ORAL ARGUMENT SCHEDULED FOR OCTOBER 21, 2010

In the United States Court of Appeals for the District of Columbia Circuit

Nos. 09-1213, *et al.*

TRANSMISSION AGENCY OF NORTHERN CALIFORNIA, *ET AL.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

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

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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Final Brief: August 25, 2010

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties

All parties appearing before the Court are indicated in Petitioners' Rule 28(a)(1) certificate.

B. Rulings Under Review:

1. "Order Conditionally Accepting Tariff Changes and Directing Compliance Filing," *Cal. Ind. Sys. Operator Corp.*, 124 FERC ¶ 61,271 (2008) JA 848; and

2. "Order Denying Rehearing," *Cal. Ind. Sys. Operator Corp.*, 128 FERC ¶ 61,103 (2009), JA 1323.

C. Related Cases:

This case has not previously been before this Court or any other court. Several appeals pending in this Circuit seeks review of orders related to the orders contested here. First, *Sacramento Municipal Utility District, et al. v. FERC*, 2010 U.S. App. LEXIS 15179 (D.C. Cir. July 23, 2010), sought review of orders approving the California ISO's Market Redesign Tariff, a change to which is at issue here. Second, there are two cases contesting compliance orders related to that Tariff, both of which are in abeyance pending the outcome of Nos. 07-1208, *et al.*: *Sacramento Municipal Utility District v. FERC*, No. 09-1141 (D.C. Cir. filed May 18, 2009), and *Sacramento Municipal Utility District v. FERC*, No. 09-1142 (D.C. Cir. filed May 18, 2009). Finally, *Turlock Irrigation District v. FERC,* No. 10-1008 (D.C. Cir. Jan. 12, 2010), seeks review of Commission compliance orders

arising from the orders on appeal, and was placed in abeyance by this Court's order of March 3, 2010, pending the outcome of this appeal.

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May 21, 2010
Final Brief: August 25, 2010

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GLOSSARY

California ISO	California Independent System Operator Corporation
Commission or FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
Imperial	Imperial Irrigation District
September 2006 Order	*Cal. Ind. Sys. Operator Corp.*, 116 FERC ¶ 61,274 (2006)
Rehearing Order	"Order Denying Rehearing," *Cal. Ind. Sys. Operator Corp.*, 128 FERC ¶ 61,103 (2009), JA 1323.
Sacramento	Sacramento Municipal Utility District
Turlock	Turlock Irrigation District
Tariff Order	"Order Conditionally Accepting Tariff Changes and Directing Compliance Filing," *Cal. Ind. Sys. Operator Corp.*, 124 FERC ¶ 61,271 (2008), JA 848.

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

Nos. 09-1213, *et al.*

TRANSMISSION AGENCY OF NORTHERN CALIFORNIA, *ET AL.*,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

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

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUES

1. Whether the Federal Energy Regulatory Commission (Commission or FERC) properly interpreted its jurisdiction under section 205 of the Federal Power Act (FPA), 16 U.S.C. § 824d, to authorize its review of a tariff revision filed by the California Independent System Operator Corporation (California ISO), governing the pricing of the sale of electricity in the California ISO market, which takes into account the impact of neighboring governmental entities on the ISO's grid.

2. Whether the Commission's acceptance, as modified, of the California

ISO's proposed Integrated Balancing Authority Area amendment to its tariff, governing the pricing of wholesale sales in the ISO-administered electric market of power imported to and exported from the ISO by two neighboring municipal utilities, the Sacramento Municipal Utility District (Sacramento) and the Turlock Irrigation District (Turlock), was a reasonable exercise of its statutory discretion and supported by substantial evidence.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutes and regulations are contained in Addendum A to this brief.

STATEMENT OF THE FACTS

I. INTRODUCTION -- THE CALIFORNIA ELECTRIC MARKET

In the contested orders, the Commission approved the ISO's Integrated Balancing Authority Area (Balancing Authority) proposal to model and price imports and exports of power to and from the ISO-controlled grid by Sacramento and Turlock (known as interchange transactions). "Order Conditionally Accepting Tariff Changes and Directing Compliance Filing," *Cal. Ind. Sys. Operator Corp.*, 124 FERC ¶ 61,271 (2008) (Tariff Order), JA 848, and "Order Denying Rehearing," *Cal. Ind. Sys. Operator Corp.*, 128 FERC ¶ 61,103 (2009) (Rehearing Order), JA 1323.

As this Court is aware, the California ISO is a non-profit, independent

organization that operates, but does not own, a substantial portion of the electric transmission system in the State of California. *See, e.g., Sacramento Municipal Utility District v. FERC*, 474 F.3d 797, 798 (D.C. Cir. 2007). The California ISO is the balancing authority for the ISO-controlled grid, the system of transmission lines and associated facilities it operates. A balancing authority is an entity responsible for maintaining a balance of electric loads and resources in a particular area, for the purpose of complying with the electric reliability standards administered by the North American Electric Reliability Corporation (earlier cases referred to this as a Control Area).[1]

This case involves an aspect of the California ISO's multi-year comprehensive redesign of its electric market (Market Redesign), intended to foster greater reliability and economic efficiency on its system. In a series of orders, the Commission conditionally approved the California ISO's Market Redesign Tariff, governing these changes, as just and reasonable. *Cal. Ind. Sys. Operator Corp.*, 116 FERC ¶ 61,274 (2006) (September 2006 Order), *order on reh'g*, 119 FERC ¶ 61,076, *order on reh'g*, 120 FERC ¶ 61,023 (2007), *order on reh'g*, 124 FERC ¶ 61,094 (2008), *aff'd sub nom. Sacramento Municipal Utility District v. FERC*, 2010 U.S. App. LEXIS 15179 (D.C. Cir. July 23, 2009).

[1]In this brief, the capitalized term Balancing Authority refers to the California ISO's specific proposal to govern the pricing of interchange transactions with Sacramento and Turlock, as opposed to its use in the generic sense.

A key part of the California ISO's Market Redesign was to set wholesale energy sales at Locational Marginal Prices, in order to more accurately price energy and ancillary services. With a Locational Marginal Price rate design, energy prices vary by location and time in order to accurately reflect the cost of energy, including the cost of transmission losses and congestion, at each location on the California ISO grid. *See* September 2006 Order, 116 FERC ¶ 61,274 at PP 10, 47. This allows the California ISO to ensure more accurate day-ahead schedules – *i.e.*, schedules that will more closely match real-time dispatch of electricity on the grid – and to communicate the true market value of electricity at every point on the grid. *Id.* P 10. By communicating the market value of electricity at each location and the cost associated with congestion between any two locations, the Locational Marginal Price rate design will create financial incentives for suppliers to dispatch the lowest cost energy available by considering the effect of its transmission on the California ISO grid. *Id.*

As the September 2006 Order went on to explain, in order to assure that day-ahead schedules will be met, the California ISO must consider all transmission constraints and generator operating limitations affecting the ISO-controlled grid. *See* September 2006 Order PP 5, 10. To this end, the ISO collects information about all such transmission constraints and generation limitations in order to

calculate the Locational Marginal Price.

