



# Memorandum

To: Whom it may concern

From: ISO Management

cc:

Date: July 18, 2003

Re: *Western Area Power Administration Federal Control Area Proposal*

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*This memorandum is for information only –*

## EXECUTIVE SUMMARY

The Western Area Power Administration – Sierra Nevada Region (Western) is considering the formation of an independent Federal Control Area as part of its 2005 Marketing Plan. Western is also considering establishing its own transmission charge on one of the two Pacific AC Intertie (PACI) 500 kV lines between Malin, Oregon and Round Mountain, California. This line is owned by Western is to be included in the Western control area. This plan is dependent upon condemnation of portions of two PG&E substation facilities.

The California ISO is concerned about the potential adverse cost and grid reliability impacts of Western's plan on California electricity customers and Market Participants. Creation of a Federal Control Area would unnecessarily complicate coordinated operations of the California – Oregon Intertie (COI) and ISO grid in Northern California. The Western plan would cross subsidize Western's customers by creating a "toll booth" to collect \$8+ million annually in inappropriately "pancaked" transmission charges from customers served by the ISO (see Attachment A).

Western's plan would result in a shift of transmission access cost from Western's Federal preference power customers to the balance of California electricity consumers. The plan would also create different market rules for different ISO Market participants, and produce "seams" issues that could threaten reliability and increase costs.

The ISO has offered to tailor its Metered Subsystem (MSS) option to meet the specific needs of Western and the U.S. Bureau of Reclamation (USBR) as an alternative to establishment of Western as a Federal Control Area. The MSS option offers several benefits to governmental and municipal utilities under the ISO Tariff. It is a lower cost alternative that would essentially maintain the existing operating relationship between the ISO and Western, avoiding the added cost, complexity, and grid reliability issues associated with the interposition of a third Control Area on the Pacific AC Intertie.

## ISO CONCERNS WITH WESTERN'S TRANSMISSION AND CONTROL AREA INITIATIVE

**Control Area Cost Comparison & Seams Issues** - The creation of a new Control Area that is carved out of the current configuration of the ISO would create additional costs and inefficiencies due to the smaller geographic scope of the ISO and the resulting additional "seams" issues and potential adverse impacts on California electricity customers. The ISO can offer Control Area services at a lower cost than Western due to economies of scale and avoidance of duplicative systems.

**Grid Operations Reliability Issues** – Western's 230 kV and 500 kV transmission systems are integral to the ISO grid in Northern California, with multiple intra-tie points to PG&E transmission. The complexity inherent in operation of this grid as two systems, combined with the complexity associated with multiple Control Area operation of COI, results in grid reliability concerns. The complexity and workload associated with pre-scheduling, path congestion mitigation, real time path de-rates, loop flow management, disturbance recovery, and outage coordination would all be increased to the detriment of reliable operations.

**"Pancaked" Wheeling and Cost Shift Issue** – Western's 2005 Marketing Plan anticipates an increase in its transmission grid access cost, associated with paying the present market rate for transmission services in California, once its present contract expires. The Western plan shifts this cost, **approximately \$80 – 100 million over ten years**, by imposing a wheeling charge, to be applied to imports into California, on its first segment of the PACI. The ISO has offered Western the option of becoming a Participating Transmission Owner (PTO) in the ISO as an alternative means of addressing Western's post 2948A transmission service costs concerns.

## BACKGROUND FACTS

Three of Western's existing contracts expire on December 31, 2004: (1) the integration contract (transmission and generation) between Western and Pacific Gas and Electric Company (PG&E) (Contract 2948A); (2) the PACI transmission arrangement with the California investor-owned utilities (Contract 2947A); and (3) the Malin-Round Mountain interconnection agreement with PG&E (Contract 2949A).

Western currently uses the PG&E integration contract (2948A) to serve approximately 2,000 GWh of annual preference customer load connected to PG&E transmission facilities ("2948A customer load" or "2948A customers"). This contract, which expires at the end of 2004, has been in place since 1967. The balance of Western's federal preference power customers are interconnected directly with Western's own transmission system.

Upon expiration of this PG&E contract, the cost of serving Western's 2948A customers would in large part be based on the charges for power delivery under the ISO Tariff. Western initially estimated that, due to the expiration of this contract, costs of serving these customers would increase by \$23 million. However, these cost increases were significantly overstated due to a misunderstanding of the ISO costs that Western would be facing. When corrected, the annual costs of serving the approximately 2,000 GWh of 2948A customer load increase by approximately \$8 million over the 1967 contract rate.

**Western's plan to establish itself as an independent Federal Control Area was initially justified on the basis of cost savings. However, Western now seems to be justifying its move on the basis of maintaining "flexibility"**

**and independence from the ISO's FERC Tariff**, for its customers directly connected to Western's 230 kV transmission system, inclusive of several large municipal utilities.

### **WESTERN'S PROPOSAL TO "ROLL IN" INCREASED POWER DELIVERY COSTS**

As a Federal Control Area, Western's plan is to have the \$8 million in annual "CAISO delivery costs" rolled into Western's transmission rate such that California's non-Western customer users of Western's transmission facilities would cross subsidize Western's 2948A customers through "pancaked" transmission rates.

