

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

California Independent System Operator Corporation	)	Docket Nos. ER04-445-000
	)	ER04-445-001
	)	ER04-445-002
	)	ER04-445-003
)	
Pacific Gas and Electric Company	)	Docket Nos. ER04-443-000
	)	ER04-443-001
	)	ER04-443-002
)	
San Diego Gas and Electric Company	)	Docket Nos. ER04-441-000
	)	ER04-441-001
	)	ER04-441-002
)	
Southern California Edison Company	)	Docket Nos. ER04-435-000
	)	ER04-435-001
	)	ER04-435-003

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

Pursuant to Rule 713 of the Federal Energy Regulatory Commission's ("Commission") Rules of Practice and Procedure, 18 C.F.R. § 385.212, the California Independent System Operator Corporation ("CAISO")¹ submits this request for rehearing of the Commission's July 30, 2004, order, 108 FERC ¶ 61,104 (2004) ("July 30 Order") issued in the above-captioned dockets. The CAISO submits that the July 30 Order is inconsistent with Commission policy and constitutes an unexplained, and therefore impermissible, departure from precedent. Further, even if the Commission's rationale for the July 30 Order were permissible, the decision is nonetheless erroneous

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

because it is not supported by any evidence, and thus, does not constitute reasoned decisionmaking.

I. SUMMARY

The July 30 Order concerns the CAISO's filing of its Large Generator Interconnection Procedures ("LGIP") and joint filing with the CAISO's jurisdictional Participating Transmission Owners ("TOs")² of a Large Generator Interconnection Agreement ("LGIA"). In the July 30 Order, the Commission did not address the substance of either filing. Instead, the Commission only stated tersely that it had previously determined that the CAISO's Governing Board had "failed to meet the independence requirement for [Independent System Operator ("ISO")] status" and that, for this reason, it would reject the CAISO's request that its proposed variations from the Commission's *pro forma* LGIP and LGIA be evaluated under the "independent entity variation" standard. July 30 Order at P 24.

The Commission's summary rejection cannot stand because its underlying premise is erroneous. Under Order No. 2003, the availability of the "independent entity variation" standard is not contingent upon whether an entity proposing variations to the *pro forma* LGIP and LGIA meets some abstract "independence requirement," but simply whether the entity making the filing *is* an Independent System Operator ("ISO") or Regional Transmission Owner ("RTO"). *Id.* at P 822. The Commission approved the CAISO as an ISO approximately seven years ago, has never made any finding to the contrary, and could not do so without providing the CAISO appropriate notice and an opportunity to be heard. The Commission's rejection of the CAISO's filings through the

² The jurisdictional Participating TOs consist of Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company

untimely introduction of a new third category -- non-independent ISOs -- is contrary to the policies of Order No. 2003, internally inconsistent, and constitutes an arbitrary, unjustified, and unlawful departure from Order No. 2003.

The Commission's ruling also does not follow from the stated rationale. Whatever concerns the Commission may have about the CAISO's governance, the basis enunciated in Order No. 2003 for granting ISOs and RTOs greater flexibility (than other transmission providers) in proposing interconnection standards and requirements, *i.e.*, the lack of a bias toward the transmission provider's or an affiliate's generation, applies with full force to the CAISO. The CAISO does not own generation and does not have an affiliate that owns generation. Thus, despite any concerns about governance, the reason for granting deference to ISOs is still valid with respect to the CAISO. The Commission's refusal to consider the CAISO's LGIP as a proposal of an ISO, consistent with Order No. 2003 is therefore arbitrary and capricious.

Even assuming *arguendo* that the Commission could reject the LGIP and LGIA filings based on a finding that the CAISO is not independent, the Commission's decision in the July 30 Order is, nevertheless, invalid because the Commission has not properly found that the CAISO is not independent under the ISO principles set forth in Order No. 2003. The sole basis for the Commission's summary conclusion that the CAISO is not independent is a July 17, 2002, Commission order addressing the governance of the CAISO. That order, however, has been vacated by the United States Court of Appeals. Accordingly, the Commission cannot rely on that order as a basis for finding that the CAISO is not independent. If the Commission intends to find that the CAISO is not independent, the Commission must revisit the issue and identify substantial evidence

supporting any determination regarding the CAISO's independence or lack thereof. The CAISO submits that there is no evidence demonstrating the CAISO's lack of independence in accordance with the standard set forth in Order No. 888. Indeed, California State law explicitly mandates that the Governing Board of the CAISO be independent from Market Participants, and the Governing Board is in compliance with the independence mandate. Thus, there is no basis for the Commission to find that the CAISO is not independent.

