

UNITED STATES OF AMERICA 100 FERC ¶ 61,271
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

Mirant Delta, LLC and
Mirant Potrero, LLC,
Complainants,

v.

Docket No. EL01-35-001

California Independent System
Operator Corporation,
Respondent.

San Diego Gas & Electric Company,
Complainant,

v.

Docket No. EL00-95-067

Sellers of Energy and Ancillary Services
Into Markets Operated by the California
Independent System Operator and the
California Power Exchange,
Respondents, et al.

California Independent System
Operator Corporation

Docket No. ER01-1877-001

Docket No. EL00-98-056

Operational Audit of the
California Independent System Operator

Docket No. PA02-1-001

California Independent System
Operator Corporation

Docket No. RT01-85-010

Pacific Gas and Electric Company

Docket No. RT01-83-003

Docket Nos. EL01-35-001, et al.

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San Diego Gas & Electric Company

Docket No. RT01-82-003

Southern California Edison Company

Docket No. RT01-92-003

ORDER ACCEPTING AND DENYING REQUESTS FOR REHEARING
AND DENYING REQUESTS FOR STAY

(Issued September 16, 2002)

1. In this order, we deny requests for rehearing and requests for stay of an order issued on July 17, 2002 involving the California Independent System Operator's (CAISO) Governing Board (Board) and its governance structure.¹ In addition, we clarify details surrounding the formation and operation of advisory committees to the CAISO that are described in that order. This order benefits California energy market participants and their customers as well as energy participants in other parts of the West, because it serves to ensure the independent operation of the CAISO, which, in turn, will allow the Commission to maintain just and reasonable rates in the West and help solve California's long-term electricity supply deficiency.

I. Background

2. In the July 17 Order, the Commission found that the continuation of the CAISO's Board, as constituted, and the CAISO's current governance structure hamper our ability to ensure non-discriminatory transmission services and just and reasonable rates in the West.² Specifically, the Commission determined that the Board is not capable of operating its interstate transmission facilities on a non-discriminatory basis and is in non-compliance with the Commission's orders.³ In order to address the Board's lack of

¹See 100 FERC ¶ 61,059 (2002) (July 17 Order).

²See id. at 61,298.

³The December 15, 2000 order in which we established remedies for the California electricity markets, see San Diego Gas & Electric Company, et al., 93 FERC ¶ 61,294 (2000) (December 15 Order), 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); the independence principle of Order No. 888, governing

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independence and to help restore the confidence necessary to attract the infrastructure investment needed to provide a long-term solution to California's electricity supply deficiency, we directed the CAISO to replace its existing Board with an independent, non-stakeholder Board through a series of actions beginning August 15, 2002 and culminating in the seating of an independent Board prior to January 1, 2003.

A. Requests for Stay

3. The California Electricity Oversight Board (EOB), the CAISO, and the City and County of San Francisco (San Francisco)⁴ request that the Commission grant a stay of the July 17 Order. According to these parties, if the Commission's July 17 Order is not stayed, the CAISO will be in violation of either the July 17 Order or State law.⁵ The EOB maintains that these facts and circumstances clearly justify a stay in this proceeding to maintain "the status quo pending orderly resolution of the issue."⁶ Therefore, the EOB

³(...continued)

independent system operators, see Order 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, FERC Stats. & Regs. ¶ 31,036 at 31,760-62 and 31,857, 61 Fed. Reg. 21,540 (1996), clarified, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996), on reh'g, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, 62 Fed. Reg. 12,274, clarified, 79 FERC ¶ 61,182 (1997), on reh'g, Order No. 888-B, 81 FERC ¶ 61,248, 62 Fed. Reg. 64,688 (1997), on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998), aff'd sub nom. Transmission Access Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), cert. denied in pertinent part, 69 U.S.L.W. 3574 (U.S. Feb. 26, 2001), aff'd, New York et al. v. FERC, __ U.S. __, 122 S. Ct. 1012 (2002); and the independence requirement of Order No. 2000, governing regional transmission organizations (RTOs), see Regional Transmission Organizations, FERC Stats. & Regs. ¶ 31,089 at 30,993 (1999), 65 Fed. Reg. 810 (2000) (Order 2000), on reh'g, Order No. 2000-A, FERC Stats. & Regs. ¶ 30,092, 65 Fed. Reg. 12,088 (2000), aff'd, Public Utility District No. 1 v. FERC, 272 F.3d 607 (D.C. Cir 2001).

⁴San Francisco supports and joins the CAISO's Request for Rehearing and Stay.

⁵See CAL. PUB. UTIL. § 337 (West 2001) (detailing the current board selection process for the CAISO).

⁶EOB's Request for Rehearing at 19. The EOB also states that as the agency of
(continued...)

requests a stay of the July 17 Order for 60 days after the issuance of this order. The CAISO asks that the Commission grant a stay "until the order is reconsidered on rehearing, and, if necessary, the authority of the Commission to impose those requirements is considered on judicial review."⁷ Californians for Renewable Energy (CARE) contends that "the Commission's proposed Standard Market Design, has raised significant socioeconomic and environmental issues that make it necessary for CARE to seek a Stay of [the Commission's] actions regarding [CA]ISO's governance at this time"⁸ until a new Board is elected using CARE's proposal for a "corporate election" process.⁹

4. The EOB and the CAISO state that the Commission's directives in the July 17 Order, requiring the CAISO replace its existing Board with a new governing Board, violate section 337 of the California Public Utilities Code.¹⁰ Furthermore, these parties contend that as a state-chartered nonprofit public benefit corporation, the CAISO cannot legally comply with the Commission's directives. They also state that the Attorney General of California has declared that any action by the CAISO to comply with the July 17 Order would violate State law and has pledged to enforce section 337 through legal action. The EOB and the CAISO maintain that this potential for enforcement action by the Attorney General of California, in and of itself, is a sufficient basis for a finding of irreparable injury. The CAISO also argues that if it were to comply with the July 17 Order, it could be placed in a state of "suspended animation" (i.e., powerless to act for lack of a governance structure that meets the requirements of its corporate charter).¹¹

5. In addition, the CAISO argues that the July 17 Order is contrary to the public interest because it threatens the ability of the CAISO to fulfill its statutory mandate, as

⁶(...continued)

the State charged with oversight responsibility of the CAISO, it must insist that the CAISO comply with State law.

