

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

Cities of Anaheim, Azusa, Banning, Colton,
and Riverside, California and City of Vernon, California

v.

Docket No. EL03-54-000

California Independent System Operator Corporation

ORDER ON ARBITRATOR'S AWARD

(Issued April 20, 2004)

1. On February 26, 2003, the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (Southern Cities) and the City of Vernon, California, (Vernon) (collectively, Petitioners) filed a petition asking the Commission to review an arbitrator's award that was issued on February 3, 2003 in American Arbitration Association Case No. 71 198 00758 00. On July 23, 2003, the Commission issued an order establishing a briefing schedule¹ and the parties subsequently submitted Initial, Reply, and Rebuttal Briefs. As discussed below, we will reverse the arbitrator's award. This order will benefit customers by ensuring that the California Independent System Operator Corporation (ISO) classifies costs accurately and recovers them in a manner consistent with its Open Access Transmission Tariff.

Background

2. This proceeding stems from a dispute concerning costs incurred by the ISO from February 7, 2000 to March 22, 2000. The costs resulted from the dispatch of generating resources required to replace certain Reliability Must Run (RMR) units that were not available during this period. Originally, the ISO billed the costs for the dispatch to replace these unavailable RMR units to Southern California Edison Company (SoCal Edison) as Out-of-Market (OOM) charges. SoCal Edison protested these charges, and

¹ Cities of Anaheim, et al. v. California Independent System Operator Corporation, 104 FERC ¶ 61,099 (2003).

the ISO, relying on Commission orders prohibiting the ISO from using its OOM dispatch authority when there are unaccepted bids in the market,² re-billed these costs as Intra-Zonal Congestion to all loads in the SP-15 Zone, including the Southern Cities and Vernon. This re-billing as Intra-Zonal Congestion costs resulted in charges of \$1,552,883 to the Southern Cities and \$351,600 to Vernon, whereas OOM charges did not impact these parties.

3. Southern Cities initiated arbitration to resolve the dispute, by filing a Statement of Claim against the ISO under section 13.2.2 of the ISO Tariff on October 30, 2000. Petitioners claimed that the ISO's characterization of the disputed charges as Intra-Zonal Congestion costs was not valid under the ISO Tariff and that, even if the characterization was valid, the charges were not properly chargeable to Existing Transmission Contract (ETC) holders. Statements of Claim were subsequently filed by Vernon and SoCal Edison. Vernon asserted that the charges against it should also be deemed improper. SoCal Edison opposed the Petitioners' reallocation of the disputed charges and argued that the claims should be rejected outright because the claims were pending before the Commission as one of the unresolved issues in Docket No. ER98-3760-000.

4. Following discovery, testimony, a hearing, and briefing, the Arbitrator issued a decision on April 15, 2002 (April 15 Arbitration Award), which stated simply that all claims of the Southern Cities and Vernon were denied.

5. On May 17, 2002, Petitioners filed a petition asking the Commission to review the April 15 Arbitration Award. On November 25, 2002, the Commission issued an order finding the April 15 Arbitration Award inconsistent with the arbitration procedures set forth in the ISO Tariff, which require the Arbitrator's decision to include findings of fact and conclusions of law. The November 25 Order referred the matter back for the parties to provide findings of fact and conclusions of law by the Arbitrator.³

6. On February 7, 2003, the Arbitrator issued a further decision which included "Findings of Fact" and "Conclusions of Law" (February 7 Arbitration Award). The Arbitrator briefly described the parties' positions and concluded that the ISO took "voltage support actions related to Intra-Zonal Congestion management" and that "ETC holders were not exempt from ISO charges for such Intra-Zonal Congestion costs." The Arbitrator concluded that the findings did not support the claims of Petitioners and the claims were therefore denied.

² See *Cities of Anaheim, et al. v. California Independent System Operator Corporation*, 101 FERC ¶ 61,235 (2002) (November 25 Order).

³ *Id.*

7. On February 26, 2003, the Petitioners filed a petition for Commission review of the February 7 Arbitration Award. On July 23, 2003, the Commission issued an order establishing a schedule for the submission of pleadings.⁴

Initial Brief of Southern Cities and Vernon

8. In its Initial Brief, Petitioners states that the record in this proceeding shows that the resource dispatches that gave rise to the disputed charges were necessary for Voltage Support, not for Intra-Zonal Congestion. Petitioners state that, contrary to suggestions by the ISO that Voltage Support is merely a subset or component of Intra-Zonal Congestion management, these two services are described in separate sections of the ISO Tariff and are governed by separate cost recovery mechanisms.

