

ORAL ARGUMENT IS SCHEDULED FOR

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

No. 04-1171

**SACRAMENTO MUNICIPAL UTILITY DISTRICT
PETITIONER,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION
RESPONDENT.**

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

**BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY
COMMISSION**

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CIRCUIT RULE 28(A)(1) CERTIFICATE

A. Parties and Amici:

The parties and amici are as stated in the brief of the Sacramento Municipal Utility District.

B. Rulings Under Review:

The rulings under review appear in the following orders issued by the Federal Energy Regulatory Commission:

1. *Sacramento Municipal Utility Dist. v. Pacific Gas & Electric Co., et al.*, Docket No. EL04-2-000, “Order Denying Complaint,” 105 FERC ¶ 61,358 (2003); and

2. *Sacramento Municipal Utility Dist. v. Pacific Gas & Electric Co., et al.*, Docket No. EL04-2-000, “Order Denying Rehearing,” 107 FERC ¶ 61,237 (2004).

C. Related Cases

The orders under review have never been before this Court or any other court. Counsel is aware of no other related cases pending in this or any other court.

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June 3, 2005

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GLOSSARY

1967 Contract	Contract between SMUD and the California Companies, providing SMUD with firm transmission service until December 31, 2004
CAISO	California Independent System Operator
California Utilities	Pacific Gas and Electric Co., Southern California Edison Co., and San Diego Gas and Electric Co.
DWR	California Department of Water Resources
EHV	Extra high voltage
FTR	Firm transmission rights
OATT	Open access transmission tariff
ROFR	Right of first refusal
SMUD	Sacramento Municipal Utility District

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**BRIEF FOR RESPONDENT
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STATEMENT OF THE ISSUE

Whether the Commission's denial of Sacramento Municipal Utility District's request for a right of first refusal upon expiration of its electric transmission contract was reasonable, given that neither the contract nor the otherwise applicable tariff, which had been filed and approved in earlier proceedings, provided for such a right.

STATUTES AND REGULATIONS

The applicable statutes and regulations are contained in the addendum to this brief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

This case involves a 1967 contract under which certain California utilities agreed to provide transmission service to Petitioner Sacramento Municipal Utility District (“SMUD”) until January 1, 2005. In 2003, SMUD filed a complaint against the utilities, contending that it had a right to extend the contract term to January 1, 2025 under the right of first refusal provision (“ROFR”) in the Order No. 888 *pro forma* open access transmission tariff (“OATT”).¹ The intent of the Order No. 888 ROFR provision is to ensure that a customer receiving long-term service (one year or more) could continue to receive transmission service.

¹ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs., Regs. Preambles [Jan. 1991-June 1996] ¶ 31,036 (1966) (“Order No. 888”), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1997), *order on reh’g*, Order No. 888-A, FERC Stats. & Regs., Regs. Preambles [July 1996-Dec. 2000] ¶ 31,048 (“Order No. 888-A”), *order on reh’g*, Order No. 888-B, 81 FERC ¶ 61,248, *order on reh’g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff’d sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000) (“TAPS”), *aff’d sub nom. New York v. FERC*, 535 U.S. 1 (2002).

The challenged orders denied the complaint. The Commission found that in 1998 the utilities had turned over the operation of their transmission facilities to the California Independent System Operator Corporation (“CAISO”) as required by California law. Thus, SMUD could only continue to take service under CAISO (not individual utility) tariffs. The CAISO service model, approved by the Commission, differs from the service model contemplated in Order No. 888. Consequently, the CAISO tariff is different from the Order No. 888 *pro forma* tariff and, *inter alia*, contains no ROFR. SMUD will still be able to obtain all the transmission service it needs, but must take it under the CAISO tariff pursuant to terms and conditions applicable to CAISO’s other transmission customers. *Sacramento Municipal Utility District v. Pacific Gas and Electric Company, et al.*, 105 FERC ¶ 61,358 (2003) (“First Order”), R 18 (JA 72), *reh’g denied*, 107 FERC ¶ 61,237 (2004) (“Rehearing Order”), R 26 (JA 87).

The petition for review followed.

II. STATEMENT OF FACTS

A. Statutory And Regulatory Background

Section 201(b) of the Federal Power Act (“FPA”), 16 U.S.C. § 824(b), grants FERC exclusive jurisdiction over transmission and wholesale sales of electric energy in interstate commerce. All rates for such transmission and sales must be just and reasonable and not unduly discriminatory. *See* FPA § 205(a) and

(b), 16 U.S.C. § 824d(a) and (b). Complaints concerning existing rates may be filed pursuant to FPA § 206(a), 16 U.S.C. § 824e(a). The complainant has the burden of proof in a § 206 proceeding. 16 U.S.C. § 824e(b).