Petitioners in this appeal are the Transmission Agency of Northern California and certain of its member municipalities[2] (collectively, the Municipals). The Municipals provide retail electric service to the customers in their service territories adjacent to the California ISO and buy and sell electricity in the wholesale market. Sacramento and Turlock were part of the California ISO's balancing authority until 2002 and 2005, respectively, when they seceded to form their own balancing authority areas. As a result, their electric transmission systems are highly integrated with the California ISO's. In fact, they essentially form a balancing authority area island surrounded by the California ISO balancing authority. *See* Exhibit ISO-1 at 35, JA 151. (A copy of this exhibit, a map indicating the parties' respective balancing authority areas, is provided as Addendum B to this brief.)

The main transmission facility in the Sacramento and Turlock balancing authority areas is the California Oregon Transmission Project, a 500 kilovolt line 345 miles long, which runs south from the Captain Jack electric substation in

[2]The other petitioners are Sacramento, Turlock, Modesto Irrigation District, the City of Redding California (Redding), and the City of Santa Clara, California. Intervenors Imperial Irrigation District (Imperial) and the City of Los Angeles Department of Water and Power filed a brief supporting petitioners on the jurisdictional issue (Imperial only) and the default price issue.

Oregon through California to the California ISO's transmission system. Tariff Order P 15, JA 835. The California Oregon Transmission Project is one of three major transmission lines, largely running parallel to each other, which form a system (the California-Oregon Intertie) connecting the grid in the Pacific Northwest to that in California. The other two lines are collectively known as the Pacific AC Intertie, which "in California is generally located within the [California ISO] balancing authority area." *Id.*

II. THE PROCEEDING BEFORE THE COMMISSION

A. The California ISO's Filing

On June 17, 2008, the California ISO filed the proposed amendments to its Market Redesign Tariff that are at issue here. R 1, JA 25. In order to improve the accuracy of the Market Redesign's Locational Marginal Price regime, the ISO sought to treat the existing Sacramento and Turlock balancing authority areas as a single Balancing Authority for energy imports and exports between Sacramento and Turlock and the ISO market. ISO Transmittal Letter at 1-2, JA 26- 27.[3] The California ISO stated that it would use the single Balancing Authority in order to calculate the price for Sacramento and Turlock's import and export energy transactions with the ISO. *Id.*

[3]At the time of the filing, the Market Redesign program was scheduled to go into effect in the fall of 2008. It actually began operation on April 1, 2009.

The California ISO explained that, absent this proposal, its Market Redesign program would be undermined "by allowing infeasible interchange schedules to be established adversely affecting the reliable operation of the transmission system and causing consumers to pay inappropriate costs." ISO Transmittal Letter at 3, JA 28. This would result, according to the ISO, from "a disparity between the scheduled location of the external resources and the actual location of the external resources dispatched within the [Balancing Authority]," causing both inaccurate Locational Marginal Prices and unnecessary costs for real-time electric dispatch. *Id.* at 3-4, JA 28-29.

More specifically, absent the Balancing Authority proposal, interchange transactions between the California ISO and Sacramento and Turlock could be modeled and priced at any one of twelve interconnection points between their respective systems. Since Sacramento and Turlock are not members of the ISO, the ISO is not privy to actual information concerning the location of the resources supporting their energy imports or exports. Transmittal Letter at 20, JA 45. Rather, the California ISO would have to assume that the interconnection point chosen by Sacramento or Turlock was the energy resource's actual location.

Therefore, for any import or export transaction to or from Sacramento and Turlock in the day-ahead market, market participants could choose the interconnection with the ISO supporting the most advantageous Locational

Marginal Price, "without regard to the location of the generation supporting the transaction." *Id.* (footnote omitted). However, if the energy transaction would actually enter the ISO system at another interconnection point, it would result in an unexpected, unmodeled flow on the ISO's grid, resulting in a higher, inaccurate Locational Marginal Price.

As a remedy for this problem, the California ISO sought to treat Sacramento and Turlock as a single entity, and to establish default prices based on interconnection points selected as a proxies for the modeling and pricing of all their imports and exports of electricity to and from the ISO. ISO Transmittal Letter at 4-5, JA 29-30.

Under this proxy price approach, the ISO explained, "all imports to the [California ISO] Controlled Grid from the [Balancing Authority] will be modeled and priced based on the injections and [Locational Marginal Prices] calculated at the Captain Jack Substation in Oregon." ISO Transmittal Letter at 4-5, JA 29-30. All exports, on the other hand, from the California ISO grid to the Sacramento/Turlock Balancing Authority "will be modeled and priced based on the injections and [Locational Marginal Prices] calculated" at a point designated the "SMUD-hub," an interconnection point consisting of several of the ISO's substations. *Id.* The ISO contended that these points represented the most reasonable assumptions concerning the location of Sacramento and Turlock

imports and exports, and that modeling their exchange transactions on this basis would more accurately reflect electric flows, reducing the costs passed on to consumers and enhancing the reliability of the ISO-controlled grid. *Id.* at 1, 25-26, JA 26, 50-51.

The California ISO further proposed that a market participant engaged in interchange transactions between the ISO and the Sacramento/Turlock balancing authorities could enter into a Market Efficiency Enhancement Agreement. ISO Transmittal Letter at 22, JA 47. Under this alternative, the market participant would supply the California ISO sufficient information "to verify the location and operation of the resources within the [Balancing Authority] that actually are dispatched to implement" such transactions. *Id*. at 21, JA 46. In exchange, proxy prices would not apply, and the California ISO would be able to charge a more accurate price. *Id*. at 22, JA 47.

B. The Tariff Order

On September 19, 2008, the Commission issued the Tariff Order, JA 848, the first order on review here, which found, subject to modification, that the California ISO's proposal to establish the Sacramento/Turlock Balancing Authority was just and reasonable. The Commission emphasized that the proposal "supports the implementation" of the ISO's new Market Redesign, which was intended to remedy the major market defects that had "contributed to the 2000-

2001 energy crisis in California." *Id.* PP 2, 3, JA 848, 849.

Under the Market Redesign mechanism, Locational Marginal Prices would be established to "ensure[] physically feasible day-ahead schedules and help[] communicate the true market value of electricity at each location and the cost of congestion between any two locations." Tariff Order P 2, JA 848 (footnote omitted). In order to calculate Locational Marginal Prices, the California ISO had implemented "a full network model of the transmission system to improve dispatch efficiency." *Id.* P 4, JA 849 (footnote omitted).[4]

However, the Commission recognized that the system was flawed because the California ISO does not necessarily have the information necessary (*i.e.*, the location of the resources) to correctly calculate Locational Marginal Prices for interchange transactions with neighboring utilities. Tariff Order P 5, JA 849. This was particularly important, the agency stated, because such interchange transactions between the ISO and neighboring systems "may have a significant effect" on the actual flow of electricity and transmission constraints on the California ISO-controlled grid, which should be reflected in Locational Marginal

[4] The Commission explained that the California ISO's "full network model is a mathematical representation of the [ISO's] physical transmission system that aims to accurately depict resources available and transmission constraints on the [ISO's] grid across all market time frames to ensure that market outcomes are consistent with real-time operation of the transmission grid." Tariff Order P 9 & n.7, JA 851.

