe on our authority.").

The challenged orders also focus on the board composition created by ABX1 5, and find it unlawful because it does not allow for fair representation of other classes of CAISO market participants. July 17, 2002 Order at ¶¶ 49-57, JA 56-58 (explaining why "the composition of the current Board . . . is not sufficiently independent to operate its interstate transmission facilities on a non-discriminatory basis [and] . . . poses a barrier to the implementation of market redesigns that are necessary to rehabilitate the CAISO and Western markets."). The composition of the Board, in particular its dominance by one market participant, the State, was also found unduly discriminatory because it "leads to the perception by other market participants that CAISO is predisposed to act in a manner that discriminates in favor of the State to the detriment of out-of-State participants," which runs afoul of the Order No. 888 precept that even the "appearance of control" by one market participant should be avoided. September 16, 2002 Order at ¶ 20, JA 198; *see also* July 17, 2002 Order at ¶ 57, JA 58 (reference to requirement that RTO governance be independent "'in both perception and reality'")(footnote omitted).

Contrary to CAISO's claim (Br. at 29), the composition of the board can and does result in "unjustified dissimilar *treatment* of like-situated suppliers or customers." (Emphasis in original). Here, the like-situated suppliers and customers are the sellers and buyers in the CAISO markets, that is, the market participants. Here, the unjustified dissimilar treatment is that no market participant, other than the State, has a say in how the board is selected because board selection is entirely within the hands of the State.

July 17, 2002 Order at ¶ 11, JA 51 (noting Governor's nominations for board were all seated); *see* December 15, 2000 Order, 93 FERC at 62,013 (rejecting Governor's position that he should select all board members as "not a reasonable position in light of [FERC's] prior determinations").

The consistent FERC view, shared by all parties when CAISO was created and expressed in the prior determinations, is that no one group should be allowed to dominate an ISO board because that precludes fair representation of all market participants in the ISO's decision making process. Here, because a switch from a stakeholder board to a non-stakeholder board was also required, fair representation of all classes of market participants would occur during the board selection process. July 17, 2002 Order at ¶ 62 n. 81, JA 59 ("The B[oard] S[election] C[ommittee] will represent a balanced mix of interested stakeholders to ensure that no market participant or class of market participants will have control over the selection of the initial Board."); *see generally id*. at ¶¶ 61-68, JA 59-60 (describing selection process).

CAISO argues (Br. at 27 *et seq*.) that FERC failed to make the necessary FPA § 206 findings to justify remedial action regarding board composition. *See* CPUC Br. at 15 (same). Here, the Commission was responding to both FPA § 206 complaints against the ABX1 5 board composition as well as CAISO's FPA § 205 filing of amended bylaws to reflect that composition. July 17, 2002 Order at ¶ 17 and ¶ 30, JA 53 and 54; September 16, 2002 Order at ¶ 17, JA 197. In such situations, this Court summarized the prerequisites for an FPA § 206 remedy: "first [FERC] must conclude under § [205] that the [utility] failed to carry its burden of proof that the proposed rate was just and

reasonable; second, it must itself demonstrate that the default position, the prior rate, is no longer just and reasonable, and third, it must establish that its substitute rate is just and reasonable." *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1579 (D.C.Cir. 1993). Those prerequisites are satisfied here.

First, the Commission found that the ABX1 5 board composition "has an unduly discriminatory effect on Western energy markets." September 16, 2002 Order at ¶ 18, JA 197. Several factors support that finding: the inconsistency between the board composition and Order No. 888 goals; the interference that a State-dominated board creates for FERC to carry out its duties; the appearance and reality that the board composition does not allow fair representation of all market participants; and the filing of complaints that make a prima facie showing of unduly discriminatory or anticompetitive behavior by the board. *Id*. at ¶¶ 17-22, JA 197-99; *see* July 17 Order ¶ 61, JA 59 (rejecting amended bylaws as "unjust and unreasonable, unduly discriminatory, and preferential" and inconsistent with prior FERC orders).