In any event, the CAISO believes that the specific elements of the filed LGIP and LGIA are just and reasonable whether the Commission applies the "independent entity variation" or the "consistent with or superior to" standard. Thus, the Commission should promptly approve the CAISO's LGIP and LGIA filings in order to promote long-term reliability, efficiency and stability. However, given that the compliance filings contain deviations from the Commission's *pro forma* LGIP and LGIA and that the Commission has not ruled on the substance of the CAISO's (and the Participating TOs) filings, the Commission should not make the compliance filings effective 60 days from the date of the July 30 Order. It could be detrimental to both the CAISO and Market Participants to implement a compliance filing that could be undone by subsequent Commission action, thereby potentially forcing the CAISO and the PTOs to unravel interconnection decisions/actions that were undertaken prior to Commission action on the compliance filing. Such a procedure adds unnecessary uncertainty to the marketplace.

II. BACKGROUND

On October 21, 2001, the Commission began the process of standardizing agreements and procedures for generator interconnection to electrical transmission systems by issuing an Advanced Notice of Proposed Rulemaking.³ The Commission followed that up with a Notice of Proposed Rulemaking (“NOPR”) issued on April 24, 2002.⁴ A wide range of generation and transmission companies, including transmission providers such as the CAISO, submitted comments on the NOPR. The Commission responded to the comments it received and, in its Final Rule issued on July 24, 2003, set out *pro forma* documents for large generator interconnection.

Order No. 2003 both addressed comments received from the various parties and set out *pro forma* LGIA, LGIP and related study agreements. Order No. 2003 directed each provider of transmission service to make a compliance filing by submitting an LGIA and an LGIP within 60 days of the date of publication of Order No. 2003 in the Federal Register.⁵ In addressing the issue of variations from the standardized *pro forma* interconnection procedures and agreement set forth in Order No. 2003, the Commission indicated that “non-independent Transmission Providers” would be permitted to propose deviations from the pro-forma LGIP and LGIA only if the deviations were in response to established regional reliability standards or were “consistent with or superior to” the *pro forma* provisions. Order No. 2003 at P 26. In contrast, the Commission stated that it would allow Regional RTOs and ISOs “more flexibility to customize an LGIP and LGIA

³ Standardizing Generation Interconnection Agreements and Procedures, Advance Notice of Proposed Rulemaking, 66 Fed. Reg. 55,140 (November 1, 2001, FERC Stats. & Regs. ¶ 35,540 (2001).

⁴ Standardization of Generator Interconnection Agreements and Procedures, Notice of Proposed Rulemaking, 67 Fed. Reg. 22,250 (May 2, 2002), FERC Stats. & Regs. ¶ 32,560 (2002).

to meet their regional needs,” in regards to both terms and conditions, and pricing policies. *Id.* RTOs and ISOs were therefore permitted to submit LGIP and LGIA terms and conditions that meet an “independent entity variation” standard that is more flexible than the “consistent with or superior to” and regional difference standards.⁶

On January 20, 2004, the CAISO filed with the Commission its proposed LGIP, and on February 9, 2004, the CAISO and its jurisdictional Participating TOs jointly filed a proposed LGIA. In those filings, the CAISO explained that the LGIP and LGIA had been developed as a result of a concerted stakeholder process among itself, the affected Participating TOs, and other Market Participants. The CAISO also explained that, although it had endeavored to retain the language of the *pro forma* LGIP and LGIA adopted in Order No. 2003 to the extent possible, it made certain modifications where necessary to (1) specify the respective roles of the CAISO and Participating TOs, reaching agreement where possible with the Participating TOs, (2) reflect regional differences, (3) incorporate appropriate and justifiable variations in accordance with the “independent entity variation” standard, or (4) incorporate changes that are consistent with or superior to the Commission’s *pro forma* procedures and agreement.

⁵ Order No. 2003 at P 910.

⁶ See *id.* at P 26, which states, in pertinent part: “Most importantly, we note that the Final Rule applies to independent and non-independent Transmission Providers alike, but non-independent Transmission Providers are required to adopt the Final Rule LGIP and Final Rule LGIA into their OATTs, with deviations from the Final Rule justified using either the ‘regional differences’ or ‘consistent with or superior to’ standard. We also allow Regional Transmission Organizations (RTOs) and ISOs more flexibility to meet their regional needs. While RTOs and ISOs are required to submit compliance filings, they may submit LGIP and LGIA terms and conditions that are meet an ‘independent entity variation’ standard that is more flexible than the ‘consistent with or superior to’ standard and the regional differences standard.”