Prices. Tariff Order P 35, JA 858.

The Commission agreed with the California ISO that, by establishing a single default pricing point for energy imports and exports, the Balancing Authority proposal "avoids creating unjust and unreasonable scheduling and pricing results caused by . . . multiple price locations for transactions" between the Sacramento/Turlock Balancing Authority and the California ISO-controlled grid. Tariff Order P 12, JA 852. In addition, the ISO's proposal decreases the incentive for "sellers into the [California ISO] markets to schedule at the most favorably priced interchange locations irrespective of the location of the resources actually dispatched to implement the transaction." *Id.*

The Tariff Order affirmed the California ISO's proposal to allow a market participant engaged in an interchange transaction with the Sacramento/Turlock Balancing Authority to enter into an alternative pricing arrangement – a Market Efficiency Enhancement Agreement. Under such an arrangement, the market participant would provide the ISO with more accurate transaction information in order "to receive a more favorable pricing structure." Tariff Order P 6, JA 850.

Among the many issues raised, the Commission denied a claim by the parties that the ISO's proposal unduly discriminated against Sacramento and Turlock. Tariff Order P 7, JA 850. Rather, the agency concluded, their treatment was rationally based on the fact that the newly-created Balancing Authority was

"integrated with the [California ISO] to a degree unmatched by any other adjacent balancing authority." *Id.*

The Tariff Order likewise rejected the contention of several parties that the Balancing Authority rate design violated, among other contracts, the terms of the Coordinated Operating Agreement, which governs certain aspects of the operation of the three-line California-Oregon Intertie. Tariff Order PP 246-255, JA 922-926.

Finally, the Commission directed several modifications to the California ISO's proposal, including one "to address a potential over-collection for losses due to modeling of parallel [*i.e.*, unscheduled] flows" of electricity on the system. Tariff Order P 8, JA 850.

C. The Rehearing Order

Numerous parties, including petitioners here, filed requests for rehearing of the Tariff Order. On July 30, 2009, the Commission issued its Rehearing Order, JA 1323, addressing a number of issues, only four of which are relevant on appeal.

At the outset, the Commission rejected a claim by petitioners Turlock, the Transmission Agency of Northern California, and intervenor Imperial – presented for the first time in their rehearing requests – that the agency lacked Federal Power Act jurisdiction to approve the California ISO's Balancing Authority proposal. Rehearing Order P 20, JA 1329.

Second, the Commission affirmed its conclusion that the Balancing

Authority default prices were just and reasonable, as it would be an "improvement in modeling and pricing" under the Market Redesign Tariff, which would "provide benefits that would be realized by not just [California ISO] ratepayers but all entities using the [California ISO] balancing authority." Rehearing Order P 59, JA 1341. The Commission further determined that, because the Market Efficiency Enhancement Agreement "provides entities willing to provide the information necessary to verify the location of the external resources that support their interchange transactions . . . with pricing the same as the [California ISO's] own ratepayers," there could be no valid claim of preferential treatment. *Id.*

Third, the Rehearing Order denied the contentions of several parties that the formation of the Balancing Authority unduly discriminated against Sacramento and Turlock. Rehearing Order PP 216-226, JA 1391-1395. Rather, the agency determined, the evidence in the record supported the combination of Sacramento and Turlock into a single balancing authority because together they were uniquely integrated into the California ISO's grid. *Id.*

Finally, the Commission again rejected the argument that the Balancing Authority area rate design violated the terms of various contractual arrangements, including the Coordinated Operation Agreement. Rehearing Order PP 254-260, JA 1401-1404.

These appeals followed.

SUMMARY OF ARGUMENT

1. The Commission appropriately determined that its authority under section 205 of the Federal Power Act, 16 U.S.C. § 824d, authorized it to review the California ISO's Balancing Authority proposal, an amendment to the ISO's FERC-jurisdictional Market Redesign Tariff. As the Commission explained, the ISO's Balancing Authority rate design applied only to calculating the Locational Marginal Price for transactions on the California ISO-controlled grid.

The Commission reasonably concluded that its orders do not violate FPA section 201(f)'s exemption for governmental entities, *see* 16 U.S.C. §824(f), because they do not directly order them to take any action, such as make refunds. Rather, the Balancing Authority rate design simply takes into account the effect of the Sacramento and Turlock systems on the ISO's jurisdictional rate, and only has an incidental impact on those municipalities.

2. The Commission's decision that the California ISO's Balancing Authority price mechanism was just and reasonable was fully supported both legally and factually.

The Commission's approval of the default prices was based on substantial evidence that, absent the ISO's proposal, imports of power to the ISO market from the Sacramento/Turlock balancing area (and exports from them) would not receive an accurate Locational Marginal Price. Likewise, the agency's approval of the

ISO's proposed default price for such imports and exports was firmly grounded on supporting expert testimony in the record, and well within FERC's broad discretion to determine whether a rate falls within a zone of reasonableness.

Nor did the Commission's decision that the California ISO could treat Sacramento and Turlock as a single Balancing Authority violate the FPA's prohibition of undue discrimination. Factual differences among customers can support different regulatory treatment. The Commission's decision here was fully supported by record evidence of the unique integration of the Sacramento and Turlock into the ISO-controlled grid and the impact of their interchange transactions on the California ISO grid.

The Court should also sustain the Commission's finding that the California ISO's Balancing Authority pricing mechanism did not violate the Coordinated Operation Agreement, governing the operation of the three California-Oregon Intertie transmission lines. The Commission reasonably construed the provisions of this FERC-jurisdictional contract as being limited to the operation of the relevant transmission lines, and having no bearing on the California ISO's pricing of transactions governed by its tariff.

ARGUMENT

I. STANDARD OF REVIEW

The Commission's orders are reviewed under the arbitrary and capricious standard of the Administrative Procedure Act. *See, e.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under this standard, this Court "will affirm the Commission's orders so long as FERC 'examined the relevant data and articulated a . . . rational connection between the facts found and the choice made.'" *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004) (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 26, 43 (1983)). In this regard, the Court "uphold[s] FERC's factual findings if supported by substantial evidence." *Florida Mun. Power Agency v. FERC*, 315 F.3d 362, 365 (D.C. Cir. 2003) (citations omitted).

Where, as here, "FERC's orders concern ratemaking," the Court is "particularly deferential to the Commission's expertise." *Midwest ISO Transmission Owners*, 373 F.3d at 1368 (quoting *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996)) (internal quotation marks omitted).

In this Court, "FERC's interpretations of the jurisdictional provisions of the Federal Power Act enjoy *Chevron* deference." *National Ass'n of Regulatory Utility Commissioners v. FERC*, 475 F.3d 1277, 1279 (D.C. Cir. 2007) (citing

cases). Under that familiar standard, *see Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842-844 (1984), if Congress has not directly spoken to the precise question at issue, the Court "must defer to a 'reasonable interpretation made by the . . . agency.'" *Whitman v. American Trucking Assn's*, 531 U.S. 457, 481 (2001) (quoting *Chevron*, 467 U.S. at 844); *see also, e.g., Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 694 (D.C. Cir. 2000) (same), *aff'd New York v. FERC*, 535 U.S. 1 (2002).