⁷CAISO's Request for Rehearing at 37.

⁸CARE's Request for Rehearing at 7.

⁹Id.

¹⁰See CAL. PUB. UTIL. § 337 (West 2001).

¹¹CAISO's Request for Rehearing at 34.

well as its responsibilities as a public utility. Considering the Attorney General of California's pledge to enforce section 337, the CAISO contends that compliance with the July 17 Order would expose its Board and management to the risk of enforcement action, including criminal prosecution. The EOB and the CAISO state that while the CAISO will suffer severe and irreparable injury if a stay is denied, a stay will not harm other parties. In addition, the EOB and the CAISO maintain that the public interest supports the issuance of a stay, because it will help the CAISO avoid unnecessary disruptions to its governance structure that will result absent a stay.

B. Requests for Rehearing

6. The CAISO, the Public Utilities Commission of the State of California (CPUC), San Francisco,¹² and the California Electricity Oversight Board (EOB) assert that the Commission's modifications to the CAISO governance structure in the July 17 Order are beyond the Commission's statutory authority under the Federal Power Act (FPA), because the FPA does not expressly provide the Commission with authority over the corporate structure of public utilities. These parties also state that the Board's structure does not constitute either a practice or rule pertaining to conduct or action on the part of a particular entity that is within the Commission's jurisdiction under the FPA, because the FPA limits the Commission to regulation of specific actions undertaken by a utility and does not allow the Commission to modify a public utility's bylaws and governance structure that shape the manner in which a public utility takes action. In addition, they assert that the Commission's decision to order modifications to the CAISO's governance structure is neither supported by substantial evidence nor a product of reasoned decision making.

7. The EOB and the CAISO also contend that, even if the Commission had jurisdiction over the CAISO's Board structure, section 206 of the FPA requires that the Commission conduct an evidentiary hearing to determine whether an existing rate, charge, or practice is unjust, unreasonable, or unduly discriminatory. Because the Commission did not hold an evidentiary hearing prior to issuing the July 17 Order, these parties allege that the order is unlawful. The CAISO also states that, if it was to comply with the July 17 Order in violation of State law, it would be against the public interest because it would put in doubt the legitimacy of the CAISO's authority to enter into contracts that are necessary to ensure reliable transmission service.

¹²San Francisco supports and incorporates by reference the CPUC's Request for Rehearing and, as noted above, the CAISO's Request for Rehearing.

8. The CPUC argues that the Commission lacks the authority to preempt State law concerning corporate governance. Instead, it suggests that the remedy available to the Commission, if it determines that the Board lacks independence, "is simply to rule that the [CA]ISO is no longer an Independent System Operator for Order 888 purposes, and to set in place a process for working out the implications of such a determination,"¹³ which would involve requiring that the CAISO either file a new Open Access Transmission Tariff or disbanding the CAISO and returning operation of its transmission assets to the California utilities. The CPUC also states that, if the CAISO is a public utility, it satisfies the independence requirement of State law that Board members "may not be affiliated with any actual or potential participant in any market administered"¹⁴ by the CAISO. The EOB and the CPUC argue that the Commission's characterization, in the July 17 Order, that the State has "pervasive control" over the CAISO supports their contention that the CAISO is an instrumentality of the State and thus is excluded from the Commission's jurisdiction pursuant to section 201(f) of the FPA.¹⁵

9. CARE states that "[n]either FERC's proposed governance scheme for the [CA]ISO, nor the [CA]ISO's current governance, under control by the California Governor . . . , complies with the fiduciary requirements necessary to be eligible as exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code."¹⁶ As such, CARE contends that the CAISO "should be subject to taxation for its transactions and may be subject to prosecution for tax evasion for failure to do so."¹⁷ In addition, CARE maintains that "[t]he FERC's proposal fails to comply with Federal and State requirement for members of such corporation to elect the directors and officers of said corporation in an annual corporate board of directors election by the corporation's membership, in this case, the consumers and ratepayers of electricity within the state of

¹³CPUC's Request for Rehearing at 3 (quoting its filing in Docket No. EL00-95-012, at 3-5).

¹⁴Id. at 15 (quoting section 337 of the Public Utilities Code).

¹⁵16 U.S.C. § 824(f) (2000).

¹⁶CARE's Request for Rehearing at 4.

¹⁷Id.

California."¹⁸ Thus, CARE proposes a board selection process for the CAISO that would involve "ratepayers" electing the Board.

II. Discussion

A. Requests for Stay

10. In our consideration of requests for stay, the Commission has applied the standards set forth in section 705 of Title 5 of the United States Code¹⁹ and has granted a stay when "justice so requires."²⁰ In addressing requests for stay, the Commission considers the following: (1) the likelihood that the moving party will be irreparably harmed absent a stay; (2) the prospect that others will be harmed if the Commission grants the stay; and (3) the public interest in granting the stay.²¹

11. In Wisconsin Gas, the court developed several principles to determine if the requirement of irreparable harm has been met for a judicial stay:

First, the injury must be both certain and great; it must be actual and not theoretical. Injunctive relief 'will not be granted against something merely feared as liable to occur at some indefinite time.' It is also well settled that economic loss does not, in and of itself, constitute irreparable harm. . . . Implicit in each of these

¹⁸Id.

