

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

California Independent System
Operator Corporation

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Docket Nos. ER00-2019-006,
ER01-819-002 and
ER03-608-000

**INITIAL BRIEF OF THE
CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

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December 17, 2003

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GLOSSARY OF TERMS

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|--------------------------|--|
| CEOB | California Electricity Oversight Board |
| COI | California-Oregon Intertie |
| FPA | Federal Power Act |
| FTRs | Firm Transmission Rights |
| HVAC or HV Access Charge | High Voltage Access Charge |
| HVTRR | High Voltage Transmission Revenue Requirement |
| ISO | California Independent System Operator Corporation |
| LMP | Locational Marginal Pricing |
| LVTRR | Low Voltage Transmission Revenue Requirement |
| MD02 | ISO's Market Redesign proposal |
| MID | Modesto Irrigation District |
| MSS | Metered Subsystem |
| MWD | Metropolitan Water District |
| NCPA | Northern California Power Agency |
| NOB | Nevada-Oregon Border path |
| Participating TOs | Transmission Owners that have turned over Operational Control of their transmission facilities and Entitlements to the ISO |
| PG&E | Pacific Gas and Electric Company |
| SDG&E | San Diego Gas & Electric Company |
| SCE | Southern California Edison Company |
| SMD | Standard Market Design |

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| Southern Cities | The Cities of Anaheim, Azusa, Banning, Colton and Riverside |
| SWC | State Water Contractors |
| SWP | California Department of Water Resources – State Water Project |
| TACWG | Transmission Access Charge Work Group |
| TANC | Transmission Agency of Northern California |
| TOU | Time-of-use pricing |
| UDC | Utility Distribution Company |
| Vernon | City of Vernon |
| WECC | Western Electric Coordinating Council |

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JOINT STATEMENT OF PROCEDURAL HISTORY¹

A. Amendment No. 27 Filed

On March 31, 2000, the California Independent System Operator Corporation (“ISO”) filed Amendment No. 27 to the ISO Tariff, proposing a new methodology for determining the ISO’s transmission Access Charges, through which Transmission Owners² that have turned Operational Control of their transmission facilities and Entitlements to the ISO (“Participating TOs”) recover the costs of those facilities and Entitlements. This filing was required by legislation restructuring the California electric industry³ and later by the

¹ All active parties that are submitting briefs and Commission Staff have had the opportunity to review, comment, and edit this Joint Statement, and all parties and Commission Staff either join in or are not opposed to this Statement.

² Capitalized terms not otherwise defined are used in the sense given in the Master Definitions Supplement, ISO Tariff Appendix A.

³ Subsection 9600(a)(2)(A) of California’s A.B. 1890 required the ISO to recommend a new rate methodology within two years after commencement of operations. Exh. MID-3; *see also Pacific Gas & Elec. Co., et al.*, 77 FERC ¶61,204 at 61,827 (1996).

Commission.⁴ Amendment No. 27 was developed over a more than two year period.⁵

Since the ISO Operations Date, the Access Charge and Wheeling Access Charge consisted of separate utility-specific rates based on the Transmission Revenue Requirement of the Participating TO. Where transmission facilities were jointly owned, the Wheeling Access Charge was a blended rate. Under Amendment No. 27 this methodology continued in effect until a New Participating TO joined the ISO. Once that occurred, the Access Charge for High Voltage Transmission Facilities⁶ was to be assessed based on the combined Transmission Revenue Requirements of all of the Participating TOs in each “TAC Area.” The TAC Areas correspond, in general, to each of the three Control Areas that were originally combined to form the ISO Control Area,⁷ and, if the Los Angeles

⁴ *Pacific Gas & Elec. Co.*, 81 FERC ¶ 61,122 (1997).

