ORAL ARGUMENT IS SCHEDULED FOR MAY 9, 2005

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

Nos. 02-1374, 02-1376, 02-1381, 02-1385, and 02-1388
(Consolidated)

SOUTHERN CALIFORNIA EDISON COMPANY, ET AL.
PETITIONERS,

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 before this Court are identified in the brief of Petitioners.

B. Rulings Under Review

Pacific Gas and Elec. Co., et al., 100 FERC ¶ 61,156 (2002);

Pacific Gas & Elec. Co., et al., 101 FERC ¶ 61,151 (2002);

Pacific Gas & Elec. Co., et al., 107 FERC ¶ 61,115 (2002).

C. Related Cases

The case on review was not previously before this Court or any other court, and the undersigned counsel is not aware of any related cases pending in this Court or any other court.

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GLOSSARY

ALJ	Administrative Law Judge
ALJ Decision	*Pacific Gas & Elec. Co., et al.,* 88 FERC ¶ 63,007 (1999), JA 346
FPA	Federal Power Act, 16 U.S.C. § 824 *et seq.*
ISO	California Independent System Operator
Mun. Br.	Opening Brief of Petitioners Sacramento Municipal Utility District, *et al*. (October 12, 2004)
Opinion No. 458	*Pacific Gas & Elec. Co., et al.,* 100 FERC ¶ 61,156 (2002), JA 393
Opinion No. 458-A	*Pacific Gas & Elec. Co., et al.,* 101 FERC ¶ 61,151 (2002), JA 443
Remand Order	*Pacific Gas & Elec. Co., et al.,* 107 FERC ¶ 61,115 (2002), JA 452
TO	Transmission owner (here, Utility Petitioners)
TRBAA	Transmission Revenue Balancing Account Adjustment
TRC	Transmission revenue credit
TRR	Transmission revenue requirements
Util. Br.	Revised Opening Brief of Utility Petitioners (October 12, 2004)

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

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUES

1. Did the Federal Energy Regulatory Commission ("Commission" or "FERC") properly uphold the Administrative Law Judge's ("ALJ") conclusion that it was unjust and unreasonable for Utility Petitioners ("TOs") to collect certain transmission loss and ancillary services costs through the Transmission Revenue Balancing Account Adjustment ("TRBAA") of the TOs' tariffs.

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 DISPOSTION BELOW

This case involves the TOs' efforts to collect the difference between the amounts that TOs must pay after electric industry restructuring to the California Independent System Operator ("ISO") for transmission losses and ancillary service charges and the amounts that the TOs can collect for those losses and services from customers having pre-restructuring contracts ("existing contracts"). The TOs proposed to collect the cost differentials, not from existing contract customers, but from all other customers that take transmission service from the ISO ("TO customers"). The TOs propose to do that by amending the Transmission Revenue Credit in the ISO Tariff (with corresponding adjustments to the TO Tariffs) to allow inclusion of the cost differentials, and thus recovery from TO customers.

As the ALJ explained, the TOs "base their position on the two-prong assertion that the Commission requires the [TOs] to honor their existing contracts and the ISO Tariff mandated that such existing contracts must be honored in a way that 'imposes no additional financial burden on either the [TO] or the contracts rights holder (beyond that in the original contract).'" *Pacific Gas & Elec. Co., et*

al., 88 FERC ¶ 63,007 at p. 65,048 (1999), JA 353 (“ALJ Decision”)(quoting ISO Tariff § 2.4.3.1 (ii)).[1] The argument goes on to say: when the cost differentials are recognized in the Transmission Revenue Credit provision of the ISO’s Tariff, they become a component of the amounts allowed to be recovered through the TRBAA in the TO Tariffs. *Id*.

The Commission set this proposed change (among other things) for an evidentiary hearing. After receiving evidence and reviewing briefs from parties on both sides of the issue (*see id*. at 65,048-51, JA 353-56), the ALJ concluded that while the existing contracts must be honored, nothing prevented them from being modified through settlement, or, if permitted, by an FPA § 205 or § 206 filing for reformation. *Id*. at 65,051-52, JA 356-57 (relying, in part, on § 2.4.4.4.4.5 of the ISO Tariff). The Judge also concluded that charging the cost differentials entirely to the TO customers, as proposed by the TOs’ filing, violated cost causation principles. *Id*. Finally, the ALJ disagreed the TOs had shown that the cost differentials met FERC criteria of volatility and significant rate effect to justify their inclusion in the TRBAA, which is an automatic rate adjustment mechanism. *Id*.

[1] “JA” refers to the Joint Appendix page number. “P” refers to the internal paragraph number within a FERC order.

After receiving briefs on exceptions and opposing exceptions, the Commission affirmed the ALJ Decision, but did "so with a somewhat different emphasis." *Pacific Gas and Elec. Co., et al.,* 100 FERC ¶ 61, 156 at P 27 (2002)("Opinion No. 458"), JA 399. Because the proposed changes were part of an FPA § 205 rate filing, the "fundamental question in this proceeding is whether the Companies' proposed TO and WDT tariffs are just and reasonable." *Id.* The TOs' tariff language arguments were rejected, and the ALJ's cost causation findings upheld. *Id.* at PP 28-31, JA 399-400.

On rehearing, Petitioners reiterated their tariff interpretation claims. *Pacific Gas & Elec. Co., et al.,* 101 FERC ¶ 61, 151 at PP 11-12 (2002)("Opinion No. 458-A"), JA 446. The Commission found, however, that the ISO Tariff language on which Petitioners relied did not address how TOs would recover the costs at issue, and that Petitioners' interpretation did not consider all relevant tariff provisions. *Id.* at PP 15-18, JA 447-48. Opinion No. 458-A also rejected Petitioners' equitable arguments for reversing the earlier FERC ruling. *Id.* at PP 19-25, JA 448-50.

After Petitioners sought review, the Commission asked for, and this Court granted, a voluntary remand to correct misstatements that caused confusion in the Opinions. *Pacific Gas & Elec. Co., et al.,* 107 FERC ¶ 61, 115 at P 1 (2002) ("Remand Order"), JA 452. Opinion No. 458-A misspoke in stating that the ISO

Tariff allowed the ISO to collect charges *from* the TOs; correctly stated, the ISO Tariff allows the ISO to collect Transmission Revenue Requirements ("TRR") *for* the TOs. *Id*. at P 12, JA 455. A second change related to the Transmission Revenue Credit, which Opinion No. 458 treated in a shorthand manner that suggested the Credit only covered shortfalls, despite the Credit's language stating surpluses are also covered. *Id.* at P 13, JA 456. As explained further, while the language of the Credit applies to both situations, the reality has been that only shortfalls have been realized. *Id*.

Correcting those factual misstatements had, however, "no effect on the basic conclusions" of the earlier Opinions, which were reaffirmed in the Remand Order at P 14, JA 456. In particular, "the terms of the ISO Tariff do not clearly answer the question of which customer group would be responsible for" the cost differentials. *Id.* Without a definitive answer in the ISO Tariff as to what group was responsible, the issue turned on "longstanding principles of ratemaking cost causation," that showed the ETC costs "should not be the responsibility of the TO Tariff customers." *Id*. at P 17, JA 457.

