

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

California Independent System
Operator Corporation

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Docket No. _____

PETITION FOR REVIEW OF ARBITRATOR'S AWARD

Pursuant to Rule 207 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.207, the California Independent System Operator Corporation ("ISO") petitions the Commission to initiate a proceeding for review of the Final Order and Award ("Award") issued on December 13, 2001, in American Arbitration Association Case No. 71 198 00711 00. Pacific Gas and Electric Company ("PG&E") initiated the arbitration under Section 13 of the ISO Tariff. The ISO is entitled to Commission review of the Award under Section 13.4 of the ISO Tariff. The ISO further petitions the Commission to establish a procedural schedule for such review. A copy of the Award is attached.

I. CONSIDERATIONS WARRANTING COMMISSION REVIEW

This Petition presents fundamental issues concerning the ability of a Control Area operator to fulfill its responsibility to maintain the reliability of the electric system within its Control Area¹ and the responsibility of the beneficiaries of that reliability to share the costs of its maintenance. At issue is whether the ISO may bill PG&E for

¹ Capitalized terms not otherwise defined herein have the meaning set forth in the ISO Tariff Master Definition Supplement, Appendix A.

Ancillary Services supporting Schedules that PG&E submits for facilities that are within the ISO Control Area but not a part of the ISO Controlled Grid.

Specifically, PG&E submits Schedules for the California-Oregon Transmission Project (“COTP”), which is owned primarily by various governmental entities, and for transmission facilities owned by the Sacramento Municipal Utility District and the Western Area Power Administration (the “Bubble”)². Because the governmental entities that own the COTP have not turned their transmission facilities over to the ISO’s operational control, the COTP is not part of the ISO Controlled Grid.

Nonetheless, the COTP is part of the Western Systems Coordinating Council (“WSCC”) Control Area for which the ISO is the Control Area operator. In order to operate a Control Area with “the highest practical degree of service reliability” the WSCC Minimum Operating Reliability Criteria (“MORC”) require (A) that a Control Area operator ensure the maintenance of sufficient Operating Reserves (which are Ancillary Services) for all firm Load in the Control Area; and (B) that a Control Area operator maintain generating capacity under automatic generation control (“AGC”) sufficient for the Control Area (i.e., Regulation, which is also an Ancillary Service). Section 2.3.1.3.1 of the ISO Tariff requires that the ISO operate the ISO Controlled Grid in accordance with criteria no less stringent than those of the WSCC.

The Arbitrator acknowledged that “[the ISO] is undoubtedly, indeed concededly, the Control Area operator for a Control Area that includes the ISO Controlled Grid as well as the COTP and Bubble facilities.” Award at 7. Nonetheless, he interpreted the Tariff as lacking the authority for the ISO to “impose charges on Scheduling

² For ease of reference the terms ‘COTP’ or ‘COTP transactions’ will also include reference to the Bubble transactions or facilities used for the Bubble transactions.

Coordinators for transactions that are within the Control Area but do not use the ISO Controlled Grid.” Award at 8. Such limitation on a Control Area operator’s authority to recover the costs of maintaining, reliability from those who benefit would have profound implications for the Commission’s efforts to ensure the availability of reliable nondiscriminatory transmission for the developing competitive electricity markets.

Over the past decade, the Commission has maintained a steady course toward increasing the reliability and availability of transmission through the encouragement initially of independent system operator corporations and now of regional transmission organizations (“RTOs”). In addition, in Order No. 888, the Commission established Control Area operators as the Ancillary Services providers of last resort in their Control Areas. There are, however, costs involved in ensuring the reliability of the transmission infrastructure. This proceeding involves the fundamental issue of cost responsibility when an independent system operator or RTO, with Control Area responsibilities, fulfills its Ancillary Services obligations with regard to Loads served by facilities that are not under its operational control, but are owned by municipal utilities. The Award would shift the costs of the benefits received by the municipal utilities to the transmission customers of the independent system operator or RTO. In such circumstances, municipal utilities, by remaining outside the independent system operator or RTO, escape responsibility for the cost of the reliability benefits provided by the Control Area operator. They would thus have no incentive to join the independent system operator or RTO. Indeed, they would have reason not to.

Further, ensuring that costs are fairly shared among beneficiaries is one of the Commission’s most fundamental responsibilities and the cost shift that would ensue

from the Award, if it is permitted to occur, should only follow full consideration of these issues by the Commission. The ISO believes such consideration will, in fact, compel reversal of the Award.

