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August 13, 2002

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

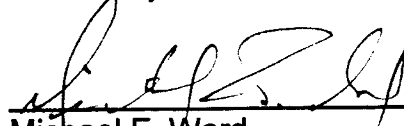
Re: Mirant Delta, LLC and Mirant Potrero, LLC, Complainants v. California Independent System Operator Corporation, Respondent
Docket No. EL01-35-000, *et al.*

Dear Secretary Salas:

Enclosed for filing are one original and 14 copies of the Request for Rehearing and Motion for Stay of the California Independent System Operator. Also enclosed are two extra copies of the filing to be time/date stamped and returned to us by the messenger.

Thank you for your assistance in this matter.

Yours truly,



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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Mirant Delta, LLC and Mirant Potrero, LLC, Complainants v. California Independent System Operator Corporation, Respondent	Docket No. EL01-35-000
San Diego Gas & Electric Company, Complainant, v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents, *et al.*	Docket No. EL00-95-005 Docket No. EL00-95-012
California Independent System Operator Corporation 000	Docket No. ER01-1877- Docket No. EL00-95-030 Docket No. EL00-98-029
Operational Audit of the California Independent System Operator	Docket No. PA02-1-000
California Independent System Operator Corporation	Docket No. RT01-85-000
Pacific Gas and Electric Company	Docket No. RT01-83-000
San Diego Gas & Electric Company	Docket No. RT01-82-000
Southern California Edison Company	Docket No. RT01-92-000

REQUEST FOR REHEARING AND MOTION FOR STAY
OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Section 313(a) of the Federal Power Act, 16 U.S.C. § 251(a) (1994) and Sections 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713 (2001), the California Independent System Operator Corporation ("ISO")[1] submits this Request for Rehearing and Motion for Stay of the Commission's July 17, 2002 Order Concerning Governance of the California Independent System Operator Corporation, 100 FERC ¶ 61,059 (2002) ("July 17 Order") in the above-captioned dockets.

I. INTRODUCTION AND SUMMARY

The current structure of the ISO Board of Governors ("Board") is dictated by California law. On January 18, 2001, the California State Legislature passed a bill, known as AB 5X, that directed the replacement of the then-existing Board of the ISO, a corporation organized and existing under California corporations law, with a five-member, non-stakeholder Board appointed by the Governor, subject to confirmation by the Electricity Oversight Board ("EOB"), a California State agency. In accordance with this State law, the prior ISO Board was replaced with a five-member Board appointed by the Governor on January 25, 2001. The ISO submitted an amendment to its bylaws to reflect the new governance structure on April 26, 2001.[2]

The July 17 Order directed the ISO to replace the current ISO Board with

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[1] Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

[2] Subsequently, another bill, SB 47, was passed by the State legislature providing for three-year staggered terms and substituting confirmation by the State Senate for confirmation by

a new two-tier governance structure by January 1, 2003. Specifically, the July 17 Order mandated an ISO Board composed of nine voting members that are independent of all market participants, a group within which the Commission includes the State of California.

As explained below, the Commission's attempt to dictate the corporate governance of the ISO in the July 17 Order improperly intrudes on the right of the State of California to control the governance of a corporation created under its laws and to protect the public welfare; exceeds the Commission's jurisdiction under the Federal Power Act ("FPA"); is unsupported by any, let alone substantial, record evidence; and is arbitrary and capricious. The Commission's insistence that the State officers and agencies charged with the protection of the interests of the end-use consumers of the State of California have no role in the governance of the ISO reflects a derogation of the Commission's fundamental mission: the protection of consumers. The Commission's professed concern with the alleged lack of independence of the current ISO Governing Board is legally insufficient to support the excessive and extremely intrusive sanction that it imposed on the ISO in the July 17 Order.

As the Court of Appeals for the D.C. Circuit has recently emphasized, the Commission possesses only that authority conferred on it by Congress through the FPA. *See Atlantic City Electric Co. v. FERC*, 295 F.3d 1, 7 (D.C. Cir. 2002). Nothing in the FPA authorizes or justifies a Commission requirement that a public utility operating transmission facilities or selling electricity at wholesale have any

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the EOB. Although the ISO Board has approved amendments to the Bylaws in conformance with SB 47, those amendments have not yet been approve by the EOB.

particular corporate structure. Indeed, despite the Commission's professed concern with independence from market participants, virtually every public utility that owns transmission facilities – and is thus subject to the Commission's jurisdiction – is governed by a corporate board that is directly answerable to market participants: the shareholders of the transmission owner indirectly own the transmission owner's marketing affiliates. The July 17 Order nowhere explains why those public utilities can continue to have governing boards that represent the interests of those that profit from the electricity marketplace, but the non-profit ISO cannot have a governing board that is appointed by State officers. Further, the July 17 Order does not explain why the "death penalty" that it ordains for the current ISO Board of Governors and the substitution of the Commission's brand of "independence" is necessary to ensure nondiscriminatory transmission access. Indeed, there is simply no basis for the Commission's implicit conclusion that it cannot ensure non-discriminatory treatment of transmission customers and wholesale purchasers in California the same way that it does so in the rest of the country: by ruling on filings proposed by jurisdictional entities to change their tariffs and, where necessary, requiring the cessation of unduly discriminatory or preferential actions that are brought to its attention by complaint or its own investigation.

Notwithstanding the patent lack of legal authority and record support for its actions, the Commission has directed the ISO to modify its governance structure in a way that is manifestly contrary to the requirements of state law. The Commission must reconsider and reverse that decision. In the interim, the ISO,

as a nonprofit public benefit corporation organized pursuant to California law, is obligated to comply with the provisions of California law that authorize its existence and determine its structure. The July 17 Order thus places the ISO in the untenable position of being required it to take actions that would expose its directors and officers to the risk of liability under California law and would, if nevertheless implemented, potentially render its actions *ultra vires*. Indeed, the Attorney General of California has informed the ISO that "any action by the ISO in seeking to comply with the Commission's July 17, 2002, Order would be in conflict with state law," and that he "will enforce California law on this issue and will take whatever legal action is necessary to do so." *See* Letter from Bill Lockyer, Attorney General, State of California to Terry Winter, August 6, 2002, attached as Exhibit 1. The ISO simply cannot take actions that are expressly prohibited by state law.

The ISO accordingly asks the Commission to vacate its orders and, instead, to enter into negotiations with the State of California to devise a mutually acceptable governance structure for the ISO. Further, the ISO asks the Commission to stay the July 17 Order until that order is reconsidered on rehearing and, if necessary, the authority of the Commission to impose those requirements is considered on judicial review. The ISO requests that the Commission grant the stay request prior to August 15, 2002, *i.e.*, the date by which the ISO is required to file with the Commission a document that lists the membership classes and stakeholders within each class for purposes of forming a Board Selection Committee.

II. REQUEST FOR REHEARING

A. BACKGROUND

In 1996, in order to serve the interests of the people of California by facilitating the provision of reliable electric service, the California legislature enacted legislation to restructure California's electricity markets. Among other initiatives, the legislation directed the newly-created Electricity Oversight Board ("EOB"), a California state agency, to incorporate the ISO as a California nonprofit public benefit corporation, organized pursuant to the Nonprofit Public Benefit Corporation Law for the charitable purposes set forth in Chapter 2.3, Part 1, Division 1 of the Public Utilities Code of the State of California, specifically to ensure efficient use and reliable operation of the electric transmission grid in the State of California. *See* Cal. Pub. Util. Code § 300, *et seq.* (West Supp. 1998); CPUC Decision No. 95-12-063 (Dec. 20, 1995), as modified by Decision No. 96-01-009 (1996), 166 PUR4th 1 (1996).

