UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	Docket No. EL04-24-000

INITIAL BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	EL04-24-000

Pursuant to the Commission's Order of February 17, 2004, in the above identified proceeding, the California Independent System Operator Corporation ("ISO") respectfully submits its Initial Brief.

SUMMARY

This proceeding is an appeal of an arbitration award ("Award") concerning the authority of the ISO to charge San Diego Gas & Electric Company ("SDG&E"), as Scheduling Coordinator, for Transmission Losses associated with Schedules on portions of the South West Power Link ("SWPL") owned by Arizona Public Service ("APS") and Imperial Irrigation District ("IID"). The Award concluded that the ISO lacked that authority.

I. Opinion No. 463-A Compels Reversal of the Arbitrator's Decision

As discussed below, the plain language of the ISO Tariff and the factual record establish that SDG&E is responsible for Transmission Losses for Schedules on the APS and IID owned portions of SWPL. Since the Arbitrator's decision, however, the Commission has issued Opinion No. 463-A, *California Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,032 (2004), which is dispositive of

the issue of SDG&E's responsibility for Transmission Losses in connection with Schedules on the APS and IID portions of SWPL.

In Opinion No. 463-A, an Order on Rehearing regarding the ISO's Grid Management Charge, the Commission rejected SDG&E's arguments and concluded that the APS and IIS Schedules transmitted Energy on the ISO Control Grid and that the ISO therefore could charge SDG&E the administrative costs of procuring Imbalance Energy to cover Transmission Losses for the APS and IID Schedules. The Commission concluded that SDG&E was responsible for submitting balanced schedules, that the ISO needed to procure Imbalance Energy to cover imbalances, and the SDG&E was therefore responsible for the net cost of procuring that Imbalance Energy, including the Imbalance Energy relating to Transmission Losses. If the ISO is authorized to charge SDG&E the administrative costs of procuring Imbalance Energy to cover Transmission Losses, then the inescapable conclusion is that the ISO is authorized to charge SDG&E for the Transmission Losses themselves.

II. The ISO Is Authorized To Assess Charges for Transmission Losses On Those Portions of SWPL Owned by APS and IID.

The Award is based upon the Arbitrator's erroneous conclusion that SDG&E "could not and did not" transfer the portions of SWPL owned by APS and IID to the ISO's Operational Control and that those portions were therefore not a part of the ISO Controlled Grid and not subject to ISO charges for Transmission Losses. Many aspects of Operational Control, however, are not related to ownership. Ownership of physical facilities is not a prerequisite to transfer of rights in connection with those facilities to the ISO. For example, some

Participating Transmission Owners transfer to the ISO's Operational Control only their rights under Existing Contracts. In the case of SWPL, the Participation Agreements (which establish the rights of the co-owners) assign to SDG&E various obligations and rights for the portions of SWPL owned by APS and IID. SDG&E also had additional responsibilities as Control Area Operator. Nothing prevented SDG&E, when transferring to the ISO Operational Control those portions of SWPL that it owns, from also transferring to the ISO those rights and obligations that it had under the Participation Agreements and as Control Area Operator regarding the portions of SWPL owned by APS and IID. The Transmission Control Agreement ("TCA") and ISO Tariff make provision for circumstances in which the Operational Control transferred to the ISO involves less than an unrestricted ability to use the facilities. The ISO Tariff and the TCA contemplate that jointly-owned facilities in the ISO Control Area may be placed under the ISO's Operational Control by the joint owner with Scheduling, Control Area, and other responsibilities for those facilities, subject to the rights conferred by the joint ownership agreements. SDG&E in the TCA properly identified the Participation Agreements as Existing Contracts restricting the ISO's use of SWPL.

The Arbitrator's conclusion also misinterprets "Operational Control" to require that the ISO have the ability to direct "whose energy, at what times, and in what amounts" is Scheduled on capacity that is under the ISO's Operational Control. The ISO's ability to direct Participating TO's, however, goes far beyond ability to direct the source, quantity or timing of energy. In addition, for example,

the ISO exercises Operational Control over the ISO Controlled Grid for the purpose of providing a framework for the efficient transmission of electricity, securing compliance with all Applicable Reliability Criteria, relieving Congestion, and assisting Market Participants to comply with other operating criteria, contractual obligations and legal requirements binding on them. Moreover, the Arbitrator's reasons for excluding capacity subject to the Participation Agreements would apply to *any* capacity subject to *any* Existing Contract on a Participating TO's facilities. Yet there is no question that capacity subject to Existing Contracts is part of the ISO Controlled Grid.

The Arbitrator also relied upon the identification of SWPL as co-owned in the TCA. The TCA does not support the Arbitrator's conclusion. In Appendix A to the TCA, SDG&E submitted a diagram of the transmission lines and related facilities, including the entirety of SWPL, that were being placed under the ISO's Operational Control, which did not identify any limitation on the Operational Control. That it marked portions of SWPL in the diagram as being "co-owned," as noted above, does not preclude the Participating TO from transferring to the ISO its Operational Control over the portions of the transmission line that it does not own. SDG&E identified the Participation Agreements as Encumbrances – restrictions on facilities under the ISO's Operational Control – in Appendix B to the TCA. SDG&E also listed the entirety of SWPL in the official ISO Register, the official listing of facilities under the ISO's Operational Control.

Further, SDG&E's own conduct reveals its intent to place the portions of SWPL owned by APS and IID under the ISO's Operational Control. SDG&E

sought to recover through its TO Tariff the cost differentials between the ISO's charges for Transmission Losses for Schedules under Existing Contracts and the compensation SDG&E could receive for the Transmission Losses under the Existing Contracts, which cost differentials can only arise from facilities under the ISO's Operational Control. Shortfalls associated with the APS and IID portions of SWPL are the *only* shortfalls that SDG&E could have sought to recover in that proceeding. From the beginning of the ISO's operations until Opinion No. 458, SDG&E treated the APS and IID portions of SWPL as under the ISO's Operational Control for the purpose of accounting for Transmission Losses.

Although the Arbitrator cites the "shares" of the Mead-Phoenix transmission line, the Pacific DC Intertie, and the California-Oregon Transmission Project ("COTP") as instances where only portions of lines have been turned over to the ISO's Operational Control without creating any operational difficulties, none of the situations is analogous to SWPL. In each case, the rights and obligations of the Participating TO, and thus the nature of the ISO's Operational Control, were far more limited than those of SDG&E with regard to SWPL.

III. SDG&E, as Scheduling Coordinator, Is Responsible for the Charges for Transmission Losses.

The ISO transacts business only through Scheduling Coordinators. SDG&E is the Scheduling Coordinator for the Schedules under the Participation Agreements and, until the Commission rejected its recovery of Transmission Losses shortfalls through the TRBA, accepted responsibility for the payment of Transmission Losses associated with those Schedules. Under the Scheduling Coordinator Agreement ("SC Agreement") that SDG&E has signed, SDG&E must

comply with the ISO Tariff, which specifically requires Scheduling Coordinators to pay for Transmission Losses. Because SDG&E submits the Schedules for the Participation Agreement to the ISO, and the ISO only deals with Scheduling Coordinators, it must follow that SDG&E is the Scheduling Coordinator for the APS and IID transactions under the Participation Agreements.

There can be no question that SDG&E signed the SC Agreement in order to Schedule the SWPL transactions. At the time it signed the SC Agreement, SDG&E could not Schedule its own retail and merchant transactions because the restructuring of the California electricity market required SDG&E to sell all of its generation into and buy all of its needs out of the California Power Exchange ("PX"). The only possible transactions for which SDG&E needed to sign an SC Agreement were the APS and IID SWPL transactions. SDG&E's internal documents also demonstrate that it understood that it would operate as Scheduling Coordinator for the APS and IID transactions on SWPL. Moreover, as discussed above, SDG&E sought to recover the Transmission Losses shortfalls associated Schedules under the Participation Agreements through its TO Tariff.

IV. The Greater Part of SDG&E's Claims Involved Charges that Have Been Deemed Valid Under the ISO Tariff.

Under the ISO Tariff, the ISO provides Scheduling Coordinators, for each day, a Preliminary, and later a Final, Settlement Statement that includes all charges payable to or owed by the Scheduling Coordinator. A Scheduling Coordinator has eight days in which to notify the ISO of errors in the Preliminary Settlement Statements, and ten days in which to notify the ISO of errors in Final

Settlement Statements. Unless a Scheduling Coordinator disputes a charge on a Preliminary Settlement Statement within those periods, the Scheduling Coordinator is deemed to have validated the charge and the Settlement Statement is binding on the Scheduling Coordinators. Of the various charge types for which SDG&E makes a claim, SDG&E failed to submit an electronic dispute form for all but one, for which it did not submit a dispute form for Charge Type 487 until December of 2000. Therefore, even if one assumes, arguendo, that SDG&E could have appropriately challenged the charges at issue, under the applicable provisions of the ISO Tariff, the greater part of SDG&E's claims are for charges that have been deemed valid, and its claims are thus precluded.

BACKGROUND

I. Procedural Background

On July 6, 2001, SDG&E submitted a Statement of Claim to the ISO, the ISO Governing Board, and the American Arbitration Association under Section 13.2.2 of the Tariff. The Statement of Claim concerned charges for Transmission Losses[1] that the ISO procured in connection with transactions scheduled by SDG&E on SWPL. On August 3, 2001, the ISO filed a Response to Claim.

In its Statement of Claim, SDG&E sought declaratory and injunctive relief against the ISO on the following bases:

1) breach of written contract;

2) breach of implied covenant of good faith and fair dealing;

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

3) declaratory relief;

4) unfair business practices under Cal. Bus. and Prof. code § 17200; and

5) breach of fiduciary duty.

Statement of Claim at 1 (R. 0001).

SDG&E claimed that the ISO improperly charged SDG&E for Transmission Losses caused by the use of SWPL by other entities with undivided, minority ownership shares in the line, in contravention of the ISO Tariff and contract obligations. Statement of Claim at 2 (R. 0002). In addition, SDG&E accused the ISO of interpreting Amendment No. 33 to the ISO Tariff in a manner that "penalized" SDG&E for the use of SWPL by these other owners. SDG&E claimed that while the ISO had corrected this problem on a prospective basis, it failed to do so retrospectively. Statement of Claim at 3 (R. 0003).

In its Response to Claim, the ISO denied each allegation made by SDG&E. Response to Claim at 5 (R. 0023).