II. STATEMENT OF FACTS

A. Statutory and Regulatory Background

FERC has been delegated authority to set just and reasonable rates for the wholesale sale and transmission of electric energy by Sections 205 and 206 of the

Federal Power Act ("FPA"), 16 U.S.C. §§ 824d and 824e. This case commenced with the TOs' FPA § 205 filing of proposed TO Tariffs in conjunction with an ISO Tariff, all of which were designed to implement California's electric industry restructuring in accordance with an earlier FERC-approved framework. *See generally* ALJ Decision, 88 FERC at 65,044-45, JA 349-50. Of the several issues set for hearing related to those filings, only the proper rate treatment for the cost differentials is at issue here.

B. Events Leading To The Challenged Ruling

After the TOs made their filing, the non-rate aspects were consolidated along with subsequent tariff modifications into a single hearing that addressed 20 issues. *See generally* ALJ Decision, 88 FERC at 65,044-45 (procedural history), JA 349-50 and 65,043-44 (listing issues), JA 348-49. Various parties introduced testimony and exhibits during the hearing, and were permitted to file initial and reply briefs. *Id*. at 65,045, JA 350. As to the cost differentials issue, numerous parties presented positions on all sides of the matter. *Id*. at 65,048-51 (summarizing positions), JA 353-56.

The claimed cost differential arose because the TOs have existing contracts that cannot be abrogated, but "that fail, according to the [TOs], to permit collection of certain costs now charged to [them] by the ISO." *Id*. at 65,051, JA 356. The TOs' "attempted response to collecting these costs is to charge them to all

customers but those with Existing Contracts." *Id*. While the ALJ agreed the existing contracts must be honored, he did not agree that "cross-subsidization is an approved method for doing so." *Id*. (footnote omitted). Rather, the ALJ found that while the existing contracts "must not be eliminated as a result of restructuring, [they] may, if permitted (or not prohibited) by the contract, be reformed through an FPA Section 205 or 206 filing." *Id*. (citation omitted); *see also id*. at 65,048 (noting TOs' Reply Comments agreed that "the ISO Tariff's Section 2.4.4.4.5 allows a bilateral settlement of cost differentials with Existing Contract holders through settlement negotiations or the institution of Section 205 or 206 Filings"), JA 353.

Regarding the TOs' proposal to charge the cost differentials to TO Tariff customers, the ALJ found that "PG&E witness Hitson conceded that the [TOs'] proposal violates cost causation principles," and that cost causation principles "dictate that the Existing Contract customers, and not all TO Tariff customers, should pay for the" cost differentials. *Id*. at 65,052 (citation omitted), JA 357. Instead of shifting those costs to TO Tariff customers, the ALJ found the "ISO Tariff explicitly provides" in Section 2.4.4.4.5 that parties with existing contracts will continue to pay for transmission losses or [a]ncillary [s]ervices in accordance with the Contracts "*as they may be modified or changed* in accordance with the terms of the Existing Contract." *Id*. (citation omitted; emphasis in original).

To the extent that Existing Contracts cannot be modified, the TOs, not the TO Tariff customers (who were not parties to the Existing Contracts), "must shoulder this cost burden, as they accepted the risk of potential cost increases at the time they negotiated the Existing Contract." *Id.* (citation omitted). Finally, a proposal to collect the charges through "use of an automatic adjustment clause, such as the Transmission Revenue Credit" requires, under FERC precedent, a showing that "the applicable costs or revenues included within the clause's scope are volatile and make a significant difference." *Id.* (citations omitted). The ALJ found the TOs' testimony "fail[ed] to demonstrate that transmission losses and ancillary service requirements charges are indeed volatile and do make a significant difference," and thus their proposal to collect the cost differential through the Transmission Revenue Credit should be denied for this reason as well as all other reasons given. *Id.*

C. The Challenged Orders

1. Opinion No. 458

Briefs on and opposing exceptions were filed with the Commission on the issue of "whether certain losses caused by the lack of harmony between the contracts and the tariff should be recovered in the Transmission Revenue Balancing Account Adjustment (TRBAA) of the [Utility Petitioners'] TO Tariffs." Opinion No. 458 at P 7, JA 396. The rate recovery proposed would "collect [the

cost differentials] by charging them to the TO Tariff customers, who then 'would be responsible for costs incurred on their own behalf as well as those incurred on behalf of the Existing Contract customers.'" *Id*. at P 8, quoting ALJ Decision, 88 FERC at 66,051, JA 356.

Opinion No. 458 summarized the ALJ Decision for denying the proposal as resting on: concerns about cost subsidization, *id*. at P 9, JA 396; record evidence that the proposal would result in double-charging for certain shippers, *id*. at P 10; ISO Tariff language that indicated existing contracts might be modified or changed, *id*. at P 11, JA 396-97; and, acceptance by the TOs of the risks of potential cost increases, *id*. Based on those findings, "the judge reasoned" that accepting the proposal "would mean that Customers who were not parties to [the existing contract] negotiations would have that burden imposed on them, resulting in impermissible cross-subsidization." *Id.*

Petitioners filed exceptions that charged the ALJ Decision abrogated contracts, ignored other ISO Tariff language, failed to show Existing Customers caused the cost differentials, and was reached too soon to permit evidence of volatility and substantial effect that would justify use of an automatic tracker. *See generally* Opinion No. 458 at PP 16-25, JA 397-99. FERC Staff and other parties filed briefs opposing exceptions supporting the reasoning and conclusions of the ALJ Decision. *Id*. at P 26, JA .

Opinion No. 458 upheld the ALJ Decision, but "with a somewhat different emphasis." *Id*. at P. 27. The Commission evaluated the TOs' transmission revenue requirements in light of the TO Tariffs, not of the ISO Tariff. *Id*. Nothing in the plain language of the ISO Tariff "compels recovery of the costs at issue through the TO Tariffs' TRBAA." *Id*. at P 28, JA 399. The language of ISO Tariff § 2.4.3.1 – allowing Existing Contracts to be followed in a manner that "to the extent possible, imposes no additional financial burden on either the Participating TO or the contract rights holder" – does not eliminate the risk of any additional financial burden, but "indicates that there may indeed be situations where an additional financial burden may fall on the Participating TO or the contract rights holder." *Id*.; See JA 283.