A state corporation, the ISO is also a "public utility" as that term is defined in Section 201 of the Federal Power Act ("FPA"), 16 U.S.C. § 824(e) (2000). The Commission approved the establishment of the ISO in two orders issued in late 1996 and authorized the ISO to begin operations in an order issued on October 30, 1997. *San Diego Gas & Electric Co.*, 77 FERC ¶ 61,204 (1996); *Pacific Gas and Electric Co.*, 77 FERC ¶ 61,295 (1996); *Pacific Gas & Electric Co.*, 81 FERC ¶ 61,122 (1997).

The initial filings regarding the ISO, consistent with the legislation creating the ISO, proposed that the ISO Board comprise representatives from various classes of stakeholders. ISO Board members were required to be residents of

California. The EOB was delegated a number of functions, including (1) establishing composition, nominating procedures and qualifications for the ISO Board, as well as selecting the initial members and confirming subsequent stakeholder selections; and (2) serving as a permanent appeal board for ISO Board decisions.

Although the Commission granted limited authorization for the EOB functions under the state legislation during the initial phases start-up, it concluded that the continuing functions of the EOB would conflict with the Commission's statutory duties under the Federal Power Act and could not remain a part of the final ISO governance structure. The Commission otherwise accepted the proposed governance structure except for the California residency requirement.

The ISO and the EOB sought judicial review of the Commission's rejection of the residency requirement and the EOB's continuing functions, but continued to work with the Commission to forge a structure acceptable to both the State and the Commission. Eventually, legislation was introduced in the California Senate (SB 96), modifying the ISO's governance structure. Rather than giving the EOB confirmation power over all members of the ISO Board, SB 96 afforded the EOB confirmation rights over only a limited number of members representing primarily end-users and applied a modified residency requirement to only those members. In addition, the structural composition of the ISO Board would be modified as soon as another state were to participate in the ISO. SB 96 provided that California could change the ISO Board into a non-stakeholder board, subject

to filing revised bylaws with the Commission. SB 96 also limited the function of the EOB as an appeal board to ISO decisions regarding certain matters within the jurisdiction of the state.

Subsequently, the EOB filed a petition for a declaratory order requesting that the Commission declare that SB 96 would resolve its concerns about the ISO's governance structure. In *California Electricity Oversight Board,* 88 FERC ¶ 61,172, *reh'g denied* 89 FERC ¶ 61,134 (1999), the Commission accepted the EOB's limited interim appointment function and limited appellate review rights set forth in SB 96. The ISO filed conforming amendments to its bylaws, which the Commission accepted on May 12, 2000. *California Electricity Oversight Board,* 91 FERC ¶ 61,124 (2000).

By fall 2000, however, it became apparent that the existing governance structure of the stakeholder-based ISO Board could not effectively address the developing electricity crisis in California. Accordingly, when the Commission in a November 1, 2000, order proposing remedies to address "dysfunctions" in the California wholesale bulk power markets, proposed that the ISO Board be replaced with a non-stakeholder board, *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,121 (2000), *order on reh'g*, 97 FERC ¶ 61,275 (2001); appeal *filed sub. Nom. California ex rel. Lockyer*, 9th Cir. No. 01-71944 (2001), *reh'g denied,* 99 FERC ¶ 61,160 (2002) ("November 1 Order"), neither the EOB, on behalf of the state, nor the ISO objected to the disbandment of the stakeholder board in their filed comments.

Although the Commission did not find or intimate that the problems of the stakeholder board were based on the involvement of State agencies in the selection of its members, it did not propose a role for the State in the selection of the new ISO Board. The ISO did not endorse the Commission's proposal regarding the structure of the new Board; rather the ISO requested additional time so that a mutually acceptable replacement would be developed. The EOB recommended that the new ISO Board be appointed by the Governor.

On December 15, 2000, the Commission rejected both the ISO's and the EOB's recommendations, and adopted a modified version of its proposal to replace the ISO's Board that ignored the Board replacement provisions of the ISO's bylaws and severely limited the State's role in governing the corporation it had created to ensure that electricity restructuring serves the interests of consumers. *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,294 (2000), *order on reh'g*, 97 FERC ¶ 61,275 (2001), *appeal filed sub. nom. California ex rel. Lockyer*, 9th Cir. No. 01-71944 (2001), *reh'g denied*, 99 FERC ¶ 61,160 (2002) (December 15 Order). The Commission ordered that the ISO replace its Board of Governors with a non-stakeholder Board, with members to be independent of all market participants. *Id.* at 62,013. In addition, the December 15 Order ordered the then-existing Board of Governors to turn over decision making power and operating control to ISO Management by January 29, 2001. *Id.* at 62,013-14. The Commission further found that the ISO corporate bylaws that were inconsistent with the December 15 Order would become null and void as of January 29, 2001 (without explaining the state law mechanism through which

such finding would be carried out). *Id.* at 62,014. The Commission called for further discussions with California representatives regarding how the replacement board would be selected, but effectively precluded appointment or confirmation of ISO Board members by the State. *Id.* at 62,013.

On January 18, 2001, AB 5X went into effect, directing the replacement of the then-sitting Board of Governors with a five-member, independent, non-stakeholder Board to be appointed by the Governor, subject to confirmation by the EOB. The new Board was confirmed on January 23, 2001 and assumed its governing duties under state corporate law on January 25, 2001. On April 26, 2001, the ISO filed amended corporate bylaws reflecting the changes made to the governing structure of the ISO.

The July 17 Order rejected the bylaws filing and resolved complaints that asserted that the ISO's current bylaws were inconsistent with the December 15 Order. The July 17 Order found that the current Board was "not sufficiently independent" to operate the ISO transmission grid in a non-discriminatory manner, July 17 Order at P 49, and directed that the current Board be replaced with an "independent, non-stakeholder board" of nine members by January 1, 2003, *id.* at P 62. The Commission directed that a slate of possible candidates for the Board be identified by a consultant and that a new committee of stakeholders select the nine Board members from this slate. *Id.* at PP 62-63. It specifically excluded officers and representatives of the State of California from participating in that process (except in a purely advisory capacity). *Id.* at P 68. To effectuate

its order, the Commission ordered the ISO to take certain actions and submit certain documents by August 15, August 30, and September 13, 2002.[3]

B. SPECIFICATIONS OF ERROR

The ISO asserts the following errors in the July 17 Order:

1. The Commission's rejection, and proposed modification, of the ISO's governance structure is beyond the Commission's statutory authority;

2. The Commission's rejection, and proposed modification, of the ISO's governance structure is neither supported by substantial evidence nor a product of reasoned decision making;

3. The Commission's rejection, and proposed modification, of the ISO's governance structure is unlawful because the Commission did not conduct an evidentiary hearing;

4. The Commission's rejection, and proposed modification, of the ISO's governance structure is an excessive remedy for the perceived deficiencies and is therefore arbitrary and capricious; and

5. The July 17 Order is contrary to the public interest.

C. ARGUMENT

1. The Commission's Attempted Interference with California's Right to Determine the ISO's Governance Structure Is Beyond the Commission's Statutory Authority.

a. Governance of Entities Organized Under State Law Is Exclusively Within the Jurisdiction of the State

[3] Specifically, the Order would require the ISO to file a list of the six member-classes and the stakeholders within each class by August 15, 2002; a list of the names and affiliations of each of the six representatives from the six member-classes by August 30, 2002; and a document identifying the executive search firm that the Board Selection Committee has chosen by September 13, 2002. July 17 Order at PP 62-63.