On January 11, 2002, and again on March 29, 2002, SDG&E filed an amended Claim for Damages. The Amended Claim of March 29 included the claim of undue discrimination, which had not been included in the original Statement of Claim (R. 0034) and which SDG&E subsequently abandoned due to a lack of any evidence that the ISO treats Transmission Losses differently on SWPL than on other similarly situated lines.

An arbitration hearing was set to commence on June 18, 2002.

On May 22, 2002, the ISO filed a Motion to Dismiss and/or Stay the Arbitration proceedings, arguing that the proceedings were an inappropriate

effort by SDG&E to 1) challenge the justness and reasonableness of the ISO's FERC-approved Tariff; 2) collaterally attack previous FERC decisions; and 3) litigate issues that were the exclusive jurisdiction of FERC. Motion to Stay at 1 (R. 0055). Following pleadings for and against the ISO's May 22 Motion, the Arbitrator issued an order to stay the proceedings on June 14, 2002, stating that the proceeding would be stayed "pending the outcome of several other proceedings involving many of the same issues presented here." (R. 0927). The proceedings in question were before FERC and involved the ability of Participating TOs, including SDG&E, to recover through their TO Tariffs the difference between the costs they received for Transmission Losses (and Ancillary Services) under Existing Contracts and the costs the ISO assessed the Participating TOs for Transmission Losses (and Ancillary Services) in connection with Schedules submitted for those Existing Contracts. The Commission ruled against the Participating TOs in Opinion No. 458, *Pacific Gas and Elec. Co.,* 100 FERC ¶ 61,156 (2002), and Opinion No. 458-A, *Pacific Gas and Elec. Co.*, 101 FERC ¶ 61,151 (2002). Following the Commission's decisions, the stay was lifted and the arbitration hearing was rescheduled.

Pre-Hearing Briefs and Proposed Findings of Fact were submitted by SDG&E and the ISO on April 10, 2003. The arbitration hearing commenced on April 15, 2003 and concluded on April 16, 2003. Following the hearing, the parties filed Initial Briefs on May 21, 2003 and Reply Briefs on August 13, 2003. Further proceedings took place via conference call on September 12, 2003, and the record was closed by order of the Arbitrator on September 17, 2003.

The Arbitrator's Award was issued on October 23, 2003, and the ISO filed its appeal of the Award with the Commission on November 14, 2003.

II. Factual Background

A. SWPL and the Participation Agreements

SWPL is a 500 kV transmission line that until last year ran from SDG&E's Miguel Substation to the Palo Verde Nuclear Power Plant switchyard in Arizona. Currently, the line runs from Hassayampa Substation adjacent to the Palo Verde switchyard to the Miguel Substation. SWPL, which prior to the formation of the ISO was located wholly within SDG&E's Control Area, is now located entirely within the ISO Control Area. At one time, SWPL was owned entirely by SDG&E, but in the early 1980s SDG&E transferred minority undivided interests in SWPL to APS and IID, so that SWPL is now jointly owned by SDG&E, APS, and IID.[2]

The rights of the joint owners of SWPL are provided in contracts between SDG&E, APS and IID, on the one hand, and SDG&E and IID, on the other. These contracts are referred to as the "Participation Agreements." Exhibit SD-3 (R. 2596) (APS) and Exhibit SD-4 (R. 2763) (IID).

Under the terms of the Participation Agreements, SDG&E serves as the Scheduling Agent for APS and IID, respectively. As Scheduling Agent, SDG&E was responsible, *inter alia,* for Scheduling all Energy deliveries over the system and determining operating capability of the line. *See*, *e.g.*, Exhibit SD-3 at § 15.4 (R. 2637). The Participation Agreements established procedures for determining

[2] The segment of SWPL from Palo Verde to North Gila is owned by SDG&E, APS and IID in shares of 76.22%, 11% and 12.78%, respectively. The North Gila to Imperial Valley segment is owned by SDG&E and IID in shares of 85.64% and 14.36%. The remaining segment from Imperial Valley to Miguel is owned solely by SDG&E. The entire line is in the ISO Control Area.

losses, and provide that, for Energy accounting purposes, the lines would be in SDG&E's accounting area; APS and IID were to Schedule Transmission Losses to SDG&E. *Id.* at § 15.6 (R. 2639). The Participation Agreements also allowed each party nonfirm use of the other parties' unused capacity. *Id.* at § 15.14 (R. 2641).

B. Transfer of SWPL to ISO Operational Control

Through a series of orders in 1997 and 1998, the Commission approved the formation of the ISO and the transfer to the ISO of transmission facilities owned by three Investor Owned Utilities ("IOUs"), including SDG&E.[3] The ISO commenced operations on March 31, 1998. Those facilities owned or controlled (through contractual entitlements) by the IOUs that were turned over to the ISO's Operational Control constituted the ISO Controlled Grid.

SDG&E transferred Operational Control of its transmission facilities and Entitlements to the ISO by signing the TCA. *See* Exh. ISO-1 (Testimony of Deborah Le Vine) at 4 (R. 1468).[4] SDG&E provided the ISO with registry data for the ISO's official record of facilities turned over to the Operational Control of the ISO. This registry data included *every component* of SWPL from the Palo Verde switchyard in Arizona to the Miguel Substation in East San Diego County. As required by the TCA, SDG&E listed its Existing Contracts[5] (i.e., Participation

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[3] *See, e.g.*, *Pacific Gas and Elec. Company, et al.*, 81 FERC ¶ 61,122 (1997); and *California Indep. Sys. Operator Corp.*, 82 FERC ¶ 61,325 (1998).

[4] The TCA, including its appendices, is included in several versions. The original TCA is included as Exh. SD-8 (R. 2888); the TCA as revised in June of 1998 is included as Exh. ISO-3 (R. 1487), and the TCA as revised December 2000 is included as Exh. ISO-4 (R. 1575).

[5] "Existing Contracts" are defined in the ISO Tariff as

Agreements) with APS and IID as Encumbrances[6] affecting the ISO's Operational Control of SWPL (meaning that the ISO must respect the scheduling entitlements of APS and IID when operating the line). SDG&E also contemporaneously signed an SC Agreement with the ISO pursuant to which it obligated itself to comply with the ISO Tariff and to pay the charges provided for in the ISO Tariff. *See also* ISO Tariff § 2.2.6.1.

Along with Operational Control of the IOUs' transmission facilities, the ISO assumed the role of Control Area operator, including what had been SDG&E's Control Area operator responsibilities. Tr. 38 (R. 1121). As Control Area operator, the ISO must maintain the Control Area in proper electrical balance. *See* Exh. ISO-12 (Testimony of Tracy Bibb) at 6 (R. 2339) and 11 (R. 2344); Tr. 38-39 (R. 1121-22). Because electricity cannot be stored, safe and reliable operation of the grid requires the ISO to ensure that the supply of electricity and the load on the system is in balance at all times. *See generally* Exh. ISO-12 (Testimony of Tracy Bibb) at 5-6 (r. 2338-39); Exh. SD-40 (Western Systems Coordinating Council Reliability Criteria Agreement) at A-1 – A-13 (R. 3660 –

> The contracts which grant transmission service rights in existence on the ISO Operations Date (including any contracts entered into pursuant to such contracts) as may be amended in accordance with their terms or by agreement between the parties from time to time.

ISO Tariff Appendix A, Master Definitions Supplement, Second Revised Sheet No. 315.

[6] "Encumbrance" is defined in the ISO Tariff as

> A legal restriction or covenant binding on a Participating TO that affects the operation of any transmission lines or associated facilities and which the ISO needs to take into account in exercising Operational control over such transmission lines or associated facilities if the Participating TO is not to risk incurring significant liability. Encumbrances shall include Existing Contracts and may include [other matters].

3672). Scheduling Coordinators are required to submit "balanced" schedules to the ISO in the Day-Ahead and Hour-Ahead Markets. *See* ISO Tariff § 2.2.7.2, Second Revised Sheet No. 15. To the extent that supply or load deviates from the scheduled amounts during real-time operations, the ISO must bring supply and load back into balance either by procuring additional energy (in the event that load is higher or supply is lower than scheduled) or by instructing generators to decrease output (in the event that load is lower or supply is higher than scheduled). *See* ISO Tariff § 2.5.22, First Revised Sheet 99, *et seq.* The ISO then assigns financial responsibility for these real-time transactions to the appropriate Scheduling Coordinators based on meter data that indicates which Scheduling Coordinators were responsible for the unscheduled deviations. *See* ISO Tariff § 11.2.4, Second Revised Sheet No. 246.

C. Transmission Losses

Transmission Losses are one factor that may cause unscheduled deviations to occur. Transmission Losses are the "Energy that is lost as a natural part of the process of transmitting Energy from Generation to Load delivered at the ISO/UDC boundary or Control Area boundary. *See* ISO Tariff, Appendix A, Master Definitions Supplement (Second Revised Sheet No. 353). If a Scheduling Coordinator needs 100 megawatts of electricity to serve load at one end of the line, it must schedule generation of more than 100 megawatts at the other end of the line because some portion of the energy will be lost during transmission due to line losses. If the ISO must procure energy during real-time

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ISO Tariff Appendix A, Master Definitions Supplement, Original Sheet No. 313. *See also* Exh. ISO-1 (Le Vine testimony) at 6 (R. 1470).

operations to cover these losses, the ISO must charge the responsible Scheduling Coordinator for such procurement pursuant to a formula provided in Section 7.4 of the ISO Tariff.

As noted above, prior to the formation of the ISO, SDG&E served as Control Area operator for SWPL and was responsible for scheduling the APS/IID transactions on SWPL. The terms of its Participation Agreements with APS and IID contemplated that SDG&E would receive energy from APS and IID to compensate it for Transmission Losses attributed to the APS/IID transactions on SWPL. *See, e.g.,* Exh. SD-3 at § 15.6 (R. 2639). The amount of energy needed to cover these Transmission Losses was calculated pursuant to a formula contained in the Participation Agreements. *Id.*

At all times subsequent to SDG&E's transfer of its transmission facilities and Entitlements to the ISO's Operational Control in 1998, SDG&E has submitted schedules to the ISO for transactions on SWPL, including the portion of the capacity owned by APS and IID. The ISO determines losses according to the methodology provided in the ISO Tariff and discussed further below. SDG&E receives daily settlement statements from the ISO showing the charges that the ISO is imposing on SDG&E for energy procured to cover Transmission Losses in connection with the APS/IID transactions on SWPL. SDG&E has been paying these charges as calculated under the ISO Tariff since the beginning of ISO operations in March 1998.