9. Petitioners argue that the ISO's attempt to equate Voltage Support with Intra-Zonal Congestion is inconsistent with the operating procedures under the ISO Tariff. With regard to ISO Operating Procedures, Petitioners state that the absence of market notices and corresponding OSMOSIS log⁵ entries documenting Intra-Zonal Congestion is compelling evidence that Intra-Zonal Congestion was not the reason for the resource dispatches that led to the disputed charges. Petitioners explains that, if Intra-Zonal Congestion occurs and the ISO does not have immediately available bids adequate to resolve the congestion, the ISO is required to issue market notices seeking additional bids to resolve the congestion. Also, Petitioners state that the Grid Resources Coordinator is required to record OSMOSIS log entries documenting the issuance of such market notices. Therefore, the absence of market notices and OSMOSIS log entries is inconsistent with the ISO's subsequent characterization of the resource dispatches as necessary to relieve Intra-Zonal Congestion.

10. Petitioners further argue that the parties have stipulated that the resource dispatches that led to the disputed charges would not have occurred if the RMR units in the SoCal Edison area had been available. Petitioners state that this stipulated fact confirms that the dispatch was for Voltage Support, not Intra-Zonal Congestion.

11. Petitioners argue that although the dollar amounts at issue in this proceeding are not extraordinarily large, the dispute here merits the Commission's close review, because

⁴ See *Cities of Anaheim, et al. v. California Independent System Operator Corporation*, 104 FERC ¶ 61,099 (2003).

⁵ Under ISO Operating Procedure M-401, "Real-Time Forward Intra-Zonal Congestion Management," the Grid Resource Coordinator is responsible for logging resource dispatches to resolve Intra-Zonal Congestion in the Out of Sequence, Market, Overgeneration Settlement Information System (OSMOSIS) log.

it concerns the ISO's obligation to classify costs accurately and to recover them in a manner consistent with its Tariff. In this case, Petitioners argue that the ISO has mischaracterized transactions not once, but twice. Petitioners argue that names and labels matter in implementing a filed tariff, and mischaracterization of charges undermines the entire purpose of a filed tariff. Additionally, Petitioners argue that, if the ISO is free to classify transactions and allocate costs as it finds expedient, without regard to its own records, operating procedures, and Tariff provisions, market participants can have no confidence that transactions are being settled properly, and the Commission cannot exercise its regulatory authority properly.

12. Petitioners also assert that, although Commission policy and the ISO Tariff generally provide that an arbitrator's award should be granted deference, the Commission should grant no deference to the Arbitrator's findings of fact and conclusions in this proceeding, because the Arbitrator provided no rationale for his decision. Specifically, the Arbitrator's decision makes no mention of the ISO Tariff, controlling legal precedent, or specific record evidence in the findings and conclusions, and the Arbitrator's finding would permit the ISO to arbitrarily allocate costs and is therefore contrary to Commission policy.

Initial Brief of the California Department of Water Resources State Water Project

13. The California Department of Water Resources State Water Project (DWR) argues that this case raises very significant policy issues of ISO Tariff and rate compliance. DWR states that the magnitude of new costs attributable to the ISO and lack of accountability associated with ISO cost socialization and inadequate metering make strict Commission enforcement of and ISO compliance with Tariff requirements essential for ratepayer protection.

14. DWR argues that the record in this proceeding confirms that the ISO arbitrarily reassigned millions of dollars of charges. DWR attached to its initial brief the testimony of an ISO representative that DWR argues shows that the ISO simply revised the logs to reallocate tens of millions of dollars of costs from SoCal Edison to Scheduling Coordinators in SoCal Edison's control area. Such "self-help" ratemaking for whatever reason, including ISO "administrative convenience," violates the filed rate doctrine and contravenes basic Federal Power Act protections.

Reply Brief of the California Independent System Operator Corporation

15. In its brief, the ISO states that Intra-Zonal Congestion can be considered any condition within a zone which precludes the ISO from being able to accept all generation and load schedules. If the ISO cannot accept all generation and load schedules, there is congestion. The ISO states that it was not able to dispatch RMR units because they were not available. And there was a constraint on the system that prevented the ISO from

accepting all load and generation schedules. Since there were bids available from other resources, the ISO had to dispatch those resources to solve the problem.

