UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)** **)**	**Docket No. ER03-407-000**

MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO MOTIONS TO INTERVENE, COMMENTS, PROTESTS, REQUEST FOR CLARIFICATION, AND REQUEST FOR A TECHNICAL CONFERENCE

I. INTRODUCTION AND SUMMARY

On January 13, 2003, the California Independent System Operator Corporation ("ISO")[1] submitted Amendment No. 48 to the ISO Tariff ("Amendment No. 48") in the above-referenced docket. As the ISO explained, Amendment No. 48 was submitted to modify the ISO Tariff to provide Congestion revenues, Wheeling revenues, and Firm Transmission Right ("FTR") auction revenues to entities other than Participating Transmission Owners ("PTOs"), if any such entities fund transmission facility upgrades on the ISO Controlled Grid.[2] In response to the filing of Amendment No. 48, a number of parties submitted motions to intervene, comments, and/or protests, and requests for clarification and for a technical conference were also submitted.[3]

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[1] Capitalized terms not otherwise defined herein shall have the meaning set forth in the Master Definitions Supplement, Appendix A to the ISO Tariff.

[2] Transmittal Letter for Amendment No. 48 Filing at 1.

[3] Motions to intervene, comments, and/or protests were submitted by the California Department of Water Resources State Water Project ("SWP"); California Electricity Oversight Board ("CEOB"); Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (collectively, "Southern Cities"); Cities of Redding and Santa Clara, California, and the M-S-R Public Power Agency (collectively, "Cities/M-S-R"); City of Vernon, California ("Vernon"); Duke Energy North America, LLC and Duke Energy Trading and Marketing, LLC; Dynegy Power Marketing, Inc., El Segundo Power, LLC, Long Beach Generation LLC, Cabrillo Power I LLC, and Cabrillo Power II LLC (collectively, "Dynegy"); FPL Energy, LLC ("FPLE"); The Metropolitan Water District of Southern California ('Metropolitan"); Mirant Americas Energy Marketing, LP, Mirant

Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213, the ISO hereby requests leave to file an answer, and files its answer, to the comments, protests, request for clarification, and request for a technical conference submitted in the above-referenced docket.[4] The ISO does not oppose the intervention of any of the parties that have sought leave to intervene in this proceeding. As explained below, however, the ISO believes that Amendment No. 48 should be accepted as submitted to the Commission, and that the relief requested in the filings submitted in response to the filing of Amendment No. 48 should be denied.

II. ANSWER

A. It Is Reasonable to Permit Entities that Fund Transmission Upgrades and Do Not Recover the Costs of Those Upgrades Through the Transmission Access Charge To Receive the Proceeds From Congestion, FTR Auctions, and Wheeling

The SWP contends that Amendment No. 48 violates the Federal Power Act by not requiring the Project Sponsor to engage in cost-based ratemaking by having the costs of the transmission upgrade rolled in to the ISO's transmission

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California LLC, Mirant Delta LLC, and Mirant Potrero LLC; Modesto Irrigation District; Northern California Power Agency; Pacific Gas and Electric Company ("PG&E"); Sacramento Municipal Utility District ("SMUD"); Sempra Energy Resources ("Sempra"); Southern California Edison Company ("Edison"); Transmission Agency of Northern California ("TANC"); Western Area Power Administration; and Williams Energy Marketing & Trading Company ("Williams"). Additionally, SMUD included a request for clarification in its filing, and SCE included a request for a technical conference in its filing.

[4] Some of the parties commenting on Amendment No. 48 do so in portions of their pleadings that are variously styled, without differentiation. Parties also request affirmative relief in pleadings styled as comments and protests. There is no prohibition on the ISO's responding to the assertions in these pleadings. The ISO is entitled to respond to these pleadings and requests notwithstanding the labels applied to them. *Florida Power & Light Co.*, 67 FERC ¶ 61,315 (1994). To the extent that any portion of this Answer is deemed an Answer to protests, the ISO requests waiver of Rule 213 (18 C.F.R. § 385.213) to permit it to make this Answer. Good cause for this waiver exists here given the nature and complexity of this proceeding and the usefulness of this Answer in ensuring the development of a complete record. *See, e.g., Enron Corp.*,

Access Charge. SWP at 5-8. SWP goes on to allege that Amendment No. 48 "gives no consideration to transmission customers who must make payments to recover all the costs of the transmission system" (*Id.* at 5) and fails to protect "against double charging through excessive Wheeling rates or multiple allocations of FTR revenues among PTOs and project sponsors." *Id*. at 7-8.