To be able to collect such "pancaked" transmission rates, Western plans to separate part of its system from the ISO, condemn some PG&E substation facilities, create its own Federal Control Area, and inflate the transmission rates for providing service on the Western-owned leg of the 500 kV PACI. The excess revenues collected would then offset the cost increases Western's 2948A customers face due to the expiration of the 1967 contract with PG&E.

### **ECONOMIC AND OPERATIONAL STUDIES**

Representatives from Western, including Regional Manager Jim Keselberg, met with the ISO in April 2002 and again in early December to advise the ISO that they were seriously considering the formation of a separate Western Control Area. Western advised that Navigant Consulting had been retained, to assess the cost and benefits of Western's proposal. (Western's own internal cost study, distributed to their customers in late 2002, had seriously overstated ISO Market and administrative costs by a factor of 10, \$16 Million vs. \$1.6 million annually)

The Navigant report was to be available in January and was to be shared with the ISO prior to release to help assure its accuracy. Western stated that they would consider the economics of the Metered Subsystem alternative offered by the ISO and committed that their ultimate decision would be driven by the most cost effective solution.

The ISO submitted a formal Metered Subsystem (MSS) proposal to Western April 8, 2003. The proposal (Attachment B) was submitted to Tom Boyko, Marketing Manager, and Tom Carter, Operations Manager. The proposal includes an economic analysis of Western's Control Area option, contrasted with the ISO's MSS option.

Western officially released the Navigant report on June 12, 2003. The report is officially titled "Analysis of Central Valley Project Operational Alternatives". Western did not allow the ISO to pre-review the report for accurate representation of ISO costs, as it had committed.

The report released by Western is only an executive summary. It does not include enough detail to allow a full analysis of the results. Accordingly, the ISO issued a formal data request to Western for the supporting detail necessary to validate the results. The ISO is working with Western to obtain the necessary information and will conduct a comprehensive review and comment on confirmed discrepancies and omissions, once it has received the information.

**A preliminary analysis of the Navigant report identified several significant errors and omissions that appear to overstate systematically, the advantages of establishing a Western Federal Control Area and to underestimate the cost benefits and operational efficiencies of Western remaining in the ISO Control Area.**

Based on this preliminary review, the ISO believes that the analysis overstates ISO control area settlements, overstates "Reliability Service" costs, understates credits received under ISO participation, overstates balancing energy and congestion costs, and understates Federal control area costs and cost escalation rates. The analysis also excludes

payments that Western would make to the ISO under their Federal control area option for the increased complexity of coordinated grid operations costs, even though Western has offered to compensate the ISO for the increased operating costs imposed by the Western plan.

**Considering the implications of these apparent errors and omissions, the ISO believes that the economics of the ISO PTO and MSS options are superior to the WAPA Control Area option.**

## **ISO METERED SUBSYSTEM OFFER**

The ISO MSS proposal is offered as a means of resolving many of Western's customers' concerns and as an alternative to the Western Federal Control Area option. **This MSS option essentially maintains the present Western relationship with the ISO, and its settlements, grid operations, and metering systems, with the exception that Western would serve as its own scheduling entity, as opposed to relying upon PG&E.** PG&E presently schedules on behalf of Western and its customers due to its 2948A integration agreement with Western, which "sunset" December 31, 2004.

MSS benefits for Western include cost allocation based on cost causation, load following facilitation, generation dispatch control, full ISO Market access, and exemption from non-contingency blackouts. This is the same type of proposal adopted by many northern California governmental electric utilities, including Silicon Valley Power, Roseville, and Northern California Power Agency (NCPA), and that is pending with the City of Colton.

**However, Western's local management seems intent on pursuing the Federal Control Area option.**

## **STATUS**

**Western has NOT made application to the Western Electricity Coordinating Council (WECC) for Control Area status, and Western staff members have been advised, internally, not to expend any "irretrievable" capital, pending completion of the Federal Register notice public process required for this action.**

ISO representatives have met with officials of the Bonneville Power Administration (BPA), the federal transmission agency and Control Area operator for the Pacific Northwest electric grid, to discuss the Western proposal. BPA operates the Control Area immediately to the north of the ISO. The ISO coordinates operation of the COI, the ISO's 500 kV connection to power from the northwest, directly with BPA. BPA is concerned for the efficient operation of the California-Oregon Intertie (COI) and is evaluating all of the alternatives for their potential impact on the Path.

## **NEXT STEPS**

**Western initiated its public process with a Federal Register notice on June 24, 2003.** It held/plans to hold two public sessions in July, an "Information" session held on July 9<sup>th</sup> and a "Public Comment" session planned for July 30<sup>th</sup>. Written comments are due no later than August 8<sup>th</sup>. **A decision is expected Fall 2003.** The ISO will be participating actively in that Western public process.

The ISO is also committed to working with Western on terms of an MSS agreement that specifically address the needs of Western, USBR, and Western's federal power customers. The ISO will continue to work on this issue with the goal of serving all of California, including Western's customers, with safe and reliable transmission service at the lowest equitable cost.