

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System Operator Corporation)	Docket No. ER03-218-000
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California Independent System Operator Corporation)	Docket No. ER03-219-000
)	
)	(not consolidated)

**REQUEST FOR REHEARING OF THE CALIFORNIA INDEPENDENT
SYSTEM OPERATOR CORPORATION**

Pursuant to Rules 713 and 212 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.713 and 385.212 (2002), the California Independent System Operator Corporation (“ISO”) hereby requests rehearing of portions of Paragraph 38 of the Commission’s January 24, 2003 order in this proceeding.¹

I. SPECIFICATION OF ERROR

The Commission has erred in requiring a change to Section 3.4.1 of the amended Transmission Control Agreement (“TCA”)² to require that any notice of withdrawal of a Participating Transmission Owner (“Participating TO”) from the ISO must be filed with the Commission, and must be approved by the Commission before becoming effective. January 24 Order at P 38.

¹ *California Independent System Operator Corporation*, 102 FERC ¶ 61,061 (2003) (“January 24 Order”).

² The TCA is the agreement among the ISO and Participating TOs that establishes the terms and conditions under which Transmission Owners place certain transmission facilities and Entitlements under the ISO’s Operational Control, thereby becoming Participating TOs. The TCA describes how the ISO and each Participating TO will discharge its respective duties and responsibilities with respect to the operation of those facilities and Entitlements. Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

II. BACKGROUND

On November 25, 2002, the ISO filed, in Docket No. ER03-219-000, an amended TCA executed by Pacific Gas and Electric Company (“PG&E”), San Diego Gas & Electric Company (“SDG&E”), Southern California Edison Company (“SCE”), and the City of Vernon (“Vernon”) (the existing Participating TOs), and the Cities of Anaheim, Azusa, Banning, and Riverside, California (together, “Southern Cities”). The purpose of the amendment to the TCA was: (1) to clarify, amend, and supplement various provisions of the current TCA in response to issues raised by the Southern Cities in their application process to become Participating TOs, (2) to identify the transmission interests that Southern Cities would be turning over to the ISO’s Operational Control, and (3) to make certain other changes to the TCA proposed by the ISO and the existing Participating TOs.

In connection with the amended TCA, the ISO also filed on November 25, 2002, in Docket No. ER03-218-000, Amendment No. 47 to the ISO Tariff, which proposed to modify the Tariff to be consistent with the provisions of the TCA that were being amended to accommodate the Southern Cities becoming Participating TOs. The process of becoming a Participating TO includes signing the TCA and turning over Operational Control of transmission facilities and Entitlements to the ISO. The Southern Cities requested several changes to the TCA prior to signing it, which necessitated minor changes to the ISO Tariff. Amendment 47 reflects the necessary Tariff revisions.

One of the changes requested by the Southern Cities was to add a provision to the TCA that would allow a Participating TO with tax-exempt financing (“Tax Exempt Participating TO”) to withdraw from the TCA when threatened with an Actual or

Impending Adverse Tax Action, as those terms are used in the TCA. This is an issue of great importance to the Southern Cities, because many of their Entitlements are financed by tax-exempt bonds, and any threat to the tax-exempt status of those bonds would be sufficient to cause them to forgo joining the ISO.³ For this reason, the ISO, the existing Participating TOs, and the Southern Cities negotiated for some time to craft language ensuring the Southern Cities could withdraw from the ISO in the face of an Actual or Impending Adverse Tax Action related to the tax-exempt bonds used to finance the acquisition of their transmission Entitlements.

In addition to the amended TCA and the companion ISO Tariff amendment, the ISO filed, on December 2, 2002, in Docket No. EC03-27-000, an application to assume Operational Control of the facilities and Entitlements being turned over by the Southern Cities. The Commission issued an order on January 24, 2003, authorizing the transfer effective January 1, 2003. *California Independent System Operator Corp.*, 102 FERC ¶ 61,058 (2003).

In the January 24 Order, the Commission ordered a change to § 3.4.1 of the amended TCA to require that any notice of withdrawal of a Participating TO from the ISO must be filed with the Commission, and must be approved by the Commission before becoming effective. January 24 Order at P 38.