¹⁹See 5 U.S.C. § 705 (2000).

²⁰See, e.g., Clifton Power Corp., 58 FERC ¶ 61,094 (1992); United Gas Pipe Line Co., 42 FERC ¶ 61,388 (1988); Trinity River Authority of Texas, 41 FERC ¶ 61,300 (1987); City of Centralia, Washington, 41 FERC ¶ 61,028 (1987); see also, CMS Midland, Inc., Midland Cogeneration Venture Limited Partnership, 56 FERC ¶ 61,177 at 61,631 (1991), aff'd sub nom. Michigan Municipal Cooperative Group v. FERC, 990 F.2d 1377 (D.C. Cir.) (denying request for stay to assure definiteness and finality in a Commission proceeding), cert denied, 510 U.S. 990 (1993).

²¹See, e.g., Independence Pipeline Company, 92 FERC ¶ 61,268 at 61,896 (2000).

principles is the further requirement that the movant substantiate the claim that irreparable injury is 'likely' to occur. Bare allegations of what is likely to occur are of no value since the court must decide whether the harm will in fact occur. The movant must provide proof that the harm has occurred in the past and is likely to occur again, or proof indicating that the harm is certain to occur in the near future.²²

12. As the CAISO states, there is only a "potential"²³ that, if the CAISO decides to follow our directives in the July 17 Order, the Attorney General of California will bring legal action against the CAISO's Board members and management, which could involve financial penalties. Therefore, because it is merely speculative that the CAISO's Board or management will face enforcement action and penalties, we find that the requisite immediate irreparable injury has not been substantiated.²⁴ Further, were the Attorney General of California to bring an enforcement action, he would be unlikely to prevail; to the extent that the claimed requirements of the State law create an obstacle to fulfilling the mandate of the July 17 Order, federal law preempts those State requirements. Because the parties requesting a stay are unable to demonstrate that they will suffer irreparable harm absent a stay, the Commission need not examine the other factors;²⁵ nevertheless, we address the other factors because we feel it is important to point out the harm to both customers and other States that would occur if a stay of the July 17 Order were granted.

13. We find that even if the EOB, the CAISO, or CARE could demonstrate that it would likely suffer irreparable harm absent a stay, the other factors do not justify

²²Wisconsin Gas Co. v. Federal Energy Regulatory Com., 758 F.2d 669 at 674 (D.C. Cir. 1985) (citations omitted) (Wisconsin Gas).

²³CAISO's Request for Rehearing at 33-34 (stating that there "is a potential for enforcement action" that could subject the CAISO's Board and management to "potential penalties").

²⁴See supra 22 and accompanying text; see also FTC v. Standard Oil Co., 449 U.S. 232, 244 (1980).

²⁵See, e.g., Wisconsin Gas, 758 F.2d at 674 (stating that "[w]e believe that analysis of the [irreparable harm] factor disposes of these motions and, therefore, address only whether the petitioners have demonstrated that in the absence of a stay, they will suffer irreparable harm").

granting a stay. A significant public interest exists in establishing an independent Board that will allow the Commission to ensure just and reasonable prices in California as well as other areas of the West and that will help restore the confidence in the Board that is necessary to attract infrastructure investment to help solve California's electricity supply deficiency. In addition, because a stay will only delay the ability of the Commission to accomplish these goals, we find that a stay will be detrimental to customers.

14. We find that CARE's request that a stay is necessary, because the Commission's proposed Standard Market Design²⁶ raises significant socioeconomic and environmental issues that require "a corporate election" to address them, to be without merit. Although CARE alludes to a public interest in a stay because of socioeconomic and environmental issues, we find that this argument is insufficient to grant a stay because it is unexplained and unsupported. CARE has neither identified the socioeconomic and environmental issues that the Commission's proposed Standard Market Design allegedly raises nor has it shown the relevance of these issues to the July 17 Order.

B. Requests for Rehearing

1. Commission's Statutory Authority

15. As we stated in the July 17 Order, and as the CAISO concedes,²⁷ "[the CAISO] is a public utility as defined in section 201(e) of the [FPA], and its transmission services and sales for resale of electric energy in interstate commerce (*i.e.*, its operation of imbalance energy markets) are within this Commission's exclusive jurisdiction."²⁸ As a public utility, the CAISO is subject to the requirements in sections 205 and 206 of the FPA. Section 205 precludes public utilities, in any transmission or power sale subject to the Commission's jurisdiction, from "making or granting any undue preference or advantage to any person or subjecting any person to any undue prejudice or disadvantage. . . ."²⁹ Section 206 further provides in relevant part:

²⁶See Electricity Market Design Structure, 67 Fed. Reg. 55,452 (2002) (Standard Market Design).

²⁷CAISO's Request for Rehearing at 6.

²⁸July 17 Order at 61,218 (citations omitted).

²⁹16 U.S.C. § 824d(b) (2000).

[W]henever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.³⁰

16. The EOB, the CPUC, and the CAISO argue that section 206(a) of the FPA imposes certain procedural and evidentiary requirements that the Commission failed to satisfy in the July 17 Order. These parties contend that section 206(a) requires substantial evidence of contemporaneous unjust, unreasonable, unduly discriminatory, or preferential behavior before the Commission can act. They state that the Commission, in the July 17 Order, did not make any findings that the State-controlled Board engaged in discrimination but instead relied on unsubstantiated allegations by market participants of discriminatory conduct by the CAISO. The EOB, the CPUC, and the CAISO also assert that section 206(a) of the FPA requires that the requisite findings of undue discrimination be made in the context of a hearing.

17. We find that the Commission has satisfied the applicable procedural and evidentiary requirements of sections 205 and 206 of the FPA. Sections 205 and 206 of the FPA give the Commission the authority to review any rule, regulation, practice, or contract affecting rates, terms and conditions of service, and, if found to be not just and reasonable, the Commission under section 206 can determine the just and reasonable practice to be observed.³¹ In the circumstances of this case, board selection and a board's control over a public utility's FERC-jurisdictional matters fall within this authority.