Second, the Commission had previously found that the prior board (established by SB 96) needed to be replaced because it was ineffective and was susceptible to influence by particular market participants. December 15, 2000 Order at 62,012. Accordingly, the "default position" (the prior board composition) was no longer just and reasonable.

Third, "[t]o establish a just and reasonable CAISO governance structure," the Commission required the adoption of selection and other procedures that are designed to substitute a representative, independent, expert, non-stakeholder board for the existing board. July 17, 2002 Order at ¶ 61-67, JA 59-60. This substitution addresses board

composition so as to cure the defects found, and thus eliminate undue discrimination, which will produce just and reasonable rates.

CAISO contends that because the § 206 finding (July 17, 2002 Order at ¶ 58, JA 58) speaks in the future tense, it does not satisfy § 206, which speaks in the present tense. CAISO Br. at 30. That contention was rejected in *TAPS*, 225 F.3d 685-87, where the Court found that FERC was not limited to remedying past discriminatory behavior, but could use its § 206 authority "to prevent undue discrimination to condition its approval of a power-pooling agreement upon removal of membership criteria which denied certain privileges to some but not all participants." *Id*. at 685 (citations omitted). So, too, here, FERC can prevent undue discrimination in the board's composition by removing a condition that allows one party to select all board members, and thus denies fair representation to other classes of market participants.

VI. CRITICISMS OF THE BOARD ARE SUPPORTED

Petitioners allege that criticisms of the Board lack substantial evidence. CPUC Br. at 16-19; CAISO Br. at 31-35. Those allegations rest, however, on a selective reading of limited portions of the cited references that do not reflect the overall tenor of those references. Review of the record shows, contrary to the allegations, that the criticisms are supported.

For example, CAISO claims that the criticism regarding the board's disinclination to address long term issues is belied by a CAISO plan that includes some elements FERC believes "'necessary to support a robust competitive wholesale market in California in the long run.'" CAISO Br. at 32, citing *California ISO*, 100 FERC ¶ 61,060 at ¶ 9. Continued

reading of that very paragraph supports FERC's criticism: "Many of the elements, however, are not proposed to be implemented for some time. It is not clear whether the limited measures [CAISO] proposes for the short-term would provide appropriate mitigation against the potential for market power abuse, and not just mitigation of prices. We are also concerned whether these market power mitigation proposals provide incentives for new entry into the generation and demand response markets." 100 FERC at ¶ 9; *see* ¶¶ 7-8 (noting proposals advanced by CAISO management that were delayed or either "reduce[d] or narrow[ed]" by the board); *see also* July 17, 2002 Order at ¶ 52, JA 57 (noting statement at April 9, 2002 meeting "that the Board is not interested in the incentives that this particular proposal may have on new generation, demand response, or forward contracting").[13]

CPUC contends that the challenged orders "stand for the proposition that an unsubstantiated assertion of discrimination, if repeated loudly and often enough, provides a basis for § 206 relief." CPUC Br. at 16. CPUC faults reliance on perception, rather than conduct, as an improper ground for making a § 206 finding. Again, the contention looks to snippets of the Report taken out of context, and ignores the stress placed in Order No.

[13] CAISO's reliance (Br. at 32 n. 19) on snippets from the Audit Report, p. 99, JA 260, is equally misplaced. Despite applauding the effort, the Report concluded that the effort "faces significant challenges" directly related to the board's composition, to wit, "dysfunctional processes now in place for stake holder input; the lack of trust and credibility in the CAISO by its stakeholders . . . and legitimate questions on the roles of various players." *Id*. The Report concluded that those underlying structural problems should be addressed before market redesign moves forward to avoid the "strong potential for stakeholders to feel as if the process has been forced on them," *id*., which is one manifestation of undue discrimination by a board dominated by one participant.

888 and subsequent decisions that ISOs should avoid the appearance, as well as the reality, of dominance by one group of participants.