III. Arbitration Decision

In his October 23, 2003 Award, the Arbitrator listed 32 "Findings of Fact" and seven[7] "Conclusions of Law."[8] The first nine "Findings of Fact" describe the parties to the Arbitration, the SWPL facilities, and the Participation Agreements between SDG&E, APS and IID. Award at 3-5 (R. 4353-55). Findings of Fact 10-24 describe the Arbitrator's findings with regard to the formation of the ISO, SDG&E's transfer of Operational Control (or, more accurately, what the Arbitrator views as the absence of such transfer) of the APS and IID portions of SWPL to the ISO, and the existence of other jointly owned transmission lines on the ISO system. For example, Findings of Fact ## 11-19 describe the Arbitrator's interpretation of the TCA and its Appendices. Finally, Findings of Fact ## 25-32 describe the specific issue of Transmission Losses, how they are assessed under the Participation Agreements as compared to the ISO Tariff, and touch upon the history of SDG&E's and the ISO's disagreement over the assessment of such charges.

The Arbitrator's Conclusions of Law can be summarized briefly:

- Only facilities placed under the ISO's Operational Control are part of the ISO Controlled Grid (Conclusion of Law # 2);
- SDG&E "could not and did not" place the APS and IID portions of SWPL under ISO Operational Control, and therefore these portions of the line are not a part of the ISO Controlled Grid (Conclusion of Law # 3);

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[7] The Arbitrator numbered two of his Conclusions of Law as # 5.

[8] As described in greater detail below, the ISO does not agree with most of the Arbitrator's Findings and Conclusions, including his interpretation of the Participation Agreements, the TCA, and the ISO Tariff, and his evaluation of the issue of Operational Control.

- Since the non-SDG&E owned portions of SWPL are not a part of the ISO Controlled Grid, the portion of the ISO Tariff related to Transmission Losses does not apply to them, they are not Market Participants as defined by the ISO Tariff, and SDG&E is not their Scheduling Coordinator as defined by the ISO Tariff (Conclusion ## 4, 5, and second 5).

- There is no time bar to SDG&E's claims against the ISO (Conclusion # 6).

The balance of the Award indicates the sums the Arbitrator considers owed by the ISO to SDG&E as a result of his decision, and directs the parties to prepare a stipulated record of the proceeding for appeal at FERC. Award at 10 (R. 4360).

STANDARD OF REVIEW

To the ISO's knowledge, the Commission has not as yet issued an order on review of an arbitration award.[9] The standard of review thus remains a matter of first impression. In its Policy Statement Regarding Regional Transmission Groups; Policy Statement, 58 FR 41626 (August 5, 1993), the Commission stated generally with regard to its review of ADR decisions:

> We will not attempt to decide in this Policy Statement exactly what degree of deference we will be willing to afford. This may depend on a number of factors including, but not limited to, the type of issue to be resolved, the degree of specificity in the RTG agreement, the ability of any party to exercise market power, and the type of ADR being used. We will make

[9] The Commission currently has pending before it two appeals of arbitration awards under the ISO Tariff. *California Indep. Sys. Operator Corp. v. Pacific Gas and Elec. Co*., Docket No. EL02-45-000 and *City of Anaheim, et al. v. California Indep. Sys. Operator Corp*., Docket No. EL03-54-000. *Kansas Gas & Elec. Co*., 27 FERC ¶ 61,335, reh'g granted in part, 28 FERC ¶ 61,112 (1984), also involved an arbitration award. In that case, however, the Commission was not called upon to review an arbitration award under a tariff that provided for appeal to the Commission. Rather, the Commission was presented with a rate that arose out of a binding arbitration, i.e., it was acting to implement the award.

> that decision based on the particular facts of the proposals presented to us.
>
> For example, it may be appropriate to give considerable deference to an arbitrator's finding on a purely factual issue, such as how much an improvement to the system will cost. This is somewhat analogous to factual decisions of administrative law judges, to which we afford considerable deference. However, just as we would not defer to an administrative law judge's decision that is directly contrary to Commission policy, we would not defer to an arbitrator's decision that is directly contrary to Commission policy. Other factors that might influence the degree of deference we would afford to the outcome of a dispute resolution process include, for example, whether a party can or does object to the decision, the degree to which the decision was reached under procedures that maximize fairness, and the degree to which the decision is based on a well-developed record.

Id. at 41631.

Section 13.4.2 of the ISO Tariff states that the parties intend that the Commission should afford substantial deference to factual findings of the Arbitrator. By implication, legal conclusions, such as the interpretation of the ISO Tariff, are not to receive this same deference. The ISO submits that the determination of tariff requirements, and ensuring that such requirements are interpreted in a manner that is just and reasonable in light of the Commission's policies, lie at the core of the Commission's responsibilities under Section 205 of the Federal Power Act. It draws upon the Commission's technical expertise and is essential to discharging the Commission's obligation to ensure that its policies are appropriately implemented. Accordingly, the Commission should review the Arbitrator's interpretation of the ISO Tariff (and any related documents) *de novo*.

Moreover, in this proceeding, the Commission should not be misled by the Arbitrator's attempt to insulate his conclusions from review by labeling them "Findings of Fact." As is apparent from a review of the Award, the "Conclusions

of Law" are summarily stated, with no explanation of legal basis. In order to parse the Arbitrator's reasoning and flawed understanding of the ISO Tariff, one must look to the implicit misinterpretations of the ISO Tariff that underlie the "Findings of Fact." The Commission must review these interpretations *de novo*¸ as well, in order to ensure a consistent and nondiscriminatory application of the ISO Tariff.

ARGUMENT

I. Opinion No. 463-A Compels Reversal of the Arbitrator's Decision

As discussed below, the plain language of the ISO Tariff and the factual record establish that SDG&E is responsible for Transmission Losses for Schedules on the APS and IID Portion of SWPL. The Commission, however, need not reach that analysis because a reversal of the Arbitrator's decision is logically compelled by Opinion No. 463-A, *California Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,032 (2004). which was issued after the Arbitrator's decision.

During the course of the arbitration, the Commission had pending before it Docket No. ER01-313, which concerned the ISO's Grid Management Charge. *See generally California Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,114 (2003). One component of the Grid Management Charge was the Market Operations charges, which included the ISO's cost of procuring Imbalance Energy to cover Transmission Losses. *See California Indep. Sys. Operator Corp.,* 99 FERC ¶ 63,020 (2002). SDG&E challenged the ISO's assessment of Market Operations charges in connection with Schedules on the APS and IID portions of SWPL on the basis that the Schedules were not on the ISO Controlled Grid. *Id. a*t 65,135. The Presiding Law Judge rejected this argument:

> The Market Operations (MO) charge is intended to recover the ISO's market and settlement-related costs that includes the ISO's administrative costs of providing Imbalance Energy. Imbalance Energy is necessary when an entity's schedule is not perfectly balanced, such as where transmission line losses occur between where the Energy enters the ISO Control Area and where the Energy leaves the ISO Control Area. To the extent SWPL Energy schedules require the ISO to procure Imbalance Energy because the SC for the transactions did not provide for losses, that is not covered in any other manner. SDG&E is assessed the administrative costs of providing this Imbalance Energy for losses associated with SWPL Energy as part of the MO charge. This is based upon the ISO's billing determinant for the MO charge: "...total purchases and sales of Ancillary Services, Supplemental Energy, and Imbalance Energy (both instructed and uninstructed)." Whether SWPL transmission facilities are, or are not, a part of the ISO Controlled Grid is not material to whether these facilities may be assessed the MO charge. Transactions assessed the MO charge "...are not limited to transactions using the ISO Controlled Grid."

Id. at 65,136 (citations and footnote omitted). The Commission summarily affirmed the Initial Decision. 103 FERC ¶ 61,114 The ISO cited this decision in its briefs to the Arbitrator. R. 4023, 4201.

SDG&E sought rehearing. In its order on rehearing, Opinion No. 463-A, the Commission rejected SDG&E's arguments and reached the following conclusions:

- The SWPL Schedules are wheel-through transactions, importing, transmitting, and exporting Generation to serve APS and IID Load. 106 FERC P. 61.

- Scheduling Coordinators are required to submit balanced Schedules. Although SDG&E is Scheduling for Loads outside the ISO Control Area, the ISO must still match Generation resources for that Load. 106 FERC P. 62.

- On this basis, the Commission affirmed the ISO's authority to charge SDG&E the Market Operation charge for the net procurement of

Imbalance Energy to cover Transmission Losses for Schedules on the APS and IID portions of SWPL. 106 FERC PP. 64-65.

Application of the same conclusions and logic to this matter can lead to but one result – the Arbitrator's decision must be reversed. If the ISO is authorized to charge SDG&E for the administrative costs of procuring Imbalance Energy to cover Transmission Losses for Schedules on the APS and IID portions of SWPL, then the ISO must also be authorized to charge SDG&E for the Imbalance Energy itself.

II. The ISO Properly Assesses Transmission Losses For Schedules on the APS and IID Portion of SWPL

The foundation of the Arbitrator's decision is his conclusion that SDG&E "could not and did not" transfer those portions of SWPL owned by APS and IID to the ISO's Operational Control. (Conclusion of Law # 2, R. 4359.) From this he deduced that those portions were not a part of the ISO Controlled Grid and not subject to Section 7.4 of the ISO Tariff, which governs charges for Transmissions Losses. The Arbitrator's finding betrays a fundamental misunderstanding of the meaning of Operational Control under the ISO Tariff, of the ability of Participating TOs to transfer their rights and obligations to the ISO's Operational Control, and of the effect of SDG&E's inclusion of SWPL in the TCA.

A. SDG&E's Lack of Ownership in Portions of SWPL Did Not Preclude SDG&E's Transfer of Its Operational Control of SWPL, Subject to the Participation Agreements, to the ISO's Operational Control.

Although the Arbitrator's reasoning is not set forth explicitly, the Findings of Fact leave no doubt that the Arbitrator bases his conclusion that SDG&E "could not" transfer to the ISO's Operational Control those portions of SWPL

owned by APS and IID on SDG&E's lack of ownership of those portions. *See* Findings of Fact ## 13, 16, 18, 19, 23 (R. 4355-57). The Arbitrator's logic fails, however, because many aspects of Operational Control are not tied to, or even related to, ownership.