On March 5, 2004, the Commission issued Order No. 2003-A, its Order on Rehearing of Order No. 2003.⁷ Therein, the Commission reaffirmed the legal and policy conclusions on which Order No. 2003 was based. In response to various rehearing requests, the Commission modified a number of the provisions of the *pro forma* LGIP and LGIA as set forth in Order No. 2003. Importantly, in Order No. 2003-A, the Commission continued to recognize the principle enunciated in Order No. 2003 that ISOs and RTOs have the flexibility to tailor the LGIP and LGIA in order to best meet their regional needs, pursuant to the “independent entity variation” standard. The Commission stated that those ISOs and RTOs that filed their own tailored interconnection agreement and procedures pursuant to Order No. 2003’s “independent entity variation” standard would not be required to refile their interconnection agreement and procedures with the Commission unless a change was needed to reflect the modifications made in Order No. 2003-A. Pursuant to this direction, the CAISO filed a revised LGIP on April 23, 2004, and jointly filed with the jurisdictional Participating TOs on the same date a revised LGIA. Consistent with the approach adopted in the CAISO’s original LGIP and LGIA filings, the CAISO and the jurisdictional Participating TOs endeavored to retain the language of the *pro forma* LGIP and LGIA, as revised in Order No. 2003-A, to the extent possible. Indeed, most of the modifications reflected in the filing were the result of directly adopting the modifications made by the Commission in Order No. 2003-A. As with its original filings, however, certain modifications to the Order No. 2003-A language were necessary for the four reasons articulated above.

⁷ 106 FERC ¶ 61,220 (2004) (“Order No. 2003-A”)

In the July 30 Order, the Commission rejected in their entirety the CAISO's proposed LGIP and the LGIA filed jointly by the CAISO and the jurisdictional Participating TOs. The Commission did not address the merits of either filing. Instead, it based its rejection solely on its view that the CAISO was not permitted to propose variations from the *pro forma* LGIP and LGIA using the "independent entity variation" standard because the Commission had already found that the CAISO was not "independent."⁸

III. SPECIFICATIONS OF ERROR

The CAISO respectfully submits that the July 30 Order erred in the following respects:

- The Commission's decision is inconsistent with its stated rationale for Order No. 2003.
- The Commission's rejection of the filed LGIP and LGIA on the grounds that the CAISO is not entitled to have such filings evaluated under the "independent entity standard" that Order No. 2003 accorded to all ISOs and RTOs constitutes an unexplained and, therefore, impermissible departure from Order No. 2003.
- The Commission's finding that the CAISO is not independent is not supported by substantial evidence and is not the product of reasoned decisionmaking.
- The Commission's decision to make the CAISO's compliance filing, as required by the July 30 Order, effective 60 days after the date of that order rather than 60 days after acceptance of the compliance filing, is unreasonable.

⁸ The Commission did not consider any of the variations that the ISO had proposed under the

IV. ARGUMENT

A. **The Commission's Failure to Apply the Standard Applicable to ISOs to the CAISO's LGIP and LGIA Filings Undermines the Policy Objectives of, and Constitutes an Impermissible Departure from, Order No. 2003.**

1. **The Commission's Decision Undermines The Policy Objectives of Order No. 2003.**

The Commission's decision rejecting the ISO's LGIP and LGIA filings undermines the Commission's own policy justifications for permitting ISOs and RTOs increased latitude to propose modifications to the standardized interconnection procedures and agreement – that is, to provide ISOs and RTOs greater flexibility to meet regional needs, taking into account the different operating circumstances of ISOs based on their individual sizes and locations. Order No. 2003 at P 827. The CAISO is still the transmission operator for the majority of the electricity grid in California. Depriving the CAISO of the benefits of ISO membership will only serve to hamstring the CAISO in carrying out its already difficult mission to provide the most reliable and efficient service possible to its Market Participants. In effect, the Commission expects the CAISO to operate the transmission systems of ever increasing numbers of Participating Transmission Owners as an ISO, but then treats the CAISO, in a regulatory sense, as if it were not doing so. Such a result is untenable, both from the legal and practical perspectives.