In 1996, the Commission issued a set of rules designed to create a more competitive environment. To assure that customers reap the benefits of a competitive energy market, Order No. 888 directed each jurisdictional transmission-owning utility to: (1) offer non-discriminatory, open-access transmission service; (2) unbundle its wholesale generation, transmission, and ancillary service; and (3) take transmission for its own wholesale sales and purchases under the same terms applicable to others. *New York v. FERC*, 535 U.S. at 11. To aid this process, FERC promulgated a *pro forma* OATT, *see* Order No. 888-A at 30,503-43, and required utilities to file OATTs that conformed to the *pro forma* version, *see* Order No. 888 at 31,727-28 and 31,768-69.²

The *pro forma* OATT contains, *inter alia*, a ROFR provision giving firm transmission customers with long-term contracts (*i.e.*, contracts for a term of one year or more) “the right to continue to take transmission service from their existing transmission provider” upon the expiration of their contracts, but only if the existing customer agrees to match the rate (up to the maximum filed rate) and term

² Utilities were permitted to file OATTs that contain non-conforming provisions, if the utilities could demonstrate that those provisions were comparable to, or superior to, their counterparts in the *pro forma* tariff. Order No. 888 at 31,770.

of contract offered by any other customer. Order No. 888 at 31,665. The purpose of the ROFR is “to preserve the certainty and continuity of transmission service.” *TAPS*, 225 F.3d at 735. The ROFR acts as a tie-breaker, so that if not enough capacity is available to meet all requests for service, the existing customer may retain the capacity if the customer meets the specified requirements. Order No. 888 at 31,665; Order No. 888-A at 30,198.

Order No. 888 also encouraged, as another “effective means of accomplishing comparable access,” the formation of independent system operators (“ISOs”) to operate regional, multi-system transmission grids. Order No. 888 at 31,727. ISOs are “are non-profit organizations that operate the transmission facilities that others own.” *Pub. Util. Dist. No. 1 v. FERC*, 272 F.3d 607, 612 n.3 (D.C. Cir. 2001). Order No. 888 set out certain principles for assessing ISO proposals that might be submitted to the Commission in the future. Order No. 888 at 31,727, 31,730-32. “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.” *Id.* at 31,730. Among other things, an ISO should “provide open access to the transmission system and all services under its control . . . pursuant to a single, unbundled, gridwide tariff that applies to all eligible users in a non-discriminatory manner.” *Id.* at 31,731.

B. Development Of The California ISO And The ISO OATT

Pacific Gas and Electric Company (“PG&E”), Southern California Edison Company (“SCE”), and San Diego Gas & Electric Company (“SDG&E”) (collectively, the “California Utilities”), filed OATTs which contained a ROFR provision. In 1996, however, California enacted Assembly Bill (“AB”) 1890 which, *inter alia*, created the CAISO to operate transmission facilities within California. As required by AB 1890, the California Utilities turned operational control of their transmission facilities over to the CAISO in 1998. The CAISO is a public utility subject to FERC jurisdiction under the Federal Power Act and files tariffs governing the facilities it operates. *See Pacific Gas and Electric Co. v. FERC*, 306 F.3d 1112, 1114 (D.C. Cir. 2002).

The CAISO OATT provisions were the product of a lengthy process involving widespread stakeholder participation and multiple Commission filings. *Pacific Gas and Electric Co., et al.*, 80 FERC ¶ 61,128 at 61,417 (July 30, 1997) (“*CAISO I*”), *order on reh’g*, 81 FERC ¶ 61,222 (Oct. 30, 1997) (“*CAISO II*”). The CAISO tariff differs from the Order No. 888 OATT in that the former, unlike the latter, does not provide for long-term reservation of transmission capacity. *CAISO II*, 81 FERC at 61,472. Instead, it provides for transmission scheduling on a day-ahead and hour-ahead basis. Because “scheduling transmission on a day-ahead and hour-ahead basis is not compatible with the long-term reservation of

discrete physical transmission rights,” a ROFR as contemplated in the Order No. 888 *pro forma* tariff is not pertinent and was not provided for in the tariff. *CAISO II*, 81 FERC at 61,472. For this reason, *CAISO II* also required the California Utilities to remove the ROFR from their previously-filed individual OATTs.³ *Id.* at 61,472 fn.196.

Transmission pricing under the CAISO model consists of two parts: (1) an access fee which gives the customer access to the entire grid and allows each transmission owner to meet its revenue requirement; and (2) a congestion charge that applies only to those users of congested transmission. *CAISO I*, 80 FERC at 61,428. Despite the lack of a ROFR, customers under the CAISO OATT have access to transmission capacity as long as they are willing to pay congestion charges.