The SWP's unsupported criticisms are without merit. Amendment No. 48 helps reduce the ISO's transmission Access Charge as the Transmission Revenue Requirement recovered by the Access Charge will not include the costs of facilities funded by Project Sponsors such as FPLE. Instead, it is only those customers who place a value on the use of the upgrade facilities by purchasing the associated FTRs or paying Congestion or Wheeling charges to move power over them that will bear the expense. Moreover, there is no double counting of FTR revenues. The ISO collects Usage Charges based on scheduled deliveries over congested interfaces. The ISO then allocates these proceeds among the applicable FTR holders. SWP fails to indicate how the construction of additional transfer capacity will cause the problems identified in their pleading.

The CEOB notes that "in the status quo" the Original Participating TOs must purchase FTRs through the auction. CEOB at 4. The CEOB worries that an Original Participating TO could "drive up the costs" in the auction resulting in a higher clearing price. *Id*. The CEOB goes on to fault Amendment No. 48 for providing a similar opportunity to the entity funding the new upgrade. *Id*. The SWP also raises similar issues. SWP at 8-10.

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78 FERC ¶ 61,179, at 61,733, 61,741 (1997); *El Paso Electric Co.*, 68 FERC ¶ 61,181, at 61,899 & n.57 (1994).

The ISO believes the concerns of the CEOB and SWP are misplaced. First, the concern is primarily an impermissible collateral attack on the existing FTR methodology as approved by the Commission in Docket ER98-3574 concerning Amendment No. 9. *California System Operator Corporation*, 87 FERC ¶ 61,143, *order on rehearing*, 88 FERC ¶ 61,156, *order on rehearing*, 89 FERC 153 (1999), *order on rehearing,* 94 FERC 61,343 (2001), review dismissed *sub nom. Cal. Dep't of Water Resources v. FERC*, 305 F. 3d 1121(2002). Moreover, the CEOB and SWP fail to note that the Original Participating TOs credit the revenues they receive from the auction to their respective Transmission Revenue Requirements, thereby reducing the transmission Access Charge rate. Similarly, the Non-Participating TO that funds an upgrade keeps the transmission Access Charge rate lower because the costs for the upgrade are not rolled into any Participating TO's Transmission Revenue Requirement. Instead the Project Sponsor is choosing that either the FTR auction revenues or the Congestion revenues (if the entity decides to purchase the additional FTRs themselves) will compensate them for the construction costs.

As discussed below, the ISO has proposed allocating FTRs to Load as part of its market redesign initiative. That is the proceeding to investigate the long-term structural components of the California and Western markets. In Amendment No. 48, the ISO needed to make the FPLE upgrade work within the existing market framework.

B. It Is Reasonable To Permit the Participating TO and the Project Sponsor To Negotiate the Revenue Allocations

A number of parties fault Amendment No. 48 for requiring the Participating TO and the Project Sponsor for the upgrade to negotiate the allocation of Congestion, FTR Auction, and Wheeling revenues. PG&E at 3; TANC at 6.

Several parties contend that parties other than the Participating TO and the Project Sponsor should participate in these negotiations or, as suggested by PG&E, have an opportunity to understand how the allocation issues have been resolved. PG&E at 3-4; Metropolitan at 10. Metropolitan also argues that changed circumstances such as the expiration of an interconnection agreement can require a reallocation of rights and that the ISO Tariff should be amended to require such a reallocation on an annual basis.