16. According to the ISO, Voltage Support is one of the Ancillary Services that the ISO procures as one tool for managing system constraints to maintain grid reliability by managing congestion, including Intra-Zonal Congestion. When contracted Voltage Support Services are available to manage such a specific constraint, the ISO uses the contract services (i.e., RMR service). However, when no RMR unit is available, the ISO has no ability to allocate costs to the transmission owner. The ISO also states that under the Tariff no rate exists to charge the transmission owner for costs incurred for resource dispatches in lieu of RMR dispatches when no RMR unit was available.

17. Also, the ISO argues that there were no procedural irregularities with regard to market notices and corresponding OSMOSIS log entries. The ISO states that the dispatches at issue were for real power generation increases and that it followed its Tariff and operating procedures. The ISO states that the record demonstrates that the logs are consistent with the dispatch of Intra-Zonal Congestion Management.

Reply Brief of Southern California Edison Company

18. SoCal Edison argues that Petitioners are incorrect when they claim that the ISO incorrectly characterized and allocated the disputed charges. SoCal Edison argues that there is Intra-Zonal Congestion whenever the ISO is unable in real time to serve all generation and demand in the zone. Here, SoCal Edison argues that the disputed costs were for a dispatch of resources to resolve a real-time constraint within the SP 15 Zone, to relieve Intra-Zonal Congestion. SoCal Edison adds that the ISO Tariff is clear that such costs are to be allocated to Scheduling Coordinators within the impacted zone. In sum, SoCal Edison argues, no ISO Tariff provision authorized the ISO to charge SoCal Edison, as a PTO, the disputed charges.

19. SoCal Edison also argues that if the Commission finds that the ISO Tariff does not address the situation at hand, and allows the ISO to shift the cost of the disputed charges to SoCal Edison, as the local PTO, where no rate schedule previously existed, this would amount to impermissible retroactive ratemaking and should not be permitted here.

20. Finally, SoCal Edison argues that while the ISO Tariff gives an arbitrator broad discretion in granting relief, it does not authorize an arbitrator to decide a matter that is already pending at the Commission, and whose outcome would affect many more parties than those participating in the arbitration. SoCal Edison adds that the Arbitrator here would have exceeded his authority had he looked beyond the ISO Tariff to address whether the Petitioners' ETCs allowed Intra-Zonal Congestion charges when that exact issue is still pending at the Commission and the ETCs were not in evidence in the arbitration. SoCal Edison adds that to find that the Petitioners were exempt from Intra-

Zonal Congestion charges, when the ISO Tariff does not so provide, would amount to a change in the rates or charges set forth in the ISO Tariff, which was beyond the scope of the underlying arbitration.

Reply Brief and Motion in Support of Arbitrator's Award by the California Electricity Oversight Board

21. The California Electricity Oversight Board (Board) argues that according to both the ISO Tariff and applicable case law, the Arbitrator's decisions should be given substantial deference and remain undisturbed. The Board also argues because the ETCs were not and are not exempt from ISO charges of Intra-Zonal Congestion costs, Petitioners were properly charged. The Board contends that where no RMR unit is available, as in this case, the ISO has no ability under the RMR contract to allocate costs to the transmission owner. The Board adds that the ISO can only levy the rates it has on file with the Commission, and no rate exists to charge the transmission owner costs incurred for resources dispatches in lieu of RMR dispatches when no RMR unit is available.

Rebuttal Brief of the Southern Cities and Vernon

22. In their Rebuttal Brief, Petitioners argue that the substantial deference standard does not preclude review of arbitration, and that in this case the award does not provide a coherent rationale for its conclusion and is not grounded in the factual record of the underlying proceeding. They state that the arguments of the ISO, SoCal Edison, and the Board, if accepted, would inappropriately transform the substantial deference standard into a blind faith standard and deny the Petitioners any relief from a wrongly-decided arbitration award.

23. Second, Petitioners contend that the ISO continues to confuse and misinterpret the arbitration record on the key factual issue of whether the resource dispatches in dispute were made to resolve a Voltage Support deficiency or manage Intra-Zonal Congestion. Petitioners note that the ISO argues that Voltage Support and Intra-Zonal Congestion Management are on a "continuum" but that the "nature" of the dispatches at issue demonstrates that they were made to relieve Intra-Zonal Congestion and not to provide Voltage Support. The Petitioners respond that the ISO's own witness refuted the ISO's current position that the dispatches at issue could not have been related to Voltage Support.

24. Next, Petitioners argue that the documentation and record evidence in the underlying proceeding refute the ISO's assertion regarding the nature of the dispatches at issue, and that, if accepted, the erroneous arguments of the ISO and SoCal Edison regarding permissible cost allocation would wrongfully deny petitioners an effective remedy.

