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

San Diego Gas & Electric Company) Docket No. ER98-496-000
Docket No. ER98-2160-000

Prepared Direct Testimony of Stephen T. Greenleaf On Behalf of the California Independent System Operator Corporation

Q: PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A: My name is Stephen T. Greenleaf and I am the Director of Policy for the California Independent System Operator Corporation (ISO). My business address is 151 Blue Ravine Road, Folsom, California 95360.

Q: PLEASE DESCRIBE YOUR PRESENT RESPONSIBILTIES AT THE ISO.

A: As Director of Policy, my responsibilities include the monitoring of issues related to the formation and operation of ISOs both nationally and internationally. My duties also include the formulation of policies at the ISO that are consistent with the rulings of the FERC and both state and federal legislatures. As Director of Policy, my responsibilities also include the preparation of testimony and exhibits before regulatory agencies and state and federal legislatures on issues related to the ISO.

Q: PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND

A: I received my Bachelor of Arts in Economics from the State University of New York at Buffalo in May 1985. In May of 1997, I received a Master of Science in Environmental Science from the John Hopkins University in Baltimore, Maryland.

Between January, 1986 and February, 1990, I worked in the Division of Applications in the Office of Electric Power Regulation at the Federal Energy Regulatory Commission. From 1990 to 1996, I was employed in the Division of Litigation in the Office of Electric Power Regulation at FERC. Between April 1996 and February 1998, I was employed in the Division of Opinions and Systems Analysis at FERC. In February 1998, I assumed my current position.

Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A: The purpose of my testimony is to discuss the advantages of establishing a formula rate to calculate fixed costs and variable O&M costs for all Reliability Must-Run (RMR) units.

Q: PLEASE BRIEFLY DESCRIBE RMR UNITS AND THE RATES THAT ARE AT ISSUE IN THESE PROCEEDINGS.

A: RMR units are the generators that may be called upon by the ISO to ensure that the reliability of the ISO Controlled Grid is maintained. ISO Tariff § 5.2.1. After an RMR unit is called upon, the unit's owner bills the ISO for the service rendered. The ISO subsequently recovers the costs it incurs for RMR service from the Participating Transmission Owner in whose Service Area the RMR generating unit is located. ISO Tariff § 5.2.7. Under the terms of the ISO Tariff, the ISO is charged with procuring RMR generation "from the cheapest available sources." ISO Tariff § 5.2.6.

Q: HOW DOES THE ISO PROPOSE FOR RMR RATES TO BE DEVELOPED?

A: As fully discussed in the testimony of Joseph N. Linxwiler, the ISO proposes that the same formula be used to determine the fixed costs and variable O&M costs of each designated RMR unit. That formula clearly identifies the fixed costs and variable O&M

costs associated with must run service and provides for an allocation of those costs to RMR units. *See* Linxwiler Testimony and Formula , Exhibits JNL-1 and JNL-6.

Q: HOW DOES A FORMULA RATE WORK IN GENERAL?

A: A formula rate allows FERC-regulated rates to change repeatedly without formal notice to the FERC under Section 205 of the Federal Power Act (FPA), so long as such changes are consistent with the approved formula. The formula is the rate. The use of a formula allows both upward and downward adjustment to the rates, depending on the costs associated with operating each RMR unit. The ISO's goal is to avoid cumbersome Section 205 filing requirements in order to reduce the costs of litigation typically associated with setting rates and to reduce the ISO's internal costs to administer RMR contracts.

Q: PLEASE COMPARE FORMULA RATES TO STATED RATES.

A: As previously stated, once the formula for a formula rate is approved, subsequent changes in rates do *not* require a filing under Section 205 of the FPA, so long as subsequent changes are consistent with the approved formula. In contrast, if a utility uses stated rates, any time that the utility's costs change such that a rate change would be warranted, the utility would have to file for approval prior to changing its rates, or a market participant (or the Commission on its own motion) would have to file a complaint to change the rates under FPA § 206. Each time a change in a stated rate is filed with the Commission for approval (or a complaint filed), litigation is required and resources of the different interested parties are required to participate in the litigation. Active involvement in litigation necessarily involves significant costs to those participating.

Q: HOW WOULD FORMULA RATES FOR RMR SERVICE BENEFIT THE ISO, IN PARTICULAR?

A: As the operator of California's electricity grid, the ISO is obligated to ensure grid reliability. ISO Tariff Section 5.2.1. Reliability requires the use of RMR service, as needed. At present, the ISO is a captive customer to RMR unit owners, but the cost of RMR service is ultimately borne by California consumers.

In California Assembly Bill 1890—which provided the legislative direction behind the restructuring of the California electricity markets—the legislature's stated intention, in pertinent part, was

> To ensure that California's transition to a more competitive electricity market structure . . . creates a new market structure that provides competitive, *low cost and reliable electric service*.

AB 1890, § 1 (emphasis added). To achieve that purpose, the legislature ordered the creation of "an Independent System Operator with centralized control of the statewide transmission grid, charged with ensuring the efficient use and reliable operation of the transmission system." AB 1890, § 1(c).

Given the stated rationale for industry restructuring and the mission of the ISO, it is unlikely that the legislature intended that reliability should be provided at any cost. Rather, it is more likely that the legislature, as well as California consumers, expects the ISO to procure RMR service at the lowest possible cost. *See also* ISO Tariff Section 5.2.7. As part of this effort, the ISO is intending to implement a competitive bidding process to procure RMR services.