Similarly, the Transmission Revenue Credit definition in the ISO Tariff does not clearly identify what parties are responsible for the cost differentials. "The issue is what can the [TOs] do to recover these costs," not whether the ISO will reflect those costs in its Tariff. *Id*. at P 28, JA 400. The Commission saw recovery as the TOs' burden because they "failed to revise the rates contained in the existing contracts to reflect the[ir] new cost of service, which includes California ISO charges." *Id*. Although the ISO reflects the cost differentials in its Tariff, ISO Tariff § 2.4.4.4.5 offers assistance to the TOs in seeking to recover those costs. "[T]he judge reasonably read that provision as recognizing that if the California

ISO rules and protocols governing transmission losses or ancillary service requirements are not the same as those in the existing contracts, the California ISO will provide the information so that the parties to those contracts may resolve the matter, by contract modification or otherwise." *Id.*[2]

Claims that the TOs "should be absolved of" responsibility to bear the risk of higher costs until contract modification "because they and their customers did not 'cause' the cost mismatch," were found to be inconsistent with the "fact that the costs are associated with service provided under the existing contracts, not the TO Tariffs." *Id.* at P 30, JA 400. Costs associated with existing contracts "should not be shifted to the TO Tariff customers." *Id.* Petitioners' misgivings that renegotiation, either informally or through FPA § 205 or § 206 proceedings, would be "inadequate" were "devoid of merit, [as] those are the remedies the statute provides." *Id.*

2. Opinion No. 458-A

[2] *See* ALJ Decision, 88 FERC at 65,052 (discussing section), JA 357. The language of § 2.4.4.4.4.5 that applies is: "To the extent that Transmission Losses or Ancillary Service requirements associated with Existing Rights or Non-Converted Rights are not the same as those under the ISO's rules and protocols, the ISO will not charge or credit the Participating TO for any cost differences between the two, but will provide the parties to the Existing Contracts with details of its Transmission Losses and Ancillary Services calculations to enable them to determine whether the ISO's calculations result in any associated shortfall or surplus and to enable the parties to the Existing Contracts to settle the differences bilaterally or through the relevant TO Tariff." JA 290.

Petitioners sought rehearing on grounds that FERC "misinterpreted the relevant terms of the California ISO Tariff," arguing that ISO Tariff § 7.1 read in conjunction

with the Transmission Revenue Credit definition "unambiguously means that" the cost differentials are to be "reflected in the Transmission Revenue Credit" and thus are to be included in the Access Charge paid by TO Tariff customers. Opinion No. 458-A at P 11, JA 446. (citation omitted). Petitioners viewed any other reading as making the Transmission Revenue Credit definition "'superfluous." *Id*. Petitioners also argued that Opinion No. 458 ignored the part of § 2.4.4.4.4.5 that states the TOs and Existing Contracts customers may settle differences "'through the relevant TO Tariff'" as a mandatory option, while the alternative ("to settle the differences bilaterally," Util.Br. at A-6) was "'truly precatory.'" Opinion No. 458-A at P 12, JA 446 (footnote omitted). Petitioners also claimed that the issue had been settled in the FERC order accepting the ISO Tariff. *Id*. at P 14, JA 446-47.

Opinion No. 458-A rejected Petitioners' "view that Section 7.1 and the definition of Transmission Revenue Credit in the California ISO Tariff must be interpreted to place the burden of the Existing Contract-related cost differentials on TO Tariff customers." *Id*. at P 15, JA 447. In particular, that view would make §§ 2.4.3.1 and 2.4.4.4.4.5 superfluous to the extent those sections provided for alternative means of resolving the cost differential issues. *Id*. While Petitioners

argue those two sections when, "read together, *require* [TOs] to recover the costs at issue through the TRBA," the Commission recounted the TOs' earlier position that those sections "allowed [the TOs] to recover the cost differential either by means of the Existing Contracts or the TO Tariffs – exactly as the [ALJ] concluded." *Id*. at P 16 (emphasis in original).

Nor had FERC's 1997 order resolved the question at hand: "the Commission was addressing the manner in which the ISO collects its revenues under the ISO Tariff . . . . [It did] not, and was not intend[ing] to, explain the next step in the process – how the TOs would recover the costs from their customers." *Id*. at P 17, JA 447-48; *see also id*. n. 28 (indicating another prior FERC order likewise "did not address the cost recovery issue"). In view of these findings, the Commission "once again" affirmed the ALJ's interpretation of the ISO Tariff as allowing recovery of the cost differentials "by filing to reform the contracts, either under [FPA] Section 205 or Section 206, as appropriate," and as avoiding imposition of those differentials on TOs and the existing contract customers only "'to the extent possible.'" *Id*. at P 18, JA 448 (footnote omitted).

Petitioners also raised equitable claims on rehearing. First, they charged that no cost shifting would occur under their proposal because, in their view, restructuring was "'adopted for the benefit of California retail [*i.e.,* TO Tariff] customers,'" and thus the cost differentials should be attributed to those customers,

not to ETC customers whose service has not substantially changed since restructuring. *Id*. at P 19 (footnote omitted). Petitioners claimed that they justifiably relied on an expectation that "on entering into the Existing Contracts[,] they would recover their costs," *id*. at P 20, and "on their interpretation of the ISO Tariff." *Id*. at P 21, JA 448-49.

Petitioners' equitable claims were found lacking. Rather than benefiting only TO Tariff customers, the Commission found restructuring "benefits that are distributed across the spectrum of industry participants." *Id*. at P 23, JA (footnote omitted). In view of this, the Commission "decline[d] to identify the TO Tariff customers as benefiting from restructuring so singularly as to require cost incurred in connection with the Existing Contracts, to which they are not parties, to be passed on to them." *Id.* As TO Tariff customers could not be singled out as the only beneficiaries of restructuring, the Commission agreed with the ALJ that assigning the cost differentials entirely to them "would amount to inappropriate cross-subsidization." *Id*. Finally, the Commission found TOs' claimed reliance on an October 1997 FERC order or on reversal of the ALJ Decision was unjustified. *Id*. at P 25, JA 449-50.

3. The Remand Order

After the petitions for review were filed, the Commission sought, and was granted, a voluntary remand. The Remand Order noted the "two basic elements" of

the earlier rulings: (1) "the ISO Tariff does not, by its terms, determine which group of the [TOs'] customers is responsible for the disputed costs," and (2) "requiring the TO Tariff customers to shoulder the burden of costs incurred by the existing Contract customers would result in unnecessary and inequitable cost-shifting." Remand Order at P 11, JA 455.

The Commission then corrected a factual misstatement in Opinion No. 458-A -- that the ISO Tariff determines the manner "in which the California ISO will collect the costs from the" TOs. *Id.* at P 12, quoting Opinion No. 458-A at P 15 (emphasis added by FERC). The correct statement is that the ISO Tariff establishes the Transmission Access Charge, "which the ISO collects (from the transmission customers) for the" TOs. *Id.* (emphasis in original). The Remand Order also clarifies "a shorthand manner" of describing the Transmission Revenue Credit definition "that could be confusing." *Id.* at P 13, JA 456. The shorthand treated the cost differentials as shortfalls that the ISO would assess to the TOs. *Id.* The definition itself provides, however, for shortfalls or surpluses, and, thus, the shorthand was misleading. Nevertheless, "in the time period relevant to this case, the matter has been one of 'shortfall,' so that [TOs] have a deficit to make up from their customers." *Id.*

In context, neither misstatement had any effect on FERC's conclusions: "the Commission continues to hold that the terms of the ISO Tariff do not clearly

answer the question of which customer group would be responsible for shortfalls caused by the" cost differentials. *Id*. at P 14, JA 456. The Commission reiterated that ISO Tariff § 2.4.4.4.4.5 language referring to the "Existing Contracts as they be modified or changed" and to the ISO's obligation to provide "details of its Transmission Losses and Ancillary Services calculations . . . to enable the parties to the Existing Contracts to settle the differences bilaterally or through the relevant TO Tariff" could be reasonably read to be "neutral on the subject of whether the TO Tariff customers, as opposed to the Existing Contract customers, will be responsible for any cost differences." *Id*. at P 15, JA 456-57.