As an initial matter, there is no dispute that Operational Control is distinct from ownership.[10] For example, each Participating TO that owns facilities has turned Operational Control of those facilities over to the ISO, but each has also retained ownership. There is thus no question that Operational Control can reside in an entity distinct from the Owner.

There can also be no dispute that ownership of physical facilities is not always a prerequisite to transfer of rights in connection with those facilities to the ISO. If it were so, then no entity could become a Participating TO solely by converting Existing Rights, i.e., placing transmission rights under Existing Contracts (on facilities that it does not own) under the ISO's Operational Control. Yet the Commission has explicitly recognized such transfer to ISO Operational Control.[11] The same is true for obligations. When the ISO's use of a transmission facility placed under its Operational Control is subject to contractual obligations, those obligations are listed as Encumbrances in the TCA.

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[10] Indeed, the U.S. Court of Appeals for the District of Columbia Circuit has explicitly recognized the distinction in concluding that the transfer of Operational Control did not require Commission approval under Section 203 of the FPA. *See Atlantic City Elec. Co. v. FERC,* 329 F.3d 856 (D.C. Cir. 2003).

[11] *See, e.g.*, *California Indep. Sys. Operator Corp*., 102 FERC 61,061 (2003) (Commission approves revision of TCA to include assumption of Operational Control of transmission interests of the City of Anaheim, California, et al. by the ISO).

With regard to SWPL, as discussed above, the Participation Agreements assign SDG&E various obligations and rights for the portions of SWPL owned by APS and IID, including those as Scheduling Agent. Exh. SD-3 at 39 (R. 2637). As Control Area Operator, SDG&E had additional responsibilities for SWPL. *See, e.g.,* Tr. at 38-39 (R. 1122-22). The Participation Agreements also included specific provisions to compensate SDG&E for Transmission Losses. *See* Exh. SD-3 at 41 (R. 2639); Exh. SD-4 at 40 (R. 2808). The Arbitrator identifies nothing, and indeed the Participation Agreements include nothing, that would have prevented SDG&E, when transferring to the ISO's Operational Control the portions of SWPL it owns, from also transferring to the ISO *those rights and obligations that it had under the Participation Agreements and as Control Area Operator* regarding the portions of SWPL owned by APS and IID.

The TCA and ISO Tariff make provision for circumstances in which the Operational Control transferred to the ISO provides the ISO with less than an unrestricted ability to use the facility in question. They explicitly recognize that facilities turned over to the ISO's Operational Control will often be subject to Existing Contracts, *i.e.,* contracts that provide transmission rights and predate the ISO, such as the APS/IID Participation Agreements. Under the ISO Tariff and Commission orders, the ISO must honor Existing Contracts. ISO Tariff § 2.4.4.1.1; *Pacific Gas and Elec. Company, et al*., 81 FERC ¶ 61,122 at 61,470-71 (1997). Existing Contracts that provide transmission rights on transmission facilities thus do not preclude the ISO's Operational Control, but establish limitations on that Operational Control; such Existing Contracts constitute

"Encumbrances" under the ISO Tariff and the TCA. As noted above, "Encumbrance" is defined as:

> A legal restriction or covenant binding on a Participating TO that affects the operation of any transmission lines or associated facilities and which the ISO needs to take into account *in exercising Operational Control* over such transmission lines or associated facilities if the Participating TO is not to risk incurring significant liability. Encumbrances shall include Existing Contracts and may include . . . [other matters.].

ISO Tariff Appendix A, Master Definitions Supplement (Original Sheet No. 313) (emphasis added). As the Original TCA set forth, the ISO simply exercises its Operation Control "subject to" the terms and conditions of the Encumbrance. *See* Exhibit SD-8 (Original TCA) § 4.1.1 at p. 11.

As a practical matter, its does not matter if the Encumbrance arises from ownership rights or contractual rights. In both cases, it simply limits the manner in which the ISO exercises its Operational Control. This was made explicit in the first revised TCA, which stated that each Participating TO shall place its lines and facilities under the ISO's Operational Control "subject to . . . the treatment of Existing Contracts under Sections 2.4.3 and 2.4.4 of the ISO Tariff and <u>subject to the applicable interconnection, integration, exchange, operating, *joint ownership and joint participation agreements*</u> . . . ." *See* Exhibit ISO-3 (First Revised TCA) § 4.1.1, at p. 10 (R.1474) (underlining in original, emphasis added).[12] In other words, the revisions to the TCA made clear that joint ownership and joint participation agreements of the type that SDG&E has with APS and IID are the

[12] Other provisions in the TCA also recognize that the ISO can have Operational Control of a transmission line notwithstanding that third-party owners, who are not Participating TOs, may hold undivided legal interests in the line. Thus, Section 4.1.1 of the TCA specifically provides: "The ISO shall recognize the rights and obligations of owners of jointly-owned facilities which are placed under the ISO's Operational Control by one or more but not all of the joint owners." *See* Exhibit SD-8 (Original TCA) § 4.1.1, at p. 12.

type of Existing Contract that the ISO must take into account when exercising Operational Control of a transmission line or facility. There would, of course, be no reason to list a joint ownership or joint participation agreement as an Encumbrance if the portion that was not owned by the Participating TO were not subject to the ISO's Operational Control in the first place.

There is thus nothing in the ISO Tariff, the TCA, or Commission precedent to suggest that SDG&E was unable to transfer to the ISO its Operational Control of the portions of SWPL owned by APS and IID. To the contrary, the ISO Tariff and the TCA contemplate that jointly owned facilities in the ISO Control Area may be placed under the ISO's Operational Control by the joint owner with Scheduling, Control Area, and other responsibilities for those facilities, subject to the rights conferred by the joint ownership agreements.

B. In the TCA, SDG&E Transferred SWPL to the ISO's Operational Control Subject to the Participation Agreements.

The Arbitrator's conclusion that SDG&E "did not" transfer to the ISO Operational Control of the portions of SWPL owned by APS and IID is equally flawed. It rests on a misreading of the ISO Tariff definition of "Operational Control," a disregard for the legal effect of the TCA and other documentation submitted by SDG&E, and, to the degree relevant, a failure to acknowledge compelling evidence of SDG&E's own intentions.

1. The Arbitrator's Interpretation of Operational Control Ignores the Realities of ISO Operations and the Remainder of the ISO Tariff.

For his conclusion that the ISO does not have Operational Control of the portions of SWPL owned by APS and IID, the Arbitrator relies heavily on the ISO Tariff definition of "Operational Control":

> The rights of the ISO under the Transmission Control Agreement and the ISO Tariff to direct Participating TOs how to operate their transmission lines and facilities and other electrical plant affecting the reliability of those lines and facilities for the purpose of affording comparable non-discriminatory transmission access and meeting Applicable Reliability Criteria.

ISO Tariff Appendix A, Master Definitions Supplement (Original Sheet No. 336). Focusing exclusively on the "purpose" provision, the Arbitrator concludes that the portions in question do not meet this definition:

> APS and IID . . . determine the use of their respective shares of SWPL. APS and IID do not submit their schedules for approval under the ISO Tariff, and with respect to such schedules, they are not subject to the non-discrimination requirements or access charges of that tariff.
>
> APS and IID determine whose energy, at what times, and in what amounts will be carried over their capacity on SWPL; [the ISO] does not make those determinations. . . . Under the definition of Operational Control in the ISO Tariff, [the ISO] cannot and does not direct SDG&E, any other Participating TO, or APS and IID how to operate the APS and IID shares of SWPL "for the purpose of affording comparable nondiscriminatory transmission access."

Findings of Fact ## 20, 21 (R. 4357). Although styled as Findings of Fact, the validity of these conclusory statements are wholly dependent on the meaning of Operational Control as used in the ISO Tariff. As discussed above, it is the Commission's responsibility to ensure that the ISO Tariff is interpreted in a manner that is consistent with Commission policy and the ISO's fulfillment of its responsibilities.

The Arbitrator's narrow reading of the definition of Operational Control would severely hamper the ISO's fulfillment of its responsibilities. As the Commission has noted, those responsibilities are not only to provide open access transmission, but also, for example, "for control area operations and [satisfying] all [Western Electricity Coordinating Council] and North American Reliability Council (NERC) and local reliability requirements and operating guidelines," *Pacific Gas and Elec. Company, et al*., 81 FERC ¶ 61,122 at 61,456 (1997), and for "efficiently manag[ing] transmission Congestion." *Id.* at 61,457-61,458. Moreover, the Arbitrator's interpretation of Operational Control cannot withstand scrutiny. Even a cursory perusal of the ISO Tariff reveals that the ISO's ability to direct Participating TO's in the fulfillment of its responsibilities goes far beyond ability to direct the source, quantity or timing of energy. *See, e.g.,* ISO Tariff § 3. As described in Section 5.1.2 of the TCA, the ISO exercises Operational Control over the ISO Controlled Grid for the purpose of "providing a framework for the efficient transmission of electricity," "securing compliance with all Applicable Reliability Criteria," "scheduling transactions for Market Participants to provide open and non-discriminatory access to the ISO Controlled Grid in accordance with the ISO Tariff," "relieving Congestion," and "assisting Market Participants to comply with other operating criteria, contractual obligations and legal requirements binding on them." Exh. ISO-4 at 22-23 (R. 1512-13), .

The Arbitrator's interpretation of Operational Control is not even logical. His reasons for excluding capacity subject to the Participation Agreements would apply to *any* capacity subject to *any* Existing Contract on a Participating TOs

facilities, each of which is listed an Encumbrance in the TCA. In *every* such case, the ISO is unable to schedule on the capacity subject to the Existing Contract;[13] under the Arbitrator's logic, all capacity subject to Existing Contracts would be excluded from the ISO Controlled Grid and the ISO would be unable to charge for Transmission Losses and Ancillary Services in connection with Schedules on that capacity. Yet there is no question that such capacity is part of the ISO Controlled Grid, subject to the Existing Contract, and the ISO must account for the Transmission Losses for Schedules on that capacity. 81 FERC ¶ 61,122 at 61,522.