³ In fact, the high level of significance of this issue to the Southern Cities is evidenced by their Petition for A Declaratory Order filed on October 4, 2002. This Petition, assigned to Docket No. EL03-7, requested that the Commission issue a Declaratory Order “affirming, under applicable federal law, the propriety of a withdrawal provision in the [TCA]” designed to protect the Southern Cities in light of their tax-exempt financing. Petition at 1. In the Petition, the Southern Cities explained that “inclusion of the withdrawal provision in the TCA is a threshold requirement with respect to the Southern Cities’ participation in the ISO.” *Id.* at 1-2. The Southern Cities withdrew their Petition on December 2, 2002, because the existing Participating TOs and the ISO had agreed on an appropriate withdrawal provision, *i.e.*, that provided in TCA § 3.4.1. In their Notice of Withdrawal, Southern Cities noted that “[a]pproval by the Commission of the tax withdrawal provisions of the TCA in Docket No. ER03-219-000 will resolve the concerns that prompted the Southern Cities’ Petition in this docket.” Notice of Withdrawal at 2.

III. ARGUMENT

A. Public Policy Dictates that Commission Approval Not Be Required

The Commission should not require Tax Exempt Participating TOs to remain in the ISO in the face of an Actual or Impending Adverse Tax Action until the Commission approves the Tax Exempt Participating TO's withdrawal. Such an outcome is antithetical to the oft-repeated goals of the Commission to encourage entities to participate in regional transmission organizations ("RTOs") and independent system operators. Requiring such approval will jeopardize the continued participation of the Southern Cities, and will discourage other entities that have tax-exempt financed transmission projects from becoming Participating TOs in the future or joining RTOs.

1. Commission Encouragement of RTO Membership

As is well documented in the Southern Cities' February 6, 2003 Request for Rehearing of the January 24 Order,⁴ the Commission has long encouraged RTO/independent system operator participation on a wide basis, with regard to both jurisdictional entities and non-jurisdictional entities. This is made clear starting in Order 888,⁵ when the Commission expressed enthusiasm for the development of, and

⁴ The City of Colton, California, which has not yet become a Participating TO but has contemplated such a move, joined the Cities of Anaheim, Azusa, Banning, and Riverside in the February 6 Request for Rehearing.

⁵ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12274 (March 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in part, remanded in part, Transmission Access Policy Study Group, et al. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom., New York v. FERC*, 122 S.Ct. 1012 (2002).

participation in, independent system operators. See, e.g., Order No. 888 at 31,652 and 31,655.⁶

Moreover, in Order No. 2000,⁷ the Commission reiterated and strengthened its encouragement of RTO membership. As pointed out by the Southern Cities in their Request for Rehearing, such Commission encouragement extended to the issue of participation in RTOs by entities with tax-exempt financing. See Southern Cities Request for Rehearing at 12, *citing* Order No. 2000 at 31,200-02.

The ISO shares the Commission's goals of encouraging New Participating TOs to join the ISO. For that reason, the ISO is anxious to make reasonable accommodations to potential New Participating TOs for amendments to the TCA that encourage greater participation in the ISO. The ISO views the language of TCA § 3.4.1 to be one such reasonable accommodation.

2. Special Concerns for Entities with Tax-Exempt Financing

Entities with tax-exempt financed transmission projects, such as the Southern Cities, have special concerns with ISO membership. Since it is unclear as to how the Internal Revenue Service ("IRS") may view participation by such entities in independent system operators in the future, they are taking a risk of a negative response in joining the ISO.⁸ Southern Cities made clear to the ISO and to the existing Participating TOs

⁶ That the Commission is not in favor of frequent filings to account for changes in agreements between entities is made clear by Order No. 2001 (*Revised Public Utility Filing Requirements*, 99 FERC ¶ 61,107 (2002)). While the ISO is aware that its TCA is not the type of agreement the Commission would have altered without a filing, it would be in the spirit of such initiatives as Order No. 2001 to allow parties to withdraw from the TCA upon certain strictly limited conditions, without the necessity of a filing with the Commission.