The ISO was created by and under the laws of the State of California in order to serve the interests of the people of California by facilitating the provision of reliable electric service. *See* Cal. Pub. Util. Code § 300, *et seq.* Because state-chartered corporations such as the ISO exist only by virtue of the statutory authorization and only to serve their statutory purpose, the State has an overwhelming interest in ensuring the proper governance of such corporations (in fact, of *all* corporations organized under state law) and the exclusive right to do so.

Except as limited by Congress acting within its Constitutional bounds, states have plenary jurisdiction over corporations, such as the ISO, that are created by state law. The governance of even *private* corporations is a matter that is definitively entrusted to the states. As the Supreme Court has stated:

> Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.

Cort v. Ash, 422 U.S. 66 (1975). The Supreme Court has emphasized that "state law . . . is the font of corporate directors' powers." *Burks v. Lasker*, 441 U.S. 471, 478 (1979).

Here, the State's interest is even more compelling, when the corporation in question would not exist but for the State legislation, which establishes the corporation's *raison d'etre*: preserving and advancing the welfare of the citizens of the State. The State enacted the laws that directed the establishment of the ISO and determine its governance; accordingly, the State – and only the State –

has the authority to change those laws. Under such circumstances, the "internal workings" of the ISO must, of necessity, be exclusively within the State's jurisdiction.

b. The Commission's Attempt to Appropriate to Itself California's Authority over the ISO Exceeds the Commission's Statutory Authority

The Commission's attempt to usurp California's prerogatives with respect to the governance of a corporation organized and existing under the laws of the State of California is a groundless and unjustifiable overreaching of the Commission's authority under the Federal Power Act. As an administrative agency, the Commission "is entirely a creature of Congress and the determinative question is not what the [agency] thinks it should do but what Congress has said it can do." *Civil Aeronautics Board v. Delta Airlines, Inc.*, 367 U.S. 316, 322 (1961). The Court of Appeals recently admonished the Commission regarding this fundamental reality:

> FERC is a "creature of statute," having "no constitutional or common law existence or authority, but only those authorities conferred upon it by Congress." Thus, if there is no statute conferring authority, FERC has none.

Atlantic City Electric Co, 295 F.3d at 7 (D.C. Cir. 2002) (citations omitted).

Nonetheless, the Commission has attempted, unjustifiably and unlawfully, to wrest control of the ISO Board from the State. The Commission attempts to justify this trespass on California's authority by (1) mischaracterizing the ISO's governance structure as constituting a rule or practice affecting a jurisdictional rate or term of service over which the Commission has authority pursuant to Sections 205 and 206 of the FPA – and (2) noting that documents setting forth

the ISO's governance are on file with the Commission. In particular, the Commission notes that Section 206 of the FPA provides the Commission with authority to fix a just and reasonable rate (or a rule or practice affecting a rate) whenever it determines, after hearing, that an existing rate (or rule or practice affecting a rate) is unjust, unreasonable, unduly discriminatory or preferential. July 17 Order at P 70. The Commission concludes that the ISO's bylaws and governance provisions contained in them affect the rates, terms and conditions of jurisdictional services and, thus, are subject to Commission review pursuant to FPA Section 206. The Commission's new and expansive interpretation of its authority constitutes an unwarranted intrusion into the affairs of the State of California and flies in the face of logic and the plain language of the FPA. Accordingly, the Commission's decision cannot be sustained.

First, the ISO's governance structure does not constitute a practice or rule. Black's Law Dictionary (Sixth Edition) defines a practice as "[r]epeated or customary action; habitual performance; a succession of acts of similar kind; custom; usage." A rule is defined as a "prescribed guide for conduct or action, regulation or principle; . . . A principle or regulation set up by authority, prescribing or directing action or forbearance." Thus, a practice or rule pertains to conduct or action on the part of a particular entity. The inherent structure of an entity, including the governance structure, does not constitute a practice or rule because no action or conduct is involved.

Sections 205 and 206 of the FPA presume the pre-existence of a public utility that is filing rates, charges, and rules, regulations, and practices affecting

rates or charges with the Commission. The bylaws and governance structure of the public utility determine the fundamental nature of the public utility and the *manner* in which it takes action. In contrast, rules and practices are *actions* of the public utility, *i.e.*, matters *undertaken* by the public utility pursuant to its bylaws. A public utility necessarily has bylaws and a governance structure that satisfies applicable State law in place prior to filing rates and terms and conditions of service with the Commission. The bylaws of a public utility cannot be considered rules or practices of the public utility any more than the Constitution can be considered a statute enacted by Congress. Because the governance structure of the ISO does not constitute conduct or action, such governance structure is not subject to Commission modification under Section 206.

Second, even if the ISO's governance structure could be considered a rule or practice – which it certainly cannot – the Commission would have authority over that structure only if it affected rates and other terms of jurisdictional service. *NAACP v. FPC*, 425 U.S. 662, 671 (1976). Yet, it cannot be said that the ISO's corporate structure and bylaws, in and of themselves, affect a rate or term of service. It is only actions taken by the ISO that can affect a rate. It is these actions that the Commission can address under section 206. The mere existence of a board with a particular governance structure cannot, without corresponding action by that board, affect a rate. A tariff provision on file with the Commission and the practices of a public utility implementing that tariff provision have the same operative effect – and can equally be the subject of

remedial action by the Commission – whether the public utility is governed by a stakeholder board, a state-appointed board, or a stockholder-elected board. Accordingly, even if the governance structure were a rule or practice, the Commission does not regulate it because it does not affect a rate.[4]

Third, nothing in the FPA expressly specifies a particular corporate or governance structure for public utilities or even implicitly suggests that the Commission has the authority to order a particular corporate or governance structure.. Indeed, it defies imagination that Congress, by enacting the FPA, intended to subject the corporate structure and governance of all public utilities to federal control. To the limited extent that Congress deemed it necessary to regulate in any manner the corporate structure of public utilities, it did so explicitly. In the very statute that enacted Part II of the Federal Power Act, Congress gave significant authority to the Securities and Exchange Commission over the corporate structure of utilities that are part of certain holding companies. Public Utilities Holding Company Act, 49 Stat. 803 (1935), codified at 15 U.S.C.

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[4] *Central Iowa Power v. FERC*, 606 F.2d 1156 (D.C. Cir. 1979) is not to the contrary. In *Central Iowa,* the court upheld a Commission decision under Section 206 invalidating the criteria for full membership in the Mid-Continent Area Power Pool. In that case, the criteria restricting full membership (to utilities with interconnections to two or more other electric systems and with transmission facilities operated at 115 kV or higher) determined whether utilities could receive certain jurisdictional services that were available only to members of the pool. The criteria defining membership eligibility were therefore integral parts of the terms of jurisdictional service. By ruling on those criteria, the Commission was performing its normal function: determining whether the rates and other terms of jurisdictional service comply were just and reasonable and nondiscriminatory. The Commission's attempt to dictate the ISO's governance structure, in contrast, does not determine in any manner which market participants are eligible to receive service from the ISO or the terms of access to the ISO Controlled Grid. The structure and membership of the ISO Board of Governors simply do not affect the ability of transmission customers to receive service from the ISO on the basis of nondiscriminatory rates and other terms.