There is also no question that the ISO is authorized to charge for Transmission Losses and Ancillary Services in connection with Schedules on Existing Contract capacity. *See, e.g.*, 81 FERC ¶ 61,122 at 61,464 n.145; 100 FERC ¶ 61,156 a P. 28. Section 2.4.4.4.4.5 of the ISO Tariff (Original Sheet No. 57) states that the ISO:

> will provide the parties to the Existing Contracts with details of its Transmission Losses and Ancillary Services calculations to enable them to determine whether the ISO's calculations result in any associated shortfall or surplus and *to enable the parties to the Existing Contracts to settle the difference bilaterally or through the relevant TO Tariff.* (Emphasis added.)

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[13] SDG&E's witness did not quarrel with this proposition:

> Q. And in fact, isn't it true that with respect to any existing contract – existing contract is defined in the ISO tariff is [sic] a contract predating the ISO's formation for transmission service rights on the line – with respect to any existing contract that gives a non-participating transmission owner, a transmission owner that doesn't have scheduling rights – I mean a transmission owner that didn't turn its rights over to the ISO– that the ISO cannot direct the holder of those existing rights under that existing contract as to the quantities, the source, the timing of energy scheduled over those rights?
>
> A. That is correct.

See 4/15/03 Tr. at pp. 73-76 (R. 1156-59).

Similarly, Scheduling Protocol ("SP") 4.3 (ISO Tariff Appendix L, ISO Protocols, Original Sheet No. 611), makes clear that it is the responsibility of SDG&E, not the ISO, to bear any differences between the ISO Tariff charges for transmission losses and any compensation SDG&E receives for transmission losses from its SWPL co-owners under Existing Contracts:

> Certain Existing Contracts may have requirements for Transmission Loss accountability which differ from the provision of this SP 4. *Each PTO will be responsible for recovering any deficits or crediting any surpluses, associated with differences in assignment of Transmission Loss requirements, through its bilateral arrangements or its Transmission Owner's Tariff*. The ISO will not undertake the settlement or billing or any such differences under any Existing Contract. (Emphasis added.)

The ISO Tariff also sets forth in explicit terms the methods by which a Participating TO, such as SDG&E, can recover any deficits (or credit any surpluses) that arise as a result of differences in transmission loss requirements between the ISO Tariff and Existing Contracts. Thus, the ISO Tariff provides that SDG&E can settle these differences bilaterally with APS and IID by either voluntarily renegotiating the terms of the Existing Contracts or by forcing reformation of those Existing Contracts to align the loss protocols of the contract with those of the ISO structure. *E.g.*, ISO Tariff § 2.4.4.1.2 (Original Sheet No. 51) ("[T]he Participating TO shall attempt to negotiate changes to the Existing Contract to align the contract's scheduling and operating provisions with the ISO's scheduling and operational procedures, rules and protocols . . ."); § 2.4.4.1.4 (Original Sheet No. 52) ("If the parties to an Existing Contract are unable to reach agreement on the changes . . . [they shall use any] dispute

resolution provisions of the Existing Contract [and/or seek reformation by filing under the Federal Power Act]").

As the Commission is well aware, the ability of Participating TOs to recover cost differentials between ISO charges for Transmission Losses and Ancillary Services and those under the Existing Contracts has been the subject of protracted litigation. *See Pacific Gas and Elec. Company, et al*., 100 FERC ¶ 61,156 (2002) (Opinion No. 458), aff'd on reh'g, 101 FERC 61,151 (2002) (Opinion No. 458-A), pet. for review pending, motion for voluntary remand granted..[14] If, as would be true under the Arbitrator's logic, the ISO were not authorized to charge for Transmission Losses and Ancillary Services for Schedules under Existing Contracts, then there would be no cost differentials and that litigation and Opinions No. 458 and 458-A would never have been necessary in the first place.[15]

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[14] Section 2.4.4.4.4.5 and at Scheduling Protocol 4.3 provides that each Participating TO must develop a Transmission Revenue Requirement ("TRR") which is comprised of the revenue requirements "associated with transmission facilities and Entitlements turned over to the Operational Control of the ISO . . . ." ISO Tariff Appendix A, Master Definitions Supplement (Original Sheet No. 354) (emphasis added). Deducted from the TRR is any Transmission Revenue Credit which includes the "shortfall or surplus resulting from any cost differences between Transmission Losses and Ancillary Service requirements associated with Existing Rights and the ISO's rules and protocols." Id. (Original Sheet No. 353) (emphasis added). Transmission Revenue Credits are then flowed to each Participating TO's transmission customers through its Transmission Revenue Balancing Account ("TRBA"), which is defined as: "A mechanism to be established by each Participating TO that has transmission customers which will ensure that all Transmission Revenue Credits. . . flow through to transmission customers." Id. (Original Sheet No. 353). Although the Commission ruled in Opinions No. 458 and 458-A that these provisions governed the ISO's collection of costs, not the disbursement to Participating TOs, the provisions unambiguously demonstrate the ISO's authority to charge Transmission Losses in connection with Schedules on capacity under Existing Contracts.

[15] As a matter of tariff analysis, the Arbitrator's logic would violate standard principles for interpreting tariffs by rendering all the provisions of the ISO Tariff concerning Existing Contracts surplusage. *See, e.g. Seminole Elec. Coop. v. Florida Power & Light Co.,* 53 FERC ¶ 61,026 (1990); *Kansas Gas & Elec. Co.,* 20 FERC ¶ 61,019 (1982). Inasmuch as the Commission has already used many of these sections in actual decisions, however, there is no need for a theoretical interpretation. The Commission has already interpreted that ISO Tariff and the Arbitrator's decision is simply inconsistent with that interpretation.

Finally, the operational situation that would result from the Arbitrator's decision is nonsensical and contrary to the actual historical operation of SWPL. Under the Arbitrator's decision, the ISO would have Operational Control over only the SDG&E owned portion of SWPL, and some other entity (or entities) would operate the portions owned by APS and IID. Since SDG&E co-owns the segment of SWPL from Hassayampa to North Gila with APS and IID, and the segment from North Gila to Imperial Valley with IID, this would result in the ISO having Operational Control of only a horizontal cross-section of the physical line in those segments and a different entity operating the other cross-section of the same line. Obviously, that would be absurd. It simply is not feasible for two entities actually to operate cross sections of a single transmission line based on a virtual division of the line to reflect the percentage of the legal interests owned.

There is no dispute that the ISO is the Control Area Operator and Schedules the transactions on the portions of SWPL owned by APS and IID. There is also no question that the ISO must address derates, outages, and emergencies regarding SWPL, and has in fact performed those functions for the entirety of SWPL since startup. Such issues cannot be addressed for a portion of a transmission line. There is also no question that the ISO directs SDG&E, as and owner of SWPL and a party to the Participation Agreements, in the performance of these functions. This is Operational Control under the ISO Tariff.

2. The Jurisdictional Documents Identify the Portions of SWPL Owned by APS and IID as Under the ISO's Operational Control, Subject to the Participation Agreements

The Arbitrator also relied upon the identification of SWPL as co-owned in Appendix A of the TCA and the identification of the Participation Agreements in Appendices A (as Entitlements) and B (as Encumbrances) as evidence that SDG&E was not transferring Operational Control of the portions owned by APS and IID to the ISO. Findings of Fact ##18, 19 (R. 4356-57). The TCA and its Appendices are jurisdictional documents on file with the Commission. *See* 81 FERC ¶ 61,122. Thus, again, the Arbitrator styles as factual findings conclusions that are in reality legal and uniquely suitable for Commission determination – the interpretation of jurisdictional documents.

Further, the TCA does not support the Arbitrator's conclusion. In Appendix A to the TCA, SDG&E submitted a diagram of the transmission lines and related facilities, including the entirety of SWPL, that were being placed under the ISO's Operational Control within the meaning of the ISO Tariff. Exh. ISO-1 at 5 (R. 1469). It did not identify any limitation on the Operational Control that it was transferring to the ISO. *See* Exh. ISO-2.[16] That it marked portions of SWPL in the diagram as being "co-owned," is insignificant. As noted above, co-ownership rights in a transmission line by a party that is not a Participating TO do not preclude the Participating TO from transferring to the ISO its Operational Control over the portions of the transmission line that it does not own. The TCA

[16] Exh. ISO-2, which consist of an oversized diagram, was omitted from the record submitted to the Commission. Rather the record includes a place holder. The ISO will correct this omission expeditiously.

and the ISO Tariff make provision for recognizing operating restrictions resulting from those co-ownership interests as Encumbrances that the ISO must respect when exercising Operational Control of the line, *see* Exhibit ISO-3 (First Revised TCA) § 4.1.1, at p. 10 (R.1474), and indeed SDG&E identified the Participation Agreements as Encumbrances in Appendix B to the ISO Tariff. Exh. SD-8 at App. B5-B6 (R. 3-18-19).

The Arbitrator's conclusion that SDG&E listed the Participation Agreements in Appendices A and B of the TCA solely because of the nonfirm transmission rights provided under the agreements is also not supported by the Appendices. Finding of Fact # 17 (R. 4356). A review of SDG&E's Appendix A reveals that, with regard to each Entitlement, SDG&E identified the transmission rights provided. *See* Exh. SD-8 at App. A-2 – A-3 (R. 2978-79). With regard to the Participation Agreements, however, it identified *only* the percentages of operating capacity on which each party was entitled to schedule. It made *no mention* of the nonfirm scheduling rights that the Arbitrator concludes are the purpose of the listing. *See* R. 2979. Moreover, it would have made no sense for SDG&E to have listed the Participation Agreements solely because of the nonfirm rights. Because SDG&E turned over to ISO the responsibility for Scheduling SWPL, it was necessary that the Participation Agreements be identified as Encumbrances. Without knowing the Scheduling capacity entitlements of APS and IID in their own "shares" of the line, the ISO would have had no way of knowing, and thus honoring, the Existing Rights of APS and IID in the line. It was necessary for SDG&E to list the Existing Contracts as

Encumbrances because the ISO needs to take account of the APS/IID Scheduling rights when exercising Operational Control of the line and coordinating its operation with the neighboring Control Areas, including APS and IID.