One way for the ISO to ensure the lowest possible cost is to actively participate in any RMR rate case that is filed by the various RMR unit owners. It is the ISO that calls upon these units for service and the ISO-Controlled Grid is part of the contractual path

for the power generated from these RMR units. Although it ultimately does not pay for RMR services, the ISO is in the best position to protect the public interest by taking an active role in the litigation of RMR rates to ensure that it procures RMR service at the lowest possible cost.

If RMR unit owners filed individualized stated rates, the ISO would have to be actively involved in each proceeding filed by the unit owners to establish or change rates. With 117 RMR units, the ISO could have to participate in as many as 117 different rate proceedings, or more depending on how often the unit owners filed for changes in rates. The ISO simply does not have the resources to actively participate in that number of cases, as it has an obligation to do. To obtain the resources necessary for the ISO to participate, ISO rates would have to be increased, or resources would have to be pulled from other areas of ISO operations. Neither alternative is acceptable. If, on the other hand, a standard formula, which clearly identifies the fixed costs and variable O&M costs associated with must run service, was approved—as proposed by the ISO—there would be no need for the plethora of Section 205 filings to be made, and no need for the ISO to expend its valuable, but limited resources on rate case litigation. Moreover, the ISO's own internal costs to administer these contracts would be reduced.

Q: WILL THE COMMISSION BENEFIT FROM THE USE OF FORMULA RATES AS OPPOSED TO STATED RATES?

A: Yes. The Commission currently regulates an industry that is changing dramatically—changes that the Commission itself is promoting. Historically, the Commission regulated the rates of a relatively small number of jurisdictional utilities. Detailed analysis of individual cost-based rates of these utilities was feasible given their

small number. However, in this emerging competitive market, there will be an increasing number of participants and it is likely that facilities will change hands frequently.

In California alone, there are 117 RMR facilities that were originally owned by the three Investor-Owned Utilities in California. Since ISO service began, Southern California Edison Company has sold its units to AES, Houston Industries and NRG Energy. Pacific Gas & Electric Company has sold some of its units to Duke Energy and is in the process of selling more units. San Diego Gas & Electric Company is in the process of divesting its generation. This trend will be repeated throughout the country.

In the end, the break-up of vertically-integrated jurisdictional utilities will lead to hundreds and hundreds of generators owned by a multitude of different market participants, all with a variety of different cost structures, selling different types of services, including RMR services. Like the California ISO, all other independent system operators and independent transmission companies that are created out of this industry restructuring will require RMR services from these different market participants.

Thus, as the country moves forward to a competitive electric market, the Commission must establish now a simple and uniform regulatory structure for the recovery of the fixed costs and variable O&M costs associated with cost based RMR service. Such a structure must recognize the changing needs of all market participants—lighter regulatory burdens, the ability to change rates quickly and efficiently, a simple way to provide for the recovery of fixed costs and for customers to verify that only appropriate costs are being recovered, and the scarce resources with which to devote to rate case litigation.

Such a structure will also accommodate the needs of the Commission. If individualized stated cost based rates were required for the many different service providers providing many different services or if a formula does not clearly identify fixed costs or variable O&M costs that are to be recovered, then the caseload and the workload for the Commission would be overwhelming. The use of clearly designed formula rates would spare Commission resources by reducing significantly the number of Section 205 filings that would have to be processed otherwise and ease the Commission's task in verifying the appropriateness of the costs being collected. The Commission has relied on formula rates in the past and has recognized the benefits of such rates—the avoidance of costly litigation by permitting automatic upward and downward adjustments to a rate without formal notice to the Commission. The situation, previously described, in which there could be a multitude of different market participants, with a variety of different cost structures, providing RMR service each requiring a cost based regulated rate, is the perfect situation for the use of formula rates.

Q: WILL RMR UNIT OWNERS BENEFIT FROM SUCH A STRUCTURE?

A: Yes. In this new market, participants—*i.e.*, generators—that were not previously regulated may find themselves subject to some degree of regulation. Without the use of formula rates, the RMR unit owners, for example, would be subject to the full panoply of Section 205 and all of the filing requirements and other regulatory burdens associated therewith. Formula rates will alleviate the need for RMR unit owners to make Section 205 filings each time its costs change. It provides a simple way to recover fixed costs and variable O&M costs. Moreover, as the RMR units change hands, which is likely in the restructured environment, having one standard way of calculating rates will inform

potential new owners of the types of payments that they can expect from RMR service, alleviate the necessity of constant rate proceedings to determine the individual rates for each RMR unit, and it will prevent under and overrecovery of costs.

Q: BESIDES ADMINISTRATIVE EFFICIENCY, ARE THERE OTHER REASONS WHY A FORMULA RATE IS PREFERABLE TO A STATED RATE?

A: RMR services will represent only a part of the revenue stream for generators providing such service. The formula rate proposed by the ISO allows for a clear identification of the fixed costs and variable O&M costs associated with RMR service. In the case of a stated rate, the rate can be more of a "black box" type of rate. With such a rate or with a formula that lacks the specificity of the one proposed by the ISO, it is more difficult to track which costs are included, making it more difficult to determine if any cross-subsidy exists. With a clearly designed formula rate, the chance that costs associated with other types of generation are included in the RMR service rate is significantly reduced.

Q: DOES THIS CONCLUDE YOUR TESTIMONY?

A: Yes.