§ 79, *et seq.* Its refusal to give the Commission comparable authority over other public utilities refutes the Commission's assertion of such authority over the ISO.

Similarly, in Section 305 of the FPA, 16 U.S.C. § 825d, Congress gave the Commission very specific and limited authority over the affiliation of directors and officers of public utilities with certain other entities. Notably, there is no limitation in Section 305 on any affiliation of a public utility's director with a state officer or agency. The Commission's assertion of the power to determine the membership and structure of the ISO's Board of Governors plainly exceeds its authority under Section 305. Moreover, if Congress had intended to give the Commission authority over corporate governance that it purported to exercise in the July 17 Order, there would have been no need for the specification of the far more limited authority contained in Section 305. *See American Rivers v. FERC*, 187 F.3d 1007, 1019 (9th Cir. 1999) (statutes should not be construed to make surplusage of any provision); *see also Chotin Towing Corp. v. FPC,* 250 F.2d 394, 395 (D.C. Cir. 1957).

The Commission's historical practice and precedent recognize that Congress authorized the Commission to regulate the jurisdictional rates and terms and conditions of service of public utilities, and practices and rules that affect such rates and terms and conditions of service, not the governance structure of the public utilities. Prior to Order No. 888 the Commission had never attempted to interfere with the governance structure of a transmission owning public utility, despite the fact that the boards of most such public utilities are controlled by market participants (the shareholders that directly own the

transmission owner itself and indirectly own its marketing affiliates). The Commission has frequently been presented with actual discriminatory practices (as well as other types of unlawful activities) approved and undertaken by such public utilities – in contrast to the potential and hypothetical discrimination it postulates here. In those instances, the Commission has imposed penalties on public utilities or otherwise ordered public utilities to cease and desist any unlawful and unduly discriminatory conduct, but never has the Commission asserted the authority to remedy unlawful, unduly discriminatory or preferential practices by directing changes to the utilities' board structure. Rather the Commission, quite properly, has regulated only the actions undertaken by those public utilities.[5] Indeed, even after Order No. 888, the Commission has not attempted to regulate the governance structure of traditional public utilities.[6]

Only with regard to ISOs has the Commission attempted to dictate corporate structure by arbitrary edict, relying only on its perception of potential discrimination or, even more remotely, potential obstacles to its plans for promoting regionally-controlled open access non-discriminatory transmission. If the authority to specify the minutia of corporate structure is necessary for the achievement of the Commission's vision – and the ISO does not believe it is –

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5 See, e.g., *Aquila Power Corp. v. Entergy Services, Inc.*, 90 FERC ¶ 61,260 (2000); *Utah Assoc. Muni. Power Sys. V. Pacificorp*, 83 FERC ¶ 61,337 (1998); *Tejas Gas Pipeline Co.* 81 FERC ¶ 61,053 (1997); *Florida Muni. Power Agency v. Florida Power & Light Co.* 67 FERC ¶ 61,167 (1994), *order on reh'g* 74 FERC ¶ 61,006 (1996).

6 Even when faced with pervasive evidence of market manipulation and the exercise of market power by sellers of electricity in California, the Commission has not considered the implementation of new, "independent," governance structures for those corporations, but rather has focused on market mitigation and the potential revocation of market-based rate authority. *See, e.g., Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 98 FERC ¶ 61,165 (2002); *San Diego Gas & Electric Co.*, 96 FERC ¶ 61, 120 (2001); *San Diego Gas & Electric Co.*, 95 FERC ¶ 61,418 (2001).

then Congress must grant that authority. The Commission cannot appropriate such authority unto itself.

Congress has not done so. Although Section 202(a) of the FPA grants the Commission certain authority to encourage *voluntary* regional coordination, it does not grant the Commission the authority to dictate the governance structure of ISOs or other entities involved in regional coordination. Indeed, the *Atlantic City Electric Co.* court specifically noted that "section 202 [of the FPA] . . . has definitively been interpreted to make clear that Congress intended that coordination and interconnection arrangements be left to the 'voluntary' action of the utilities." 295 F.3d at 12. In this instance, the public utilities in California have "voluntarily" sought to undertake regional coordination through the ISO and its governance structure that is established pursuant to State law. Section 202(a) does not provide the Commission with substantive powers to compel any particular technique of regional coordination. *Id.*; *see also Duke Power Co. FPC,* 401 F.2d 930, 943 (D.C. Cir. 1968). It logically follows that the Commission cannot require entities performing a regional coordination function, *i.e.*, ISOs, to have a particular governance structure.

Finally, the mere fact that the ISO has filed its bylaws with the Commission does not provide the Commission with the authority that it otherwise lacks. The ISO cannot, by its actions, expand the authority of the Commission beyond that provided by statute. Moreover, at the time the ISO filed its bylaws, the Commission claimed authority under Section 203 of the FPA to review and modify the bylaws as a condition to approval of the investor-owned utilities'

transfer of operational control of their transmission facilities to the ISO. *See Pacific Gas & Elec. Co.,* 81 FERC ¶ 61,122 at 61,437 (1997). The United States Court of Appeals for the D.C. Circuit, however, has recently concluded that transfer of operational control does not require Commission approval under Section 203. *Atlantic City Electric Co*, 295 F.3d at 12 (D.C. Cir. 2002). Accordingly, the Commission may not construe actions taken in response to the Commission's asserted, but nonexistent, authority as voluntary submission to Commission jurisdiction.

2. The July 17 Order Is Not Supported by the Evidence, Is Arbitrary and Capricious, and Does Not Reflect Reasoned Decision Making.

a. The Evidence Does Not Support a Finding of a Discriminatory Practice that Affects Rates.

Even if the Commission's untenable claim of authority over the ISO's governance structure were sustainable, it would be the ISO's right to determine and file its bylaws under Section 205 of the FPA. *See, e.g., Atlantic City Electric Co.*, 295 F.3d at 10. The Commission could only modify that structure after a finding, supported by substantial evidence, that the bylaws were discriminatory or unjust or unreasonable and a finding that they affected rates. *See NAACP v. FPC,* 425 U.S. at 668. The Commission has made no such finding.

Under Section 205, the ISO has the right to file amended rates and practices at any time. As the Court of Appeals stated in *Atlantic City Electric Co.*:

> The Courts have repeatedly held that FERC has no power to force public utilities to file particular rates unless it first finds the existing filed rates unlawful. . . . Nor may FERC prohibit public utilities from filing changes in the first instance. Rather, this Court, among others, has stressed that *the power to initiate*

> *rate changes rests with the utility* and cannot be appropriated by FERC in the absence of a finding that the existing rate was unlawful.

295 F.3d at 10 (emphasis added). Thus, even if it had complied with all aspects of the Commission's December 15 Order, the ISO would retain the right to file revised bylaws, as it did on April 26, 2001.[7] Thus, in order to direct the modification of the ISO's governance structure as set forth in those revised bylaws – if it had the authority to do so – the Commission would have to find those bylaws to be discriminatory, unjust or unreasonable or to affect rates in a discriminatory, unjust, or unreasonable manner. The Commission's recitation of findings made in its November 1 and December 15 orders, July 17 order at PP 49, 58 - 60, cannot constitute findings in support of the modification of the ISO's governance structure.