II. BACKGROUND

A. Factual Background

By arrangement with the ISO, PG&E submits the COTP Schedules to the ISO. The ISO assigned PG&E a Scheduling Coordinator ID for that purpose. Whether PG&E was operating as Scheduling Coordinator, as defined in the ISO Tariff, for the COTP Schedules was at dispute in the arbitration.

The ISO Tariff sets forth the ISO's rights, duties, and obligations, including its core responsibilities of ensuring the safety and reliability of the larger Control Area. In this regard, it has consistently been the ISO's position that the ISO is authorized under the ISO Tariff to procure such Ancillary Services as are necessary to operate the Control Area in a manner consistent with WSCC Minimum Operating Reliability Criteria ("MORC") and North American Electric Reliability Council reliability criteria. When a Scheduling Coordinator schedules Energy with the ISO, but does not, or can not, make provision for adequate self-provision of Ancillary Services, the ISO procures those services to the extent required to ensure reliability of the Control Area, and bills the responsible Scheduling Coordinator for the costs incurred in doing so.

The amount of costs at issue in this proceeding is undisputed. During the period from March 31, 1998, through April 30, 1999, the ISO incurred \$14,172,337.08 in Ancillary Services and other service costs in connection with COTP scheduling information submitted to it by PG&E. Of this amount, approximately \$11 million was

incurred by the ISO to procure Regulation and approximately \$3 million was incurred to procure Replacement Reserves. PG&E paid for these services before it disputed the charges and the ISO's authority to charge.

Thereafter, from May 1, 1999, through June 30, 2001, the ISO incurred \$40,376,867 in Ancillary Services and other service costs in connection with COTP Schedules submitted to it by PG&E. Of this amount, \$36,698,567 was incurred to procure Regulation to support the COTP Schedules. The costs incurred by the ISO represent actual, out-of-pocket costs. They do not include any "profit." These costs have been passed to the market pending resolution of the dispute raised by PG&E in April 1999.

B. Procedural Background

Following a protracted period of Good Faith Negotiations with the ISO, PG&E filed a Statement of Claim against the ISO under Section 13.2.2 of the Tariff in October 2000. Statements of Claim and Petitions to Intervene raising the same issues as the PG&E Statement of Claim were filed by the following entities: Modesto Irrigation District; Cities of Redding, and Santa Clara, CA; M-S-R Public Power Agency and the Transmission Agency of Northern California; Sacramento Municipal Utility District; and Turlock Irrigation District. The Northern California Power Agency filed a Petition to Intervene but not a Statement of Claim. On November 22, 2000, the ISO filed a Response to Claim and Counterclaim.

In its Statement of Claim, PG&E sought reimbursement from the ISO for the amounts it claims it paid to the ISO by mistake (or through deception) during the period between April 1998 and April 1999. In its Response to Claim and Counterclaim, the

ISO denied that PG&E was entitled to reimbursement of the Ancillary Service costs PG&E had paid to the ISO during the period between April 1998 and April 1999, and it sought recovery from PG&E for the Ancillary Service costs incurred by the ISO since May 1, 1999, plus interest. In addition, the ISO sought a declaration that PG&E is required to continue to pay for costs incurred by the ISO to support COTP Schedules and to continue to act as the COTP Scheduling Coordinator.

On August 2, 2001, PG&E and the Intervenors filed a “Motion for Summary Judgment” (“Motion”) seeking summary disposition of their claim(s) and of the ISO’s counterclaim based on their contention that the ISO lacks the authority under its Tariff to assess Ancillary Services costs attributable to transactions off the ISO Controlled Grid. In addition, PG&E denied that it ever agreed to pay any charges related to COTP schedules. The ISO’s Opposition to the Motion contended that both disputed factual and legal issues precluded granting of the Motion. After a full hearing on September 5, 2001, the Arbitrator denied the Motion on September 14, 2001, ruling that the Tariff standard applicable to such motions had not been satisfied. However, the Arbitrator also ruled that the evidentiary hearing would be phased, pursuant to Rule 32(b) of the American Arbitration Association Rules. In the first phase, evidence would be heard on the decisional significance of the ISO’s statements accompanying its filing at FERC of Amendment No. 2 (FERC Docket Nos. EC96-19-015 and ER96-1663-016) and of FERC’s ruling on that filing, apparently in light of those statements, 82 FERC ¶ 61,213 (1998). The denial of the Motion was without prejudice to its renewal at the end of this first phase of the hearing. If not renewed or if made and denied, the second hearing phase would cover the remainder of the parties’ presentations.