18. In the July 17 Order, we found that the current Board is not independent and determined that the Board's lack of independence has an unduly discriminatory effect on Western energy markets. This conclusion was based on the finding in Order 888 that a non-independent governance structure has an unduly discriminatory and anti-competitive

³⁰Id. at § 824e(a).

³¹See id. at §§ 824d(a)-824(b).

effect on markets.³² In addition, our July 17 Order found that the pervasive control over a public utility by the State interferes with the Commission's exclusive jurisdiction to ensure and establish just and reasonable rates.³³ For instance, in the July 17 Order, we explained that the State's control of the CAISO conflicted with the CAISO's independent rights and responsibilities under section 205 of the FPA, by allowing the State to dictate what filings the CAISO will make with the Commission.³⁴ Under the FPA, public utilities are required to comply with the Commission's directives, not those of the State, regarding compliance with the FPA.³⁵

19. As the Commission found in the July 17 Order, there is an inherent conflict between a State-controlled CAISO and the State's role as the dominant purchaser in the CAISO's markets. In other words, the fact that the State is a market participant,³⁶ while at the same time, in the position of choosing all of the Board members makes the CAISO's governance structure inherently non-independent.³⁷ Even if at some future

³²See July 17 Order at 61,227; Order 888 at 31,730.

³³See July 17 Order at 61,228.

³⁴See, e.g., *Commonwealth of Massachusetts, Dep't of Pub. Util. v. FERC*, 729 F.2d 886 (1st Cir. 1984) (state cannot dictate a public utility's FERC rate filings).

³⁵See July 17 Order at 61,228.

³⁶See July 17 Order at 61,221 (stating that "[o]n January 17, 2001, the Governor issued an emergency proclamation giving the California Department of Water Resources (DWR), which is a department of the State government that reports directly to the Governor, authority to enter into arrangements to purchase power"). As we stated in the July 17 Order, "DWR has purchased substantial amounts of capacity and energy in the CAISO's imbalance market and has entered into long-term contracts for electric energy to serve retail load in California. As a result of these activities, DWR is now the largest purchaser of energy in the California wholesale market." July 17 Order at 61,222.

³⁷In this regard, the CAISO's actions regarding the Board are not only in violation of the Commission's orders but appear to be in violation of section 337 of the Public Utilities Code, which states that "[a] member of the independent governing board . . . may not be affiliated with any actual or potential market participant in any market administered by the Independent System Operator." CAL. PUB. UTIL. § 337(a) (West
(continued...))

point the State is no longer a market participant in the CAISO's markets (e.g., the DWR stops entering into arrangements to purchase power), State control of the CAISO and its board selection process would still conflict with this Commission's exclusive authority to ensure just and reasonable rates and prevent unduly discriminatory practices as well as with the statutory framework of the FPA, which, as noted, allows public utilities the ability to make rate filings and which requires them to comply with this Commission's regulations and directives regarding matters within our exclusive jurisdiction. As we stated in the July 17 Order:

Under Section 205 of the FPA, public utilities have the right and responsibility to determine what filings they will make voluntarily. As a public utility, the CAISO should be independent of State control in deciding what filings to submit to the Commission. Furthermore, as a general matter under the FPA, public utilities are required to comply with the Commission's directives, not those of the State, regarding compliance with the FPA. Pervasive 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 61,228.

20. Furthermore, a State-controlled Board leads to the perception by other market participants that the CAISO is predisposed to act in a manner that discriminates in favor

³⁷(...continued)

2001). The Governor has appointed a number of Board members who do not satisfy this criterion, because they are in fact employees of the State or associated with other market participants. In fact, the original Board that the Governor nominated included "the California Secretary of Business, Transportation, and Housing; a senior advisor to the Governor; an attorney with the Utility Reform Network; and an attorney with a California law firm, who was also a former chair of the Oversight Board." July 17 Order at 61,221 (citing Press Release from Office of the Governor of California, Governor Davis Names Members of the CAISO Board (January 24, 2001) at <http://www.governor.ca.gov>). The current Board continues to include members that are State employees. See California ISO, Board of Governors at <http://www.caiso.com/docs/09003a6080/0b/45/09003a60800b4585.pdf>. For example, a current Board member is an employee in the Governor's Office of Planning and Research.

of the State to the detriment of out-of-State participants. In Order 888, we explained that an "ISO's rules of governance . . . should prevent . . . [the] appearance of control . . . of decision-making by any class of participants."³⁸ In addition, in Order No. 2000, we found that the principle of independence is the "bedrock" on which an RTO must be built and requires an RTO's governance structure to be independent "in both reality and perception."³⁹ In the July 17 Order, we also found that "even the perception that the authority who controls the interstate transmission grid is biased can be enough to prevent proper market forces from working, thus hindering market reliability and efficiency."⁴⁰ The July 17 Order further explained that "removing this conflict of interest [*i.e.*, one market participant choosing all the CAISO's Board members] . . . is a critical step in solving significant Western energy market problems."⁴¹ Thus, even the perception of bias can have the same type of adverse effects on electricity markets that actual discriminatory practices by the Board do.

21. We find that the perception among market participants that the Board is predisposed to act in a discriminatory manner, because the selection process is controlled by one market participant, the State, has been exacerbated by the Governor selecting Board members who are employed by the State.⁴² However, any Board chosen by the Governor (even Board members not employed by the State) would likely lead, and has already led, to the perception by other market participants that the Board is beholden only to the interests of the State and has no incentive to fairly balance the interests of all market participants, which is the touchstone for determining the lawfulness of the CAISO's actions on interstate interests.