25. Finally, Petitioners argue that the applicability of congestion charges to ETC holders is a live issue in this proceeding that can and should be resolved in favor of the Petitioners.

Discussion

26. The ISO uses a Local Area Reliability Service process to determine which resources the ISO requires to be designated as “Must-Run,” in order to ensure system reliability. When transmission constraints limit imports into certain areas (*i.e.*, load pockets), generation located near load is needed to serve customers in those areas and/or provide transmission support to protect the system from voltage collapse, instability, and thermal overloading.⁶

27. Section 2.5.18 of the ISO Tariff describes the procurement process for Voltage Support and states that Voltage Support will be provided by RMR units. Under section 5.2.8, costs for RMR units are charged to the Responsible Utilities in whose control areas the RMR units are located. In contrast, section 7.2.6.2 of the ISO Tariff provides that the ISO is to manage Intra-Zonal Congestion in real-time using Available Adjustment Bids and Imbalance Energy Bids based on their effectiveness and in merit order. Under section 7.3.2, costs for Intra-Zonal Congestion management are charged to all Scheduling Coordinators within the congested zone based on their metered demands and exports.

28. The underlying dispute in this proceeding involves whether the dispatch of non-RMR, *i.e.*, market, units over a period of time, approximately 6 weeks, was to provide RMR service or to manage Intra-Zonal Congestion. First, we note two facts: (1) this service would have been provided by contracted-for RMR units if those units had not been out of service because of mechanical problems; and (2) the period at issue, February and March, is a period when load is not very high.

⁶ Agreements with RMR units enable the ISO to dispatch those units to deliver energy in order to meet local reliability needs or to provide ancillary services including Voltage Support when needed, regardless of price. RMR unit owners at those times have location-specific market power and could potentially charge a high price in the absence of an RMR agreement. The RMR agreements prevent RMR unit owners from taking advantage of location-specific market power.

Under its Tariff, the ISO passes through to the Participating Transmission Owners (PTO), such as SoCal Edison, the cost of RMR agreements for the RMR units located in each PTO’s service area. SoCal Edison, in turn, passes these RMR costs through to its TO Tariff customers as reliability services.

29. In this regard, the parties have stipulated that, if the resource dispatches that resulted in the charges disputed by Petitioners had been from the relevant RMR units,⁷ the costs for such dispatches would have been billed to the PTO, SoCal Edison. Accordingly, the ISO's initial allocation of the disputed charges was made entirely to SoCal Edison. The ISO subsequently reclassified the disputed charges as Intra-Zonal Congestion as a response to a Commission order issued on April 12, 2000, after the time period in which the disputed charges arose. Accordingly to the ISO, this order held that the ISO Tariff required that, if generators had submitted bids, the ISO must accept those bids and follow Intra-Zonal Congestion, not OOM procedures.⁸ Thus, the costs were reallocated to all metered demand (metered load and exports) in the SP 15 Zone.

30. Notwithstanding the ISO's reallocation, the resources at issue here were dispatched because the previously contracted-for RMR units were unavailable; those resources were, in essence, dispatched to provide RMR service. ISO witness Woertz testified that "the RMR units, had they been available, could have been dispatched because there was a voltage issue that needed to be addressed. And the RMR contract does permit the ISO to dispatch those RMR units in response to a voltage concern."⁹

31. The ISO argues in its Reply Brief that the dispatches increased real power generation, and increases in real power generation are consistent with Intra-Zonal Congestion management and not Voltage Support. The ISO further states that, in contrast, local area problems only causing voltage deficiency (that have not escalated to transmission congestion) are resolved through Voltage Support in which the real power generation is usually decreased rather than increased, as was the case here. The ISO concludes that Petitioners have not and cannot refute that increases in real power generation are Intra-Zonal Congestion Management, not Voltage Support. In this regard, ISO witness Woertz stated, "Voltage support can be considered a form of intra-zonal congestion because if you do not respond to the voltage support problem, you're not able to support all your schedules..."¹⁰

⁷ The four RMR units in the SoCal Edison area were: (1) Alamitos 4 (320 MW); (2) Huntington Beach 2 (215 MW); (3) Redondo Beach 5 (175 MW); and (4) Redondo Beach 6 (175 MW).

⁸ California Independent System Operator Corporation, 91 FERC ¶ 61,026 (2000).

⁹ Tr. 93, lines 12-17.

¹⁰ Id.