The Commission also required the CAISO to file, by June 30, 1998, a plan to make long-term firm transmission rights (“FTRs”) available beginning on January 1, 1999. *CAISO I*, 80 FERC at 61,427. Transmission rights are financial instruments that allow market participants to hedge the risk of fluctuating congestion charges and entitle their holders to share in the distribution of revenues from transmission congestion charges during the period of time for which the FTR

³ The only service still offered under individual utility OATTs is service that was contracted for before the CAISO became operational.

is issued. *California Independent System Operator Corp.*, 87 FERC ¶ 61,143 at 61,570 (May 3, 1999) (“*CAISO III*”). FERC did not require the CAISO also to develop long-term physical transmission service. *Id.*

The FTR proposal subsequently submitted by the CAISO and conditionally approved by the Commission limited the initial offering to FTRs of one year duration. *Id.* Although not required by FERC, the FTRs proposed by the CAISO also constitute physical transmission rights to the extent they entitle their owners to certain scheduling priorities over congested interfaces in the day-ahead market. *California Independent System Operator Corp.*, 94 FERC ¶ 61,343 at 62,267-68 (Mar. 28, 2001).

Various parties requested that the CAISO provide firm physical transmission rights in addition to financial rights. FERC denied the requests, finding that FTRs need not provide customers with firm physical transmission rights in order for them to secure transmission service that is as good as, or superior to, the service under the Order No. 888 *pro forma* tariff. *California Independent System Operator Corp.*, 88 FERC ¶ 61,156 at 61,525 (Aug. 2, 1999) (“*CAISO IV*”).

The Commission also directed the CAISO to use its experience with the one-year FTRs to develop proposals to provide longer term FTRs and to report on its plans for such proposals by December 1, 2000. *CAISO III*, 87 FERC at 61,572; *CAISO IV*, 88 FERC at 61,525. CAISO’s report proposed leaving the maximum

term at one year or possibly less. The report also stated that FTR market features are directly linked to the comprehensive market redesign ordered by the Commission after the California energy crisis, and would be reconsidered as part of that comprehensive redesign. That proceeding, which is docketed as No. ER02-1656-000, is ongoing.⁴

C. SMUD's Contract And Complaint

On August 1, 1967, SMUD and the California Utilities entered into the "Contract Between California Companies and Sacramento Municipal Utility District for Extra High Voltage Transmission and Exchange Service for 200 MW of Extra High Voltage Transmission and Exchange Service ("1967 Contract"). See Complaint at 1-2. R 1, JA 9-10. The contract had a termination date of January 1, 2005 and contained no rollover provision. In a letter dated January 31, 2003, SMUD notified the California Utilities of its desire to extend the contract's original terms until January 1, 2025 under the Order No. 888 ROFR provision. *Id.* at 3. JA 11. The California Utilities responded, *inter alia*, that the contract did not provide

⁴ SMUD filed a petition for review of orders issued in that proceeding. See *Sacramento Municipal Utility District, et al. v. FERC*, D.C. Cir. Nos. 04-1390 and 04-1391 (consol.) (filed Nov. 17, 2004), in which review was sought of *California Independent System Operator Corp., et al.*, 107 FERC ¶ 61,274 (June 17, 2004), *order on reh'g*, 108 FERC ¶ 61,254 (Sept. 20, 2004). Additional rehearing requests were filed as well. On May 26, 2005, the Court granted FERC's motion to dismiss the appeal because the orders are not final or ripe for review. Subsequently, FERC issued an order denying rehearing and requiring the CAISO to make further tariff filings. 110 FERC ¶ 61,041 (Jan. 24, 2005). On March 21, 2005, the California Public Utilities Commission petitioned for review (D.C. No. 05-1089). FERC's motion to dismiss is pending.

for rollover and Order No. 888's ROFR was incompatible with the CAISO open access transmission system.

On October 8, 2003, SMUD filed a complaint against the California Utilities, contending that it had the right to extend the 1967 Contract and its existing transmission service under the ROFR provision of the *pro forma* OATT. *See*, Complaint at 5. R 1, JA 13. The CAISO, the California Electricity Oversight Board, the Modesto Irrigation District, the Metropolitan Water District of Southern California, and the California Department of Water Resources State Water Project intervened. PG&E and SCE jointly, and SDG&E separately, replied in opposition to the complaint.

D. The Challenged Orders

The Commission denied SMUD's complaint. The Commission explained that the Order No. 888 ROFR does not provide for an automatic contract extension beyond the term of the relevant contract. Rather, it assures access to capacity, if the customer is willing to meet certain conditions. First Order, 105 FERC at P 22.⁵ JA 75. If transmission capacity is insufficient to serve all customers, the ROFR serves as a tie-breaker and permits a customer receiving long-term transmission service to continue to receive transmission service, so long as the customer is

⁵ "P" refers to the paragraph numbers in the Commission order.

willing to take service under the pertinent OATT and to match any competing request for service. First Order, 105 FERC at P 22. JA 75.