Chevron deference also applies to the Commission's interpretation of jurisdictional contracts. *E.g.. Cajun Elec. Power Coop. v. FERC*, 924 F.2d 1132, 1135-1136 (D.C. Cir. 1991). This is true even if the "issue simply involves the proper construction of language," and not a matter within the agency's special expertise. *National Fuel Gas Supply Corp. v. FERC*, 811 F.2d 1563, 1569-70 (D.C. Cir. 1987). *See also Cajun Elec. Power Coop.*, 924 F.2d at 1135 (noting that "[a]ny agreement that must be filed and approved by an agency loses its status as a strictly private contract and takes on a public interest gloss").

II. THE COMMISSION REASONABLY INTERPRETED ITS FPA JURISDICTION TO ENCOMPASS REVIEW OF THE CALIFORNIA ISO'S BALANCING AUTHORITY TARIFF AMENDMENT.

In the Rehearing Order, the Commission had its first opportunity to address the jurisdictional challenge to its decision. Rehearing Order PP 20-25, JA 1329-1331. Certain parties argued that, by approving the ISO's Balancing Authority

proposal, the Commission was regulating the rates, terms and conditions of sales of electricity by governmental entities, in violation of the exemption found in FPA section 201, 16 U.S.C. § 824(f).

The Commission rejected the parties' contention, explaining that the California ISO's proposal was simply a request by the ISO, a jurisdictional entity, to alter its jurisdictional Market Redesign Tariff, a matter within the agency's "core authority" under section 205 of the FPA. Rehearing Order P 20 & n.13 (citing 16 U.S.C. § 824d), JA 1329. Like the Market Redesign Tariff which it modified, the Balancing Authority proposal involves the rate the California ISO is allowed to charge for service provided under its tariff, "only applying to scheduled transactions that impact the [California ISO]-controlled grid." *Id.* P 21, JA 1330.

More broadly, the Commission determined, its review of this mechanism to govern the pricing of transactions in the California ISO market fell squarely within judicial recognition "that the Commission's authority includes all aspects of wholesale sales," and that, even if such "regulation may affect the conduct of non-jurisdictional entities," it is not "an exercise of jurisdiction over" those entities. Rehearing Order P 22 & nn. 16, 19, JA 1330 (citing *National Ass'n of Regulatory Utility Commissioners*, 475 F.3d at 1280-1281, and *Transmission Access Policy Study Group*, 225 F.3d at 696).

Before the Court, Turlock (joined only by fellow petitioner Transmission

Agency of Northern California and intervenor Imperial) challenges the Commission's jurisdictional reasoning. Turlock argues that section 201(f) of the FPA "unequivocally exempts government entities, like the Municipals, from FERC's rate-setting authority under Sections 205 and 206 of the FPA . . . and [that] their voluntary participation in" the California ISO market "does not give FERC authority to regulate their rates." Pet. Br. 57 (internal quotation omitted) (citing *Transmission Agency of N. Cal. v. FERC*, 495 F.3d 663, 674 (D.C. Cir. 2007), and *Bonneville Power Admin. v. FERC*, 422 F.3d 908 (9th Cir 2005)); Int. Br. 18-19.

This argument, however, mischaracterizes both the nature and extent of the Commission's regulation here. As the agency clarified below at Turlock's behest, "the [Balancing Authority] Proposal establishes only the rates, terms and conditions for sales in the [California ISO]'s market." Rehearing Order P 25, JA 1331. Through the day-ahead and real-time markets established by its Market Redesign mechanism, the California ISO establishes the price that purchasers and sellers of wholesale electricity will pay for both energy and ancillary services in its market. Thus, the Commission is regulating an aspect of the wholesale price for electricity set by the jurisdictional California ISO that fits well within FERC's broad section 205 authority. *See, e.g.*, *Pacific Gas & Electric Co. v. FERC*, 306 F.3d 1112, 1114 (D.C. Cir. 2002) (observing that the California ISO "is subject to FERC's regulatory authority," including its authority to ensure just and reasonable

rates under FPA sections 205 and 206).

As the Commission explained, it is not regulating the Sacramento and Turlock balancing authorities or the rates for service therein. Rather, it approved the California ISO's modeling these "external transmission systems in order to help accurately model power flows and manage congestion" on the California ISO-controlled grid. Tariff Order P 36, JA 859 (footnote omitted). The ISO "will use [this] external data to calculate accurate [Locational Market Prices] for transactions on its system, but will not impose [Locational Market Prices] on outside areas." *Id.* P 46, JA 862.

In other words, the agency is permitting the California ISO to take into account a non-jurisdictional neighboring system's power flow in calculating its jurisdictional price for jurisdictional service. This is not a case in which the Commission is attempting to directly regulate a statutorily-exempt transaction, as in *Southern Cal. Edison Co. v. FERC*, 603 F.3d 996 (D.C. Cir. 2010), where the Court found that the agency effectively mandated the method for the calculation of retail rates subject to exclusive state jurisdiction. Rather, the Commission here is regulating only the calculation of the jurisdictional California ISO's energy interchange rate. In so doing, the Commission's regulation has, at most, only an incidental effect on Sacramento and Turlock.

This Court has recognized that such an incidental effect of FERC

jurisdictional regulation on non-jurisdictional entities does not violate the FPA. In *Transmission Agency of Northern California*, the Court upheld the Commission's FPA section 205 jurisdiction to review a non-jurisdictional municipality's revenue requirement, because it was a component of the California ISO's jurisdictional rate. 495 F.3d at 671-72. The Court held that FPA section 201(f)'s exclusion of municipalities from FERC jurisdiction did not divest the Commission of authority to consider a municipality's activity related to the setting of a FERC-jurisdictional rate. *Id. See also, e.g., Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009) (affirming Commission approval of ISO's installed capacity requirement as within the agency's FPA jurisdiction, despite the fact that it provided a market incentive for a state to require construction of new generation).

Governmental entities such as Sacramento and Turlock, like any other market participant, will pay or be paid the California ISO's jurisdictional market price for energy transactions in the ISO market. But no court has suggested that the payment of jurisdictional rates by a governmental entity violates the FPA. To the contrary, in *Bonneville Power Administration*, on which petitioners rely (Pet. Br. 57-58), the Ninth Circuit held only that section 201(f) prevented the Commission from specifically ordering an exempt municipality to make a refund of overcharges (a proposition with which this Court agreed in *Transmission Agency of Northern California*). However, the *Bonneville* court specifically

distinguished a refund order from FERC regulation of a municipality's participation in the jurisdictional California ISO market: "FERC's order does more than simply reset the market-clearing price for power in the FERC-jurisdictional ISO and [California Power Exchange] markets." 422 F.3d at 919. A refund order was qualitatively different, the court explained, from a Commission order that the ISO "operate the market in a different fashion or to set a market-clearing price for power on a going forward basis." *Id.* at 920.