The ISO maintains that it is proper for the Participating TO and the Project Sponsor to negotiate the allocation of revenues. As discussed in the next section, an allocation based on a calculation of the incremental capacity addition may not be appropriate under all circumstances. As the Participating TO and the Project Sponsor are the entities most directly affected by the division of revenues based on the specific factors of the particular upgrade, they should negotiate a division of the revenues. The ISO does recognize the importance of making the market aware of the results of the negotiation and will do so by means of a market notice to all Market Participants. In addition, to the extent the Project Sponsor purchases FTRs through the FTR auction, the results are posted on the ISO website. As is true today, only the results of the FTR auction are posted; the

ISO does not provide information during the auction as to who is bidding on a particular path.

With regard to the issue raised by Metropolitan, the ISO agrees that changed circumstances such as the expiration of an Existing Transmission Contract can affect the revenue allocation. The ISO disagrees, however, that such a possibility requires an annual reevaluation of an agreement between the Participating TO and the Project Sponsor. The ISO believes a better approach would be for the Participating TO to factor such known changes into its negotiations with the Project Sponsor over the allocations.

Metropolitan also notes that FPLE's upgrade is conditioned on Edison's right to use certain Metropolitan facilities. Metropolitan at 9. If the use of the upgraded facilities depends on the continuation of the Metropolitan/Edison agreement, then this is all the more reason why the revenue allocation shares should be determined by agreement between the Participating TO and the Project Sponsor, since the Participating TO has first-hand knowledge of the agreement. The ISO doesn't interpret contracts but only takes instructions from the Participating TO as to how to implement Existing Contracts.[5] Moreover, as Metropolitan notes, its agreement with Edison lasts until 2017. The ISO understands that the agreement allows Edison a first right of refusal to use any Metropolitan transmission that Metropolitan is not using. Accordingly, the ISO has this right as it is included as an Entitlement under the Transmission Control Agreement. Furthermore, transfer capabilities are determined by WECC based

[5] *See* ISO Tariff at Section 2.4.4.4.1.1.

on power flow analysis. Metropolitan is a WECC member and should have taken part in the evaluation.

Sempra and Vernon note the importance of disputes between the Participating TO and the Project Sponsor being resolved in a timely manner. Sempra at 2-3; Vernon at 5-6 The ISO strongly agrees with the importance of timely resolution of the allocation issue. Nevertheless, Sempra, based possibly on a mistake in the transmittal letter, misreads Section 3.2.7.3(d) as permitting arbitration to commence up to 90 days after the in service date. Sempra at 3. In fact, the ISO Tariff provision proposed in Amendment No. 48 provides for arbitration if no agreement is reached "by the later of the time the incremental capacity is placed in service or 90 days after this provision becomes effective." Assuming the ISO's proposed language is put into effect before the next such project is undertaken, under this provision arbitration would have to proceed if no agreement is reached at the in-service date (not 90 days thereafter). Moreover, Amendment No. 48 does not prevent an early recourse to arbitration if the parties reach an impasse.

TANC's concern that entities that have "no contractual relationship" with the ISO should not be subject to the ISO Tariff's ADR provisions (TANC at 6) is unfounded. What is at issue in Amendment No. 48 is how proceeds for Congestion, FTR auctions, and Wheeling *recovered under the ISO Tariff* are disbursed by the ISO. It is appropriate for an entity that seeks to have funds paid to it from the ISO to be subject to the ADR provisions of the ISO Tariff. The ISO also disagrees with TANC's statement that the use of escrow accounts does not

create incentives on the part of both the Participating TO and the Project Sponsor to reach an agreement. As both entities will have potentially significant sums at stake there should be a strong desire for both the Participating TO and the Project Sponsor not to have the money tied up for a prolonged period.

PG&E also notes that Amendment No. 48 does not address whether or not the Participating TO will be responsible for operations and maintenance ("O&M") expenses associated with the upgrade. PG&E at 3. This is correct. The amendment did not attempt to dictate a resolution of every issue that could come up in the design, implementation, and operation of a transmission upgrade. The ISO recognizes that certain issues will be resolved in agreements specific to a particular project. In response to PG&E's question, the ISO does support including O&M costs for upgrades in the Participating TO's transmission rates if they assume responsibility for the new facilities.