Denying the CAISO the ability to rely on the "independent entity variation" to justify any deviation from the *pro forma* LGIP and LGIA serves no purpose. A primary

"consistent with and superior to" standard, stating that the CAISO had not explained with specificity which variations met this standard. July 30 Order a P 24.

purpose of Order No. 2003 was to prevent undue discrimination in the form of transmission providers “favoring” their own generation or generation owned by an affiliate in the interconnection process. Order No. 2003 at P 822. That problem does not exist here because the CAISO does not own generation and does not have an affiliate that owns generation. Indeed, in Order No. 2003, the Commission recognized that ISOs should be treated differently than transmission providers who own, or whose affiliates’ own, generation because they do not raise the same concern regarding undue discrimination. Thus, even though the Commission may have concerns about the CAISO’s governance, the rationale for permitting use of the “independent variation standard” in Order No. 2003, *i.e.*, the lack of a bias toward the transmission provider’s or an affiliate’s generation, still applies to the CAISO. As such, the Commission should grant deference to the CAISO. There is no rational basis, or need, to deny the CAISO the opportunity to rely on such standard under these circumstances.

2. The Commission Has Determined that the CAISO Is an ISO, and the Commission Cannot Deprive the CAISO of ISO Status Without Due Process

Order No. 2003 explained that, if the entity proposing variations to the *pro forma* LGIP and LGIA was an ISO or RTO, then that entity would have increased latitude or flexibility with respect to those variations:

With respect to an RTO or ISO, at the time its compliance filing is made, . . . we will allow it to seek "independent entity variations" from the Final Rule pricing and non-pricing provisions. This . . . recognizes that an RTO or ISO has different operating characteristics depending on its size and location and is less likely to act in an unduly discriminatory manner than a Transmission Provider that is a market participant. The RTO or ISO shall therefore have greater flexibility to customize its interconnection procedures and agreements to fit regional needs.

Order No. 2003 at PP 822, 827. This passage makes no distinction among ISOs, nor does it single out the CAISO for separate and less favorable treatment than other ISOs. Because the CAISO is an ISO, and the “independent entity variation” enunciated in Order No. 2003 applies to all ISOs, the CAISO should be permitted to rely on such standard, just like all other ISOs.

If an entity is an ISO or RTO, then, as Order No. 2003 correctly recognized, it has certain inherent characteristics that justify a greater degree of flexibility in customizing its interconnection procedures and agreements in order to accommodate regional needs: namely, RTOs and ISOs have different operating characteristics, depending on their size and location, and are less likely to act in an unduly discriminatory manner than transmission providers that are themselves market participants or which have affiliates that are market participants. This description is as applicable to the CAISO as it is to every other ISO. The CAISO does, indeed, have different operating characteristics from other transmission providers because of its role in operating the transmission lines of a number of Participating TOs, as well as an energy market. Moreover, the CAISO is not itself a “market participant” in any sense of the term and does not have an affiliate that is a market participant. Further, the CAISO is a not-for-profit, revenue neutral entity, the primary mission of which is to ensure the reliability of the electrical grid entrusted to its oversight. As such, it has no financial interest in the transmission or interconnection services that it would provide under the proposed terms of the LGIP and LGIA. Thus, the CAISO is less likely to act in an unduly discriminatory manner than a transmission provider that is itself a Market Participant or that has an affiliate that is a market participant. In particular, the CAISO is

in no position to favor a marketing or generation affiliate because it has no marketing or generation affiliate.

The absence of a distinction between “independent” and “non-independent” ISOs and RTOs in Order No. 2003 is not surprising, for the simple reason that, by definition, there can be no such entity as a “non-independent ISO.” The term Independent System Operator is not a generic descriptor, but denominates a status defined by the Commission in Order No. 888.⁹ Therein, the Commission articulated eleven criteria for recognition as an ISO, the first of which was independence. *Id.* at 21,596. The concept of a “non-independent” ISO is thus an oxymoron. A transmission provider cannot be an ISO if it is not independent.

When the Commission authorized the CAISO’s operation, it recognized the CAISO’s status as an ISO.¹⁰ Although the Commission conditioned its orders on the resolution of certain governance issues, those issues were resolved¹¹ and the Commission unconditionally approved the CAISO’s governing structure.¹² Over the seven years since those governance issues were resolved, the Commission has never found, or even suggested, that the CAISO is no longer an ISO. To the contrary, the Commission has explicitly stated otherwise. *See, e.g., Remediating Undue Discrimination through Open Access Transmission Service and Standard Electricity*

⁹ FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh’g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048, *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 relevant part sub nom.* Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *aff’d sub nom.* New York v. FERC, 535 U.S. 1 (2002).