Here, the California Utilities no longer provide transmission service under Order No. 888 *pro forma* tariffs because they have turned over operational control of their facilities to the CAISO. Thus, SMUD, if it continues to take transmission service, will have to take transmission service under the CAISO tariff. *Id.* at P 23. JA 75. The Order No. 888 ROFR provision is inapplicable to SMUD (or any other customer in the CAISO service area) because the service model of the Order No. 888 *pro forma* tariff differs from the CAISO service model. *Id.* CAISO's day-ahead and hour-ahead scheduling system grants non-discriminatory access to transmission service to all customers, and (unlike the Order No. 888 *pro forma* tariff) does not offer long-term transmission service. SMUD nevertheless still has access to transmission service, but under the terms of the CAISO tariff rather than its expired 1967 Contract. *Id.*

SMUD requested rehearing, which the Commission subsequently denied. Rehearing Order, 107 FERC at P 1. JA 87. The Commission reiterated that the California Utilities have turned over operational control of their transmission facilities to the CAISO, that they no longer provide transmission service under an Order No. 888 *pro forma* tariff, that the CAISO tariff is the only tariff relevant to

SMUD's transmission, and that SMUD enjoys non-discriminatory access to transmission service under the CAISO tariff. *Id.* at P 12. JA 88.

The Commission also rejected SMUD's argument that denying SMUD the right of first refusal here constituted a new policy. Rehearing Order, 107 FERC at P 13. JA 88. As the CAISO tariff is the governing tariff for the transmission service SMUD requests, it controls. That tariff, which does not contain a ROFR, was approved by FERC in earlier proceedings. Accordingly, the Commission was not adopting a new policy, but following the filed, governing tariff. *Id.*

FERC also found that SMUD's complaint was not the appropriate proceeding in which to address the lack of availability of long-term firm transmission service under the CAISO tariff. *Id.* at P 14. JA 88. SMUD should pursue that issue in Docket No. ER02-1656, *see supra* page 9, which is addressing CAISO's comprehensive market redesign proposal. *Id.*

SUMMARY OF ARGUMENT

The challenged orders did nothing more than apply the governing CAISO tariff to the facts in this proceeding and treat SMUD as all other California customers are treated upon expiration of their pre-existing contracts. The CAISO tariff, like SMUD's contract, does not contain a ROFR provision; thus, SMUD, which must take transmission service from the CAISO and pursuant to the CAISO tariff, was not entitled to a right of first refusal upon the expiration of its contract.

The challenged orders neither repealed by adjudication a regulation adopted by the Order No. 888 notice and comment rulemaking nor applied new policies retroactively. Rather, as indicated above, the orders applied a tariff which had been approved by the Commission in earlier proceedings. In any case, no “rule” in Order No. 888 requires a utility always to offer a ROFR. Instead, Order No. 888 permits the filing of an OATT with terms different from those in the *pro forma* OATT, if the deviation is justified, and recognizes in particular that variations from the *pro forma* tariff may be necessary to accommodate the needs of regional entities such as ISOs.

To the extent that SMUD is arguing that the challenged orders had to find that the CAISO tariff is “as good as or superior to” the *pro forma* tariff, the argument is a prohibited collateral attack on other orders. The Commission approved the omission of a ROFR from the CAISO tariff in earlier orders which were not appealed, and has also determined elsewhere that FTRs in conjunction with appropriate congestion management can provide service as good as that offered under the *pro forma* tariff.

SMUD’s argument that the Commission had previously ordered the CAISO to offer long-term firm service lacks merit. The Commission directed the CAISO to propose FTRs for terms longer than one year, but rejected requests that it order the development of long-term physical transmission rights. The development of the

longer term services is being raised in the ongoing redesign of the California energy markets. Currently, SMUD can receive transmission (as do all other CAISO customers, including the California Utilities) pursuant to the existing CAISO tariff, which the Commission has approved as being as good as, or superior to, the *pro forma* tariff.

SMUD's other arguments are not persuasive. FERC's primary ground for denying the complaint was not that contract extension at current terms was not possible under Order No. 888, but that SMUD takes service under the CAISO tariff and that tariff does not provide a right of first refusal. Also, Order No. 888's statement that ROFR mechanisms will be adjudicated on a case-by-case basis is irrelevant here because the tariff does not contain a ROFR provision. Finally, the Commission has not ignored SMUD's concern about service continuity by referring it to the ongoing redesign proceeding; SMUD has service continuity now as long as it is willing to pay the transmission charges and abide by the terms and conditions of the CAISO tariff.

ARGUMENT

I. STANDARD OF REVIEW

"The role of judicial review is only to ascertain" if the agency "has met the minimum standards set forth in the statute." *U.S. Postal Serv. v. Gregory*, 534 U.S. 1, 7 (2001). A court reviews FERC orders under the "arbitrary and

capricious” standard set out in the Administrative Procedure Act at 5 U.S.C. § 706(2)(A). *E.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). That standard requires the Commission to “examine the relevant data and articulate a . . . rational connection between the facts found and the choice made.” *Motor Vehicle Mfrs. Ass’n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)); *see also, e.g., Midwest ISO Trans’n Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004). As demonstrated below, the Commission’s orders meet these standards.