22. In making our determination that the current Board is not independent and that an independent Board and governance structure are necessary, we also relied in part on

³⁸Order 888 at 31,731.

³⁹Order No. 2000 at 31,061.

⁴⁰July 17 Order at 61,227. We also stated in the December 15 Order that "State selection of all the board members is not a reasonable position in light of our prior determinations and the current procedures which only allow the state to veto approximately half of the prospective candidates." December 15 Order at 62,103.

⁴¹July 17 Order at 61,227.

⁴²See supra note 37 and accompanying text.

specific examples showing the CAISO's discriminatory practices. For instance, as noted in the July 17 Order, the Commission has received complaints containing the prima facie elements for showing that the CAISO engaged in unduly discriminatory or anti-competitive behavior.⁴³ In addition, independent reports, including the Operational Audit of the California Independent System Operator⁴⁴ and the Government Accounting Office Report: Restructured Electricity Markets,⁴⁵ detailed the CAISO's unduly discriminatory behavior.⁴⁶

23. In light of all of the systemic problems that exist because of the CAISO's current governance structure, we adopted a remedy in the July 17 Order, pursuant to our authority under sections 205 and 206, that sets up a board selection process that does not favor particular market participants and therefore will help ensure that an independent Board is chosen.

24. The EOB, CPUC, and the CAISO state that if the Commission wants to ensure the non-discriminatory treatment of transmission customers and wholesale purchasers in the CAISO's markets, the Commission can address discriminatory actions that the Board takes when they are brought to the Commission's attention by either a Commission-

⁴³See, e.g., Mirant Delta, LLC, Complaint Against the CAISO, Docket No. EL01-35-000 (2001).

⁴⁴See Docket No. PA02-1-000 (2002).

⁴⁵See GAO REP. NO. 02-427, at 30. The GAO Report states that:

[E]mployees for the state agency responsible for buying electricity had access to the transmission system operator's control center and may have had access to real-time data not provided to other market participants, even though the transmission system operator's rules prohibit such treatment for market participants. . . . Although FERC ordered state staff to leave the operations room, developers remain concerned that the state may receive special treatment from the transmission operator. This concern continues because the state has so much potential influence over the market, which raises the risk of entering the market for independent developers.

Id.

⁴⁶See July 17 Order at 61,222 n.46, 61,227.

initiated investigation or by a complaint. The Commission is obligated not only to remedy past discrimination but also to take all reasonable steps to prevent possible undue discrimination from occurring, because sometimes we are unable to adequately remedy such behavior after the fact and even the perception or risk of discrimination will discourage the market entry and investment needed to ensure just and reasonable rates.⁴⁷ Furthermore, we are also unable to ensure just and reasonable rates if a Board dictates or restrains a public utility's compliance with the Commission's rate directives.

25. These parties fail to understand the rationale underlying the July 17 Order that a Board that is chosen by one market participant (in this instance the State) is, as discussed above, inherently non-independent and thus likely biased. Accordingly, we find that the CAISO is incorrect when it argues that the governance structure of the CAISO does not constitute a practice, conduct, or action that affects rates and other terms of jurisdictional service over which the Commission has jurisdiction. Under section 206 of the FPA, where such practices lead to unlawful rates, we can mandate the CAISO's governance structure so as to assure lawful rates. Again, as described in the July 17 Order, we find that the CAISO's current governance structure adversely affects rates and other matters within the Commission's exclusive jurisdiction under the FPA. Therefore, the steps that the Commission took in the July 17 Order were required by the Commission's mandate, pursuant to sections 205 and 206 of the FPA, to remedy unjust and unreasonable rates and unduly discriminatory behavior.

26. With regard to the EOB's, CPUC's, and CAISO's assertion that section 206(a) of the FPA requires that the requisite findings of undue discrimination be made in the context of a hearing, the Commission in this proceeding has held a "paper" hearing that satisfies section 206 of the FPA. That section does not require that the Commission establish an evidentiary hearing before an administrative law judge, if we decide, as we did in the July 17 Order, that the proceeding has allowed for full ventilation of all issues and the matter does not involve a contested issue of material fact.⁴⁸

⁴⁷See 16 U.S.C. § 824e(a) (2000).

⁴⁸The use of a "paper" hearing rather than a trial-type evidentiary hearing has been addressed in several cases. See, e.g., Public Service Company of Indiana, 49 FERC ¶ 61,346 (1989), order on reh'g, 50 FERC ¶ 61,186, opinion issued, Opinion 349, 51 FERC ¶ 61,367, order on reh'g, Opinion 349-A, 52 FERC ¶ 61,260, clarified, 53 FERC ¶ 61,131 (1990), dismissed, Northern Indiana Public Service Company v. FERC, 954 F.2d 736 (D.C. Cir. 1992).

2. Preemption

27. Section 337 of the Public Utilities Code states that the CAISO's "governing board shall be composed of a five-member independent governing board of directors appointed by the Governor and subject to confirmation by the Senate."⁴⁹ The CPUC, EOB, and the CAISO acknowledge that section 337 is inconsistent with the July 17 Order, but state that order does not preempt State law (namely, section 337). Furthermore, these parties state that no provision in the FPA explicitly authorizes the Commission to require that a public utility operating transmission facilities at wholesale have a particular form of corporate governance structure. Therefore, they assert that the July 17 Order is of no force or effect.

28. Although the FPA does not explicitly provide a requirement that a public utility have a particular type of corporate governance structure, the Supreme Court has held that regulatory preemption does not require "express congressional authorization to displace state law."⁵⁰ Under the Supreme Court's preemption doctrine the question of whether a federal statute, regulation, or order⁵¹ preempts state law requires an inquiry into

⁴⁹See CAL. PUB. UTIL. § 337(a) (West 2001).