Similarly, a determination of compliance or noncompliance with the "independence" requirements or Orders No. 888 and 2000, July 17 Order at PP 49, 56 – 57, cannot substitute for specific findings that the ISO's governance structure is unjust, unreasonable or unduly discriminatory or has resulted in unjust, unreasonable or unduly discriminatory rates. As the Court of Appeals noted in *Atlantic City Electric Co.*:

> No matter how "bedrock" the principle of ISO independence may be, Order No. 888 is merely a regulation. It cannot be the basis for denying [public utilities'] their rights provided by a statute enacted by both houses of Congress and signed into law by the president.

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[7] As noted above, State law has been amended since the filing of those bylaws. The ISO has approved bylaw amendments to reflect those statutory changes, but those amendments have not yet been approved by the EOB.

295 F.3d at 11. Regardless of whether the Commission can impose its version of "independence" as a prerequisite for designation as an ISO, the Commission has not required that all transmission providers be ISOs. Because, as noted above, FPA Section 202(a) provides that regional coordination should be left to the voluntary action of utilities, it follow that the ISO's regional coordination scheme cannot be unlawful under Section 206 simply because the Commission believes that a different arrangement might better achieve the purposes of Section 202(a). *See Central Iowa* at 12. *Cf. New England Power Company,* 52 FERC ¶ 61,090 at 61,336 (1990), *reh'g denied,* 54 FERC ¶ 61,055, *aff'd Town of Norwood v. FERC*, 962 F.2d 20 (D.C. Cir. 1992); *citing City of Bethany v. FERC,* 727 F.2d 1131, 1136 (D.C.Cir. 1984), *cert. denied,* 469 U.S. 917 (1984) (utility need establish that its proposed rate design is reasonable, not that it is superior to alternatives). To do so would undermine Congress' determination under Section 202(a) that regional coordination be voluntary.

Although the Commission reviews agreements and rates filed to implement the coordination, it does so under the standards of Section 205, *id.*, or 206. Neither section 203 nor Order No. 888 expands those standards. *Id.* at 11-12. The ISO's purported noncompliance with the "independence" standard of Order No. 888's voluntary "ISO principles" simply cannot substitute for findings that meet the statutory requirements set forth in Section 206.

Further, Section 206 does not permit the Commission to modify a jurisdictional rate, or practice affecting such a rate, because it is inefficient, because a "perception" of bias interferes with market reliability and efficiency,

because it impedes the development of a "well-functioning Western energy market,"[8] or because corporate leadership is "inexperienced." *See* July 17 Order at PP 49, 51 – 53, 60. The Commission is not charged with policing such matters. The purpose of the Commission's authority under Sections 205 and 206 is the protection of consumers from excessive rates and charges and from discriminatory rates. *See, e.g., Federal Power Commission v. Sierra Pacific Power Co.,* 350 U.S. 348 (1956); *Electrical Dist. No. 1 v. FERC,* 774 F.2d 490 (D.C. Cir. 1985); *City of Frankfort, Ind. v. FERC,* 678 F.2d 699 (7th Cir. 1982); *Borough of Ellwood City v. FERC,* 583 F.2d 642 (3rd Cir. 1978), *cert. denied* 440 U.S. 946 (1979); *Municipal Light Boards of Reading and Wakefield, Mass. v. FPC*, 450 F.2d 1341 (D.C. Cir. 1971). The necessary findings for action under Section 206 are thus clear: the jurisdictional rate or related practice must be discriminatory, unjust, or unreasonable. *Nothing else suffices.*

Neither can the Commission justify its actions because "[p]ervasive control over a public utility by the State conflicts with the Commission's exclusive jurisdiction over these matters and, in particular, the rates, terms, and conditions of transmission service in interstate commerce," July 17 Order at P 54; *see also* P 50. Not only is there no mention in Section 206 of state control over public utilities or conflicts with the Commission's jurisdiction, and not only are the

[8] Moreover, the Commission's allegation that continuation of the existing Board will hamper the ability of the ISO to implement the necessary market redesign lacks a factual foundation. The ISO has already established a team to implement the market redesign proposal ("MD02 proposal") approved by the Commission on July 17 in Docket No. ER02-1656, has retained outside consultants to assist in the MD02 implementation process and is diligently pursuing implementation of the various market reforms. On August 9, 2002 –almost one week prior to the date it was required to do so –the ISO issued a Request For Proposals for an independent entity to calculate reference prices in connection with the Automated Mitigation Procedures which the Commission approved in the July 17 Order.

Commission's regulations and jurisprudence completely devoid of any prohibition of state control over a public utility, but the FPA recognizes that it is entirely appropriate for state-owned or state-controlled entities to own and operate transmission facilities. Indeed, the FPA *exempts* those entities from FERC jurisdiction. 16 U.S.C. § 824(e). If complete state control is permitted, the less intrusive regime adopted in AB 5X is *a priori* lawful.

Indeed, the Commission's invocation of the statutory findings that would be necessary for the modification of the ISO's governance structure – if the Commission had the authority to do so – boils down to one sentence: "With regard to the composition of the current Board, the Commission concludes that the CAISO is not sufficiently independent to operate its interstate transmission facilities on a non-discriminatory basis." July 17 Order at P 49. The Commission's conclusion, however, is not only unsupported by substantial evidence, but it is unsupported by *any* evidence. Not only does the Commission not make any findings regarding any such evidence, but the record recited by the Commission is devoid of any.[9]

Rather, the evidence is quite to the contrary. The current Board has taken deliberate and responsible action to ensure the continued available of

[9] The Commission does note a Government Accounting Office Report indicating Generators' perceptions that that the California Department of Water Resources ("CDWR") receives special treatment, July 17 Order at ¶ 52, and finds that CDWR's participation in the markets could lead to such a perception, *id.* at ¶¶ 53,57. A perception does not, of course, equate to discrimination. The Commission also cites comments in an Audit Report prepared for the Commission that ISO officers view pressure to provide CDWR access to the control room and market information as evidence of lack of independence. *Id.* at n. 46. There is no suggestion, however, that such access led to a discriminatory effect on rates. Moreover, there is absolutely no evidence in the record that the ISO Board of Governors has interfered with the ISO's full compliance with the Commission's prior direct orders to ensure that no preference is afforded

nondiscriminatory transmission service in California. Under the current Board, the ISO proposed a market mitigation plan, most of which the Commission adopted in its April 26, 2001, and June 19, 2001, Orders. *See San Diego Gas & Elec. Co.,* 95 FERC ¶ 61,115 (2001); *San Diego Gas & Elec. Co.,* 95 FERC ¶ 61,418 (2001). That plan, together with actions by the State and others, successfully ameliorated the California energy crisis in 2001. More recently, the Board approved, and the ISO has submitted, a plan for the comprehensive redesign of the ISO's markets. Ironically, on the same day that the Commission concluded that the Board stood in the way of necessary market redesign, July 17 Order at P 51, the Commission adopted – as consistent with its goals – almost all of the proposals developed under the Board's tenure, *see generally California Ind. Sys. Oper. Corp.*, 100 FERC ¶ 61,060 (2002).

Most importantly, the Commission forgets that it is the Commission, not the ISO Board, that ultimately determines whether the rates and terms and conditions of service go into effect. If the Commission finds the Board's proposals or actions unjust, unreasonable, or unduly discriminatory, it may modify such proposals or order the ISO to cease and desist such actions. Under these circumstances, it should not matter to the Commission who ultimately is governing the ISO.