II. THE COMMISSION’S DENIAL OF A ROFR FOR SMUD’S 1967 CONTRACT WAS BASED UPON THE APPLICABLE CAISO TARIFF AND DID NOT MODIFY ORDER NO. 888

The challenged orders did nothing more than apply the CAISO tariff to the facts of this proceeding. “Specifically, the Commission found that the California utilities no longer provide transmission service under an Order No. 888 *pro forma* tariff since they have turned over operational control of their facilities to the CAISO.” Rehearing Order, 107 FERC at P 12. JA 88. The CAISO tariff, like SMUD’s 1967 Contract, does not contain a ROFR provision. Consequently, SMUD, which can now take transmission service from the CAISO and pursuant to the CAISO tariff, was not entitled to a right of first refusal upon the expiration of its contract. *Id.* at P 13. JA 88.

SMUD nevertheless contends that Order No. 888 established a rule, promulgated through APA notice and comment procedures, which it characterizes as entitling it to a ROFR for long-term transmission service (Br. at 25). SMUD further contends that FERC acted unlawfully in the challenged orders by modifying the rule without notice and comment (Br. at 23) or (in the alternative) by applying new policies retroactively (Br. at 34).⁶ These arguments reflect a faulty analysis of Order No. 888 and omit the effect of the Commission's subsequent orders approving the structure and tariffs of the CAISO.

A. Order No. 888 Explicitly Permits Utilities To File OATTs With Terms Different From Those In The *Pro Forma* Tariff

SMUD's theory, that FERC has *de facto* repealed, without notice and comment, what SMUD views as the ROFR rule, lacks merit because there is no such rule. Nothing in Order No. 888 mandates ROFRs in all transmission tariffs under all circumstances. To the contrary, Order No. 888 states explicitly that a utility may file an OATT with terms different from those in the *pro forma* OATT, if the utility can justify the deviation:

We recognize that there may be circumstances in which a public utility believes that the Final Rule pro forma tariff does not provide sufficient flexibility or that the utility can propose superior non-rate terms and conditions. Thus, . . . a public utility . . . may file . . . a tariff with terms and conditions that differ from those set forth in this

⁶ See also brief of intervenor California Department of Water Resources ("DWR") at 6.

Rule, provided that it: . . . (4) demonstrates that such terms and conditions are consistent with, or superior to, those in the compliance tariff.

Order No. 888 at 31,770. Thus, no “rule” requires a utility always to offer a ROFR, contrary to SMUD’s implication. Moreover, as discussed *infra* at 22-23, the Commission explicitly found that the CAISO tariff, which offers FTRs and day-ahead/hour-ahead scheduling but no ROFR, satisfies the “consistent with or superior to” test.

SMUD’s argument also ignores Order No. 888’s recognition that independent system operators such as the CAISO may have different requirements that make a procrustean result infeasible:

In Order No. 888, however, we recognized that modifications to the *pro forma* Tariff may be necessary in order to accommodate the needs of regional entities. We are faced with a similar situation here [T]he transmission service in the restructured California market will be provided through a set of rights and relationships that are very different from those underlying the traditional models of physical rights which formed the basis of our *pro forma* Tariff.

CAISO I, 80 FERC at 61,427. *See also* Order No. 888 at 31,727 and 31,730 (finding that ISOs may be an effective means for accomplishing comparable access and providing guidance on “minimum ISO characteristics”); *id.* at 31,636 (permitting variations for regional practices in the *pro forma* tariff); and Order No. 888-A at 30,449 (utilities may modify *pro forma* tariff provisions to reflect prevailing regional practices). Thus, not only did Order No. 888 allow terms to

vary from those in the *pro forma* OATT, it recognized that ISOs provide another way to achieve non-discriminatory access to transmission service and that tariff variations might be necessary to accommodate the needs of these regional entities.

B. The Commission Approved The CAISO Tariff In Orders That Preceded SMUD's Complaint

1. SMUD's Complaint Constitutes An Impermissible Collateral Attack On The Commission's Earlier Orders Approving the CAISO Tariff

SMUD contends (Br. at 29) that service under the CAISO tariff is “on its face” inferior to that offered under the Order No. 888 *pro forma* tariff because there is no ROFR to give a priority to existing firm transmission customers. Petitioner's assertion ignores the judicial review process under FPA § 313, 16 U.S.C. § 825*l*. FPA § 313 requires that review be commenced within 60 days of issuance of an order that allegedly aggrieves petitioner. A party cannot raise an issue on judicial review of later orders that challenges earlier Commission decisions in orders that were not the subject of judicial review. Such a “collateral attack” on an earlier, final order is impermissible. *See, e.g., City of Nephi v. FERC*, 147 F.3d 929, 934 (D.C. Cir. 1998); *Georgia Industrial Group v. FERC*, 137 F.3d 1358, 1363 (D.C. Cir. 1998).