¹⁰ *See San Diego Gas & Electric Co., et al.*, 77 FERC ¶ 61,204 (1996); *Pacific Gas & Electric Co., et al.*, 77 FERC ¶ 61,295 (1996), *Pacific Gas & Elec. Co.*, 81 FERC ¶ 61,122 (1997) (Orders authorizing the establishment of the CAISO).

¹¹ *See California Electricity Oversight Board*, 89 FERC ¶ 61,134 at 61,380-81 (1999).

Market Design, 100 FERC ¶ 61,138 at P 23 (2002) (indicating that the Commission approved the CAISO as an ISO). Indeed, the Commission has disclaimed any suggestions that its concerns about CAISO governance have affected the CAISO's status as an ISO. At oral argument before the Court of Appeals for the District of Columbia Circuit, the Commission's Solicitor, when asked by the Court whether the Commission could not, instead of attempting to mandate the governance structure of the CAISO, simply find that the CAISO was not an ISO under the terms of Order No. 888, stated that the CAISO was still an ISO:

JUDGE SENTELLE: So very easily you could say, or FERC could say this entity is not independent. It's not an ISO within the meaning of 888, right?

MR. LANE: You could say that, Your Honor.

JUDGE SENTELLE: Yes.

MR. LANE: But you would be incorrect, because the definition of an ISO is that the group of utilities still own the facilities, but the ISO operates it.

Transcript of Proceedings, *California Independent System Operator Corp. v. FERC*, No. 02-1287, *et al.* (May 17, 2004) at 19:23-20:5. A few moments later, after Mr. Lane noted that the first ISO principle under Order No. 888 was independence, Judge Sentelle asked Mr. Lane if the independence principle in Order No. 888 was what the Commission was acting on, "then isn't your proper action to say this isn't an independent SO?" *Id.* at 20:23-21:1. Once again, Mr. Lane answered in the negative. *Id.* at 21:2-6.

Therefore, the CAISO continues to be an ISO, under the terms of Order No. 888, as approved by the Commission, as acknowledged in the Commission's orders

¹² See *California Electricity Oversight Board*, 91 FERC ¶ 61,124 (2000).

concerning the ISO, and as reflected in the public avowals of the Commission and the Commission's counsel.

Importantly, even if the Commission wished to find that the CAISO was no longer an ISO, it certainly could not deprive the CAISO of ISO status without due process – namely, notice and an opportunity to be heard on the matter.¹³ Moreover, any such finding would have to be supported by substantial evidence and a rational explanation. Yet, by its July 30 Order, the Commission, for practical purposes, circumvented these basic tenets of administrative procedure by disregarding the very status it previously granted the CAISO without any explanation and without the support of substantial evidence. The Commission has done this by denying the CAISO the opportunity to propose and justify modifications to the standardized interconnection procedures and agreement under the standard that, by the explicit terms of Order No. 2003, is available to all ISOs and RTOs, thus denying to the CAISO the attendant advantages of ISO status.¹⁴

¹³ "It is well-established that '[a] party is entitled ... to know the issues on which decision will turn and to be apprised of the factual material on which the agency relies for decision so that he may rebut it. Indeed, the Due Process Clause forbids an agency to use evidence in a way that forecloses an opportunity to offer a contrary presentation.'" *Williston Basin Interstate Pipeline Co. v. FERC*, 115 F.3d 54, 63 (D.C. Cir. 1999). Thus, the Commission would need to inform the CAISO of the specific facts upon which it intends to rely to support a finding the CAISO is no longer an ISO.

¹⁴ Notwithstanding the fact that the Commission's rejection of this order is unfounded for the reasons set forth herein, the outright rejection of this order is a departure from previous practice whereby orders were conditioned upon resolution of governance, and therefore appears punitive in nature.