Finally, the Commission's conclusion that a Board that includes persons charged with representing the interests of end-users (but is *independent* of industry domination) must be modified runs counter to the Commission's

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CDWR's market activities or the ISO's submission of a detailed proposal for the comprehensive reform of the ISO's markets.

statutory mission. As discussed above, Congress established FERC to protect end-users from excessive and discriminatory rates. As Judge (now Justice) Scalia has stated, "[Section 206] must be read in light of the Federal Power Act's primary purpose of protecting the utility's customers." *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490 (D.C. Cir. 1985), *citing Town of Alexandria, Minn. v. FPC*, 555 F.2d 1020, 1028 & n. 42 (D.C.Cir.1977) (FPA's primary aim is the protection of consumers from excessive rates and charges). Because end-users are the ultimate beneficiaries of regulation under the FPA, it is not only permissible, but reasonable that the non-profit ISO be governed by a board that is structured to be responsive to the interests of consumers. In light of the total lack of evidence supporting the Commission's conclusion otherwise, the evidence to the contrary, and the fundamental inconsistency of the Commission's conclusion with the purpose of the FPA, that conclusion cannot stand.

b. Even if the Commission Had Jurisdiction Over the ISO's Governance Structure, the Commission Could Not Modify the ISO's Governance Structure Without a Hearing.

As the Commission notes, "FPA Section 206 provides the Commission with authority to fix a just and reasonable rate (or rule or practice affecting a rate) whenever it determines, *after hearing*, that an existing rate (or rule or practice affecting a rate) is unjust, unreasonable, unduly discriminatory, or preferential." July 17 Order at P 70. (emphasis added). The Commission, however, did not hold the required evidentiary hearing prior to issuing the July 17 Order.

The plain language of Section 206 requires that the Commission hold a hearing prior to determining that an existing rate, charge or practice is unjust,

unreasonable, or unduly discriminatory. The Commission, therefore, does not have the discretion to waive a hearing when it is acting pursuant to its authority under Section 206. Because the Commission did not hold an evidentiary hearing prior to issuing its Order, the Order is unlawful under Section 206.

Although several courts have suggested in *dicta* that a hearing would not be required under Section 206 where there are no material facts in dispute, *see, e.g., New York State Elec. & Gas Corp. v. FERC,* 712 F.2d 762, 769 (2d Cir. 1983)*; New York State Elec. & Gas Corp. v. FERC,* 638 F.2d 388, 399 (2d Cir. 1980), cert. denied 454 U.S. 821 (1981); *Public Serv. Co. of New Hampshire v. FERC,* 600 F.2d 944, 955 (D.C. Cir. 1979), the ISO is unaware of any case that has so held. *Cf. Georgia Power Co. v. FPC*, 373 F.2d 485 (5th Cir. 1967) (following determination after hearing that rate was unreasonable, Commission not required to hold *additional* hearing to establish new rate). None of the cases that the courts cite in support of these *dicta* involved an unambiguous statutory requirement for a hearing. In certain instances, the statute in question merely provided an "opportunity for a hearing." *See Citizens for Allegan County, Inc. v. FPC,* 414 F.2d 1125 (D.C. Cir.1969) (Section 203 of the FPA); *Independent Bankers Ass'n of Georgia v. Board of Governors of Federal Reserve System*, 516 F.2d 1206 (D.C. Cir. 1975) (Section 4(c)(8) of the Bank Holding Company Act of 1956).[10] In another instance, the statute was silent on the need for a hearing, as in the case of a Commission decision to reject a filing or complaint. *See*

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[10] The legislative history of Section 4(c)(8) indicates that Congress altered the statutory language from "due notice and hearing" to "due notice and opportunity for hearing" in order to establish that a hearing was not necessary in all instances. *Id.* at 214.

Municipal Light Boards of Reading and Wakefield, Mass. v. FPC, 450 F.2d 1341 (D.C. Cir. 1971).

It is a cardinal principle of statutory interpretation that the unambiguous language of a statute be given effect. *Chevron, U.S.A, Inc. v. Natural Resources Defense Council,* 467 U.S. 837 (1984). There is nothing ambiguous about the meaning of "after hearing," and *dicta* cannot outweigh this clear directive. The Commission's attempt to modify the ISO's governance structure without an evidentiary hearing is therefore impermissible.

Even if there were exceptions to the plain language of the statute, such an exception would certainly be inappropriate in this case. First, there are material facts at issue here. Most importantly, the Commission's central factual determination that the ISO Board is "not sufficiently independent to operate its interstate transmission facilities on a non-discriminatory basis" (July 17 Order at P 49) is strongly contested by several parties. *See, e.g.,* July 17 Order at PP 31, 40. As noted above, the Commission's assertion that the ISO Board has stood in the way of effective market mitigation and reform is not only debatable, but patently unfounded. Other contested issues of material fact include whether the continuation of the existing ISO Board will hamper the ability of the ISO to implement its market redesign proposal and whether the current Board presents a significant impediment to a well-functioning Western Energy market.

Moreover, a hearing is necessary because of the importance of the ISO governance issues. *See Municipal Light Boards of Reading and Wakefield, Mass. v. FPC*, 450 F.2d 1341, 1345 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 989

(1972) (even if no dispute concerning material facts, hearing necessary where there is "a need to ventilate the underlying facts to aid in policy determination"). The fundamentally conflicting views between state and federal jurisdiction reflected in the dispute, the precedential value of a Commission decision to exclude a state's participation in ensuring the reliability of the transmission system within its borders, and the potential for the Commission to disregard a state's interests in protecting its end-users from a repeat of the ravages inflicted upon consumers by electricity providers in 2000 and 2001, raise issues involving major, fundamental policy concerns that necessitate the public exposition of the evidentiary basis of Commission action. The Commission's decision to make judgments regarding the functioning of the ISO Board without a public evidentiary hearing on the issue was contrary to the public's interest in a full and fair consideration of this important issue.

c. The Commission's Remedy Is Excessive and Therefore Arbitrary and Capricious.

Finally, even if, despite the considerations noted above, the Commission had authority to modify the ISO's governance structure and had properly found that the ISO's governance structure had a discriminatory effect on rates, the decision to modify the governance structure would represent an excessive remedy, and thus be arbitrary and capricious. As discussed above, the Commission has throughout its history addressed discrimination by controlling the practices of public utilities, not by modifying their fundamental structure. Similar principles must be applied here.

The Supreme Court's decision in *NAACP v. FPC, supra,* is illustrative of the appropriate remedy to be imposed by the Commission when faced with a determination of discrimination. In that case, the Court also concluded that the Commission could not, based on its statutory criterion to act in the public interest, impose nondiscriminatory labor policies on public utilities. 425 U.S. at 669-70. The Court also concluded that the Commission could – indeed, must – disallow the inclusion in rates of costs to the extent that those costs arose from discriminatory employment practices, *e.g.*, duplicative labor costs or legal expenses. *Id.* at 665. Significantly, the Court did not suggest that the Commission could go further and impose nondiscriminatory labor policies based on a finding that employment discrimination could lead to unjust rates. In a footnote, the Court noted:

> The Federal Communications Commission has adopted regulations dealing with the employment practices of its regulatees. These regulations can be justified as necessary to enable the FCC to satisfy it obligation under the Communications Act of 1934 to ensure that its licensees' programming fairly reflects the tastes and viewpoints of minority groups. It has nowhere been argued that the Federal Power Commission needs similar regulations in order to promote energy production at reasonable prices.

Id. at 670 n.7 (citations omitted). Similarly, there is no basis to conclude that FERC needs to regulate the ISO's governance in order to ensure nondiscriminatory transmission access when it has less extreme measures – measures that will not intrude upon the fundamental right of a state to govern the corporations created under its laws – to accomplish that goal.