C. The Commission Should Not Mandate an Allocation Based on Incremental Additions To the System

Several parties request that the Commission require that the allocation be made on a proportional basis based on the incremental additions to the system. Sempra at 4; Williams at 5-6; Vernon at 4. Williams, however, states that Participating TOs should have the "first priority" to recover their shares of wheeling revenues based on a historic average of the last three years with "surplus revenue" being allocated to Project Sponsors.

The ISO's rationale for directing that the Project Sponsor and Participating TO negotiate the shares of the Congestion, FTR Auction, and Wheeling revenues was presented in the transmittal letter to Amendment No. 48 and will

not be repeated here. There are a number of factors other than a straight incremental capacity analysis that may be relevant to the determination, including, but not limited to, the relative contributions of the Participating TO and the Project Sponsor to the overall increase in capacity, the effect of the upgrade on other lines, the responsibility for future O&M costs, anticipated changes in the ISO market design or the nature of the facility (i.e. whether it is primarily a radial line), and contractual issues, such as the one Metropolitan raises in their protest, discussed above.

The ISO disagrees with Dynegy that some unidentified independent entity should measure the benefits of the upgrades and allocate the FTRs and FTR revenue rights. Dynegy at 5. The ISO Tariff already provides that an independent entity – an arbitrator – will decide the allocation issue in the event the parties reach an impasse. Dynegy's proposal is an unnecessary complication.

With regard to Vernon's argument that Wheeling and FTR auction revenues should go to the Utility Distribution Company in the area in which the beneficiaries are located, the ISO notes that the Tariff already provides for these funds to go to the Participating TO. Apart from the specific changes in Amendment No. 48 intended to provide shares of those revenues to an entity funding an upgrade to the grid that was not getting the cost of the upgrade reimbursed through a Transmission Revenue Requirement, Vernon's argument therefore is instead a collateral attack on the treatment of those revenues in the ISO Tariff previously approved by the Commission.

D. Amendment No. 48 Does Not Impair Non-ISO facilities

Metropolitan notes that the Blythe-Eagle Mountain line that was upgraded interconnects with a Metropolitan substation (Eagle Mountain). Metropolitan at 8. Metropolitan notes use of its facilities is subject to an agreement with Edison. *Id*. Metropolitan states, however, "[t]o the extent that Metropolitan has been involved in the technical studies used to determine the upgrade transmission capacity, and any use of Metropolitan's system is consistent with the results of that study and the provisions of the Agreement with SCE, Metropolitan's concern is alleviated." *Id*. The process to establish a new rating for the upgraded facility is conducted through the Western Electricity Coordinating Council. Metropolitan is a member of WECC and was made aware of the planning process that established the new rating for this facility. Accordingly, Metropolitan should have addressed its concern in that forum

TANC faults Amendment No. 48 for failing to recognize that improvements to non-ISO facilities may increase the capacity on ISO Controlled Grid facilities. TANC at 7. TANC, however, is focusing on only one side of the equation. If an upgrade to an ISO Controlled Grid facility increases the transfer capacity of a non-ISO Controlled Grid facility, TANC is suspiciously silent with regard to providing compensation from the non-ISO Controlled Grid facility receiving the benefit.

As noted below, Amendment No. 48 is primarily tailored to the narrow circumstances presented by FPLE's project. Broader seams issues such as the collateral effect of upgrading adjacent grid facilities should await consideration in

the market redesign docket (ER02-1656) or as part of the Western regional coordination efforts now underway.

E. The ISO Agrees that Only One Form of Credit Is Appropriate.

PG&E notes that the Commission requires that in-area generators which fund network upgrades be given transmission credits and argues that the ISO's proposal could lead to a "double benefit" if the Project Sponsor receives a full credit from the Participating TO and then receives Congestion revenues, FTR auction revenues, and Wheeling revenues from the ISO. PG&E at 4.

The claim of "double benefit" is misplaced. First, the use of transmission credits for generators typically involves the paradigm in which generators reserve transmission service and then receive a discount on their transmission rates for any network upgrades they fund. Under the ISO model, Loads and exports pay for transmission based on their take-out location.