3. The Commission Cannot Treat the CAISO Differently than Other ISOs under Order No. 2003 Without Properly Justifying its Departure from Order No. 2003, or Engaging in a New Rulemaking to Modify the Terms of Order No. 2003

As explained above, the CAISO is still an ISO and will continue to be such unless substantial evidence permits the Commission to find otherwise, after following appropriate due process procedures. Under 18 C.F.R. § 35.28(f)(ii), deviations from the *pro forma* LGIP and LGIA are to be evaluated according to the standards set forth in Order No 2003 – which specifies that a Transmission Provider approved as an ISO or RTO may propose deviations from the LGIP and LGIA prescribed in the Order “to fit regional needs.” Order No. 2003 at P. 827. The Commission is bound by its own regulations, and cannot play “fast and loose” with those regulations. *Panhandle Eastern Pipeline Co. v. FERC*, 613 F.2d 1120, 1135 (D.C. Cir. 1979). That a regulation as written does not provide the Commission the desired result, does not authorize the Commission to ignore the regulation. *Id.* Therefore, the Commission cannot deny the CAISO the ability to propose deviations from the *pro forma* LGIA and LGIP on the same basis as any other ISO or RTO.

Moreover, even if the standard is not considered part of the Commission’s regulations, the Commission cannot apply a different standard without recognizing that it is departing from Order No. 2003, and justifying that departure. It is axiomatic that if a regulatory agency wishes to depart from established precedent on a particular matter, it must provide a justification for doing so. *See Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) (noting that “if an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute”); *see also Williston Basin Interstate Pipeline Co. v. FERC*, 165

F.3d 54, 69 (D.C. Cir. 1999) (“By failing to distinguish the authority on which Williston Basin relied in support of its position, and which at least superficially contravened the Commission’s ruling, the agency appeared to “gloss[] over or swerve[] from prior precedents without discussion . . . thereby foregoing reasoned decision making.”); *Hatch v. FERC*, 654 F.2d 825 (D.C. Cir. 1981).

In the July 30 Order, however, the Commission failed to justify its departure from Order No. 2003. Indeed, the July 30 Order, because it conjures up the new concept of a non-independent ISO – a concept that is not contemplated by Order No. 2003 and cannot indeed exist -- does not even recognize that the Commission is departing from Order No. 2003. Thus, the July 30 Order offers no explanation for departing from Order No. 2003’s application of a single standard to all ISOs and RTOs. Because the Commission did not enunciate any reasons or provide any justification for its departure from Order No. 2003 in the July 30 Order, the Commission’s disparate treatment of the CAISO is arbitrary, capricious, and not the product of reasoned decision making.

Further, even if the Commission is now of the opinion that the standard for proposing modifications to the standardized interconnection terms of Order No. 2003 should be refined to include some distinction between ISOs, the Commission can only revise that requirement after additional notice and comment procedures. Because Order No. 2003 was issued after notice and comment, it can only be revised after further notice and comment.¹⁵ The Commission cannot modify the final rule unannounced under the pretext of a ruling on the CAISO’s compliance filings. It “may not slip by the notice and comment rule-making requirements needed to amend a rule

¹⁵ See *Columbia Falls Aluminum Co. v. EPA*, 139 F.3d 914 (D.C. Cir.1998) (“Once a rule is final, an agency can amend it only through a new rulemaking.”).

by merely adopting a de facto amendment to its regulation through adjudication.”

Marseilles Land & Water Co. v. FERC, 345 F.3d 916 (2003). In sum, unless or until the Commission, upon appropriate notice and comment procedures, modifies either Order No. 2003 or the CAISO’s status as an ISO, the Commission must evaluate the CAISO LGIP and LGIA filings under the “independent entity variation” standard where proposed. For this reason, the Commission must grant rehearing.

B. Even Assuming *Arguendo* That the Commission Could Reject the LGIP/LGIA Because the CAISO Does Not Meet the Independence Requirement, It Has Not, and Can Not, Properly Make Such a Finding

Preliminarily, the CAISO notes that the Governor of California is currently in the process of making new appointments to the CAISO Governing Board. Therefore, it is premature for the Commission to make a finding that the CAISO is not independent, prior to the Commission evaluating the effect that these new appointments have on the composition of the ISO Governing Board and the overall independence of the CAISO. The ISO is today seeking an extension of the compliance filing in this matter so that the Commission can take these matters into account.

Aside from this consideration, the July 30 Order cannot stand. Assuming, *arguendo*, that the Commission can properly reject the CAISO’s request to evaluate its proposed variations from the pro-forma LGIP and LGIA under the “independent entity variation” standard based on a finding that the CAISO is not independent, the Commission’s decision in the July 30 Order is nevertheless invalid, because the Commission has not properly made such a finding, and the Commission has no grounds for doing so given present circumstances.