⁵⁰Fidelity Fed. Sav. & Loan Ass'n v. Cuesta, 458 U.S. 141, 154 (1982). Federal preemption of state law is provided for in Article VI of the United States Constitution, which states that federal law "shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. CONST. art. VI, cl. 2. Thus, as the Supreme Court has noted, the effect of the Supremacy Clause is that "state law that conflicts with federal law is 'without effect.'" Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516 (1992) (quoting Maryland v. Louisiana, 451 U.S. 725, 746 (1981)).

⁵¹The Supreme Court has recognized that the actions of federal agencies, such as the Commission, may preempt state law. See, e.g., Fidelity Fed. Sav. & Loan Ass'n v. Cuesta, 458 U.S. at 153-54 (stating that "[w]here Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily").

congressional intent.⁵² In situations where congressional intent is not manifestly clear, the Court has listed several circumstances in which intent may be implied:

Preemption occurs when Congress, in enacting a federal statute, expresses a clear intent to pre-empt state law, when there is outright or actual conflict between federal and state law, where compliance with both federal and state law is in effect physically impossible, where there is implicit in federal law a barrier to state regulation, where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law, or where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress.⁵³

29. We find that section 337 of the Public Utilities Code frustrates, and/or conflicts with, the design and objectives of a federal statute (sections 205 and 206 of the FPA), federal regulations (Orders 888 and 2000), and an agency's orders (the Commission's November 1, December 1, and July 17 Orders),⁵⁴ because section 337 allows the Governor, who represents the interests of the State (a single market participant), to choose all of the CAISO's Board members. Specifically, section 337 precludes creation of an independent Board and thus prevents this Commission from ensuring that the CAISO's rates are just and reasonable rates and not unduly discriminatory. Also, section 337 conflicts with Order 888's independence principle that an ISO should be independent of any individual market participant,⁵⁵ because it allows one market participant to select all the Board members. In addition, it stands as an obstacle to the accomplishment of the objective of Order 888 (i.e., to ensure open and non-discriminatory interstate transmission service), because a non-independent Board is likely to engage in

⁵²See Rice v. Sante Fe Elevator Corp., 331 U.S. 218, 230 (1947) (holding that the central issue in all preemption cases is the determination of whether Congress truly intended to displace state law).

⁵³Louisiana Public Serv. Comm'n v. FCC, 476 U.S. 355, 368-69 (1986) (citations omitted).

⁵⁴See Gade v. National Solid Waste Mgmt. Ass'n, 505 U.S. 88, 107 (1992) (holding that a state regulatory scheme that frustrated the purpose of a federal regulatory program is preempted by the federal program).

⁵⁵See Order 888 at 31,730-31. In Order 888, the Commission cited sections 205 and 206 of the FPA as providing us with the authority for our rulemaking.

preferential treatment towards a particular market participant. Furthermore, it stands as an obstacle to the accomplishment of the objective of Order 2000 (i.e., to prevent undue discrimination that impedes the formation of fully competitive electricity markets by encouraging the formation of regional transmission organizations), because before the CAISO can qualify as an RTO it must have an independent Board.⁵⁶ Section 337 is also in conflict with the FPA's goal of preventing and remedying undue discrimination and ensuring just and reasonable rates, because a Board that is non-independent will have actual and perceived discriminatory effects that will adversely affect the interstate transmission markets in the West. Finally, it is in direct and actual conflict with the November 1, December 15, and July 17 Orders' requirements that: (1) the CAISO's Board must be changed to a non-stakeholder Board which does not interfere with just and reasonable rates by the CAISO, and (2) the Board not be selected entirely by one market participant. Accordingly, we conclude that section 337 is preempted.⁵⁷

30. The CPUC, the CAISO, and the EOB state that the CAISO was established as a not-for-profit corporation pursuant to State law, with responsibilities directly related to the health, safety, and well-being of California residents and businesses. Therefore, they argue that the July 17 Order improperly intrudes on the right of the State to control the governance structure of a corporation created under its laws. The CAISO was established and operates, however, in the interstate transmission market,⁵⁸ an area that

⁵⁶See Order 2000 at 31,046.

⁵⁷See, e.g., *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (holding that state law is preempted by federal law when it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress").

⁵⁸The Commission initially authorized the establishment of the CAISO in the November 26 Order, see *San Diego Gas & Electric Company, et al.*, 77 FERC ¶ 61,204 (1996) (November 26 Order), and the December 18 Order, see *Pacific Gas & Electric, et al.*, 77 FERC ¶ 61,265 (1996) (December 18 Order). In addition, in the October 30 Order, the Commission issued an order authorizing the CAISO to commence its operations. See *Pacific Gas & Electric*, 81 FERC ¶ 61,122 (1997) (October 30 Order). In those orders, we stated that the CAISO was a public utility that was subject to our jurisdiction. For example, in the November 26 Order, we stated that: "[t]he ISO . . . Governing Board[] will have a direct effect on matters that are within this Commission's exclusive jurisdiction: sales for resale of electric energy in interstate commerce by public utilities and transmission of electric energy in interstate commerce by a public utility."

(continued...)

has never been subject to State regulation.⁵⁹ In such circumstances, federal law controls, as the Supreme Court has stated:

On the one hand, the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States. On the other hand, the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests.⁶⁰

31. As we stated in the July 17 Order, "the Commission finds that the Board, as currently constituted, poses a barrier to the implementation of market redesigns that are

⁵⁸(...continued)

November 26 Order at 61,829. In addition, in the December 28 Order, we noted that "the California . . . Legislature acknowledge[s] that this Commission has exclusive authority over the rates, terms and conditions of sales for resale of electric energy in interstate commerce by public utilities. . . ." December 18 Order at 62,088 n.44. Furthermore, in the November 26 Order, the Commission concluded that the Board "direct[s] and control[s] public utilities subject to the Commission's jurisdiction and therefore affect[s] rates, terms and conditions of jurisdictional service (see FPA section 205(c)). Therefore, the State of California's expressed purpose that [the CAISO] represent[s] primarily the interests of California consumers is not controlling when that purpose may result in unduly discriminatory or preferential treatment of Market Participants." October 30 Order at 61,451.