Other documents available to or filed with the Commission further demonstrate the error of the Arbitrator's interpretation of the jurisdictional TCA. SDG&E listed the entirety of SWPL in the official ISO Register. Exh. ISO-1 at 9 (R. 1473). Section 4.2.1 of the TCA states that "[t]he ISO shall maintain a register (the "ISO Register") of all transmission lines, associated facilities and Entitlements that are for the time being subject to ISO's Operational Control." *See* Exhibit SD-8, § 4.2.1, p. 16 (R. 2907). The TCA describes the ISO Register as the official listing of facilities under the ISO's Operational Control. *See* Transmission Control Agreement § 4.2, Exh. SD-8 at 16 (2907). Similarly, the ISO Tariff defines ISO Register as: "[t]he register of all the transmission lines, associated facilities and other necessary components that are at the relevant time being subject to the ISO's Operational Control." ISO Tariff Appendix A, Master Definitions Supplement (Original Sheet No. 329). In cross-examination at the hearing before the Arbitrator, SDG&E's witness admitted that the information in the register was provided by SDG&E.[17]

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[17]
Q. And you say at page six of your rebuttal testimony that SDG&E has not ratified or endorsed the ISO's unilateral listing of all SWPL facilities in the transmission registry; do you see that?

A. Yes, I do.

Q. The information that the ISO listed in the transmission registry came from San Diego Gas and Electric, did it not?

A. Yes, it did.

Further, when SDG&E sought approval from the Commission of the transfer of Operational Control to the ISO, it filed with the Commission a map and a listing of its transmission facilities. The map shows the entirety of SWPL as being part of SDG&E's high voltage transmission system and, in fact, includes (in detail D) a close-up view of the SWPL. Exh. SD-42 (R. 3699-3700).The listing, like the listing SDG&E provided to the ISO for inclusion in the ISO Registry, lists each segment of SWPL (Imperial Valley-Miguel, Imperial Valley-North Gila and North Gila-Palo Verde). Exh. SD-43 (R. 3702-3706).

Indeed, the TCA requires a Participating TO, such as SDG&E, "that is placing a transmission line or associated facility (including an Entitlement) that is subject to an Encumbrance under the Operational Control of the ISO" submit a set of "protocols for its operation" that give effect to any Encumbrances on the facility. *See* Exhibit SD-8 (Original TCA) § 6.4.2, at pp. 32-33 (R. 2923-24). SDG&E did, in fact, give the ISO protocols so as to enable the ISO to exercise Operational Control of SWPL while respecting the capacity entitlements that APS

> Q. And San Diego Gas and Electric supplied a chart of all the components of SWPL f or listing in that registry, correct?
>
> A. Yes.
>
> * * *

[ISO Exhibit No. 26 is marked for identification]

* * *

> Q. And this is the listing that SDG&E supplied to the ISO for inclusion in the ISO register, correct?
>
> A. (Witness reviewing document.) Correct.
>
> Q. And it includes each segment of the Power Link from Palo Verde to North Gila and from North Gila to Imperial Valley, Imperial Valley to Miguel, correct?
>
> A. Yes.

See 4/15/03 Tr. at pp. 110-111 (R. 1193-94); *see also* Exh. ISO-26 (letter from SDG&E to the ISO forwarding information to be included in the ISO Register) (R. 2453).

and IID held in the line. Protocols were only required with respect to a transmission line that is "subject to an Encumbrance under the Operational Control of the ISO." *Id*. The Arbitrator's "factual" conclusions are thus contrary to the legal effect of the jurisdictional documents and for that reason must be rejected.

3. SDG&E's Course of Conduct Demonstrates that It Transferred Its Operational Control of the Portions of SWPL Owned by APS and IID to the ISO.

The Arbitrator also relies upon a March 1998 letter from SDG&E in which it states that it is transferring Operational Control only for that portion of SWPL that it owns for his conclusion that the ISO does not have Operational Control, subject to limitations, over the portions of SWPL owned by APS and IID. Finding of Fact #19. It is highly questionable whether SDG&E's intent is at all relevant to the issues in this proceeding. The TCA, not intent, establishes the facilities and entitlements, including those subject to joint ownership, that a Participating TO *must* turn over to the ISO's Operational Control:

> Subject to Section 4.1.2 and the treatment of Existing Contracts under Sections 2.4.3 and 2.4.4 of the ISO Tariff and subject to the applicable interconnection, integration, exchange, operating, joint ownership and joint participation agreements, each Participating TO shall place under the ISO's Operational Control the transmission lines and associated facilities forming part of the transmission network that it owns or to which it has Entitlements. The ISO shall recognize the rights and obligations of owners of jointly-owned facilities which are placed under the ISO's Operational Control by one or more but not all of the joint owners.

TCA § 4.1.1, Exh. ISO-3 at 10 (R. 1500).. Even if intent were relevant, however, the evidence cited by the Arbitrator is so overwhelmingly contradicted by SDG&E's course of conduct that the Commission should disregard it.

Several days prior to the beginning of ISO operations, SDG&E sought amendments to its own TO Tariff, on file with the Commission, to allow recovery of the cost differentials ("shortfalls") between the ISO's charges for Transmission Losses for Schedules under Existing Contracts and the compensation SDG&E could receive for the Transmission Losses under the Existing Contracts. SDG&E sought to recover the shortfalls through its TRBA, known as a Transmission Revenue Balancing Account ("TRBA"). *See* Exh. *Id.* at 13-15 and cited Exhibits (R. 1477-79);ISO-6, Filing Letter and TO Tariff Amendment at 19 (R. 1645-18, 1675). In other words, SDG&E sought to recover these shortfalls through its own TO Tariff (rather than seeking to renegotiate or reform its Existing Contracts with APS and IID), as it believed was contemplated under ISO Tariff Section 2.4.4.4.4.5. *See* Exh. ISO-9 at 9-16 (R. 1958-65); Exh. ISO-10 at 6-13 (R. 2038-45).

SDG&E's filing, and its litigation in support of this filing, is completely inconsistent with any assertion that it did not intend to place the portion of SWPL owned by APS and IID under the ISO's Operational Control. Under Section 7.1 of the ISO Tariff, the TRBA is designed to flow through Transmission Revenue Credits. *See also* ISO Tariff Appendix A, Definition of Transmission Revenue Balancing Account. As previously discussed, Transmission Revenue Credits are defined to reflect, *inter alia*, the shortfall between what the ISO charges Participating TOs for Transmission Losses in connection with Schedules under Existing Contracts and what the Participating TOs can collect from Existing Contract customers. ISO Tariff Appendix A, Definition of Transmission Revenue

Credits. Transmission Revenue Credits are also one of the two components by which a Participating TO *recovers its Transmission Revenue Requirement* (the other being the transmission Access Charge). ISO Tariff § 7.1. The Transmission Revenue Requirement, in turn, is "the total annual authorized revenues associated with transmission facilities *turned over to the Operational Control* of the ISO by a Participating TO." ISO Tariff Appendix A, Definition of Transmission Revenue Requirement. In other words, a Participating TO can only include in a TRBA shortfalls associated with facilities under the ISO's Operational Control. By filing to recover the Transmission Losses shortfalls through the TRBA, SDG&E was thus seeking to recover costs associated only with facilities under the ISO's Operational Control.

The shortfalls associated with the APS and IID portions of SWPL, however, are the *only* shortfalls that SDG&E could have sought to recover in that proceeding. At the hearing before the Arbitrator, SDG&E's witness Mr. Yari confirmed that it was these costs, and these costs alone, which SDG&E sought to recover in the FERC TO Tariff proceedings:

> Q. And SDG and E was claiming these costs from the beginning, from the first time that the ISO charged them with these losses, continuing until FERC recently denied the request to include these charges in the TRBA, correct?
>
> A. That's correct.
>
> * * *
>
> Q. And so it's the only transmission line – and so I – I take it then that SDG and E has no transmission facility other than the South West Power Link which give rise to these transmission loss shortfalls that you need to try to recover through a mechanism such as transmission revenue balancing account adjustments?

A. That is correct.

* * *

Q. SDG&E's participation in the FERC proceedings seeking to recover these transmission loss differentials through its transmission revenue balancing account was related to recovering these costs on the South West Power Link, and no other facility, correct?

A. That is correct, in addition to the fact that SDG and E in principle supports the fact that if restructuring should not result or leave the participating transmission owners in this case with funds that have no way of – of recovering.

We - the filing was a joint filing that you're referring to. It was spearheaded by PG&E and in principle, SDG and E supported the notion that if there are certain grid management charges or lost potential, that the entities in general terms should be able to recover that as part of the restructuring through its transmission rates as well.

See 4/15/03 Tr. at 64-67 (R. 1147-50).

While Mr. Yari suggested that SDG&E was also participating in the proceeding to support a "principle" spearheaded by Pacific Gas and Electric Company ("PG&E"), the record establishes that SDG&E participated in the proceeding to recover shortfalls associated with SWPL. As set forth in Exhibit ISO-22 (R. 2441-42), SDG&E had been claiming as an adjustment to its TRBA in the TO Tariff proceedings many millions of dollars relating to the transmission loss cost differentials on the APS and IID SWPL transactions. Indeed, SDG&E in fact included these charges – which can only be assessed in connection with facilities and Entitlements under the ISO's Operational Control – in its rates. As discussed above, in Opinion Nos. 458 and 458-A, the Commission ruled that the Participating TOs could not include the cost differentials in their TRBAs. The

investor-owned Participating TOs have filed a Petition for Review with the U.S. Court of Appeals for the District of Columbia Circuit regarding these decisions. Case No. 02-1374. On February 12, 2004, the court granted a Motion for Voluntary Remand from the Commission.

As part of its order, the Commission directed SDG&E to submit a refund report to the Commission outlining how SDG&E will refund to ISO Market Participants the amounts which it has collected in its TRBA for the APS and IID SWPL transactions. 100 FERC ¶ 61,156 at 61,574. As Ms. Le Vine testified, the ISO is currently working with SDG&E to process this refund to the market. *See* 4/15/03 Tr. at 243-44. (R. 1326-27).

The Arbitrator's reliance on the March 31, 1998, letter is thus misplaced. It can only be read as a reminder that SDG&E was not transferring to the ISO Scheduling rights on the capacity owned by APS and IID. From the beginning of the ISO's operations until Opinion No. 458, SDG&E treated the APS and IID portions of SWPL as being under the ISO's Operational Control for the purpose of accounting for Transmission Losses. As will be discussed further below, SDG&E also accepted without objection its responsibility for payment of the Transmission Losses.