The Commission reiterated that the language in ISO Tariff § 2.4.3.1, indicating existing contracts continue on in a manner that "to the extent possible, imposes no additional financial burdens" on the TOs or the existing contract customers, was advisory, and found that "it is not clear what the actual financial burdens on the contract rights holders are or have been." *Id*. Without the contract "dictat[ing] which customers are responsible for the shortfalls in question," the Commission again found that cost causation principles meant that the cost differentials "should not be the responsibility of the TO Tariff customers." *Id.* at P 17, JA 457.

SUMMARY OF ARGUMENT

Petitioners=assertion that they be allowed to collect the cost differentials

from TO Tariff customers rests on the fact that the Transmission Revenue Credit definition encompasses the cost differentials. This requires, according to Petitioners, that the cost differentials be automatically flowed through the TRBA for payment by TO Tariff customers. Petitioners also rely on Sections 2.4.4.4.4.5 and 2.4.3.1 of the ISO Tariff as confirming their view. Petitioners' reading does not consider those sections in their entirety or how they operate in concert.

But prior to a textual analysis, the Commission questioned whether the ISO Tariff even addresses the fundamental issue here: whether the proposed TO Tariffs are just and reasonable. That issue can only be answered by analyzing the revenue requirements for each TO along with its proposed TO Tariff. Contrary to Petitioners' view, separate analysis of each TO Tariff does not detract from the open access goal of minimizing discriminatory discrimination practices. That goal is achieved through FERC's *pro forma* tariff, which prescribes the non-rate terms that must be included in all transmission tariffs to assure comparability of service among providers. In contrast, the instant matter involves tariff rate terms, which differ from one provider to the next based on their differing transmission revenue requirements. As the Access Charge of the ISO Tariff makes clear, FERC determines the tariff revenue requirement for each TO. Thus, the rate question at issue here, recovery of the cost differentials, is properly addressed in the context of individual TO Tariffs, not in context of the ISO Tariff.

The ISO Tariff does not, in any event, support Petitioners=view that they must be allowed to recover the cost differentials from TO Tariff customers. Petitioners=reliance on the ISO Tariff=s Transmission Revenue Credit is misplaced because that provision merely allows the ISO to assess the differentials to the TOs, and does not speak to what happens after assessment is made. The Commission found the Credit's language silent on which customer group is responsible for the cost differentials. Nor does Section 2.4.4.4.4.5 speak to what happens. Rather, it requires the ISO to calculate and to provide the parties to the Existing Contracts with its calculation ot each TO=s cost differentials, so that the parties may settle any issues related to them Ailaterally or through the relevant TO Tariff.@

The ALJ relied on other language in Section 2.4.4.4.4.5 -- that cost differential payments shall be made in accordance with the Existing Contracts As they may be modified or changed@ as support for the view that the TOs may make FPA ▪ 205 or ▪ 206 filings, as permitted, to resolve the payment question. Indeed, Petitioners=briefs at the FERC hearing level noted Section 2.4.4.4.4.5 offered several options for resolving who pays the cost differentials. The Commission thus properly found no support in the Section for Petitioners=claim that the cost differentials *must* be recovered from TO Tariff customers. On this point, while the Commission agreed the TO Tariff recovery is a possible recovery option, it did not agree such recover was the sole option. Petitioners can point to no

tariff language that makes TO Tariff recovery the only recovery option. Absent such language, FERC properly determined the ISO Tariff was neutral on the question of which customer group should pay the differentials.

Similarly, the language of ISO Tariff § 2.4.3.1 does not mandate recovery should come from the TO Tariff customers. That Section's language invites the ISO and affected parties to develop protocols that "to the extent possible" impose no further costs on the parties to the Existing Contracts. The Commission reasonably read that limiting phrase to reflect the parties' expectation that additional costs would be inevitable in some situations.

Having found the ISO Tariff did not mandate which customer group should pay the cost differentials, the ALJ, as affirmed by the Commission, turned to traditional cost causation principles. Petitioners argue that cost causation principles are irrelevant, that the conclusion reached -- having TO Tariff customers pay results in improper cross subsidization -- is not supported by substantial evidence, and that the conclusion results in impermissible trapped costs. Those points are invalid.

Petitioners' claim that cost causation principles are irrelevant rests on their view that they should be allowed to recover the differentials from someone. As the TOs are contractually precluded from recovering the differentials from Existing Contract customers, the TOs assume they must be allowed to recover the

differentials from the TO Tariff customers. The TOs' assumption ignores a fundamental cost causation tenet: that those were cause costs must pay for them. Neither the ALJ nor FERC saw the TO Tariff customers as the cause of the cost differentials or as singularly benefiting from restructuring that they should be required to pay the differentials. Accordingly, no basis exists for the TOs' foisting the differentials on TO Tariff customers.

Petitioners' alleged lack of substantial evidence to support the finding that TO Tariff customers should not be required to pay for the differentials rests on two sentences of a Utility Petitioners=witness. But the ALJ found that very same witness conceded the proposal to charge TO Tariff customers violated cost causation principles. Further, the differentials were shown to be associated with the Existing Contracts, not with TO Tariff customers. The Commission also rejected Petitioners= evidence that restructuring benefits only retail (*i.e.,* TO Tariff) customers, finding, instead, based on its expertise and experience, that the benefits are distributed among all industry participants. Thus, the Commission did not find the record evidence to show that TO Tariff customers should be singled out to pay the cost differentials.

Petitioners=trapped costs claim has no legal basis. This Court recently rejected an almost identical claim as legally infirm. First, the Court indicated that under fixed rate contracts, such as the Existing Contracts here, TOs take the risk

that their costs will go up, and their returns lowered, while their recovery under the contract remains the same. Here, the ALJ and the Commission found that risk was foreseeable and accepted by the TOs when they entered the Existing Contracts. Next, valid cost trapping claims rest on federal preemption over state regulation that interferes with FERC's authority. But such considerations do not apply here, where Petitioners attempt to use trapping to restrict FERC's own action. The proper recourse in such situations is, as found here, for the TOs to seek recovery from their contractual partners.

FERC's motion to dismiss the petition for review by the Municipal Petitioners should be granted. Municipal Petitioners agree to dismissal of the *Mobile-Sierra* portion of their petition. Municipal Petitioners assert that their first remaining claim — FERC erred in finding the ISO Tariff bars recovery of the cost differentials via the TO Tariffs — is ripe and, therefore, should not be dismissed. But Municipal Petitioners lack any injury-in-fact related to that claim, which is being raised by Utility Petitioners. As framed by Municipal Petitioners, their first claim alleges injury only to PG&E, not to them. Accordingly, they lack standing to present this issue and, therefore, it should be dismissed. FERC does not object, however, to Municipal Petitioners' brief on this issue being treated as a brief of intervenor in support of petitioners.