⁵⁹As the Supreme Court has stated: "It is . . . perfectly clear that the original FPA did a good deal more than close the gap in state power. . . . The FPA authorized federal regulation not only of wholesale sales that had been beyond the reach of state power, but also the regulation of wholesale sales that had been previously subject to state regulation . . . [and] regulation of interstate transmissions. . . ." *New York v. FERC*, ___ U.S. ___, 122 S. Ct. 1012, 1025 (2002).

⁶⁰*Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 377-78 (1983) (citations omitted).

necessary to rehabilitate the CAISO and Western markets."⁶¹ In addition, in the July 17 Order, we found that the "[c]ontrol of the Board by one state threatens the CAISO's ability to treat in-state and out-of-state transmission users on a non-discriminatory basis, thus undermining the prospect of broader regional cooperation throughout the West."⁶² Because, as we found in the July 17 Order, section 337 imposes a direct rather than an indirect burden on interstate commerce, we find that the law is an invalid interference with interstate commerce.⁶³ The Commission, as noted, has been charged by Congress to ensure that the rates, terms, and conditions for the transmission or sale of electric energy in interstate commerce are just and reasonable and not unduly discriminatory, and the CAISO's State-controlled Board interferes with these objectives.

32. The EOB, the CAISO, and the CPUC also argue that the express and limited authority over corporate governance granted to the Commission by Congress in section 305 of the FPA⁶⁴ is a clear indication that Congress did not intend the Commission to have authority over corporate governance in other sections of the FPA. However, their argument does not take into account the fact that the Commission's authority under section 206, unlike in section 305 (concerning interlocking directorates of public utilities), is not a grant of power that is specifically tailored to apply only to a limited set of factual circumstances. There is nothing in the FPA to preclude the Commission from addressing governance of public utilities, and moreover, section 206 is a broad grant of authority to the Commission to remedy all unduly discriminatory rules, regulations, practices, and contracts that affect Commission-jurisdictional rates and services.⁶⁵ In fact, section 206's prohibition against undue discrimination is sufficiently

⁶¹July 17 Order at 61,226-27.

⁶²Id. at 61,228.

⁶³See *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 377 (1983) (citing *FERC v. Mississippi*, 456 U.S. 742, 755-757 (1982); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 339 (1982)).

⁶⁴16 U.S.C. § 825d (2002).

⁶⁵With regard to the CPUC's related argument that in other Congressional statutes the Commission and the SEC were not granted authority over the corporate structure of public utilities, we find that these statutes have no relevance for interpreting Congress'

broad to support the Commission's determination that the governance rules for ISOs must require that the board selection process for those entities be independent from any one market participant, even though ISOs are a relatively new creation established in response to changes in the electricity market since the FPA was enacted.⁶⁶ In addition, the Commission has the authority to fill in gaps left by a statute to ensure that its objectives are met.⁶⁷

33. The CPUC and the EOB maintain that section 201(a) of the FPA, which states that "such Federal regulation . . . extend[s] only to those matters which are not subject to regulation by the States,"⁶⁸ limits the Commission in its regulation of matters, such as corporate governance, that are regulated by the states. However, the language in section 201(a) of the FPA does not nullify the clear authority of the Commission to prevent undue discrimination pursuant to sections 205 and 206 of the FPA and to assure just and reasonable rates under those sections.⁶⁹ The language in section 201(a) is not a limitation on the use by the Commission of authority specifically conferred on it by Congress;⁷⁰ in

⁶⁵(...continued)

intent with regard to sections 205 and 206 of the FPA.

⁶⁶Congress when enacting the FPA could hardly have foreseen the need to specifically state that the Commission should have jurisdiction over the governance structure of managers of large parts of transmission systems, such as ISOs, because changes in bulk power markets have occurred since the passage of the FPA that have made the traditional management of the transmission grid by vertically integrated electric utilities inadequate to support the efficient and reliable operation of transmission systems, which are needed for the continued development of competitive electricity markets. See Order 2000 at 30,992-93 (discussing the changes to the nation's transmission grid that have resulted in the need for independent managers of the transmission system to ensure fully competitive markets).

⁶⁷See 16 U.S.C. § 825h (2000); see, e.g., Project Decommissioning at Relicensing, 69 FERC ¶ 61,336 at 62,278 (1994).

⁶⁸16 U.S.C. § 825d (2000).

⁶⁹See F.P.C. v. Southern California Edison Co., 376 U.S. 205, 215 (1964).

⁷⁰See Duke Power Co. v. F.P.C., 401 F.2d 930, 938 (D.C. Cir. 1968) (stating that:
(continued...))

this instance the exclusive power of the Commission to regulate public utility transmission services and sales for resale of electric energy in interstate commerce offered by the CAISO. Thus, the fact that the State also has regulatory power in an affected area (e.g., corporate governance) does not preclude the exercise of the Commission's authority.⁷¹

34. The CPUC and the CAISO also state that the fact that Congress did not provide either the Securities and Exchange Commission or the Commission with the authority to dictate the membership of corporate boards in the Public Utility Holding Company Act⁷² demonstrates that Congress did not intend the Commission's jurisdiction under the FPA to extend to corporations chartered under state law. However, with the exception of this vague assertion, they offer no support to demonstrate that this was indeed Congress' intent. We believe that the FPA's prohibition against undue discrimination and unjust and unreasonable rates is broad enough to support our determination here that board selection and governance requirements are practices that have a direct effect on whether the CAISO's rates are just, reasonable, and not unduly discriminatory for transmission and sales in California and the West.