In sum, the Court should sustain the Commission's reasonable interpretation of its FPA jurisdiction to encompass its review of the California ISO's Balancing Authority amendment to the Market Redesign Tariff.

III. THE COMMISSION'S APPROVAL OF THE CALIFORNIA ISO'S BALANCING AUTHORITY AMENDMENT WAS SUPPORTED BY SUBSTANTIAL EVIDENCE AND ENTIRELY REASONABLE.

A. The Commission Appropriately Determined That The Balancing Authority Default Price Was Just And Reasonable.

The Commission agreed with the California ISO that the use of "default import and export pricing points" using a "single hub approach" was just and reasonable. Tariff Order P 82, JA 874; *see* Rehearing Order PP 34-35, JA 1333-1334. The Commission further found that, "absent necessary modeling information, it is reasonable for the [California ISO] to create assumptions that enable it to compute a proxy price" for such transactions. Tariff Order P 120, JA

889. Additionally, based on the evidence presented, the agency concluded that "the [California ISO] has appropriately chosen to make an assumption that imports are likely to flow through Captain Jack and exports are likely to flow through the SMUD hub." *Id.* P 82 & n.65, JA 874 (citing Exhibit ISO-1 at 58-60, JA 169-171); *see also* Rehearing Order P 58, JA 1340 (California ISO's "default pricing points for imports and exports . . . absent more information . . . represent[] a reasonable assumption as to the location of the external resources utilized to serve interchange transactions" between the Sacramento/Turlock Balancing Authority and the ISO). Furthermore, the Commission approved the Market Efficiency Enhancement Agreement mechanism for any party willing to provide the necessary information to the ISO for a more accurate (and presumably more favorable) Locational Marginal Price. Tariff Order P 160, JA 900; Rehearing Order P 186, JA 1381.

Before the Court, the Municipals attack the Commission's approval of the Balancing Authority default price specifically because it rests on the assumption that all imports to the ISO from Sacramento and Turlock are sourced at the Captain Jack substation while, they claim, both the agency and the ISO know this is not true. Pet. Br. 50, 53; Int. Br. 11-14.

The Commission's assumption in this regard, however, is both reasonable and factually supported. As the agency explained, because the ISO lacks specific

locational information with respect to interchange transactions from or into Sacramento and Turlock, it is employing "a proxy price," which necessarily makes an "assumption about the location of a resource used to support an interchange transaction." Tariff Order P 83, JA 874. Thus, as petitioners concede (Pet. Br. 53), the Commission does not contend "that *all* interchange transactions are sourced at Captain Jack." Tariff Order P 83, JA 875 (emphasis in original). "The critical point," the Commission emphasized, is "not whether or not all imports are sourced north of Captain Jack, but rather whether it represented the most reasonable assumption absent sufficient information to verify resource locations." Rehearing Order P 64, JA 1343 (footnote omitted).

The Commission found that the Captain Jack substation was a reasonable location on which to base the proxy default price. Tariff Order P 82, JA 874. In reaching this conclusion, the Commission relied on ISO witnesses Mr. Rothleder and Dr. Price. *Id.* & n.65, JA 874 (citing Exhibit ISO-1 at 58-60, JA 169-171). They testified that the Captain Jack and SMUD hub default price proxy points represented "reasonable approximations of the marginal resources likely to support, respectively, imports and exports" to and from the Sacramento/Turlock Balancing Authority. Exhibit ISO-1 at 60, JA 171. As they went on to explain:

> On any given day, the [California ISO] believes that it is a reasonable assumption that entities within the [Sacramento/Turlock Balancing Authority] will procure generally less expensive power available from the Pacific Northwest. Absent information that verifies that such

> entities are not dispatching their own internal generation to support a scheduled import to the [California ISO], the [ISO] believes that the Captain Jack System Resource represents a reasonable approximation of the marginal resources likely to be used to support the scheduled interchange transaction.

Id. at 60-61, JA 171-172.

The Municipals also attempt to paint the default prices as unjust because the California ISO based them on a "'buy low and sell high' framework to the advantage of customers in the [California ISO's] system." Pet. Br. 51 (quoting Exhibit ISO-1 at 58, JA 169). But the actual testimony from which the Municipals cite is not so simplistic:

> Since the [California ISO] selected a low priced location as the default location for pricing all imports (sales to the [California ISO]) and a high priced location for the default location for pricing all exports (purchases from the [California ISO]), the [California ISO] has eliminated the price incentive to simultaneously buy at low priced locations such as Captain Jack and sell at high priced locations such as the SMUD hub.

ISO Exhibit 1 at 58, JA 169. Thus, the testimony explains the basis for the default proxy prices which the Commission, as explained above, found to be just and reasonable. It does not support the view that the California ISO is manipulating the default price to give its ratepayers a leg up. Rather, as the Commission explained, the Balancing Authority default rate "will not result in any out-of-pocket losses or underrecovery of costs" for market participants, but "simply the loss of the higher payments they projected by making sales into the [California

ISO] markets." Tariff Order P 120, JA 889.

Moreover, the alternative to proxy prices would be to allow Sacramento and Turlock to model their transactions so as to cause inaccurate market prices and infeasible scheduling. In this regard, the Commission emphasized that the "improvement in modeling and pricing" under the Market Redesign Tariff "would provide benefits that would be realized by not just [California ISO] ratepayers but all entities using the [California ISO] balancing authority." Rehearing Order P 59, JA 1341; *see also* Tariff Order P 121 & n.112, JA 890 (citing Exhibit ISO-3 at 6, JA 251) ("As [California ISO] witness Harvey explains, improved congestion management benefits the [ISO] and its neighbors by increasing market efficiency and reducing infeasible schedules in the real-time market"). In other words, neighboring systems like Sacramento and Turlock would enjoy some benefit from the FERC-approved default pricing rate design.

The Commission did not claim that the default price mechanism was perfect. *See* Tariff Order P 120, JA 889 (acknowledging that the "default price may, in limited circumstances, create an artificially low price for energy"). But this Court does not require perfection in reviewing whether the Commission's approval of a rate mechanism is just and reasonable. Indeed, "[t]he statutory requirement that rates be 'just and reasonable' is obviously incapable of precise judicial definition, and we afford great deference to the Commission in its rate decisions."

Blumenthal v. FERC, 552 F.3d 875, 881 (D.C. Cir. 2009) (quoting *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1*, 128 S.Ct. 2733, 2738 (2008)) (internal quotation marks omitted); *Maine Pub. Utils. Comm'n v. FERC*, 520 F.3d 464, 470-471 (D.C. Cir. 2008) (citing cases), *rev'd in part on other grounds sub nom. NRG Power Mktg. v. Maine Pub. Utilities Comm'n*, 130 S.Ct. 693 (2010).