Municipal Petitioners' second claim — that FERC erred by concluding the

cost differentials were caused by Existing Contract customers C is not ripe for review in this appeal. As to Municipal Petitioners, that question is to be decided in ongoing FERC proceedings in which the TOs propose to recover the differentials from Existing Contract customers. Those cases will offer Municipal Petitioners the opportunity to show they did not cause the differentials, and to challenge any FERC ruling that they think aggrieves them. As a result, their claim here is not ripe because it rests on future contingent events and no harm will result if a ruling on the question is delayed.

ARGUMENT

I. STANDARD OF REVIEW

FERC orders are reviewed under the arbitrary and capricious standard of the Administrative Procedure Act. 5 U.S.C. § 706(2)(A). *E.g., Sithe Ind. Power Ptnrs., L.P. v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under this standard, a court looks to whether the Commission has "examine[d] the relevant data and articulate[d] a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *see also Midwest ISO Trans'n Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004). The Commission's factual findings, if supported by substantial evidence, are conclusive. 15 U.S.C. § 717r(b). This Court gives "substantial deference" to FERC's interpretation of its own orders, *Natural Gas Clearinghouse*

v. FERC, 105 F.3d 397, 399 (D.C. Cir. 1997) as well as to its interpretation of ambiguous tariff language. This Court also gives "*Chevron*-like deference" to FERC's interpretation of tariffs; if the language is ambiguous, the Court "defer[s] to FERC's construction so long as it is reasonable." *Consolidated Edison Co. of N.Y., Inc., v. FERC*, 347 F.3d 964, 972 (D.C. Cir. 2003); *see also Koch Gateway Pipeline Co. v. FERC*, 136 F.3d 810, 814 (D.C. Cir. 1998).

II. THE ISO TARIFF DOES NOT SPECIFY WHO SHOULD PAY THE COST DIFFERENTIALS

Petitioners assert that the ISO Tariff "unambiguously provides that" the cost differentials are to be included in the calculation of Access Charges (which includes Transmission Revenue Requirement ("TRR") and Transmission Revenue Credit ("TRC"), *see* ISO Tariff § 7.1, JA 301) and, therefore, must be paid by the TO Tariff customers. Util.Br. 24; Mun.Br. 10. For this assertion, Petitioners rely on the TRC definition, which states, in part: "the shortfall or surplus resulting from any cost differences between Transmission Losses and Ancillary Service requirements associated with Existing Rights or Non-Converted Rights and the ISO's rules and protocols." Util.Br. 24; JA 328. As the cost differentials fit this description, Petitioners argue they are automatically included "as part of the TRBA (and thus to recover[y] through the Access Charge" paid by TO Tariff customers. Util.Br. 25. Petitioners assert that §§ 2.4.4.4.4.5 and 2.4.3.1 "confirm that the TOs

were to recover any Cost Differentials through their individual TO Tariffs." *Id.* 25; Mun.Br.13.

Petitioners' reading does not reasonably interpret the noted ISO Tariff sections when considered in their entirety and in concert, as discussed below. But, even prior to that analysis, the Commission questioned use of the ISO Tariff as controlling here. The ISO Tariff cannot determine the "fundamental question in this proceeding[:] whether the [TOs'] proposed TO and WDT tariffs are just and reasonable." Opinion No. 458 at P 27, JA 399. Likewise, it does not determine what costs the TOs could reasonably recover: "in approving the California ISO Tariff, [FERC] made clear that the [TOs'] transmission revenue requirements were to be evaluated in their individual TO Tariff proceedings." *Id.* (citing *Pacific Gas & Elec. Co. et al.*, 81 FERC ¶ 61,122 at 61,455 n. 113 (1997)).

The TOs find that statement "puzzling given the reason for establishing the ISO," that is, to minimize the chance for transmission providers to use their control over transmission facilities for discriminatory purposes. Util.Br. 30. But their puzzlement occurs because the TOs confuse two separate objectives: minimizing discriminatory transmission practices and allowing recovery of transmission costs.

Minimizing discriminatory practices is accomplished by the open access *pro forma* tariff, whose uniform non-rate terms assure comparable transmission for all shippers. Here, a *pro forma* TO Tariff with uniform non-rate terms was designed to

reach that goal. *See generally* ALJ Decision, 88 FERC at 65,046-47, JA 351-52 (noting that *pro forma* TO Tariff offers "heightened level of comparability" for transmission service, although concluding that, for jurisdictional reasons, FERC could not adopt a *pro forma* TO tariff that would cover retail transactions).

In contrast, cost recovery requires an analysis of each provider's differing transmission revenue requirements ("TRR"). Rather than the ISO Tariff "prescrib[ing] an overall framework for how the Access Charges were to be determined," as claimed (Util.Br. 30-31), the Tariff definition of TRR contemplates FERC will set each jurisdictional provider's TRR. *See* JA 329 (defining TRR as "total annual authorized revenues . . . for which FERC jurisdictional entities are permitted to include in their Access Charges . . . or in the case of non-FERC jurisdiction entities, the equivalent revenue amount authorized by the appropriate jurisdictional regulatory authority"). Thus, the ISO Tariff does not prescribe how Access Charges are to be determined (Util.Br. 30); the FPA (or other governing statute) does under the just and reasonable standard. "FERC *independently examines* each of these jurisdictional utilities' TRRs to ensure that they are just and reasonable." *Pacific Gas & Elec. Co. v. FERC*, 306 F.3d 1112, 1114 (D.C. Cir. 2002)(emphasis added). It follows that the ISO Tariff does not control whether inclusion of the cost differentials in each TO's Access Charge is just and reasonable. Opinion No. 458 at P 28, JA 399-400.

In any event, the ISO Tariff provisions do not support Petitioners' reading that the cost differentials must be charged to TO Tariff customers. The TRC definition, while encompassing cost differentials within its scope, is irrelevant to the issue at hand "because there is no dispute that the ISO will assess these [differentials] to the [TOs]." *Id.* at P 28, JA 400. Further, the ISO will have to assess the differentials to the TOs only because they "failed to revise the rates contained in the existing contracts to reflect [their] new cost of service, which includes California ISO charges." *Id.* The real issue here is what happens after the differentials are assessed – "what can the [TOs] do to recover these costs." *Id.* Neither the TRC definition nor any other provision of the ISO Tariff speaks to that issue. *See* Remand Order at P 14, JA 456 ("the terms of the ISO Tariff do not clearly answer the question of which customer group would be responsible for" the cost differentials).