35. In addition, the EOB and the CPUC allege that the Commission's statements in the July 17 Order describing the State as having "pervasive control" of the CAISO and how "the state has direct control of the CAISO with respect to all matters" stand for the

⁷⁰(...continued)

"Born simply a statement of aims, and later reworded without any discernible purpose to substantively change its character, [section 201(a)] is not a limitation on the Commission's exercise of any authority Congress distinctly conferred upon it. This provision is 'merely a policy declaration of great generality. It cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose.' So, 'once a company is properly found to be a 'public utility' under the Act the fact that a local commission may also have regulatory power does not preclude exercise of the Commission's functions.'" (citations omitted)).

⁷¹Our determination here and in the July 17 Order does not preclude the EOB from continuing to function in its oversight role over a limited number of State retail functions. See *Western Power Trading Forum v. FRC*, 245 F.3d 798 (2001). Rather, the issue here concerns the need for the Commission to fulfill our responsibilities that are within our exclusive jurisdiction over interstate transactions under the FPA.

⁷²See Public Utility Holding Company Act of 1935, 15 U.S.C. § 79z-5a (2000).

proposition that the CAISO is an "instrumentality of the state," pursuant to section 201(f) of the FPA.⁷³ These parties rely on section 201(f) to argue that, as an instrumentality of the State, the CAISO does not fall under the Commission's jurisdiction. We find no merit to this argument.

36. The CPUC and the EOB distort the Commission's statement, which was made in the context of describing the problems that have resulted from the CAISO's lack of independence, as standing for the idea that the CAISO has become an official instrumentality of the State that is not within the Commission's jurisdiction. The mere fact that the State has inappropriately attempted to assert its control over the CAISO is not enough to make it an instrumentality of the State under section 201(f). Furthermore, these parties' challenge to the CAISO's status as a public utility subject to the Commission's jurisdiction comes over four years after the Commission first asserted jurisdiction over the CAISO and authorized limited operation of it and after numerous filings in which the CAISO sought the Commission's approval.⁷⁴

37. It is interesting to note that the CPUC and the EOB, in attempting to argue that the CAISO is not subject to the Commission's jurisdiction based on section 201(f), acknowledge that the CAISO is currently under state control. However, the California Independent System Operator, as its name suggests, should operate independently from the State, as well as from all other parties.

3. Other Issues

38. We find that the tax issues CARE raises are unsupported, irrelevant to this proceeding, and beyond the scope of this proceeding. Similarly, CARE's assertion that the CAISO's Board must be elected by California consumers and ratepayers is unsupported by evidence. Because we find no merit to CARE's arguments, we will deny CARE's request for rehearing. With regard to CARE's request that the CAISO's Board be replaced with California ratepayers, we find no merit to this proposal for the reasons described above in which we identified the problems with a Board that represents the interests of one stakeholder group.

Requests for Rehearing Concerning the Advisory Committees

⁷³16 U.S.C. § 824(a) (2000).

⁷⁴See supra note 58.

39. California Municipal Utilities Association (CMUA), Dynegy, and the Metropolitan Water District of Southern California (Metropolitan) request rehearing concerning the advisory committees described in the July 17 Order. CMUA asks that the Commission clarify that it did not intend to prohibit a more formal stakeholder advisory committee structure, including the ability of the stakeholder advisory committee to vote on recommendations to the CAISO's Board. Dynegy requests that the Commission require that the stakeholder advisory process structure be consistent with the processes developed in the Commission's Standard Market Design and/or orders concerning regional transmission organizations. In addition, Metropolitan requests that the Commission allow the DWR to participate in the stakeholder advisory committee (which is composed of non-state entities) because it is currently a market participant that does not participate in establishing or enforcing State energy policy.

40. We will grant CMUA's request for clarification that the July 17 Order does not prohibit the adoption of a more formal structure for the stakeholder advisory committee than was detailed in that order. In addition, once an independent Board is seated pursuant to the July 17 Order, we direct that the Board submit a proposal, within 30 days of its first meeting, to the Commission that details how advisory committees will be formed and operated. To the extent possible, we direct that the independent Board submit a proposal that is consistent with the processes for stakeholder advisory committees we have approved for other regional transmission organizations.⁷⁵

41. In addition, we will deny Metropolitan's request for rehearing. In the July 17 Order, the Commission directed the creation of two advisory committees: one to serve as the State's and its agencies' representative, and the other to serve the interests of the other CAISO stakeholders. While DWR may not "participate in establishing or enforcing state energy policy,"⁷⁶ as Metropolitan alleges, there can be no doubt that this State agency implements State energy policy. In creating two advisory committees in the July 17 Order, the Commission allowed State entities, including DWR, to participate in a separate advisory committee through which they can voice their concerns to the Board.

42. We disagree with Metropolitan's assertion that "[u]nless DWR is able to participate in the Stakeholder Advisory Committee, it will be unjustly deprived of an opportunity to express its own views, and hear the views expressed by other market

⁷⁵See, e.g., Avista Corporation, et al., 95 FERC ¶ 61,114 (2001).

⁷⁶Metropolitan's Request for Clarification at 6.

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participants . . ."⁷⁷ We find that DWR will have every opportunity to express its views through the State advisory committee. For these reasons, we reject Metropolitan's request for rehearing that we allow DWR to participate in the CAISO's stakeholder advisory committee.

The Commission orders:

(A) The requests for stay of the CAISO, the EOB, CARE, and San Francisco are hereby denied, as discussed in the body of this order.

(B) The requests for rehearing of the CAISO, the CPUC, San Francisco, Metropolitan, Dynegy, CARE, and the EOB are hereby denied, as discussed in the body of this order.

(C) The request for rehearing of the CMUA is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

⁷⁷Id. at 6.