4. SWPL Is Not Analogous to the Other Lines and Existing Contracts Cited by the Arbitrator.

The Arbitrator cites the "shares" of the Mead-Phoenix transmission line, the Pacific DC Intertie, and the COTP as instances where only portions of lines have been turned over to the ISO's Operational Control without creating any operational difficulties. None of the situations is analogous to SWPL. Each case

involves only transmission rights that were turned over to the ISO's Operational Control. *See* Tr. at 189-90 (R. 1272-73). Both the Mead-Phoenix line and the Pacific DC Intertie are outside the ISO's Control Area. Tr. at 177-79 (R. 1260-62).. The ISO is not responsible for balancing, and does not calculate, Transmission Losses for those lines. Tr. at 294-95 (R. 1379-80). Therefore, the ISO, with regard to these to lines, is similarly situated to APS and IID with regard to SWPL.

The Arbitrator's reference to the COTP is also inapt, because the record does not include evidence on how Transmission Losses are handled on the COTP. Moreover, although the COTP is in the ISO's Control Area, it is also distinguishable from SWPL in that only PG&E's Existing Rights, an Entitlement, were placed under the ISO's Operational Control. Tr. at 191 (R. 1274).

III. As Scheduling Coordinator for Schedules Under the Participation Agreement, SDG&E Is Responsible for Payment of Transmission Losses In Connection with Those Schedules

The ISO transacts business only through Scheduling Coordinators. Scheduling Coordinators are the entities that directly interface with the ISO and which are financially responsible to settle transactions in the ISO markets. ISO Tariff § 2.2.6. SDG&E is the Scheduling Coordinator for the Schedules under the Participation Agreements and, until the Commission rejected its recovery of Transmission Losses shortfalls through the TRBA, accepted responsibility for the payment of Transmission Losses associated with those Schedules.

A. SDG&E Is the Scheduling Coordinator for Schedules Under the Participation Agreements

SDG&E has signed an SC Agreement with the ISO. *See* Exhibit SD-21 (R.3226-32). "SC Agreement" is defined by the ISO Tariff to mean:

> An agreement between a Scheduling Coordinator and the ISO whereby the Scheduling Coordinator agrees to comply with all ISO rules, protocols and instructions, as those rules, protocols and instructions may be amended from time to time.

ISO Tariff Appendix A, Master Definitions Supplement (Original Sheet No. 345A). The ISO Tariff, in turn, specifically requires Scheduling Coordinators to pay for Transmission Losses as determined under Section 7.4 of the ISO Tariff.

Because SDG&E submits the Schedules for the Participation Agreements to the ISO, Exh. SD-1 at 16 (R. 2535), and the ISO only deals with Scheduling Coordinators, it must follow that SDG&E is the Scheduling Coordinator for the APS and IID transactions under the Participation Agreements.[18] This is consistent with Commission precedent. The Commission has held that it is the submission of schedules, not the subjective intent of the entity submitting the schedules, that determines whether the entity is the Scheduling Coordinator. In *California Indep. Sys. Operator Corp.*, 97 FERC ¶ 61,151 (2001), the Commission addressed the responsibility of the Department of Water Resources ("DWR" or "Department") for transactions that it undertook as guarantor for Southern California Edison Company and PG&E. The Commission ruled that the Department "functions as the Scheduling Coordinator" and therefore was financially responsible for any transactions scheduled by the ISO on its behalf:

[18] Indeed, SDG&E has a specific Scheduling Coordinator identification number to the APS and IID Schedules. *Id*.

> We note that DWR has already executed a Scheduling Coordinator Agreement with the ISO. This agreement includes, among other things, an obligation by DWR to abide by and perform all of the obligations under the ISO Tariff, without limitation. This includes an obligation to pay for scheduled and unscheduled transactions made on the Scheduling Coordinator's behalf by the ISO. . . . Although this agreement was entered into prior to SoCal Edison and PG&E losing their creditworthy status, nothing in the agreement limits the scope to DWR's scheduling of its own load, or distinguishes DWR's functioning as the creditworthy party for the net short position for the non-creditworthy UDCs. . . .
>
> Therefore, because DWR has assumed responsibility for purchases by the ISO, and because DWR functions as a Scheduling Coordinator for this net short position of PG&E and SoCal Edison, DWR must abide by the requirements of the ISO Tariff and the Scheduling Coordinator Agreement.

97 FERC at 61,659. By the same reasoning, SDG&E is the Scheduling Coordinator and financially responsible for Transmission Losses in connection with the APS and IID Schedules.

The Arbitrator nonetheless found that SDG&E is not the Scheduling Coordinator. Conclusions of Law ## 5, 6 (R. 4359-60).[19] He reasoned that because the portions of SWPL owned by APS and IID are not under the ISO's Operational Control, they are not part of the ISO Controlled Grid, that APS and IID are therefore not Market Participants, and that SDG&E cannot be their Scheduling Coordinator. Conclusions of Law ## 3, 5 (R. 4359). As discussed above, the Arbitrator's first premise is false, so the entire syllogism must fail.

[19] As noted above, the Award includes two Conclusions of Law #5. The reference here is to the first of the two.

B. SDG&E Understood from the Beginning of ISO Operations that It Was the Scheduling Coordinator Responsible for Transmission Losses Associated with Schedules Under the Participation Agreements.

The ISO expects SDG&E to argue that, in signing an SC Agreement, it never agreed to become the Scheduling Coordinator for the APS and IID Schedules. The evidence, however, is entirely to the contrary. At the hearing, SDG&E, through the testimony of Mr. Yari, suggested for the first time that it had signed the SC Agreement with the ISO *not* to schedule the APS/IID SWPL transactions but to schedule its own merchant transactions – *i.e.*, energy transactions relating to SDG&E's own residential customer load. *See* Tr. at pp. 67-68 (R. 1150-51).[20] This explanation is not credible. Mr. Yari had to admit that SDG&E did not – in fact, *could* not – schedule its own merchant transactions because the restructuring of the California electricity market required SDG&E to sell all of its generation into and buy all of its needs out of the PX. *See* Tr. at pp. 68-69 (R. 1152-53).[21] In other words, it was the PX, not SDG&E, that signed an

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[20]
Q. And under the terms of the scheduling coordinator agreement, SDG and E agreed that it would be responsible for costs calculated under the ISO tariff, correct, transmission loss costs?

A. Again I want to make this clear, that SDG and E as a whole entered into a scheduling coordinator agreement to become a scheduling coordinator for the purposes of maintaining flexibility to be able to schedule just as a market participant.

The Arbitrator: On whose behalf?

The Witness: On – on behalf of our own customer if needed . . . .

[21]
Q. Mr. Yari, at the time of ISO startup, SDG and E didn't schedule its own resources, did it? Wasn't that done by the California PX?

A. It was done by the PX, that is correct.

Q. And the PX had their own scheduling coordinator with the ISO, correct?

A. Correct.

Q. So the only transactions that you needed were the APS/IID transactions on SWPL; isn't that correct?

SC Agreement with the ISO to schedule all of SDG&E's transactions to serve its end-use customers. The *only* transactions that SDG&E was scheduling directly with the ISO as a Scheduling Coordinator were the APS/IID SWPL transactions. Thus, the *only* possible transactions for which SDG&E needed to sign an SC Agreement were the APS/IID SWPL transactions.

SDG&E's internal documents also establish that it understood it would operate as Schedule Coordinator for, and be responsible for, the APS and IID transactions on SWPL. An internal SDG&E email, from David Korinek, the Manager of Grid Operation Services at the time, dated February 23, 1998 (approximately one month *prior* to the beginning of ISO operations) shows that SDG&E knew that under Scheduling Protocol 4.3 (which is expressly discussed in the email), it would need to invoice (or credit) APS and IID for any shortfalls (or surpluses) arising from discrepancies between the ISO Transmission Loss charges and the transmission loss calculations provided under the Existing Contracts. The email states in relevant part:

> SDG&E will need to provide the *scheduling coordinator (SC) service* for these existing SWPL flow-through contracts. . . .
>
> * * *
>
> B) . . . Grid Ops posts (via WENet) a separate inter-SC trade with the PX for the loss (GMM) component of the IID/APS schedules.

A. Not necessarily . . . .

Q. But at the time the scheduling coordinator agreement was signed, the only transactions that SDG and E was scheduling with the ISO were the APS/IID transactions on SWPL, correct?

A. I would assume that that was correct. I personally wasn't involved, but that is a correct assumption.

> * * *
>
> E) Settlements (per SP 4.3 and SABP 4)-
>
> Grid Oper Services will review ISO settlement statements, reconcile any discrepancies related to IID/APS existing contract schedules, and issue invoice or credit to IID/APS. (At this time we are still looking into IID and APS settlement options-energy repayment may no longer be possible).
>
> * NOTE—We are not obligated to serve as the scheduling coordinator for any additional schedules that IID/APS bids into the ISO *above and beyond their existing contract rights on SWPL.* They will need to make separate Scheduling Coordinator arrangements in such cases.

Exhibit ISO-20 (Email from David M. Korinek to David L. Melby, dated February 23, 1998) (emphasis added) (R. 2435-36). This email is a contemporaneous document that indisputably establishes that SDG&E understood at the beginning of ISO operations that it would be (1) serving as the Scheduling Coordinator for the APS/IID Existing Contract rights on SWPL, (2) responsible for paying the ISO transmission loss charges on the APS/IID schedules and (3) reconciling directly with APS and IID any differences between the ISO Transmission Losses charges and those provided for in the Participation Agreements.

C. Until the Commission Rejected Its Recovery of Transmission Losses Shortfalls through the TRBA, SDG&E Accepted Responsibility for the Payment of Transmission Losses Associated with Schedules Under the Participation Agreements.

As discussed above, SDG&E sought to recover through filings at FERC the Transmission Losses shortfalls associated with Schedules under the Participation Agreements through its TRBA. The evidence before the Arbitrator, which he chose to ignore, also showed conclusively that SDG&E paid the ISO charges for Transmission Losses for years without objection. SDG&E's witness acknowledged at the arbitration hearing that SDG&E never asserted that the ISO

was improperly charging these amounts until after the Initial Decision ruling that it could not recover those charges through the TRBA. *See* Tr. at 86 (R. 1169).[22] The documentary evidence is compelling, however, that SDG&E did not inform the ISO of its belief that the charges were improper until almost a year later in late 2000. Although SDG&E's witness claimed to have earlier conversations about the charges, on cross-examination he admitted that he could not remember "the exact words" that he used, *id.*, and conceded that SDG&E has no documentary evidence whatsoever to substantiate these supposed conversations even though they involved millions of dollars of alleged improper charges. *Id*. at 89 (R. 1170). SDG&E's credibility on this point becomes even more suspect when one considers that SDG&E wrote to the ISO during this time period concerning the transmission loss issue, without ever mentioning its supposed view that the ISO was "improperly" charging SDG&E for these costs. Exh. SD-12 (R. 3151-52).