Pursuant to Pre-Hearing Order No. 5 and Section 13.3.6 of the ISO Tariff, PG&E and the Intervenors brought an oral motion for Summary Disposition at the conclusion of the first phase of the arbitration hearing that commenced on October 1, 2001. The Arbitrator denied that motion on October 2, 2001. Thereafter, the arbitration hearing continued to the second hearing phase for five days of additional testimony and evidence, and concluded on October 10, 2001. Following the hearing, the parties filed initial and reply briefs.

C. Arbitration Decision

The Arbitrator issued his Award on December 13, 2001. The Award granted PG&E's claim (with the claims of the other parties subsumed in this Award) and denied the ISO's counterclaim in its entirety. Specifically, the Arbitrator concluded that Tariff provisions defining the ISO's authority to charge for Ancillary Services did not extend that authority to the Control Area, but confined it to the ISO Controlled Grid, which does not include the COTP facilities. The Arbitrator stated that this conclusion was reinforced by the history of Amendment No. 2 to the Tariff, filed on February 25, 1998. The Arbitrator also concluded that PG&E had not, in pre-startup discussions, agreed to assume the obligations of a Tariff-defined Scheduling Coordinator for the COTP schedules.

The Arbitrator concluded that, absent Tariff authority to charge PG&E for COTP-related Ancillary Services, Commission precedent did not provide an alternative basis for the ISO to recover its variable costs. The Arbitrator also concluded that PG&E's claim was contestable and not time barred because PG&E was not deficient in failing to learn of the disputed charges before April 1999. Finally, the Arbitrator concluded, based

on the principles of fairness and equity that PG&E should not be made to bear the costs of the ISO's exercise of its discretion as Control Area operator regarding the Ancillary Services required to satisfy the applicable reliability standards (although he did conclude that it would not be unreasonable to require all the participants in the market to bear those costs).

III. STATEMENT OF ERRORS

Section 13.4.1 of the ISO Tariff authorizes an appeal of an arbitration award to the Commission on the basis that the award is contrary to or beyond the scope of relevant ISO documents, Federal law, Commission regulations or decisions, or state law. The ISO submits that this appeal meets these criteria in the following regards:

1. The Arbitrator erred in concluding that the references in the ISO Tariff to the ISO Controlled Grid, rather than to the Control Area, limit the ISO's ability to recover from PG&E the costs of Ancillary Services procured in connection with Schedules on facilities that are within the Control Area but are not part of the ISO Controlled Grid. This conclusion is contrary to the ISO's responsibilities and authority set forth in Sections 2.3.1.1.1, 2.5.1, 2.5.2.1, 2.5.2.2, and 2.5.3.1 of the ISO Tariff, among others. These provisions direct the ISO to establish a Control Area and to ensure adequate Operating Reserves and Regulation according to WSCC MORC. Because these criteria apply to the Control Area, the ISO's responsibility for the ISO Controlled Grid cannot be separated from its Control Area responsibilities.

2. The Arbitrator erred in concluding the Commission's rejection of Amendment No. 2 to the ISO Tariff, 82 FERC ¶ 61,312 (1998), precluded the ISO from recovering from PG&E the costs of procurement of Ancillary Services in connection with

the COTP Schedules. The evidence establishes that the ISO and PG&E had already reached agreement regarding PG&E's responsibility for Ancillary Services in connection with the COTP Schedules such that Amendment No. 2 was not necessary in order to establish the responsibility, and there is no substantial evidence to the contrary.

3. The Arbitrator's conclusion that PG&E is not the Scheduling Coordinator for the COTP Schedules under the terms of the ISO Tariff is not supported by the language of the ISO Tariff or by substantial evidence. PG&E's Scheduling Coordinator Agreement does not include any limitations on its responsibility for the entities for which it agreed to schedule. Further, there is no substantial evidence contrary to the ISO's testimony that PG&E agreed to be responsible for Ancillary Services in connection with the COTP Schedules. The Arbitrator further erred in his Award in failing to reflect the various Orders of the Commission entered into the record. He specifically failed to reflect that the Commission recognized PG&E's role as Scheduling Coordinator for these transactions in *Pacific Gas and Electric Co.*, 93 FERC ¶ 61,322 (2000), *reh'g denied*, 94 FERC ¶ 61,204 (2001).