Petitioners claim that the correction in the Remand Order means "the ISO Tariff provisions *do* 'determine which group of the [TOs'] customers is responsible for the disputed costs,'" Mun.Br. 12; *see* Util.Br. 31 (same). After correcting its misstatement, the Commission reiterated that Section 2.4.4.4.4.5 leaves open the question of who should pay the cost differentials. Remand Order at P 15,JA 456-57. That section states:

> To the extent that Transmission Losses or Ancillary Service requirements associated with Existing Right or Non-Converted Rights

> are not the same as those under the ISO's rules and protocols, the ISO *will not charge or credit* the Participating TO for any cost difference between the two, but will provide the parties to the Existing Contracts with details of its . . . calculations to enable them to determine whether the ISO's calculations result in any associated shortfall or surplus and to enable the parties to the Existing Contracts to settle the differences bilaterally or through the relevant TO Tariff.

JA 290 (emphasis added).

Far from supporting Petitioner's view, that language shows FERC's interpretation is reasonable. The provision that cost differentials are neither charged

nor credited by the ISO belies any notion that they are automatically flowed through to the TRR for recovery from the TO Tariff customers, as Petitioners insist. Util.Br. 25. Rather, as FERC reasonably interpreted that language, "the ISO Tariff is neutral on the subject of whether TO Tariff customers, as opposed to Existing Contract customers, will be responsible for any such differences." Remand Order at P 15, JA 457; *see also* Opinion No. 458 at P 29, JA 400 (where ISO calculates a cost differential, "the California ISO will provide the information so that the parties to those contracts may resolve the matter, by contract modification or otherwise").

The TOs assert that the cost differentials must be included in the TRBA for recovery from TO Tariff customers by the terms of § 2.4.4.4.4.5. Util.Br. 32. They claim that the Commission "artfully elided the plain language" of that section to

state that cost differentials may be resolved "'by contract or *otherwise.*'" *Id.* at n. 58, citing Opinion No. 458 at P 29, JA 400 (emphasis added by Petitioners). Those charges focus solely on the last phrase of § 2.4.4.4.4.5 – "to settle the differences bilaterally or through the relevant TO Tariff" – and ignore earlier language that parties "shall continue to pay for Transmission Losses or Ancillary Services requirements [that is, the factors that may lead to cost differentials] in accordance with such Existing Contracts *as they may be modified or changed in accordance with the terms of the Existing Contract*." JA 290 (emphasis added).

The ALJ referred to the latter language as indicating that an FPA "Section 205 or 206 filing is the appropriate method for achieving these permitted modifications." ALJ Decision at 65,052, JA 357. The Commission found Petitioners did "not take into account" the above-emphasized part of § 2.4.4.4.4.5 "on which the Initial Decision relied," and agreed the ALJ had "reasonably read" the language, "may be modified or changed," as contemplating that "the parties to those contracts may resolve [the cost differentials], by contract modification or otherwise." Opinion No. 458 at P 29, JA 400.

As the Commission saw it, that language (read in conjunction with § 2.4.3.1) does not support Petitioners' argument that the ISO Tariff "*require*[s] the Companies to recover the costs at issue through the TRBA." Opinion No. 458-A at P 16, JA 447 (emphasis in original). In fact, this "newly minted argument"

contradicted the TOs' earlier statements that "ISO Tariff Section 2.4.4.4.4.5 allows the Companies to bilaterally settle differences with their Existing Contract holders . . . through settlement or by making Section 205 or 206 filings" and that it "provides the Companies *several options* for addressing" the cost differentials. *Id.* (emphasis added); *see* ALJ Decision at 65,048, JA 353(noting same argument in Reply Comments). The Commission did not "artfully elide[] the plain language," as Petitioners charge (Util.Br. 32 n. 58); it simply considered language that Petitioners chose to ignore.

Petitioners allege the challenged orders read the TO Tariff option out of § 2.4.4.4.4.5. Util.Br. 32-33; ISO Br. 18. That mischaracterizes FERC's ruling that the TO Tariff option is neither mandatory nor the only option available to resolve cost differential issues. That ruling responded to arguments made below that the provision along with § 2.4.3.1 "*require* the Companies to recover the costs at issue through the TRBA." Order No. 458-A at P 16, JA 447 (emphasis in original); *see* ALJ Decision at 65,048, JA 353(summarizing Petitioners' position as to why they claim cost differentials should be recovered through TRBA).

While the Commission responded to that position by concluding recovery through the TO Tariff is not the *sole* option, it did recognize the TO Tariff as *an* option. *See, e.g.,* Opinion No. 458-A at P 16, JA 447 ("the ISO Tariff allowed the Companies to recover the cost differentials by means of the Existing Contracts or

the TO Tariffs –exactly as the Presiding Judge concluded").[3] That conclusion rested on a finding that "the ISO Tariff is neutral on the subject of whether TO Tariff customers, as opposed to the Existing Contract customers, will be responsible for any" cost differentials. Remand Order at P 15, JA 457. Petitioners disparage that finding by stating the Tariff is "neutral only in the sense that it allows the TOs the choice of whether to recover Cost Differentials through the TO Tariff." Util.Br. 33. Petitioners point to no language that gives them the right to make that choice; absent such a directive, their effort to recover through the TO Tariff is subject to review under the FPA, which, as discussed in the next section, implicates traditional cost-causation ratemaking principles.

Likewise, Section 2.4.3.1 does not support Petitioners' view that the TRC definition requires cost differentials be recovered from TO Tariff customers. Util.Br. 26; Mun. Br. 11. The section exhorts the ISO and parties to the existing contracts to "develop operational protocols . . . which allow existing contractual rights to be exercised . . . in a way that . . . to the extent possible, imposes no additional financial burden" on any contract party. JA 283. Petitioners treat that language as a command not to impose additional financial burden "whenever there

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[3] The only TO Tariff proposal here was to flow through all cost differentials to TO Tariff customers. ALJ Decision at 65,051, JA 356 ("The Companies attempted response to collecting these costs is to charge them to all customers but those with Existing Contracts"). Consequently, the Commission was not faced with alternative proposals that could reasonably employ the TO Tariff.

is some way to do so," Util.Br. 34. But not all ways to do so are reasonable under the FPA. FERC properly recognized that reality by interpreting the "qualifying phrase 'to the extent possible' [as] indicat[ing] that there may indeed be situations where an additional financial burden may fall on the [TO] or the contract rights holder." Opinion No. 458 at P 28, JA 399-400.

In short, the language of §§ 2.4.4.4.4.5 and 2.4.3.1 support FERC's reasonable construction that the ISO Tariff does not dictate which customer group is required to pay the cost differentials, but leaves the question open. It follows that, contrary to Petitioners' claims, the ISO Tariff does not automatically or necessarily mandate the cost differentials be recovered from the TO Tariff customers.

III. RECOVERY THROUGH THE TO TARIFF VIOLATES COST CAUSATION PRINCIPLES

Petitioners argue that cost shifting concerns are irrelevant (Util.Br. 35-36; ISO Br. 25-26), are not supported by substantial evidence (Mun.Br. 15-17), and result in trapped costs (Util.Br. 38-39). Those arguments are invalid. As explained in FERC's rulings, the ISO Tariff did not dictate what customers should pay the cost differentials, and thus the question turns on whether shifting the costs to the TO Tariff customers violates cost causation principles. The Municipal Petitioners presented no evidence on this subject, and the TOs' witness agreed that charging TO Tariff customers would violate cost causation principles. In addition, the

Commission found the restructuring benefits are spread among all system users. All those factors provided substantial evidence that shifting cost differentials to the TO Tariff customers would violate cost causation principles. Finally, Petitioners' trapping argument has no legal basis.