⁷ Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 810 (January 6, 2000), FERC Stats. & Regs. ¶ 31,092 (2000), petitions for review dismissed, *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

⁸ In that regard, the ISO notes that the Southern Cities' Request for Rehearing explains that the

that the risk of an adverse tax ruling was one they were not willing to take. As well-documented in their Request for Rehearing, the costs of “guessing wrong” are substantial, both to the Southern Cities themselves, as well as to the agency that provided the tax-exempt bonds on which their financing was based and to the other participants in the transmission project. See Southern Cities’ Request for Rehearing at 6-10.

Setting aside the issue of the Southern Cities’ expectations and requirements, removing the protections of TCA § 3.4.1 would have chilling effects on the participation of other entities with tax-exempt financed transmission projects. For example, the City of Colton, California, substantially similarly-situated to the Southern Cities, already has expressed its unwillingness to take any further steps to become a Participating TO in light of the Commission’s ruling on TCA § 3.4.1. It is not a great leap to consider the views of Colton to be representative of many if not all entities with tax-exempt financed transmission projects. Like the Southern Cities, they likely will consider the risks of an adverse tax action to outweigh the benefits of joining the ISO.

Of even greater importance, the Southern Cities are only some of the participants in the transmission projects turned over to ISO Operational Control. The projects were financed by the Southern California Public Power Authority (“SCPPA”). Thus, if the Commission’s approval of any withdrawal is required, and such decision is delayed and the bonds are no longer considered tax-exempt by the IRS, every participant in the bond financing is impacted. As an example, in addition to Anaheim and Riverside, the

opinion of the bond counsel for the entity that provided their tax-exempt financing that Southern Cities’ participation in the ISO would not adversely affect the tax-exempt nature of the bonds was contingent on the language in TCA § 3.4.1 being approved. Absent such language, the bond counsel would not have given its approval of the Southern Cities’ participation, and this participation would never have taken

Los Angeles Department of Water and Power (“LADWP”) is a participant in the SCPPA financed Southern Transmission System. Consequently, if the IRS determines that Anaheim’s and Riverside’s participation in the ISO jeopardizes the tax-exempt status of those bonds, and withdrawal from the ISO is not achieved in time, then LADWP also loses the benefit of the tax-exempt status of the bonds for this transmission project. This is an untenable position in which the ISO believes Southern Cities cannot be placed.

B. Commission Precedent Dictates that Entities be Permitted to Withdraw From Independent System Operators in Similar Circumstances

In a precisely on-point precedent, the Commission has allowed language in an operating agreement for another independent system operator that provides an avenue for withdrawal for participants in that independent system operator whose tax-exempt status is jeopardized. In *Central Hudson Gas & Electric Corporation, et al.*, 88 FERC ¶ 61,138 (1999) (“*Central Hudson*”), the member systems of the New York Independent System Operator (“NYISO”) proposed language to protect the Long Island Power Authority (“LIPA”) from any potential adverse effects joining the NYISO could have on its use of publicly financed tax-exempt bonds. The member systems proposed “that if LIPA’s tax-exempt status is jeopardized, LIPA will be able to withdraw from the ISO with 30 days notice.” 88 FERC at 61,403. The Commission accepted this proposal. There is no basis for any different result here.⁹

place. Southern Cities’ Request for Rehearing at 8.

⁹ If the Commission should find the language providing for 30 days notice before a withdrawal is effective to be an important element of the *Central Hudson* withdrawal provision, the ISO notes that Southern Cities have undertaken to provide as much notice as possible for any necessary withdrawal. See Southern Cities’ Request for Rehearing, n. 8. For its part, the ISO undertakes to provide notice of

The case cited by the Commission in support of its decision to require its approval before a Participating TO's withdrawal can become effective is both less on point and older than the *Central Hudson* order. In *Midwest Independent Transmission System Operator, Inc.*, 84 FERC ¶ 61,231 (1998) ("*Midwest ISO*"), where the Commission did require that a notice of withdrawal from the relevant agreement must be filed with the Commission, and was not effective until the Commission approved it, 84 FERC at 62,151, no question of the needs of entities with tax-exempt financing was presented. In addition, in that proceeding several parties objected to the provision allowing entities to withdraw without prior Commission approval.