Rather, the Court has explained, "[t]he burden is on the petitioners to show that the Commission's choices are unreasonable and its chosen line of demarcation is not within a zone of reasonableness as distinct from the question of whether the line drawn by the Commission is precisely right." *Maine Pub. Utils. Comm'n*, 520 F.3d at 471 (quoting *ExxonMobil Gas Mktg. Co. v. FERC*, 297 F.3d 1071, 1084 (D.C. Cir. 2002)) (internal quotation marks omitted). The Municipals cannot meet their burden here.

The Municipals also challenge the Commission's finding that proxy default prices were necessary. According to them, the perceived need is based on the false premise that Sacramento and Turlock would buy cheap Pacific Northwest power to resell into the California ISO, rather than using such power to reduce costs for their own load, contrary to "good utility practice." Pet. Br. 50-52.

However, the Commission's decision that such default prices could help the California ISO prevent market participants from scheduling transactions at interconnection points yielding preferential Locational Marginal Prices was fully

supported. First, the Commission relied on its prior experience with other ISO markets, where this pricing mechanism has already been established as "provid[ing] compelling evidence that, as a general matter, organized markets with [Locational Marginal Prices] create opportunities through artificial scheduling to arbitrage price differences at intertie scheduling points." Tariff Order P 58, JA 866. Second, the agency relied on specific record evidence presented by the California ISO "of the operational effects the current scheduling practices have on real-time operations because of the artificial day-ahead schedules." *Id.* P 59 & n.45, JA 866-867, (citing Exhibit ISO-1 at 21-27, 37, JA 137-143, 153).

Moreover, the Commission specifically balanced "record evidence of the operational effects that scheduling practices have on real time operations" against "[Sacramento's] claim that it uses Northwest imports to serve its own load," and found that Sacramento's "assertion alone is not conclusive" on this point. Rehearing Order P 163, JA 1373-1374. In such a case, this Court has firmly established that "[w]hen the record would support more than one outcome, we must uphold FERC's order because '[t]he question we must answer . . . is not whether record evidence supports [the petitioner's desired outcome], but whether it supports FERC's.'" *Maine Pub. Utils. Comm'n v. FERC*, 520 F.3d at 470 (quoting *Fla. Mun. Power Agency v. FERC*, 315 F.3d 362, 368 (D.C. Cir. 2003)); *Fla. Gas Transmission Co. v. FERC*, 604 F.3d 636, 645 (D.C. Cir. 2010) (same).

At bottom, as the Court explained in *Blumenthal*, because an organized electric market "presents 'intensely practical difficulties' demanding a solution from FERC . . . [the agency] must be given the latitude to balance the competing considerations and decide on the best resolution." 552 F.3d at 885 (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968)). The Commission's agreement with the California ISO that default prices are appropriate for Sacramento and Turlock reasonably balanced such competing considerations and should be sustained by this Court.

B. The Commission Reasonably Concluded That The ISO's Balancing Area Authority Does Not Unduly Discriminate Against Sacramento and Turlock.

The Commission fully analyzed and rejected the Municipals' claim that the California ISO's Balancing Authority proposal was unduly discriminatory under FPA sections 205 and 206 because it would apply solely to Sacramento and Turlock. Tariff Order PP 193-216, JA 907-914; Rehearing Order PP 216-226, JA 1391-1395. In considering this argument, the Commission applied the customary legal standard that "[d]ifferences in rates are justified where they are predicated upon differences in facts," so that the question becomes whether the record demonstrates such differences to support different rates. Tariff Order P 209 & n. 156, JA 912 (citing cases); *see, e.g., Cities of Bethany v. FERC*, 727 F.2d 1131, 1139 (D.C. Cir. 1984).

Based on the record before it, the Commission concluded that the Sacramento and Turlock balancing areas "represent unique sets of factors in their relationships and interconnections with the [California ISO]," so that they presented scheduling and pricing concerns for the ISO under the Market Redesign program that other neighboring balancing authorities did not. Tariff Order P 209, JA 912; *see also* Rehearing Order P 217 & n.156, JA 1392 (explaining that the ISO "demonstrated [that] [Sacramento] and Turlock represent unique sets of factors" and that "it is reasonable for the [ISO] to consider the individual characteristics and market impacts of its neighboring balancing authority areas in determining whether and how to implement its [Balancing Authority] Proposal") (citing Exhibit ISO-1 at 28-43, JA 144-159).

The Commission's decision in this regard was based on a number of factors, all supported by record evidence, including: (1) both the number and size of the interconnections between the California ISO and the Sacramento/Turlock balancing areas (Tariff Order P 212, JA 913; Rehearing Order P 218, JA 1392); (2) the extremely high level of integration between the Sacramento/Turlock balancing areas with that of the California ISO (*id.*), such that "until a few years ago, both [Sacramento] and Turlock were an integrated part of the [California ISO's] balancing authority area" (Tariff Order P 214 & n.162, JA 913 (citing Exhibit ISO-1 at 28, JA 144)); and (3) the significance of unscheduled power flows between the

Sacramento and Turlock balancing areas and the California ISO-controlled grid (Tariff Order P 213 & n.161, JA 913 (citing Exhibit ISO-1, Appendix A at 8, 11 JA 208-211); Rehearing Order P 220, JA 1393 (citing same evidence)).

The Commission also focused on the ISO's rationale for modeling Sacramento and Turlock as one Balancing Authority, including "their degree of integration with not just the [California ISO], but also each other," so that considering them separately "would undermine the goal of eliminating infeasible schedules and improving modeling accuracy and congestion management." Tariff Order P 211, JA 912. In this regard, the Commission emphasized testimony by the California ISO's expert witnesses that Sacramento and Turlock should be considered as a single balancing area:

> [B]ecause [Sacramento] and Turlock have an interconnection with each other, interchange transactions between the two balancing authority areas could be scheduled by contract path without scheduling through the [California ISO]. This would make it possible for a schedule to be made from Turlock to the [California ISO] for power that is actually being sourced from within the [Sacramento] balancing authority area or the Pacific Northwest.

Tariff Order P 210 & n.158, JA 912 (citing Exhibit ISO-1 at 32, JA 148). *See* Rehearing Order P 224, JA 1394 (same).

Before this Court, the Municipals challenge the Commission's decision to allow the ISO to establish the Sacramento/Turlock balancing area by concentrating on various individual factors the ISO relied on to support its proposal, such as the

comparison of the size and number of interconnections and the extent of parallel flows with other contiguous balancing areas. Pet. Br. 40-43. As the Commission emphasized, however, the "[p]arties' efforts to focus on individual factors and any one particular data set miss the larger point of considering the totality of factors and unique characteristics" underlying the agency's decision on this issue. Rehearing Order P 220, JA 1393.

In any event, upon closer scrutiny, even the individual elements upon which the Municipals base their claim do not reveal arbitrary decision-making by the Commission. For example, they assert that "FERC arbitrarily ignored evidence that . . . flow reversals were non-existent and resulted solely from arithmetic errors in [California ISO's] analysis." Pet. Br. 44 (citations omitted). But the Commission specifically addressed the only actual evidence cited by the Municipals on this point:

> [Sacramento] asserts that actual flow data published in figures 1 and 2 of Exhibit ISO-1 [JA 139, 140] is significantly different than the actual metered flow data measured by [Sacramento]. We have reviewed the data presented by [Sacramento] and find that there were still hundreds of megawatts in differences between scheduled and actual flows at the Cottonwood and at the combined Rancho Seco/Lake substations.