While it is true that the Report relies, in part, on perception, the perception was based on interviews with a number of stakeholders which showed that "the almost universal reaction of the industry was that the CAISO was no longer independent." Audit Report at 30, JA 239. The only exception to the reaction was from "other State agencies;" "none of the stakeholders or other parties . . . interviewed believed that the CAISO could ever be independent under this arrangement." *Id*.[14] Such uniform response supports the conclusion that, until the governance issues are resolved, "'there is no hope for a comprehensive solution' for the problems in California." July 17, 2002 Order at ¶ 14, JA 52 (quoting Audit Report at 10). While FERC and the Report acknowledged (as CPUC points out, Br. at 16) the board's "best intentions" to be fair and independent, "the net result of [its] inception was a loss of independence by the CAISO" that "ha[s] led to a series of major problems." July 17, 2002 Order at ¶ 15 & n. 46, JA 52 (quoting Audit Report at 31, JA 240).

In sum, both criticisms were amply supported on the record, and that support shows the governance structure results in undue discrimination.[15]

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[14] See also Audit Report at 31, JA 240 (noting "the view by virtually all of the officers at the CAISO that the current [Board] is not independent" and the characterization that the process for stakeholder input was "an exercise in futility because the CAISO would often file or proceed as it wanted, ignoring the stakeholder input").

[15] Petitioners both assert that FERC ignored "numerous tangible risks that have deterred infrastructure development in California and nationwide – risks that have absolutely nothing to do with any allegation or perception of unequal treatment." CPUC Br. at 18; CAISO Br. at 33-34. No doubt that those are also risks, but they are ones over

CAISO also challenges FERC's conclusion that the governance structure effectively allows the State to dictate what filings CAISO will make with FERC. CAISO Br. at 30-31. CAISO claims that there is "no more reason why CAISO must be 'independent of State control in deciding what filings to submit' than a shareholder-owned utility should be similarly independent of its private owners." *Id*. at 31. That claim ignores the fundamental premise of the FPA: that authority to make or to change rates for interstate transmission lies solely with the public utility subject only to FERC's authority to set aside or to modify those rates upon the proper finding. *United Gas Co. v. Mobile Gas Corp.*, 350 U.S. 332, 341 (1956).

It follows that States have no authority to propose what rates a public utility should set for its interstate transmission under the FPA. *Comm. of Massachusetts, Dept. of Public Utilities v. United States*, 729 F.2d 886 (1st Cir. 1984), cited July 17, 2002 Order at ¶ 54 n. 69, JA 58. That case involved what the court called a "regulator-compelled" rate filing in which the State required that a filing be made regarding FERC-jurisdictional rates. The court rejected that effort as "allow[ing] a state to do what FERC itself cannot, namely to change an *inter*state rate practice that FERC has not found unreasonable." 719 F.2d at 888 (citations omitted; emphasis in original). The court mentioned two harms resulting from regulator-compelled filings: (1) they "would prevent the utility from choosing among reasonable rate-practice alternatives;" and (2) they

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which FERC has little, if any, control, and their presence does not obviate the problems inherent in the board's governance structure. As the latter problems fell within FERC's exclusive jurisdiction under the FPA, and were ones FERC could remedy, it properly focused attention on them.

"threaten[] confusion, possibly chaos" because individual states "in a multistate service area" could each require the public utility providing service "to file a *different* set of 'reasonable' rate practices with FERC." *Id*. (emphasis in original).

Here, the governance structure requires board approval of all filings made with FERC. This allows the State, which dominates the board, to dictate what filings will be made regarding CAISO's interstate services. Such "State-compelled" filings violate the Congressional scheme by allowing the State, not the utility, to dictate what rate practices will be proposed for interstate services. As "the rate-making powers of [public utilities] were to be no different from those they would possess in the absence of the [FPA]," *Mobile*, 350 U.S. at 343, Congress envisioned that private owners of "shareholder-owned public utilities" (CAISO Br. at 31) would control the filings made. It did not intend that either FERC or a State would be able to compel what filings would be made.

CONCLUSION

For the reasons stated, the Commission's orders should be affirmed in all respects.

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CERTIFICATE OF COMPLIANCE

In accordance with Circuit Rule 28(d)(1), I hereby certify that this brief contains 13,767 words, not including the tables of contents and authorities, the certificate of counsel, this certificate and the addendum.

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