First, the Commission has not made a proper finding, based on substantial evidence, that the CAISO is not independent. In the July 30 Order, the Commission did not undertake to explain why or how the CAISO fails to meet the independence requirement of Order No. 888. Instead, the Commission's decision was based *solely* on its July 17, 2002, Governance Order, *California Independent System Operator Corp.*, 100 FERC ¶ 61,059 (2002). ("Governance Order"). That order, however, was vacated and remanded by the D.C. Circuit Court of Appeals, *California Indep. Sys. Oper. Corp. v. FERC*, 372 F.3d 395 (D.C. Cir. 2004). Therefore, the Commission cannot rely on any findings made therein. When an Article III court reverses and remands an order, the order is considered repealed and revoked. *See Federal Communications Comm'n v. Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940). The Supreme Court has pronounced that a reversed judgment is "without any validity, force or effect, and ought never to have existed." *Butler v. Eaton*, 141 U.S. 240, 244 (1891) (Emphasis added.). This is significant because, as the U.S. Court of Appeals for the D.C. Circuit has explained, there is a distinction between invalidating a lower order and merely remanding it, without vacating it. *See, e.g., Commonwealth of Massachusetts v. NRC*, 924 F.2d 311, 336 (D.C. Cir. 1991) ("In appropriate cases we will remand without vacating an agency's order where the reason for the remand is a lack of reasoned decisionmaking. . . . 'Relevant to the choice are the seriousness of the order's deficiencies (and thus the extent of doubt whether the agency decided correctly) and the disruptive consequences of an interim change that may itself be changed,'" *quoting UMW v. Mine Safety and Health Admin.*, 920 F.2d 960, 967 (D.C. Cir. 1990).) The Governance Order must therefore be treated as null and void in all respects, and the

Commission therefore cannot rely on any findings made therein as the basis for rulings in other cases. Because the Commission's sole basis for its finding in the July 30 Order that the CAISO is not independent is based on the Governance Order, that finding must fail as arbitrary and capricious and not the product of reasoned decisionmaking.

In any event, even if the Commission were to revisit this issue today, there would not be any basis for finding that the CAISO fails to meet the independence requirements of Order No. 888. Order No. 888 required that, to meet the independence standard for an ISO, an ISO must be independent of any individual market participant or any one class of market participant. Order No. 888 at 31,730. In that regard, an ISO cannot be owned by any market participant, and the ISO and its employees cannot have a financial interest in the economic performance of any power market participant. *Id.* at 31,731.

The CAISO's governance meets this requirement. Although Order No. 888 does not define market participant, the Commission provided a definition in Order 2000.¹⁶ It has two parts. A market participant is any entity that either: (a) "sells or brokers electric energy, or provides transmission or ancillary services" to the ISO in question; or (b) "has economic or commercial interests that would be significantly affected by the [RTO's] decisions or actions." *Id.* at 31,061-62. The Commission stated that a broader definition of Market Participant that included every residential, commercial, industrial or wholesale service customer in the region was "too encompassing and was not [the Commission's] intent." *Id.* at 31,062. The Commission stressed that it was "narrowing the definition of a market participant in the Final Rule to include those who sell or broker electric energy but not those who buy electric energy." *Id.* Only as a backstop, did the

Commission include the second prong of the market participant test. The Commission explained that although the definition of market participant was generally limited to sellers and brokers, this second prong was necessary in order to guard against “circumstances where buyers of electric energy could buy a controlling interest in a for-profit RTO and manipulate its access and curtailment decisions to their advantage.” *Id.*

Safeguards exist such that “market participants,” so defined by the Commission, cannot participate in the CAISO governance. In that regard, members of the CAISO Governing Board are prohibited by statute from having a direct or indirect affiliation with participants in CAISO markets, thereby establishing the independence from Market Participants that is enunciated in Order No. 888. See Cal. Pub. Util. Code §337(b). This limitation establishes the ISO’s independence from market participants in accordance with the standard set forth in Order No. 888. Moreover, consistent with the definition of Market Participant set forth in Order 2000 and the independence principles enunciated in Order No. 888, neither the CAISO nor any Governing Board member has a financial interest in the economic performance of any entity that sells electric energy, provides transmission service, or provides Ancillary Services to the CAISO. Order No. 888 at 31,731; Order No. 2000 at 31,061-62. The CAISO notes that the CAISO Bylaws require that all CAISO employees and Board members to be financially independent of market participants. *Id.*¹⁷ Further, in accordance with Order No. 889, the CAISO has Standards of Conduct on file with the Commission reflecting the standards enunciated in Order No. 888.