It was not until March 21, 2000, approximately six months after the Initial Decision in Docket No. ER97-2358 and nearly two years after the beginning of ISO operations, that SDG&E wrote to the ISO, noting that the Initial Decision, if upheld by the Commission, would preclude SDG&E from recovering transmission loss differentials on SWPL unless SDG&E could force reformation of its contracts with APS/IID:

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[22] Q. But as far as you're aware, you have no knowledge of any conversation where anyone at SDG and E told anyone at the ISO that you, the ISO, are improperly assigning these transmission losses under your Tariff to SDG&E, correct, prior to late '99?

A. That is correct.

> . . . the CA ISO calculates losses pursuant to its tariff and protocols. These loss calculations are significantly higher than that calculated under the current ETC [Existing Transmission Contract] procedure that was adopted prior to the transfer of operational control pursuant to the TCA. A recent FERC Administrative Law Judge has concluded that recovery of such "loss under-recovery" cannot be recovered through the Transmission Owners Transmission Revenue Balancing Account Adjustment ("TRBAA") mechanism. An unfavorable decision by FERC on this question would leave SDG&E unable to recover from APS and IID this loss differential unless FERC and/or an arbitrator determines that the current ETC loss calculation should be modified.

Id. Even this letter nowhere claims that the ISO has been improperly charging SDG&E for these costs or asks for any refunds of amounts previously charged, but rather presumes the legitimacy of the charges. Moreover, the letter specifically acknowledges SDG&E's role as Schedule Coordinator for the Schedules under the Participation Agreements. *Id.* SDG&E's proposed solution to its financial difficulty -- moving the ISO's Control Area boundary so as to remove SWPL from ISO control, *id.* -- is also an admission that the charges are legitimate as long a SWPL is in the ISO's "control," whether SDG&E chooses to define that as Operational Control or not.

Despite SDG&E's undocumented and vague assertion of prior oral communications, the evidence at the arbitration hearing established that the first written notice to the ISO of SDG&E's claim that the charges for Transmission Losses were improper was its filing of a settlement dispute form in December 2000. Tr. 90:12-18 (R. 1173). This is approximately two and one-half years after SDG&E began receiving daily settlement statements detailing the charges. Even then, SDG&E only disputed that portion of the charges reflecting the cost of

energy purchased above the then existing soft price cap. *See* Exhibit ISO-13 at 6 (R. 2354).

In short, SDG&E, for two and a half years after the beginning of ISO operations, accepted its role as Scheduling Coordinator for the APS and IID Schedules under the Participation Agreements and its responsibility for charges for Transmission Losses associated with those Schedules. In doing so, SDG&E was acting consistently with the ISO Tariff and the TCA. Its new position, that the ISO is improperly charging SDG&E for these costs, is inconsistent with those documents and should be rejected.

D. The Arbitrator's Decision Ignores and Negates the Commission's Policy Established in Opinions No. 458 and 458-A

The policy established by Opinion Nos. 458 and 458-A was unambiguous. Participating Transmission Owners could not recover the cost differentials incurred as the result of Existing Contracts from those customers under the ISO Tariff. In Opinion No. 458, the Commission concluded:

> The fact is that the costs are associated with service provided under the existing contracts, not the TO Tariffs, and should not be shifted to the TO Tariff customers.

100 FERC at 61,574. Particularly relevant to this proceeding, the Commission elaborated in Opinion No. 458-A:

> San Diego maintains that the added costs for transmission losses and ancillary services did not arise from any changes in the cost of serving Existing Contract customers: service to those customers "has not been substantially changed by virtue of industry restructuring." [FN30] Rather, San Diego states, restructuring was "adopted for the benefit of California

> retail customers, as part of the effort to promote competitive markets."
>
> . . . .
>
> . . . Concerning the application of cost causation principles, we cannot agree that the benefits of energy industry restructuring have accrued merely to TO Tariff customers. On the contrary, we have observed that enhanced reliability and market development resulting from industry restructuring are benefits that are distributed across the spectrum of industry participants. [FN39] Thus, we decline to identify the TO Tariff customers as benefiting from restructuring so singularly as to require costs incurred in connection with the Existing Contracts, to which they are not parties, to be passed on to them. In sum, it was hardly unreasonable for the judge to find that such an assignment of costs would amount to inappropriate cross-subsidization. The Companies' contention that they may not be able to recover these costs from some of the Existing Contract customers does not change this result. It is well-established that while regulated companies must have a reasonable opportunity to recover their costs, they enjoy no guarantee that they will necessarily do so.

101 FERC at PP 22, 24.

The Arbitrator's decision could not be more directly at odds with the Commission's policy. In his introduction, the Arbitrator recognized that the case arose from the need to accommodate Existing Contracts in electric deregulation. He described his decision as follows:

> The Arbitrator recognizes that it may take some effort to spread the cost of this award to the appropriate customers, but unless this is done, the share holders of SDG&E may have to bear the costs of the change in the law and its affect [sic] on the contracts in question.

Award at 2.

The ISO has supported, and continues to, support, the Participating TOs in their appeal of Opinions No. 458 and 458-A. Until such time as the Commission reverses itself on remand or is reversed on appeal, the Commission must apply the policy of these decisions uniformly. That policy requires reversal of the Arbitrator's decision.

IV. The Greater Part of SDG&E's Claims Are Precluded by Sections 11.7.2 and 11.7.3 of the ISO Tariff

Under the ISO Tariff, the ISO provides Scheduling Coordinators, for each day, a Preliminary, and later a Final, Settlement Statement that includes all charges payable to or owed by the Scheduling Coordinator. ISO Tariff § 11.6.1. The ISO Tariff provides a specific time table by which Scheduling Coordinators may correct or dispute charges in Settlement Statements. Under Section 11.6.1.2, a Scheduling Coordinator has eight days in which to notify the ISO of errors in the Preliminary Settlement Statements, and ten days in which to notify the ISO of errors in Final Settlement Statements. Under Section 11.7.2 of the ISO Tariff, unless a Scheduling Coordinator disputes a charge on a Preliminary Settlement Statement within eight business days from the date of issuance, the Scheduling Coordinator is deemed to have validated the charge and the Settlement Statement is binding on the Scheduling Coordinators. Similarly, Section 11.7.3 of the ISO Tariff provides each Scheduling Coordinator ten days within which to dispute any Incremental Changes that appear in a Final Settlement Statement, after which it is deemed to have validated the charges. Disputes are properly raised by way of an electronic "settlement dispute form" sent to the ISO by the Scheduling Coordinator within the allowable time limits.

See Scheduling and Billing Protocol ("SABP") 4.4.1.1; Exh. ISO-13 (Direct Testimony of Spence E. Gerber) at 5-6 (R. 2353-54). Under ISO Tariff Section 11.6.3, a Scheduling Coordinator can be relieved of the deadlines in Sections 11.7.2 and 11.7.3 only by requesting and receiving the approval of the ISO Governing Board for a settlement re-run. A party requesting a re-run must demonstrate "good cause" to obtain the ISO Governing Board's approval.

The evidence in the hearing establishes, and the Arbitrator made no contrary finding, that of the various charge types for which SDG&E makes a claim (Charge Types 404, 405, 407 and 487), SDG&E failed to submit an electronic dispute form for all but Charge Type 487. Even then, SDG&E failed to submit a dispute form for Charge Type 487 until December of 2000. *See* Exh. ISO-13, p. 6 (R.2354.; *See also* at pp. 90-92 (R. 1173-75); *see* also Exh. ISO-24 (R. 2446). This proceeding does not concern, and SDG&E does not allege, a denial of a re-run by the ISO Governing Board.

The Arbitrator nonetheless concluded that Sections 11.7.2 and 11.7.3 of the ISO Tariff were not applicable to SDG&E because it was not the Scheduling Coordinator for the Energy Scheduled on the APS and IID portions of SWPL. Conclusion of Law # 6 (R. 4360). The ISO has established above that SDG&E was indeed the Scheduling Coordinator for Schedules under the Participation Agreements. Nonetheless, even if one were to assume, arguendo, that SDG&E were not the Scheduling Coordinator for those Schedules, once again, the Arbitrator's conclusion does not follow from his premise.

There is, of course, no question that the ISO is authorized to assess charges to SDG&E, which is *a* Scheduling Coordinator. The Arbitrator's reasoning boils down to an assertion that the ISO Tariff time limitations do not apply because the ISO is not authorized to assess these *particular* charges to SDG&E. The same can be said, however, about any disputed charge. Sections 11.7.2 and 11.7.3 of the ISO Tariff would be virtually meaningless if the merits of a dispute were to determine their applicability.

When SDG&E signed the SC Agreement, it agreed to "abide by . . . the obligations under the ISO Tariff placed on Scheduling Coordinators in respect of . . . Settlement, . . . billing and payments . . . and dispute resolution." (R. 3231.) The SC Agreement does not make exceptions for charges the Scheduling Coordinator believes are unauthorized. SDG&E was aware of the ISO charges for Transmission Losses when it began receiving daily Settlement Statements from the ISO detailing these charges from March 1998. Exh. SD-15 at 3 (R. 3173). As discussed above, SDG&E was not only aware of the charges on its statements, it fully understood what they were and accrued them in its TRBA and then sought recovery of these charges through its TO Tariff. Yet SDG&E did not comply with the dispute provisions of the ISO Tariff until December 2000, and even since then only with regard to one Charge Type. *See* Exhibit ISO-13, p. 6 (R.2354); *see* also 4/15/03 Tr. at pp. 90-92 (R. 1173-75).

As a result, under the applicable provisions of the ISO Tariff, the greater part of SDG&E's claims are for charges that have been deemed valid and the validity of which has not properly been challenged by SDG&E (through an

application to the ISO Governing Board for a re-run). Sections 11.7.2 and 11.7.3 thus preclude SDG&E's claims for amounts that were not disputed under those sections.

CONCLUSION

For the reasons stated above, the ISO respectfully requests that the Commission reverse the decision of the Arbitrator.

Respectfully submitted,

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Dated: March 9, 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 compiled by the Secretary in this proceeding.

Dated at Washington, DC this 9th day of March, 2004.

/s/ Michael E. Ward

Michael E. Ward