3. The July 17 Order Is Contrary to the Public Interest

The July 17 Order is contrary to the public interest because threatens the ability of the ISO to fulfill its statutory mandate – as well as to fulfill its responsibilities as a public utility. As discussed more fully in the Motion for Stay, the Commission's Order would place the ISO in an untenable position and expose its Board and management to the risk of enforcement action, including criminal prosecution. Because the ISO's governance structure is established under the Public Utilities Act, replacing a lawfully appointed Board of Governors with a new governing body selected through a process that is not sanctioned by that Act would constitute an obvious contradiction of the Act. Even criminal penalties are possible. Sections 2110 and 2111 of the California Public Utilities Code set forth criminal penalties applicable to any person that procures, aids, or abets the violation of the Public Utilities Act. Moreover, as discussed above, the Attorney General of California has pledged to enforce California law and take legal action. Such exposure cannot but interfere with the ability of the Board and management to devote their full attention to ensuring the reliability of the transmission grid and the efficiency and fairness of the markets in California.

In addition, any step to seat a governing body selected through a different process might not only be deemed a violation of State law, but might exceed the ISO's authority under its chartering legislation and internal corporate documents. Such action might lead to a situation in which the ISO were be powerless to take any action because it lacked a Board of Governors meeting the applicable State legal requirements.

The July 17 Order will inevitably impair the ISO's ability to enter into necessary business transactions, including those necessary to implement its market redesign program. The inability of the ISO to ignore the clear requirements of state law, notwithstanding the contrary directives of the July 17 Order, will undoubtedly raise questions regarding the legitimacy of the ISO authority to enter into contracts; yet the ISO's ability to do so is critical to its fulfillment of its responsibility to ensure the reliability of transmission service on the ISO Controlled Grid.

III. MOTION FOR STAY

The ISO's Request for Rehearing raises significant issues that must be addressed by the Commission. To the extent that the directives in the Commission's July 17 Order remain in effect during the pendency of the Commission's consideration of those issues, the ISO will be placed in an untenable position that will interfere with its ability to fulfill its responsibilities both under state law and as a public utility provider of transmission services. Accordingly, the ISO's moves the Commission to stay the July 17 Order until 60 days after an order on the merits of requests for rehearing.

A. STANDARD FOR STAY

In evaluating requests for a stay, the Commission applies the standard set forth in Section 705 of Title 5, U.S.C., formerly the Administrative Procedure Act. Under Section 705, an agency will grant a stay where "justice so requires." In applying that standard, the Commission will evaluate whether (1) the moving party will suffer irreparable injury absent a stay; (2) issuance of a stay would substantially harm other parties; and (3) issuance of a stay is in the public

interest. *City of Tacoma*, 85 FERC ¶ 61,130 (1998); *KansOk Partnership*, 73 FERC ¶ 61,293 (1995); *Commonwealth Gas Pipeline Corp.*, 29 FERC ¶ 61,054 (1984). All elements of this standard are easily satisfied in this instance.

B. A Stay Is Required to Avoid Irreparable Injury.

The July 17 Order places the ISO in "regulatory limbo," but a limbo with significant consequences. The Order requires the ISO to unseat and replace a Board of Governors selected in accordance with the specific requirements of California law, as set forth in AB 5X with a new governing body selected in complete disregard of those procedures and the ISO's own corporate bylaws. In fact, the only persons and entities excluded by the Commission from participating in the selection of the new governing body are the State officers and agencies that are charged with that responsibility under California law.

As discussed above, if the ISO were to comply with the Commission's Order, such action would create a clear conflict with corporate requirements and state law. As a state-chartered public benefit corporation, the ISO simply cannot act in a manner that contradicts state law. Replacing a lawfully appointed Board of Governors with a new governing body selected through a process that is not sanctioned by the ISO's chartering legislation would expose the ISO to enforcement actions against the ISO, its officers and its directors, including exposure to criminal prosecution under Sections 2210 and 2211 of the California Public Utilities Code. As previously noted, the Attorney General of California has stated that *any action* by the ISO to comply with the July 17 Order would violate state law, and has pledged to enforce California law and take legal action. This potential for enforcement action, in and of itself, is a sufficient basis for a finding

of irreparable injury. *See Union Pacific RR Co. v. City of Las Vegas*, 747 F. Supp. 1402 (D. Nev. 1989) (irreparable harm shown where party would be subject to enforcement action and fines or unwarranted interruptions of its business operations).

In truth, the ISO has no choice. The ISO derives its very existence from the same state law that, as amended by AB 5X and SB 47, defines the process through which its Board of Governors must be selected. Taking any step to seat a governing body selected through a different process would not only conflict with State law, subjecting the ISO, its directors and its officers to potential penalties, but might exceed the ISO's authority under its chartering legislation and, if implemented, lead to a situation in which the ISO might be powerless to take any action because it lacked a Board of Governors meeting the applicable State legal requirements. The ISO would plainly suffer irreparable injury by virtue of the fact that replacement of the ISO Board of Governors in compliance with the July 17 Order could effectively place the ISO in "suspended animation," powerless to act for want of a governance structure that meets the requirements of its corporate charter.

C. A Stay Will Not Harm Other Parties.

While the ISO will suffer severe and irreparable injury if a stay is denied, a stay will not harm other parties. The ISO has operated under its current governance structure for a year and a half. As previously noted, during that period, the ISO has proposed a market mitigation plan that was substantially accepted by the Commission, successfully implemented that plan, and, in concert with actions by the State and others, thereby ameliorated the crisis in the

California power markets. The ISO has also prepared and submitted a market redesign that, by the Commission's own admission, furthers the Commission's policy objectives. *See generally,* 100 FERC ¶ 60,060. The July 17 Order identifies no instance in which the current Board of Governors required the ISO to institute or perpetuate a practice that subjected market participants to discriminatory treatment in violation of a Commission order or unjust or unreasonable rates as a result of the ISO's governance structure. Although the Order notes findings in the Audit Report regarding CDWR's presence in the control room and access to information, July 17 Order at n. 46, neither the Audit Report nor the Commission identified and discriminatory impact therefrom. The only specific concern alluded to in the Order concerned the potential for discrimination from fact that CDWR is an active power purchaser to meet the needs of California end-users, July 17 Order at PP 53,57, but the Order fails to note that once the Commission specifically directed the ISO to deny CDWR any special access to information, notwithstanding CDWR's unique role in responding to the Commission's directives, the Board of Governors supported the ISO's compliance with that directive. There simply is no evidentiary basis for a finding that a stay will harm other parties.

In addition, there is no reason to believe that any party that believed it was injured could not seek appropriate remedies through Commission action. A stay would not deprive parties of their rights, under Section 206, to bring a complaint if they believed that they were suffering from undue discrimination, and it would not affect the Commission's right to direct the ISO to take remedial action. Indeed,

the ISO has consistently acted in good faith to implement all Commission orders regarding the terms and conditions of transmission under the ISO Tariff and the ISO compliance with those terms and conditions.

D. The Public Interest Supports the Issuance of a Stay.

As discussed above, it is in the public interest to avoid the unnecessary disruption of the ISO governance. If the July 17 Order is not stayed, the "regulatory limbo" it creates will inevitably impair the ISO's ability to enter into necessary business transactions, including those necessary to implement its market redesign program. The inability of the ISO to ignore the clear requirements of state law, notwithstanding the contrary directives of the July 17 Order, will undoubtedly raise questions regarding the legitimacy of the ISO's authority to enter into contracts; yet the ISO's ability to do so is critical to its fulfillment of its responsibility to ensure the reliability of transmission service on the ISO Controlled Grid. The Commission has previously found that the public interest supports a stay where, in the absence of a stay, a party would be placed in "regulatory limbo" due to conflicting obligations under state and federal laws. *KansOk Partnership*, 73 FERC ¶ 61,293 (1995).