Generators can receive credit for network upgrades in several ways. For example, the Participating TO can pay the generator for the upgrade and then include the cost in the Participating TO's Transmission Revenue Requirement. Alternatively, the Project Sponsor could seek cost recovery as FPLE has done through a proportional allowance of Congestion, FTR Auction, and Wheeling revenues.

The Participating TO is in a perfect position to ensure that there is no double benefit. If PG&E has fully reimbursed a Project Sponsor for an upgrade, it would not agree to allocate additional revenues to the Project Sponsor for that project. If the Participating TO and a Project Sponsor work out alternative

crediting arrangements, these can be accommodated within the negotiated framework established by Amendment No. 48.

F. Amendment No. 48 is Not Inconsistent with the Settlement Reached in EL02-103-000.

Southern Cities allege that the revision to Section 7.3.1.6 to the ISO Tariff proposed in Amendment No. 48 is inconsistent with the settlement accepted by the Commission in Docket No. EL02-103-000. Southern Cities at 5-6. This concern is misplaced.

The ISO agrees with Southern Cities that the settlement in Docket No. EL02-103 correctly implements how New Participating TOs should credit Net FTR revenues and Usage Charges against its Transmission Revenue Requirement. Since Amendment No. 48 deals with allocating revenues to entities paying for upgrades to the grid, not how project costs are included in the Transmission Revenue Requirement, nothing in the revision to Section 7.3.1.6 alters this outcome.

It is important to note that 7.3.1.6 concerns the ISO's disbursement of Usage Charge revenues. Accordingly, the ISO added provisions permitting it to disburse revenues to Project Sponsors that were not collecting a Transmission Revenue Requirement.

G. Amendment No. 48 Does Not Prejudice the Outcome of the ISO's Market Redesign Initiative

A number of intervenors contend that Amendment No. 48 is unnecessary given that the ISO has filed its Comprehensive Market Redesign Proposal ("MD02") and that the ISO has recommended a methodology in which FTRs are

directly assigned to Loads. CEOB at 5; SWP at 12 (Amendment 48's provision of FTR/CRR entitlements to certain entities must be expected to prejudice the allocation of FTR/CRRs to others through the ISO's market redesign). Dynegy worries that the Participating TO will not fairly negotiate with the non-utility Project Sponsor and recommends that Phase 3 of MDO2 is the logical place to address the issue. Dynegy at 3.

Nothing in Amendment No. 48 precludes further consideration of the long-term congestion management approach to be determined in either the ISO's own market redesign proceeding or the Commission's Standard Market Design Rulemaking and the process for compensating non-utility Project Sponsors of transmission upgrades. Thus, SMUD's request that the Commission condition the acceptance of Amendment No. 48 on the outcome of these and other Dockets (SMUD at 3-4) is unnecessary.

The ISO currently expects that the MD02 process and the SMD Rulemaking will significantly change the ways FTRs are implemented and allocated when the ISO moves to a Full Network Model and congestion management through Locational Marginal Pricing. Nevertheless, the ISO needs tariff authority now to properly compensate FPLE for the money it expended upgrading the transmission network in 2002.

The ISO agrees with the SWP that allocation of Wheeling revenues to Participating TOs is a potential issue in Docket No. ER00-2019. SWP at 3. Again, since Amendment No. 48 only provides that the Project Sponsor and Participating TO reach agreement between themselves as to how Wheeling

revenues allocated to the Participating TO are shared between themselves, nothing in Amendment No. 48 changes the existing allocation to Participating TOs or prejudices the outcome of that proceeding.

H. Further Proceedings on Amendment 48 Are Not Warranted

Edison correctly notes that Amendment No. 48 "is not intended to apply to the vast majority of situations" and effectuates the terms of the agreement reached between Edison and FPLE regarding revenue allocation. Edison at 2-3. Nevertheless, Edison requests a technical conference to determine a "definitive methodology." *Id*. At 4. PG&E also requests a technical conference be held regarding Amendment No. 48. PG&E at 5. SMUD requests clarification of the term "beneficiary" as used in Section 3.2 of the ISO Tariff. SMUD at 5-6. SMUD questions whether, if a project benefits customers in another Control Area, the ISO would expect the adjacent Control Area to pay for the costs. *Id*. At 6-7.