4. The Arbitrator's conclusion that the ISO did not properly take into account the self-provision of Ancillary Services in procuring Ancillary Services for the COTP Schedules is erroneous in that –

- a. it disregards or misinterprets the distinctions between the various forms of Ancillary Service, e.g., Operating Reserves and Regulation;
- b. it disregards or misinterprets the specific Tariff requirements for the self-provision of Regulation;

- c. it disregards or misinterprets the obligations placed by the ISO Tariff on Scheduling Coordinators that self-provide Ancillary Services; and
- d. it disregards or misinterprets the accommodations made by the ISO for the self-provision of Operating Reserves by the COTP parties.

Appendix A of the Ancillary Services Requirements Protocol of the ISO Tariff requires certification of units to provide Regulation Service. The evidence establishes that, with the recent exception of SMUD, none of the entities for which PG&E provided COTP Schedules was certified to provide Regulation Service. Furthermore, the evidence is uncontradicted that PG&E never provided the ISO with information regarding such entities' provision of Operating Reserves. Under Section 2.5.20.5 of the ISO Tariff, the responsibility for notifying the ISO of self-provision of Ancillary Services lies with the Scheduling Coordinator; the ISO has no responsibility to seek such information.

5. The Arbitrator misinterpreted Commission and judicial precedent that would allow the ISO to recover its variable costs of procuring Ancillary Services for the COTP transactions even if the ISO Tariff did not authorize charges for those services. Under *Central Maine Power Co.*, 56 FERC ¶ 61,200 (1991), *Central Hudson Gas & Electric Corp.*, 61 FERC ¶ 61,089 (1992), *Pacificorp Electric Operations*, 60 FERC ¶ 61,292 (1992), *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249 (5th Cir. 1986), and *Transcontinental Gas Pipe Line Corp. v. FERC*, 998 F.2d 1313 (5th Cir. 1993), it is appropriate for the Commission to allow a utility to recover its out-of-pocket expenses for benefits provided during a period that an appropriate tariff rate was not on file.

6. The Arbitrator's conclusion that PG&E's claim for the period from April 1998 to April 1999 is not time-barred under the Tariff is not supported by substantial

evidence. The evidence establishes that PG&E was aware that the ISO was charging PG&E for Ancillary Services in connection with the COTP Schedules from the outset and there is thus no basis for excusing PG&E from the time limits on challenging settlement statements that are specified in Sections 11.6 and 11.7 of the ISO Tariff.

IV. REQUEST FOR PROCEDURES

Article 13.4 of the ISO Tariff provides for appeals from an arbitrator's award. It requires that the appealing party provide notice to the participants in the arbitration within 14 days of the award. The ISO provided such notice on December 27, 2001. It further requires that the appealing party make an appropriate filing with the Commission to trigger review within 10 days of the notice to parties and file the record with the Commission within 30 days of the notice, unless the Commission orders otherwise.

The ISO Tariff, however, provides no guidance as to the nature of the document to be filed to trigger Commission review or as to the procedures that follow such filing. Despite considerable research, the ISO has been unable to identify any Commission precedent regarding the appeal of arbitration awards. Neither has the ISO been able to identify any Federal or California statutes or case law, any applicable Uniform Acts, or any procedures of the American Arbitration Association that would provide guidance on the appeal of arbitration awards to regulatory agencies.

In the absence of other guidance, and in light of the fact that the record is not to be filed until after the initial filing, the ISO has proceeded somewhat analogously to Rule 15 of the Federal Rules of Appellate Procedure, by limiting this filing to a Petition for Review, with a copy of the Award, supplemented with such additional information as the

ISO believes will assist the Commission in evaluating the Petition and establishing appropriate procedures for review.

The ISO would therefore request that the Commission establish appropriate procedures for a review of the Arbitrator's Award that will allow all parties to fully present to the Commission their arguments against and in support of the Award. Section 13.4.2 of the ISO Tariff provides that the appeal will take place on the record as it existed before the arbitrator (except in the event of new legal authority or an allegation of fraud or similar misconduct). Therefore, review can occur through briefing with citations to the record. The ISO would suggest an initial brief filed by the ISO, followed in sequence by briefs of intervenors supporting the ISO, of PG&E, and of intervenors supporting PG&E. As the petitioner, the ISO should also be permitted a reply brief.

V. SERVICE

The ISO is serving the petition on all parties to the arbitration, as well as the Public Utilities Commission of the State of California and the California Electricity Oversight Board. The ISO is serving the arbitrator via e-mail. Notice of the appeal was previously posted on the ISO Home Page.

VI. CONCLUSION

The ISO therefore requests that the Commission initiate a proceeding for the review of the Award and establish procedures and a procedural schedule for that review.

Respectfully submitted,

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