The Commission, as explained in the next section, approved the omission of a ROFR from the CAISO tariff, the tariff under which SMUD must take service from the CAISO, in 1997. *See* Rehearing Order, 107 FERC at P 13 (JA 88);

CAISO II, 81 FERC at 61,472. SMUD participated in that proceeding. *See id.* at 61,470. SMUD’s contention now, several years later, that the CAISO tariff is deficient because it lacks a ROFR, is an impermissible collateral attack on those earlier orders.

For its part, SMUD contends (Br. at 31) that a collateral attack argument is a *post hoc* rationale. This is not so. Although the challenged orders did not use the words “collateral attack,” FERC did recognize that SMUD was asking for a ROFR that had already been rejected in the orders approving the CAISO tariff. *See* Rehearing Order, 107 FERC at P 13. JA 88. (“The [First] Order did not alter any existing provision of the CAISO tariff, which already did not contain right of first refusal provisions.”). In any event, the issue is the Court’s jurisdiction to consider the matters raised on appeal. SMUD would like the Court to address the merits of the existing CAISO service model and tariff, but the time by which an appeal had to be filed in order for the Court to have jurisdiction of those matters has long since expired. *See also, supra* at page 9, explaining the Commission’s ongoing comprehensive reevaluation of the CAISO market design. SMUD may raise its concerns there. Rehearing Order, 107 FERC at 14. JA 88.

2. FERC Approved The CAISO’s Omission Of A ROFR

SMUD (Br. at 23) and DWR (Br. at 7) contend that the challenged orders effectively announced a new policy to deny the right of first refusal. However, the

challenged orders relied upon the CAISO tariff, which had been approved *sans* ROFR years before SMUD filed its complaint. *See* Rehearing Order, 107 FERC at P 13 (JA 88); *CAISO II*, 81 FERC at 61,472. DWR argued in the CAISO tariff proceeding that existing contract holders should have the right of first refusal with respect to service under the CAISO tariff. *Id.* FERC disagreed:

As proposed, the ISO will attempt to accommodate the transmission service schedules of participants on a daily basis. To the extent that the ISO receives more requests for service than it can accommodate, it will attempt to efficiently ration constrained transmission capacity through congestion pricing. The ISO's proposal to schedule transmission on a day-ahead and hour-ahead basis is not compatible with the long-term reservation of discrete physical transmission rights. Moreover, in Order No. 888, the Commission was addressing the tension that existed for the use of available transmission capacity between native load, existing third-party contracts, and new third-party transmission customers. That tension does not exist here.

We find that the ISO's congestion pricing proposal is significantly different from the circumstances we considered in Order No. 888. In Order No. 888 we were addressing the firm reservation of physical transmission rights whereas the ISO's congestion management proposal is applicable to the efficient rationing of constrained transmission on an hourly basis. Therefore we find DWR's assertion that the right of first refusal should extend to the ISO congestion pricing proposal to be inapposite.

Id. As the Rehearing Order stated, the CAISO tariff "already did not contain right of first refusal provisions." 107 FERC at P 13. JA 88. Consequently, FERC's rejection of SMUD's argument that it had implemented a new policy in the First Order was proper.

SMUD (Br. at 32) and DWR (Br. at 13) contend further that the Commission promised to “revisit” the availability of a ROFR “after that long-term firm service had been developed.” For this proposition, SMUD relies on the statement in *CAISO II* “that existing customers may wish to assert a right of first refusal with respect to the [CAISO] transmission *rights* proposal that will be implemented [later].” *CAISO II*, 81 FERC at 61,473 (emphasis added). The cited language, however, refers to the financial rights proposal, not to the rollover of physical capacity rights as in the Order No. 888 ROFR.

CAISO II, moreover, goes on to state that the Commission intended “to revisit this issue when the ISO submits its transmission rights proposal” *Id.* Thus, the Commission expected the issue to be raised in a generally-applicable proceeding addressing the CAISO tariff, not in specific adjudications addressing the application of that tariff. SMUD’s implication (Br. at 36) that it could have “reasonably relied” on being able to obtain a ROFR at the expiration of its 1967 Contract with the California Utilities is simply not feasible given that: (1) these utilities have turned over operating control of their facilities to the CAISO; and (2) SMUD now must take its transmission service under the CAISO tariff which does not provide for a ROFR.⁷

⁷ Both SMUD and DWR characterize several adjudicative orders as standing for the proposition that the Commission intended the ROFR to be “automatic” in its operation. See SMUD’s Br. at 8 (citing *Tennaska Power Services Co.*, 102 FERC ¶

3. The Commission Has Found That FTRs In Conjunction With Appropriate Congestion Management Can Provide Service As Good As Service Offered Under The *Pro Forma* Tariff