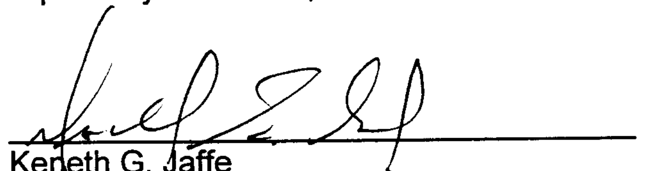
The need for certainty regarding the ISO's authority is particularly keen at this moment. As previously noted, also on July 17, 2002, the Commission approved, with modification, the ISO's proposed market redesign. 100 FERC ¶ 61,060. Indeed, the Commission cited the need to move forward with market redesign as a reason for its Order on Governance. If the July 17 Order is not stayed, the ability of the ISO to move forward aggressively with the redesign of its markets will be severely hampered. In order to implement its market redesign,

the ISO will presently need to enter contracts for software design and development and related services. Uncertainty regarding the ISO's authority can only undermine the ISO's efforts to move forward on this and other critical matters. Denial of a stay will inevitably create a situation in which the ISO is hamstrung by conflicting state and federal requirements for its basic governance structure and the ISO therefore cannot build on the foundation of its proposed market redesign.

IV. CONCLUSION

For the reasons discussed above, the ISO asks the Commission to vacate its orders and, instead, to enter into negotiations with the State of California to devise a mutually acceptable governance structure. Further, the ISO asks the Commission to stay the July 17 Order until that order is reconsidered on rehearing and, if necessary, the authority of the Commission to impose those requirements is considered on judicial review.

Respectfully submitted,



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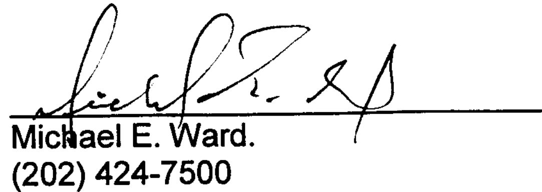
CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, DC this 13th Day of August, 2002.



Michael E. Ward.
(202) 424-7500

Exhibit 1

STATE OF CALIFORNIA

OFFICE OF THE ATTORNEY GENERAL

BILL LOCKYER
ATTORNEY GENERAL

August 6, 2002

Terry Winter, President
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, California 95630

Re: Order Concerning Governance of the California Independent System Operator Corporation, issued July 17, 2002, by the Federal Energy Regulatory Commission

Dear Mr. Winter:

My office has been provided a copy of an Order Concerning Governance of the California Independent System Operator Corporation ("ISO"), issued July 17, 2002, by the Federal Energy Regulatory Commission ("FERC"). By this Order, FERC has directed the ISO, following procedures set forth in the Order, to amend its bylaws to adopt a two-tier form of governance by January 1, 2003. Although FERC does not acknowledge in its Order that the ISO's current governance structure is mandated by California law, that is, in fact, the case. As a consequence, the ISO cannot comply with FERC's Order without violating California law. As the Attorney General, it is my duty to ensure that non-profit public benefit corporations such as the ISO comply with California corporate law requirements. I am, therefore, advising the ISO that, should the ISO comply with FERC's Order, I will act to uphold and enforce the existing provisions of California state law relating to the ISO's governance.

As you are aware, the ISO is a non-profit public benefit corporation, registered with the Attorney General pursuant to the provisions of California Government Code Section 12584. As a non-profit public benefit corporation, the ISO is subject to oversight by the Attorney General, whose oversight powers and duties, in addition to other existing powers, are set forth in California Government Code sections 12591 and 12598 and the Nonprofit Public Benefit Corporation Law, California Corporations Code sections 5110 through 6910. Indeed, the primary responsibility for supervising corporations such as the ISO and ensuring compliance with articles of incorporation and with provisions of state law resides in the Attorney General.

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The Attorney General has broad powers under common law and California statutory law to carry out his enforcement responsibilities. (Gov. Code, § 12598.) The Attorney General's authority extends to requiring non-profit public benefit corporations to file written reports concerning maintenance and supervision of assets, investigating transactions and relationships for the purpose of ascertaining whether the purpose of the corporation is being carried out, and, importantly, to secure compliance with California law.

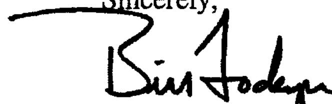
On January 18, 2001, the Governor signed into law the bill known as AB5X, passed by the California State Legislature to amend section 337 of the Public Utilities Code. Pursuant to amended section 337, the previously-existing ISO board was replaced with a five-member, non-stakeholder board which was appointed by the Governor and confirmed by the Electricity Oversight Board. The Governor appointed five members to the ISO board who were confirmed by the Electricity Oversight Board on January 23, 2001. The provisions of Public Utilities Code section 337 were amended in October 2001, in SB47, creating staggered three year terms with the directors appointed by the Governor and approved by the Senate. No further amendments have occurred.

As stated above, the ISO is a California non-profit public benefit corporation, organized under California state law. California law requires the ISO to have a governance structure of the type currently memorialized in the ISO's bylaws. The ISO cannot amend its bylaws in the way dictated by FERC without directly violating California law. In effect, FERC has ordered the ISO to either violate California law or change California law. The ISO may not do the former and cannot do the latter. Moreover, as with any corporation organized under state law, no outside party has the right to dictate either the process for selection of a board of directors or its composition. What FERC suggests would be equivalent to telling other corporate entities such as PG&E or any of the sellers (such as Mirant who lodged the complaint at FERC) who should be on their boards of directors. FERC's Order, therefore, exceeds any possible jurisdiction FERC has under the Federal Power Act. Simply put, there is no legal authority permitting FERC to dictate the governance of a corporation organized under state law — either by way of ordering the corporate entity to effectively contravene existing law or by ordering a state legislature to enact legislation.

It has been noted that the Commission has directed the ISO to file a document listing the six member-classes and the stakeholders within each class by August 15, 2002, with further lists to be submitted by August 30, 2002. Afterward, the ISO has been directed to hire a search firm and, by September 13, 2002, to file the name of the firm with FERC. Under the FERC's order, eight to nine board members are to be selected and FERC has dictated the length of their terms as well as other processes such as removal.

In my regulatory capacity over non-profit, public benefit corporations, as set forth in both common law and under the California Government Code, it is my duty to caution that any action by the ISO in seeking to comply with the Commission's July 17, 2002, Order would be in conflict with state law, namely Public Utilities Code section 337. As Attorney General, I will enforce California law on this issue and will take whatever legal action is necessary to do so. Lawful implementation of FERC's directives by the ISO would require the enactment of new law by the California legislature. Unless and until that occurs, the ISO will be placed in the position of violating existing California law if it seeks to initiate a new board selection process or replace the existing ISO board. The ISO is urged to seek the advice of its counsel in this matter, keeping in mind my resolve to uphold and enforce California law by all available legal means.

Sincerely,



BILL LOCKYER
Attorney General

cc: Barry Goode, Secretary of Legal Affairs
Dennis Lane, FERC Solicitor
ISO Board of Directors