Tariff Order P 39 & n.26, JA 860 (citing Exhibit SMUD-3 at 38-41, JA 448-455); *see also* Rehearing Order P 69, JA 1345 (same).

The Municipals' discrimination argument is based on "evidence to the

contrary" by their witnesses from that of the California ISO's witnesses concerning technical matters relating to the degree and kind of integration between various utilities and the California ISO. Pet. Br. 41. But this Court "defers to the Commission's resolution of factual disputes between expert witnesses." *Electricity Consumers Resource Council v. FERC*, 407 F.3d 1232, 1236 (D.C. Cir. 2005) (citing *Wisc. Valley Improvement Co. v. FERC*, 236 F.3d 738, 746-47 (D.C. Cir. 2001)).

The Municipals further contend that the former status of Sacramento and Turlock as part of the California ISO balancing authority area, "and the fact that [the ISO] allegedly gleaned 'detailed knowledge' from such integration, are not reasoned bases upon which to discriminate" against those parties. Pet. Br. 43 (quoting Tariff Order P 214, JA 913, and Rehearing Order P 219, JA 1393). On the latter point, the Commission explained that the Municipals' "detailed knowledge" argument was based on a misconception:

> [I]t is illogical to conclude that the [Balancing Authority] proposal is an attempt by the [California ISO] to justify using data it already possesses for modeling and pricing interchange transactions. . . . [T]he information the [California ISO] has on the physical characteristics of the [Sacramento] and Turlock balancing authority areas is a result of their integrated development as a part of the same single control area and differs materially from the type of day-ahead and real-time data the [ISO] is seeking for modeling and pricing purposes.

Tariff Order P 214, JA 914.

Thus, Sacramento and Turlock are not being placed in a balancing area together simply because they were previously part of the California ISO-controlled grid. Rather, their unique status derives from their level of integration into the California ISO balancing area, their relation to each other and the effects they can have on the ISO grid.

"In order to prevail on an undue discrimination claim, petitioners must demonstrate not only differential rates between two classes of customers, but also 'that two classes of customers are similarly situated for purposes of the rate.'" *Washington Water Power Co. v. FERC*, 201 F.3d 497, 504 (D.C. Cir. 2000) (quoting *"Complex" Consolidated Edison Co. of New York v. FERC*, 165 F.3d 992, 1012 (D.C. Cir. 1999)). Here, the Commission relied on technical record evidence to support its conclusion that Sacramento and Turlock were uniquely integrated into the California ISO's transmission system to support an individual price mechanism. This Court is "particularly reluctant to interfere with the agency's reasoned judgments" when its orders involve "complex . . . technical questions." *Fla. Gas Transmission Co.*, 604 F.3d at 645 (quoting *B&J Oil & Gas v. FERC*, 353 F.3d 71, 76 (D.C. Cir. 2004) (internal quotation marks omitted). In accordance with this standard, the Municipals cannot prevail on their claim that Sacramento and Turlock are in the same situation as other balancing authorities with respect to their level of integration into the ISO's system and the effect they

can have on that system.

C. The Commission Reasonably Interpreted The Terms Of The Coordinated Operation Agreement.

For more than a decade, the three lines comprising the California-Oregon Intertie have been run as a single, integrated system governed by the owners of the lines – Pacific Gas and Electric Company, the Western Area Power Administration, and the California-Oregon Transmission Project participants, which include petitioners Transmission Agency of Northern California and Redding. *See generally PacifiCorp*, 121 FERC ¶ 61,278 at PP 2-4 (2007). This system is governed by a number of contracts among various interested parties, including, as relevant on appeal, the Coordinated Operation Agreement. Tariff Order P 220, JA 915.[5]

The Commission rejected the contention of a number of parties to the proceeding below that the California ISO's Balancing Authority rate design violated certain terms of the Coordinated Operation Agreement. Tariff Order PP

[5]While the California ISO is not a party to the Coordinated Operation Agreement, the Commission noted, "it is not in dispute that the [California ISO] should honor existing contracts that have been executed by its transmission-owning members." Tariff Order P 247, JA 923. Before the Commission, the Municipals argued that the Balancing Authority mechanism violated various other contracts governing the operation of the California-Oregon Intertie, including one to which the California ISO is actually a signatory. The Commission denied these claims, *id.* PP 287-294, JA 934-936; Rehearing Order P 276, JA 1409, and petitioners have abandoned them on appeal.

220-255, JA 915-926; Rehearing Order PP 242-260, JA 1398-1404. As the Commission explained, "[t]he Coordinated Operation Agreement provides for the shared usage, coordinated operation, maintenance and planning of the California-Oregon Intertie," and "does not concern how energy is priced once it enters the [California-ISO]-controlled grid." Tariff Order P 247, JA 923 (footnote and citations omitted); *see also* Rehearing Order P 254, JA 1402 ("If a [California Oregon Transmission Project] transaction is not scheduled to use the [California ISO]-controlled grid, the [Balancing Authority] pricing proposal does not apply to that transaction, and thus does not violate the Coordinated Operation Agreement").

In reaching this result, the Commission specifically relied on Section 5 of the Agreement,[6] which limits the scope of the Agreement to "operating and maintaining the [Pacific AC Intertie] and the [California Oregon Transmission Project];" it does not extend to "how [the California ISO] prices voluntary interchange transactions in its market." Tariff Order P 248, JA 923; Rehearing

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[6] Section 5 of the Agreement states, in relevant part:

> This Agreement governs the coordinated operation of the [Pacific AC Intertie] and [California Oregon Transmission Project]. It is the intent of the Parties to maintain the System as coordinated facilities to benefit its Transfer Capability. . . . [Except as specifically provided], [n]o Party provides or shall be required to provide any transmission or other electric service to another Party under this Agreement.

Agreement Section 5, JA 598.

Order P 255, JA 1402.

The Commission also scrutinized Section 8.4 of the Coordinated Operation Agreement, which provides that "'[n]o Party shall be charged any rate . . . for any power[] which flows over the System[.]'" Tariff Order P 251, JA 925 (quoting Agreement Section 8.4, JA 610). In this regard, the agency emphasized that "each provision of the Coordinated Operation Agreement must be read in connection with the scope of the agreement itself," which is established by Section 5. *Id.* Reviewing these provisions in tandem, the Commission concluded that Section 8.4 should not be interpreted to "preclude the [California ISO] from setting a rate for voluntary interchange transactions under the [California ISO] Tariff that impact the [California ISO] system." *Id*.; *see also* Rehearing Order P 255, JA 1402 (Section 8.4 "does not prohibit" the ISO "from setting a price that applies to energy that enters its system" since that is beyond the scope of the Agreement).