¹⁶ *Regional Transmission Organizations*, 65 Fed. Reg. 809 (2000).

¹⁷ See Amended and Restated Bylaws of California Independent System Operator Corporation, Article III, Section 4.2 (available at <http://www.caiso.com/docs/2000/06/01/2000060110361815044.pdf>).

In any event, the Commission previously found the CAISO to be an ISO at a time when the CAISO had a Governing Board that comprised stakeholder representatives, including representatives of entities that sold power to the CAISO and provided transmission service and Ancillary Services to the CAISO. Thus, the Commission concluded that the previous Board met the ISO criteria for independence. The State law safeguards that are now in place ensure that members of the CAISO Governing Board are, individually, more independent of Market Participants than was the case under the CAISO's previous stakeholder Governing Board. Under these circumstances, there is no reasonable basis for the Commission to find that the CAISO's Governing Board does not meet the independence requirement of Order No. 888. The current Board certainly is more independent than the stakeholder Board which the Commission previously found satisfied the Order No. 888 independence standard.

C. The CAISO's Compliance Filing Should be Made Effective Upon Commission Acceptance of That Filing, Rather than 60 Days After the Date of the July 30 Order

In the July 30 Order, the Commission stated that the ISO's compliance filing made pursuant to that order will be effective 60 days after the date of the July 30 Order. July 30 Order at 25. The Commission should grant rehearing on this issue and state that the CAISO's compliance filing will become effective upon the Commission's order accepting that compliance filing, thus allowing existing procedures to remain effective until that time. This approach makes more sense than a 60-day effective date because the Commission has yet to make any substantive ruling on the ISO's compliance proposal. That compliance proposal will include deviations from the standardized

interconnection procedures and agreement set forth in Order No. 2003 and 2003-A that the Commission may or may not accept. The CAISO believes that the specific elements that it is proposing are just and reasonable whether the Commission applies the “independent entity variation” standard or the “consistent with or superior to” standard and, as such, should be approved by the Commission. However, the CAISO believes that it is important at this time to have some certainty and stability in the interconnection process. It would be detrimental to both the CAISO as well as Market Participants for the CAISO to implement a compliance filing that could be undone by a subsequent Commission order. For instance, if the Commission were to order changes to the CAISO’s compliance filing after the provisions of that compliance filing went into effect, such modifications could change the fundamental basis for the commitments made between interconnecting generators and the relevant Participating TOs. Modifications to the CAISO’s compliance filing might also require the CAISO to reconstruct the interconnection queue.¹⁸ Finally, setting the effective date for the ISO’s compliance filing prior to the Commission’s approval of that order is inconsistent with the principle articulated in *Electrical District No. 1 v. FERC*, 774 F.2d 490 (D.C. Cir. 1985), in which the Court found that the Commission could not lawfully make a rate increase effective as of the date of its order directing a compliance filing, rather than upon the date of acceptance of the compliance filing. *Id.* at 494-95. Accordingly, the Commission should grant rehearing and state that the compliance filing will be effective on the date that the Commission issues an order on such filing.

¹⁸ See *Order Granting Rehearing*, 100 FERC ¶ 61,235 (2002) (Granting rehearing and setting the effective date for modifications to the CAISO Tariff dealing with interconnection issues to the date of the order approving those modifications).

Finally, as stated above, the Governor of California is in the process of making new appointments to the CAISO Board. The CAISO recommends that the Commission not take further action regarding the substantive elements of the CAISO's filing in this proceeding until issues regarding the independence of the CAISO Board are resolved. Moreover, the Commission should ensure that the CAISO existing interconnection procedures remain in effect until all matters in the instant proceeding are resolved. Regulatory stability is a key prerequisite to well functioning markets and investment in the markets and the establishment of interim interconnection rules would only serve to destabilize the California market.

V. CONCLUSION

Wherefore, for the reasons discussed above, the CAISO respectfully requests that the Commission reverse the July 30 Order, and re-evaluate the CAISO and joint LGIP and LGIA filings under the "independent entity variation" standard, as set forth in Order No. 2003.

Respectfully submitted,

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Dated: August 30, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, CA, on this 30th day of August, 2004.

/s/ Gene L. Waas
Gene L. Waas