SMUD contends (Br. at 29) that service under the CAISO tariff is “on its face” inferior to that offered under the Order No. 888 *pro forma* tariff. As demonstrated above, this is the wrong case in which to advance this argument. The CAISO tariff has been effective since 1998. SMUD’s recourse now, if it does not like the tariff’s provisions, is to make its arguments and advocate its position in the ongoing market redesign proceeding. *See* Rehearing Order, 107 FERC at P 14 (JA 88) (SMUD’s concerns about the CAISO market structure and access to long-term transmission service should be raised in ongoing comprehensive market redesign proceeding); *see supra* page 9 (discussing ongoing proceeding); *see also Florida Municipal Power Agency v. FERC*, 315 F.3d 362, 366 (D.C. Cir. 2003) (agency need not consider or resolve all issues at one time and has “broad discretion” to manage its own dockets and priorities) (quoting *Telecomm. Resellers Assoc. v. FCC*, 141 F.3d 1193, 1196 (D.C. Cir. 1998)).

61,140 (2003); *Public Service Co. of New Mexico*, 85 FERC ¶ 61,240 at 62,005 (2002); and *Exelon Generation Co.*, 99 FERC ¶ 61,235 (2002); DWR’s Br. at 8-11 (adding *Constellation Power Sources, Inc. v. American Electric Power Service Corp.*, 100 FERC ¶ 61,157 (2002)). All of the cited cases, however, arose in the context of transmission provider tariffs that contained a ROFR provision. Thus, they are not relevant here, where SMUD takes service under a tariff that contains no ROFR provision.

In any case, the Commission has found that providing financial rights (FTRs) along with appropriate congestion management represents an acceptable alternative to the *pro forma* tariff. On May 8, 1999, *CAISO III* conditionally accepted the CAISO's proposal to implement FTRs with a term of one year. Intervenors complained that the proposal was not "as good as or superior to" transmission service under the *pro forma* tariff because of the one-year term limitation. The Commission agreed that eventually the FTR proposal must be revised to include long-term FTRs, but found that limited-term FTRs would be acceptable initially "so as to limit the risk exposure of acquiring such rights and to provide all participants with an opportunity to develop expertise with FTR mechanisms." *CAISO III*, 87 FERC at 61,572.

Various parties, including DWR, sought rehearing of *CAISO III*, contending that the Commission erred in not requiring the CAISO to offer firm physical transmission rights in addition to FTRs. FERC denied the requests, finding that FTRs need not provide customers with firm physical transmission rights in order for them to secure transmission service that is as good as or superior to the service under the Order No. 888 *pro forma* tariff. *CAISO IV*, 88 FERC at 61,525. "Properly designed financial rights can provide customers with an equivalent level of price certainty and service quality as long as the ISO has the necessary mechanisms in place to manage congestion efficiently, *i.e.*, without frequently

having to resort to non-price schemes for rationing available capacity.” *Id.* The Commission found further that the CAISO congestion management mechanisms satisfy this requirement. *Id.*

C. The Commission Did Not Require The CAISO To Offer Long-Term Physical Transmission Service

SMUD also errs in arguing (Br. at 40-43) that the Commission has ordered the CAISO to offer long-term firm service. Rather, the Commission approved the CAISO tariff with one-year FTRs, and directed the CAISO to use its experience with the one-year FTRs to develop proposals to provide longer term FTRs. *CAISO III*, 87 FERC at 61,571; *CAISO IV*, 88 FERC at 61,525. FTRs are financial instruments that allow market participants to hedge the risk of congestion costs. The Commission did not require the CAISO to develop an instrument offering firm capacity rights. *CAISO III*, 87 FERC at 61,571.

SMUD contends (Br. at 33) that the distinction between physical and financial rights is a red herring because SMUD “has not claimed that ROFR rights must be *physical*, but that it is entitled to at least *equivalent* ROFR protection for long-term service.” [emphasis in the original] However, SMUD’s case rests on the Order No. 888 ROFR, (*see* Br. at 23 and Complaint at 5 (JA 13)), the objective of which is to protect access to physical capacity.

The purpose of the Order No. 888 *pro forma* ROFR is “to preserve the certainty and continuity of transmission service.” *TAPS*, 225 F.3d at 735. The

“policy rationale for giving an existing firm transmission customer . . . served under a contract of one year or more, a reservation priority (right of first refusal) when its contract expires is that it provides a mechanism for allocating transmission capacity when there is insufficient capacity to accommodate all requestors. If there are capacity limitations and both customers (existing and potential) are willing to pay for firm transmission service of the same duration, the right of first refusal provides a tie-breaking mechanism that gives priority to existing customers so that they may continue to receive transmission service.” Order No. 888 at 30,197.⁸

There is no question here as to whether SMUD has access to the transmission capacity it needs. It does. Rehearing Order, 107 FERC at P 12 (JA

⁸ The *pro forma* tariff ROFR provision is Section 2.2, which states that:

Existing firm service customers (. . . with a contract term of one-year or more), have the right to continue to take transmission service from the Transmission Provider when the contract expires. . . . If at the end of the contract term, the Transmission Provider’s Transmission System cannot accommodate all of the requests for transmission service the existing firm service customer must agree to accept a contract term at least equal to a competing request by any new Eligible Customer and to pay the current just and reasonable rate, as approved by the Commission, for such rate. This transmission reservation priority for existing firm service customers is an ongoing right that may be exercised at the end of all firm contract terms of one-year or more.