32. We disagree with the ISO's assertion that the increases in real power generation that occurred in the time period at issue must be viewed as Intra-Zonal Congestion and not Voltage Support. While the ISO is correct that, in most instances, when Voltage Support is supplied, real power generation is decreased, that is not always the case. The record clearly indicates that there was a voltage concern. The record also clearly indicates that there were increases in real power generation. In this context, the increase in real power generation addressed the voltage concern, by increasing the amount of real power transmitted over other lines, effectively taking the strain off the lines with the voltage concern; there was now adequate voltage support for those lines. Critically in this regard, as ISO witness Woertz stated, the voltage concern would have been addressed by the RMR units had they been available.

33. The Commission has long recognized the value of parties seeking to resolve disputes through means other than formal litigation before the Commission, and thus has stated that it is desirable and appropriate, if otherwise consistent with the public interest, for the Commission to adhere to the results of a binding arbitration award given that arbitration is a valuable way to avoid time-consuming and expensive administrative proceedings.¹¹ The ISO Tariff thus provides for arbitration,¹² and further provides for the Commission to accord substantial deference to an arbitrator's findings of fact.¹³ However, the ISO Tariff also provides for a right of appeal to the Commission upon a claim that an arbitrator's decision is contrary to or beyond the scope of, among other things, the relevant ISO documents, the Federal Power Act, or the Commission's

¹¹ E.g., Policy Statement Regarding Regional Transmission Groups, FERC Stats. & Regs. ¶ 30,976 at 30,877 (1993).

¹² Section 13.4.1 of the ISO's Tariff provides, "A party may apply to the FERC or any court of competent jurisdiction to hear an appeal of an arbitration award...."

¹³ 104 FERC ¶ 61,099 at P 10. Section 13.4.2 of the ISO's Tariff provides that: "The parties intend that FERC or the court of competent jurisdiction should afford substantial deference to the factual findings of the arbitrator. No party shall seek to expand the record before the FERC or court of competent jurisdiction beyond that assembled by the arbitrator, except (i) by making reference to legal authority which did not exist at the time of the arbitrator's decision, or (ii) if such party contends the decision was based upon or affected by fraud, collusion, corruption, misconduct or misrepresentation."

regulations or decisions.¹⁴ As explained above, under the ISO Tariff Voltage Support and Intra-Zonal Congestion Management are separately defined services and each has separate cost recovery provisions and what occurred here more properly falls within the former rather than the latter.

34. As explained above, the resource dispatches that resulted in the disputed charges would not have occurred if the generating units subject to RMR contracts had been available; had the RMR units in SoCal Edison's service area been available, SoCal Edison would have been billed the costs for such dispatch. In this regard, we add that we believe the Arbitrator did not fully consider either the policy underlying the establishment of RMR contracts or their purpose in relation to the ISO. While the ISO Tariff directs that Intra-Zonal congestion costs be assigned to all Scheduling Coordinators within the affected zone, when RMR units are not available and other resources are dispatched in their place, then those other resources are being dispatched, not for Intra-Zonal Congestion, but for Voltage Support. Assignment of the costs of those resources to Intra-Zonal Congestion, rather than Voltage Support, would not be consistent with cost causation principles.¹⁵

35. Accordingly, the disputed charges should be borne by SoCal Edison, as the PTO, pursuant to section 5.2.8 of the ISO Tariff, rather than allocated as Intra-Zonal Congestion to all Scheduling Coordinators, including Petitioners.

¹⁴ Id. Section 13.4.1 of the ISO's Tariff provides that an appeal may be "only upon the grounds that the award is contrary to or beyond the scope of the relevant ISO Documents, United States federal law, including, without limitation, the FPA, and any FERC regulations and decisions, or state law. Appeals shall, unless otherwise ordered by FERC or the court of competent jurisdiction, conform to the procedural limitations set forth in this Section 13.4.1."

¹⁵ E.g., *Sithe/Independence Power Partners, L.P. v. FERC*, 285 F.3d 1, 4-5 (D.C.Cir. 2002); *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 708 (D.C.Cir. 2000), *aff'd*, 535 U.S. 1 (2002).

The Commission orders:

The Award of the Arbitrator in favor of the ISO is hereby reversed. The disputed charges are for Voltage Support and should be classified and billed as such, pursuant to section 5.2.8 of the ISO Tariff. The ISO is hereby directed, within 60 days, to revise its billing and make refunds, with interest, as appropriate; the ISO is hereby directed, within 30 days thereafter, to file a refund report.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.