It is firmly established that "[i]n construing tariffs, courts and agencies must look to the four corners of the tariff and consider the entire instrument as a whole." *Consolidated Gas Transmission Corp. v. FERC*, 771 F.2d 1536, 1545 (D.C. Cir. 1985) (citation omitted). Similarly, this Court has stated that "[t]he purposes for which a tariff was imposed should be considered when interpreting the tariff," and has warned against "'decid[ing] the question of the scope of [a] tariff without consideration of the factors and purposes underlying the terminology employed.'"

Id. (quoting *United States v. Western Pacific Railroad*, 352 U.S. 59, 67 (1956)).

The Commission's interpretation of the Coordinated Operation Agreement is in accord with these basic principles of construction. The Commission looked to the overarching purpose of the Agreement expressed in Section 5 – the coordinated operation of the Pacific AC Intertie and California Oregon Transmission Project, to maintain them as coordinated facilities within a transmission system – and interpreted the contract's more specific rate restrictions in accord with its general intent. This reasonable interpretation by the FERC of the Agreement, a jurisdictional contract, is entitled to *Chevron* deference (*see* p. 17, *supra*), and should be sustained by this Court.

The Municipals argue that the Commission's interpretation of the Coordinated Operation Agreement "is not entitled to deference" because, "[u]nder the unambiguous terms" of the Agreement, "[California Oregon Transmission Project] Participants cannot be charged for parallel flow effects on [the Pacific AC Intertie] that occur as a result of their use of [the California Oregon Transportation Project]." Pet. Br. 33-34. In this regard, the Municipals particularly emphasize that the Commission's view "ignores the essential fact that [the Pacific AC Intertie] *is* part of [California ISO's] Grid." *Id.* 34 (emphasis in original).

This Court has long held that "[a] tariff or contract is ambiguous when it is 'reasonably susceptible of different constructions or interpretations.'"

Consolidated Gas Transmission Corp., 771 F.2d at 1545 (quoting *Lee v. Flintkote*, 593 F.2d 1275, 1282 (D.C. Cir. 1979)). Here, the Commission addressed the question of whether the California ISO's Market Redesign Tariff amendment governing the price of transactions in the ISO market imported from (or exported to) Sacramento and Turlock violated the terms of the Coordinated Operation Agreement. The terms of the Coordinated Operation Agreement do not on their face address this question. *See* Tariff Order P 248, JA 923 (discussing the Agreement).

In any event, the Commission fully explained that the Balancing Authority "proposed charges apply to [California Oregon Transportation Project] transactions that include the scheduled use of the [California ISO]-controlled grid." Rehearing Order P 254, JA 1402. It does not, however, "affect the coordinated operation of the [Pacific AC Intertie] and the [California Oregon Transportation Project]," which is the subject of the Coordinated Operation Agreement. *Id.* P 255, JA 1402. Moreover, the Balancing Authority price has no application to any parallel flows: "[I]n order to be subject to [its] pricing mechanism, the transaction must be *scheduled* to make use of the [California ISO]-controlled grid." *Id.* P 256, JA 1402 (emphasis the Commission's).

It is true, as the Municipals observe, that the Pacific AC Intertie is part of the California ISO grid. But the California ISO Market Redesign Tariff establishes

the price for electricity on the ISO's grid, and the Balancing Authority amendment does not change that. The fact that a part of the California ISO grid is subject to another contract for different purposes – coordinating its operation as part of the California-Oregon Intertie – is simply not relevant to the rates established by the ISO-tariff. *See* Tariff Order P 251, JA 925.

The Municipals also claim that because the Commission eliminated the charge for losses from California Oregon Transmission Project imports into the California ISO from the default price, the agency essentially conceded the applicability of the Coordinated Operation Agreement to these transactions. Pet. Br. 36.

The Commission's orders refute this alleged contradiction. The Commission determined that to the extent that California Oregon Transmission Project customers "already pay . . . a rate under the [Transmission Agency of Northern California] or [Western Area Power Administration] tariffs for losses," they should receive an appropriate adjustment to prevent being billed a second time for losses by means of the California ISO's Tariff. Tariff Order P 106, JA 884. Thus, this adjustment was to make the Balancing Authority rate consistent with other rate tariffs, not the Coordinated Operation Agreement.

In sum, the Commission's reading of the Coordinated Operation Agreement as not trumping the price terms of the Balancing Authority amendment to the

California ISO's Market Redesign Tariff is reasonable and should be affirmed by the Court.

CONCLUSION

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

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief contains 9,056 words, not including the tables of contents and authorities, the glossary, the certificate of counsel and this certificate.

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ADDENDUM A

STATUTES

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Section 201(f) of the Federal Power Act, 16 U.S.C. § 824(f), provides as follows:

(f) No provision in this subchapter shall apply to, or be deemed to include, the United States, a State or any political subdivision of a State, an electric cooperative that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

Section 205 of the Federal Power Act, 16 U.S.C. § 824d, provides as follows:

(a) All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of

such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f)(1) Not later than 2 years after November 9, 1978, and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause, if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

Section 206 of the Federal Power Act, 16 U.S.C. § 824e, provides as follows:

(a) Whenever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date of the filing of such complaint nor later than 5 months after the filing of such complaint. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date of the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the publication date. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: Provided, That if the proceeding is not

concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: Provided, That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission's order. For purposes of this subsection, the terms "electric utility companies" and "registered holding company" shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended.

(d) The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

(e) Short-term sales

(1) In this subsection:

(A) The term “short-term sale” means an agreement for the sale of electric energy at wholesale in interstate commerce that is for a period of 31 days or less (excluding monthly contracts subject to automatic renewal).

(B) The term “applicable Commission rule” means a Commission rule applicable to sales at wholesale by public utilities that the Commission determines after notice and comment should also be applicable to entities subject to this subsection.

(2) If an entity described in section 824 (f) of this title voluntarily makes a short-term sale of electric energy through an organized market in which the rates for the sale are established by Commission-approved tariff (rather than by contract) and the sale violates the terms of the tariff or applicable Commission rules in effect at the time of the sale, the entity shall be subject to the refund authority of the Commission under this section with respect to the violation.

(3) This section shall not apply to—

(A) any entity that sells in total (including affiliates of the entity) less than 8,000,000 megawatt hours of electricity per year; or

(B) an electric cooperative.

(4)(A) The Commission shall have refund authority under paragraph (2) with respect to a voluntary short term sale of electric energy by the Bonneville Power Administration only if the sale is at an unjust and unreasonable rate.

(B) The Commission may order a refund under subparagraph (A) only for short-term sales made by the Bonneville Power Administration at rates that are higher than the highest just and reasonable rate charged by any other entity for a short-term sale of electric energy in the same geographic market for the same, or most nearly comparable, period as the sale by the Bonneville Power Administration.

(C) In the case of any Federal power marketing agency or the Tennessee Valley Authority, the Commission shall not assert or exercise any regulatory authority or power under paragraph (2) other than the ordering of refunds to achieve a just and reasonable rate.

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Transmission Agency of Northern California, et al. v. FERC **Docket No. ER08-1113**
D.C. Cir. Nos. 09-1213, *et al.*

CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d), and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 25th day of August 2010, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system or via U.S. Mail, as indicated below:

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