Order No. 888 at 31,933.

88) (noting that SMUD has “non-discriminatory access to transmission service under the CAISO tariff”). The issue is the rates, terms, and conditions for that access. SMUD prefers the traditional, pre-ISO model under which it can contract for twenty years of transmission capacity at set rates and terms. Under the CAISO service model and tariff, which the Commission approved in earlier proceedings, transmission is scheduled and delivered on a day-ahead and hour-ahead basis, and customers are not limited in the amounts of transmission they can request. SMUD must pay the prevailing congestion charges, but it has access to the transmission that it needs.

SMUD can also hedge these congestion costs by using FTRs. SMUD complains that the Commission permitted “the CAISO to operate *temporarily* without ROFR or long-term service provisions in its tariff.” Br. at 42 [emphasis in original]. But the Commission directed the CAISO to consider FTRs for terms longer than one year, not to consider provisions that would allow access to capacity on a long-term contractual basis. *CAISO III*, 87 FERC at 61,571; *CAISO IV*, 88 FERC at 61,525. SMUD also provides no citation for the proposition that the Commission permitted the CAISO to operate only “temporarily” without a ROFR. In fact, the Commission explicitly rejected the proposition “that existing contract holders should have the right of first refusal with respect to service under the ISO tariff.” *CAISO II*, 81 FERC at 61,472.

C. SMUD'S Other Arguments Lack Merit

SMUD contends (Br. at 27) that FERC's Response to SMUD's June 23, 2004 motion for summary reversal⁹ asserted that the denial of ROFR protection was an "interpretation" and not a "modification" of Order No. 888 and that that "strains credulity." FERC's Response, in fact, did not state that the denial of ROFR protection was an "interpretation" of Order No. 888. More importantly, neither do the challenged orders. FERC's consistent position has been that the relevant tariff is not the Order No. 888 *pro forma* tariff, but the CAISO tariff which was approved without a ROFR by the Commission in an earlier proceeding, and is the tariff under which SMUD now must take service. *See* Rehearing Order at P 13. JA 88.

SMUD also contends (Br. at 37-39) that FERC's "principal stated ground[] for rejecting SMUD's complaint" is that Order No. 888 does not authorize a contract extension under the same terms and conditions of the 1967 Contract. SMUD's characterization of FERC's findings is not accurate. The Commission denied SMUD's complaint because the only relevant tariff is the CAISO tariff, which does not contain a ROFR provision. Rehearing Order, 107 FERC at P 12-13. JA 88. While the First Order does contain language suggesting that the Commission was considering SMUD's request as one for contract extension (*see*

⁹ The Court denied the motion for summary reversal on September 22, 2004.

First Order, 105 FERC at P 23 (JA 75)), the Rehearing Order makes clear that FERC's denial of SMUD's complaint rested on the CAISO tariff, which does not contain a right of first refusal.

SMUD also argues (Br. at 43-44) that FERC acted arbitrarily by not specifically addressing its argument below that FERC had departed from its policy of adjudicating ROFR mechanisms on a case-by-case basis. As discussed *supra* at 15, however, FERC relied upon the fact that the CAISO tariff does not contain a ROFR provision. *See* Rehearing Order, 107 FERC at P 13. JA 88. Mechanisms for exercising a right of first refusal are irrelevant where there is no ROFR to begin with.

Finally, SMUD complains (Br. at 45-47) that the Commission has wholly ignored its concern about service continuity by referring it to another proceeding for relief. As discussed above, however, SMUD has service continuity as long as it is willing to pay access and congestion charges pursuant to the CAISO tariff. The ongoing California restructuring proceeding, *see supra* page 9, may result in FTRs with a term longer than one year, to SMUD's liking, but in the meantime, SMUD has access to transmission service under a tariff which the Commission, in orders issued elsewhere, has already approved and at rates, terms, and conditions applicable to all other customers.

The primary purpose of an ISO, moreover, is to ensure fair and non-discriminatory access to transmission service for all users. *See* Order No. 888 at 31,730. As SMUD is seeking a service not currently available under CAISO's tariff to other users, FERC's suggestion that SMUD pursue its concerns in a market design proceeding in which the concerns of other users and the needs of the transmission system can be considered is appropriate. *Cf.*, *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council*, 453 U.S. 519 (1978); *Michigan Public Power Agency v. FERC*, 963 F.2d 1574, 1579 (D.C. Cir. 1992) (agencies accorded substantial deference in ordering their proceedings).

CONCLUSION

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

Respectfully submitted,

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