A. Cost Shifting Was Properly Considered

The TOs assert that "the concept of 'cost shifting' does not apply here" because the "Access Charge is designed to ensure that a TO receives compensation for the total revenue requirement associated with its transmission facilities." Util.Br. 35 n. 61. In other words, the TOs do not care who must pay, so long as they recover their entire claimed transmission revenue requirements ("TRR"). That approach ignores the fundamental principle of cost causation: that "'all approved rates reflect to some degree the costs actually caused by the customer who must pay them.'" *Midwest ISO Trans. Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004)(citations omitted).

Nothing in the record shows that the TO Tariff customers actually caused the cost differentials. Quite the contrary, the proposal to assign cost differentials to TO Tariff customers would mean they "would be responsible for costs incurred on their own behalf as well as those incurred on behalf of the Existing Contract customers." ALJ Decision at 65,051, JA 356. That, as the ALJ properly found, amounts to cross-subsidization and, thus, violates cost causation principles. *See id.*

at 65,052, JA 357 ("Cost causation principles dictate that the Existing Contract customers, not all TO Tariff customers, should pay the" cost differentials).

B. Substantial Evidence Supports FERC's Findings

On exceptions, Petitioners did not challenge those findings, but, instead, argued "'there has been no showing in this docket that the Existing Contracts or their customers caused'" the cost differentials. Order No. 458 at P 20, JA 398 (footnote omitted); *see* Order No. 458-A at P 19, JA 448 (same). Municipal Petitioners now argue evidence allegedly supports their view that "Cost Differentials arose, not from an under-recovery of the costs of loss and ancillary services from ETCs, but from the cost of restructuring of the electric industry in California." Mun.Br. 16. The allegedly supporting evidence consists, not of any evidence submitted by Municipal Petitioners, but of two sentences from Mr. Hitson, a witness for Utility Petitioners, *id.* at 17, that purportedly show the cost differentials should be "'shared broadly among those customers who are the direct beneficiaries of the ISO Tariff structure and industry restructuring,' namely, TO Tariff customers." Opinion No. 458-A at P 19, JA 448 (footnote omitted); *see* Mun.Br. at 18 (claiming FERC failed "to address Municipal Petitioners' arguments," but failing to point to any evidence ignored).

The Commission rejected Petitioners' reasoning and conclusion. First, the very witness cited by Municipal Petitioners supported FERC's conclusion: "PG&E

witness Hitson conceded that the Companies' proposal violated cost causation principles." ALJ Decision at 65,052, JA 357. As to whether existing contract customers "caused" the cost differentials, FERC found "the costs are associated with service provided under the existing contracts, not the TO Tariffs, and should not be shifted to the TO customers." Opinion No. 458 at P 30, JA 400; *see* ALJ Decision at 65,052, JA 357 (noting that the cost differentials are "incurred as a result of the ISO's billing requirements, which affect service provided under those Existing Contracts").[4] FERC, based on its experience, also rejected the view (Mun.Br. 17) that restructuring benefits only TO Tariff customers: "we have observed that enhanced reliability and market development resulting from industry restructuring are benefits that are distributed across the spectrum of industry participants." Opinion No. 458-A at P 23, JA 449.

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[4] Municipal Petitioners assert here, but did not do so below, that "the premise of FERC's order is that the ETCs . . . are all non-compensatory, and hence the cause of the Cost Differentials." Mun.Br. 15-16. As the claim was not made on rehearing, the Court lacks jurisdiction to consider it. FPA § 313(b), 16 U.S.C. § 825*l*(b). In any event, it is speculative: this case did not address whether the ETCs were compensatory when entered. The material question here is whether they are compensatory now that the ISO provides transmission. *See* Remand Order at P 16 n. 20, JA 457 (nothing was "introduced into the record in this case [as to] the amount, if any, of the" allegedly non-compensatory costs). A Municipal Petitioner states that it self-supplies ancillary services for all its load, "thereby causing no additional cost to PG&E or the ISO related to ancillary services" (Mun.Br. 16). This point was addressed and found "irrelevant" because in that situation Utility Petitioners "will incur no related costs that need to be recovered." Opinion No. 458 at P 31, JA 400.

Those findings led the Commission to reject Petitioners' proffered conclusion that the TO Tariff customers should be assigned the cost differentials. Mun.Br. 18. Because the cost differentials are associated with service provided under the existing contracts, the differentials "should not be shifted to the TO Tariff customers," but, rather, the TOs should "reform their existing contracts by means of FPA Section 205 and 206." Opinion No. 458 at P 30, JA 400. Further, all industry participants benefit from restructuring; the TO Tariff customers do not benefit "so singularly as to require the costs incurred in connection with the Existing Contracts, to which they are not parties, to be passed on to them." Opinion No. 458-A at P 23, JA 449.

As to the claim that the "Access Charge is not designed to recover costs relating to service to a particular group of customers, but rather to ensure that the TO's overall revenue needs are met," (Util.Br. 35 n. 61), the Commission noted that revenues from existing contract customers are a "revenue credit incorporated into" the TRR, and thus the TRR assigned to TO Tariff customers is reduced by that credit so as to "prevent[] double recovery in TO Tariff rates." Opinion No. 458-A at P 24, JA 449. Thus, contrary to the TOs' claim, the Access Charge rate design does reflect different customer groups' responsibility for a portion of a TO's overall revenues related to the incurrence of costs for service to each group.

In sum, cost causation principles are relevant here and were properly factored, based on substantial evidence, into the conclusion that TO Tariff customers should not be saddled with payment of the cost differentials.

C. Petitioners' Trapping Claim Is Invalid

Petitioners' so-called trapping argument (Util.Br. 38-39) has no basis. This Court recently rejected a virtually identical claim: "The MISO Owners here make something of a reverse cost trapping argument – FERC has trapped costs under rates that are set by states or other contractual partners and has thereby diminished the MISO Owners' return." *Midwest ISO Trans. Owners*, 373 F.3d at 1372. In that case, the risk was unproven, *id*., while, here, the risk was foreseeable at the time the existing contracts were executed. "If the Existing Contracts forbid the Companies' applications for rate modifications under Section 205 or 206, the Companies themselves must shoulder this cost burden, as they accepted the risk of potential cost increases at the time they negotiated the Existing Contracts." ALJ Decision at 65,052, JA 357 (footnote and citation omitted); *see* Opinion No. 458-A at P 23, JA 449 ("It is well established that while regulated companies must have a reasonable opportunity to recover their costs, they enjoy no guarantee that they will necessarily do so.")(citations omitted)

The Court also ruled that reverse cost-trapping arguments "fail[] as a legal theory." *Midwest ISO Trans. Owners*, 373 F.3d at 1372. Valid trapping claims are