The ISO believes that the amendment should be accepted without the need for further proceedings. First, the ISO understands that the FPLE upgrade of Edison's Blythe-Eagle Mountain line was a somewhat unique circumstance. The ISO is unaware of other projects in which the Sponsor does not anticipate becoming a Participating TO and including the costs of the upgrade in its Transmission Revenue Requirement, but instead would elect to receive Congestion, FTR Auction, and Wheeling proceeds. Thus, the ISO, the parties, and the Commission may be expending significant resources trying to develop additional implementation detail unique to a situation in which the

Participating TO and the Project Sponsor have, at least in part, reached an agreement[6].

Second, as noted above, nothing in Amendment No. 48 prevents alternative approaches to allocation of FTRs/CRRs and their associated revenues from being developed through the MD02 and SMD stakeholder processes. The ISO does not consider another stakeholder forum on these issues to be necessary at this time. The ISO and stakeholders could expend an inordinate amount of time to come up with a "definitive methodology" that would apply in general, not just to this admittedly unique situation, but to the current market structure, only to reinvent the methodology as the market design changes or when the Commission reaches a decision in ER00-2019.

Third, with regard to the issues raised by SMUD, the ISO does not believe it necessary to define "beneficiary" in the context of Amendment No. 48. The ISO has not attempted to directly assign the costs of network upgrades to specific beneficiaries. To the contrary, the ISO plans to file an amendment in the near future that would remove the concept of attempting such a direct assignment. Nevertheless, this issue is separate from the questions raised by FPLE as a Project Sponsor not seeking to recover its costs through an addition to the transmission Access Charge. With regard to the issue SMUD raises on the potential effect of upgrades on other Control Areas, as stated previously, the ISO is not aware of additional upgrades to be done by Non-Participating TOs. With

[6] In a letter to the ISO dated January 9, 2002, Southern California Edison indicated they had reached agreement with FP&L on the allocation shares of Congestion and FTR Auction revenues, but had not reached agreement on the allocation of Wheeling revenues.

the changing landscape at the moment, (i.e. MD02, SMD, ER00-2019) the ISO does not consider further proceedings in this docket to be the best use of scarce resources. Moreover, FPLE notes in its intervention that it entered into system facility agreements with the Western Power Administration and the Imperial Valley Irrigation District as well as with Southern California Edison Company. FPLE at 1. It is standard industry practice to enter into such agreements regarding integrated operation of facilities.

The ISO does support the clarification requested by FPLE. FPLE at 3. If the Project Sponsor bids on and receives FTRs it will still receive auction revenues as well as the Congestion revenues associated with the FTRs it purchased in the auction. It is only in the situation provided for in Amendment No. 27, in which an entity joins the ISO as a Participating TO, turns over Operational Control over its facilities and is given FTRs for a limited transition period, that the quoted language from section 9.5.3. would apply. *See*, *California Independent System Operator Corp.*, 91 FERC ¶ 61,205, 61,726-27 (2000). If necessary for further clarification, the ISO would modify section 3.2.7.3 (b) as follows: "as set forth in Section 9.5.3, provided each of the Project Sponsors or beneficiaries do not receive FTRs from the ISO **as a New Participating Transmission Owner as provided for in Section 9.4.3**."

The ISO disagrees with Vernon that FTRs associated with new upgrades should similarly be given to Project Sponsors. Vernon at 7. The ISO believes that under the current market design, letting market participants place a value on

the upgrades through an auction is consistent with the existing process used for the facilities of the investor-owned utilities turned over to the ISO's control.

The ISO agrees with Southern Cities that if an entity that is already a Participating TO funds an upgrade that is owned or operated by another Participating TO, the Participating TO that provided the funding should recover the costs through its Transmission Revenue Requirement. Southern Cities at 5.

III. CONCLUSION

For the foregoing reasons, the ISO respectfully requests that the Commission accept Amendment No. 48 as submitted to the Commission.

Respectfully submitted,

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Date: February 19, 2003

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 19th day of February, 2003.

/s/ David Rubin

David Rubin