In this case, of course, the ability to withdraw without Commission approval is strictly limited to the precise concern of Southern Cities: This right of withdrawal can *only* be exercised by a Tax Exempt Participating TO if faced with "an Impending Adverse Tax Action or an Actual Adverse Tax Action." TCA § 3.4.1. Moreover, the withdrawing entity must provide written notice of such withdrawal supported by either a copy of the entity's "nationally recognized bond counsel's opinion or an IRS determination" supporting the Participating TO's view that an Actual Adverse Tax Action is imminent or has occurred. TCA § 3.4.2.1.

As well, in this case, no party objected to the provision allowing for such withdrawal. Instead, the Commission has acted *sua sponte* to foreclose an avenue for withdrawal – an avenue that was carefully negotiated to cover only the minimum circumstances required by the Southern Cities' tax-exempt financed transmission

such an impending withdrawal to the Commission immediately upon receiving it from the withdrawing Participating TO.

projects. Clearly, in this case the Commission should follow its own example in *Central Hudson*, rather than being led astray by the different circumstances of *Midwest ISO*.¹⁰

**C. Long-Standing Provisions of the ISO Tariff Support
Accommodation of the Special Circumstances of Entities
with Tax-Exempt Financing**

The need to accommodate the special circumstances of entities with tax-exempt financed transmission projects has been a matter of concern and addressed in the ISO Tariff since the creation of the ISO. In fact, Section 2.1.3.1 of the ISO Tariff provides with respect to transmission facilities under ISO Operational Control: “Nothing in this ISO Tariff or the TCA shall compel (and the ISO is not authorized to request) any ... Tax Exempt Participating TO to violate: (1) restrictions applicable to facilities which are part of a system that was financed in whole or part with ... Tax Exempt Debt” The inclusion of TCA § 3.4.1 is directly responsive to that long-standing provision of the ISO Tariff and should be accepted by the Commission as consistent with that provision.

IV. REQUEST FOR EXPEDITED CONSIDERATION

The current posture of the Southern Cities’ participation in the ISO is no longer clear. While they have turned over Operational Control of their Entitlements effective January 1, 2003, and ISO customers have been able to utilize these Entitlements, a condition precedent for such turnover has not been met. The ISO does not agree with the Southern Cities that “there is no effective TCA in place,” Southern Cities’ Request

¹⁰ With regard to the issue of whether the Commission has the authority to require its approval before an entity may withdraw from an arrangement in which it has transferred operational control to another, such as joining an independent system operator, Southern Cities correctly point out that it is not necessary to address this issue here. Southern Cities’ Request for Rehearing at 16. Rather than a broad question of the Commission’s authority in such cases, what is presented here is a very narrow exception to a general requirement that Commission prior approval be secured before an entity may withdraw from the ISO. As the Commission demonstrated in *Central Hudson*, it is capable of making such exceptions.

for Rehearing at 17, but nonetheless acknowledges that the current posture is one of uncertainty. The Commission should act promptly to remove this uncertainty, which is harmful to the operation of the ISO Controlled Grid, detrimental to the Commission's and the ISO's mutual goal of encouraging ISO participation, and hazardous to the future of RTOs, by allowing the original language of § 3.4.1 to remain as agreed upon by the parties to the TCA.

V. CONCLUSION

For the reasons described above, the ISO respectfully requests that the Commission grant rehearing of the January 24 Order on an expedited basis to allow the original text of TCA Section 3.4.1 to remain as intended by the parties to the TCA, and remove the requirement that a withdrawal from the ISO based on an Impending or Actual Adverse Tax Action is not effective without Commission approval.

Respectfully submitted,

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Dated: February 20, 2003

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, DC, this 20th day of February, 2003.

/s/ Julia Moore

Julia Moore