"based on the Supremacy Clause and principles of federal preemption," and address efforts by state authorities that "impermissibly interfere[] with FERC's authority to set just and reasonable rates." *Id.* A reverse cost-trapping claim cannot be based on those principles because "[f]ederal preemption and the Supremacy Clause do not circumscribe FERC's authority." *Id.*

Yet, Petitioners' trapping claim would circumscribe FERC's authority based on alleged contractual grounds. *See* Util.Br. 38 & n. 65 (claiming FERC's "denying the TO the ability to recover Cost Differentials through the TRBA would effectively 'trap' these costs"). As this Court instructed, if "the FERC-approved application of the Cost Adder to . . . grandfathered loads results in 'trapped' costs, [the companies'] initial recourse is to their . . . contractual partners armed with principles of federal preemption and the Supremacy Clause – not to FERC." *Midwest ISO Trans. Owners*, 373 F.3d at 1372. That instruction is consistent with FERC's contractual interpretation "that the Companies may seek to recover the contested costs through the Existing Contracts, by filing to reform the contracts, either under [FPA] Section 205 or 206, as appropriate." Opinion No. 458-A at P 18, JA 448.[5]

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[5] Petitioners claim that "the traditional antipathy toward 'trapped' costs'" would have made it unlikely that FERC's 1997 order would have required them to "absorb the burden of Cost Differentials." Util.Br. 38 n. 67. The Commission found, however, that the claim "is totally without merit" because Petitioners could not reasonably assume that Order "resolved the issue here in their favor." Opinion

IV. FERC'S MOTION TO DISMISS SHOULD BE GRANTED

FERC previously moved to dismiss the petitions (Nos. 02-1381, 02-1385, and 02-1388) filed by Municipal Petitioners for lack of jurisdiction. *See* "Motion to Unconsolidate Nos. 02-1381, 02-1385, and 02-1388 and To Dismiss Those Cases" (filed May 21, 2003)("Mot.") and "Reply In Support of Motion For Leave To File Out of Time and Motion to Dismiss" (filed June 13, 2003). By Order of August 22, 2003, the Court referred the motion to the merits panel and directed the parties to address in their briefs the issues presented in the motion. Municipal Petitioners have conceded that their "*Mobile-Sierra* claim is not ripe, and consent to dismissal of that portion of their petitions." Mun.Br. 23.

Municipal Petitioners have not conceded on two other claims: "that FERC acted arbitrarily: (1) in interpreting the ISO Tariff to bar PG&E from recovering the costs of certain transmission losses and ancillary services under its own TO Tariff, and (2) in concluding, without consideration of contrary arguments, that the [cost differentials were] caused by ETC customers." *Id*. at 20. The first claim was not considered in FERC's motion, which addressed only the second claim. Mot. 4.

No. 458-A at P 25, JA 448-49. As FERC explained earlier, *id*. at P 17, JA 447-48, the 1997 Order addressed "the manner in which the ISO collects its revenues under the ISO Tariff," the Order did "not, and was not intended to, explain the next step in the process – how the TOs would recover the costs from their customers."

Municipal Petitioners admit the Utility Petitioners also raise the first claim, and turn this fact into their entire opposition, asking, in effect, how FERC can seek to dismiss their claim when FERC has not contested the ripeness of the same claim by Utility Petitioners. *Id.* at 21. But, as noted, FERC's Motion did not address this claim at all, and thus did not argue it was unripe. Municipal Petitioners are correct that the first claim is ripe, but as they lack injury-in-fact on that claim, dismissal of it as to them is appropriate. *See* Mot. 5 n. 1 (noting motion raises justiciability questions).

On its face, the first claim, as formulated, does not show injury-in-fact to Municipal Petitioners. Instead, their formulation shows injury to PG&E: the first claim states FERC's orders "bar PG&E from recovering [cost differentials] under its own TO Tariff." Mun.Br. 20. While a bar to PG&E may indirectly affect Municipal Petitioners, they do not suffer the requisite direct injury to establish their standing to raise the claim. Further, no hardship arises from dismissal, as the TOs raise the same claim for resolution. FERC submits that the appropriate course on this claim would have been for Municipal Petitioners to intervene on behalf of the TOs, and FERC has no objection, should the Court dismiss the petitions, to treating Municipal Petitioners' brief on this point as a brief of an intervenor supporting the TOs.

Municipal Petitioners suggest that because their second claim "has been definitively resolved against these petitioners[,] they will have no further opportunity to contest FERC's finding if they are denied review" here, *id*. at 20-21, thus making them liable, "with millions of dollars at stake," for payment of cost differentials. *Id*. 22-23.[6] While Municipal Petitioners claim that PG&E's filing for cost differential recovery is sufficient to negate FERC's lack of ripeness claim, *id*., that is not the law.

Mere filing of a rate change does not make the second claim ripe because, until PG&E's proposed rates are litigated and resolved by FERC, Municipal Petitioners concede their potential liability, if any, for cost differential recovery is unknown. *See* Mun.Br. 22 ("It is true that the orders on review do not themselves authorize the collection of the costs at issue from Municipal Petitioners"). Where the effect a ruling will have on petitioners' rates is contingent on a future proceeding, the ruling is unripe for review. "What the precise effect [of the challenged ruling] will be, no one can now say. The injury has not yet materialized nor has the factual record related to that injury been established." *Alabama Mun.*

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[6] Municipal Customers state they "are currently paying [PG&E's proposed] charges while the lawfulness of those charges is being adjudicated." Mun.Br. 22-23. That statement tells only half the story: the proposed charges are in effect, but subject to refund. *See Pacific Gas & Elec. Co.* ,90 FERC ¶ 61,010 at 61,023 ordering para. (A) (2000)(making PG&E's proposed rate effective subject to refund). Thus, while Municipal Petitioners are currently paying the proposed rates, any amounts found to be excessive will be refunded to them with interest.

Distributors v. FERC, 312 F.3d 470, 473 (D.C. Cir. 2002); *see also Texas v. United States*, 523 U.S. 296, 300 (1998)("a claim is not ripe for adjudication if it rests upon contingent future events that may not occur as anticipated, or indeed may not occur at all").

Even if the challenged orders had caused PG&E to make its filing,[7] Municipal Petitioners have yet to suffer any cognizable injury from that filing, as they have refund protection against any overcharges. *See, supra*, n. 5; *See also New York State Elec. & Gas Corp. v. FERC*, 177 F.3d 1037, 1040-41 (D.C. Cir. 1999)(finding a rate-related claim unripe before completion of the actual rate case). Here, the actual rate case involving Municipal Petitioners' liability, if any, for cost differentials is ongoing; they will suffer no hardship if review of their second claim (Mun.Br. 20) is delayed until completion of that rate case. Accordingly, Municipal Petitioners' second claim should be dismissed as unripe.

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[7] PG&E made its filing "on the heels of the [ALJ] Decision," Opinion No. 458-A at P 25 n. 42, JA 450, thus undermining any inference that the challenged FERC orders were the proximate cause of the filing.

CONCLUSION

For the reasons stated, the petitions in Nos. 02-1381, 02-1385, and 02-1388 should be dismissed, and the challenged FERC orders should be affirmed in all respects.

Respectfully submitted,

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