⁵ The ISO began developing an Access Charge methodology in December 1998. Exh. ISO-1 at 29. For a year the ISO conducted a stakeholder process. *Id.* at 30–32. The stakeholder group could not reach a consensus. On October 28, 1999, the ISO Board appointed a TAC Negotiating Group (*id.* at 47), which consisted of 2 representatives from the End Users, 2 representatives of the Original PTOs and 2 representatives of the potential new PTOs. *Id.* at 49; The TAC Negotiating Group submitted a proposal to the ISO Board, which was further refined by the End-Use Customer representatives. Exh. ISO-1 at 18, 56; Exh. ISO-2. Ultimately, the ISO Board approved Amendment No. 27. Exh. ISO-2.

⁶ High Voltage Transmission Facilities are those transmission facilities in the ISO Controlled Grid that operate at 200 kV and above.

⁷ In July 1999, the City of Pasadena which was initially its own Control Area became part of the ISO Control Area and is part of the East Central TAC Area.

Department of Water and Power (“LADWP”) chose to become a Participating TO, its Control Area would become a fourth TAC Area.

In Amendment No. 27, the ISO proposes a ten-year period of transition during which the High Voltage Access Charges (“HV Access Charge” or “HVAC”) for the TAC Areas gradually combine to form a single ISO Grid-wide Access Charge. The proposal is to blend a cumulative ten percent per year of the individual High Voltage Transmission Revenue Requirements for each TAC Area with the sum of all Participating TOs' High Voltage Transmission Revenue Requirements. In addition, all New High Voltage Facilities, including capital additions to Existing High Voltage Facilities are immediately included in the ISO Grid-wide rate. The Low Voltage Access Charge would continue to be based on each Participating TO's Low Voltage Transmission Revenue Requirements. Among other provisions, Amendment No. 27 includes a proposed cap on the amount of the cost increases associated with the addition of New Participating TOs that the ratepayers of the Original Participating TOs would be required to assume during the ten-year transition period. This cap was set at an annual \$32 million for Pacific Gas and Electric Company (“PG&E”) and Southern California Edison Company (“SCE”) and \$8 million for San Diego Gas & Electric (“SDG&E”). Amendment No. 27 also includes a mechanism to prevent the ratepayers of New Participating TOs from incurring an increase in transmission rates as a result of joining the ISO.

The Commission noticed the filing on April 7, 2000. Numerous parties submitted timely interventions, protests, or comments.⁸ On May 8, 2000, the ISO filed an Answer to the protests and comments, to which SCE filed a reply and Vernon filed an opposition to the reply. By order issued May 31, 2000, the

⁸ California Department of Water Resources , California Electricity Oversight Board (“CEOB”), California Manufacturers and Technology Association, California Municipal Utilities Association (“CMUA”), California Power Exchange Corporation, Calpine Corporation (“Calpine”), Cities of Anaheim, Azusa, Banning, Colton and Riverside (“Southern Cities”), Cities of Redding, Santa Clara and Palo Alto and the M-S-R Public Power Agency (“Cities/M-S-R”), City of Burbank (“Burbank”) , City of Roseville, City and County of San Francisco (“San Francisco”), City of Vernon (“Vernon”) , Cogeneration Association of California and Energy Producers and Users Coalition (“CAC/EPUC”) , Duke Energy Trading & Marketing, L.L.C., Enron Energy Services, Inc., Glendale Water and Power Department (“Glendale”), Independent Energy Producers Association, Lassen Municipal Utility District (“Lassen”), Los Angeles Department of Water and Power (“LADWP”), The Metropolitan Water District of Southern California (“MWD”) , Modesto Irrigation District (“MID”), Northern California Power Agency (“NCPA”) , Pacific Gas and Electric Company (“PG&E”) , Sacramento Municipal Utility District (“SMUD”) , Sempra Energy, Southern California Edison Company (“SCE”), Southern Energy California, L.L.C., Southern Energy Delta, L.L.C. , Southern Energy Potrero, L.L.C. , State Water Contractors , Transmission Agency of Northern California (“TANC”), Trinity Public Utility District, Turlock Irrigation District (“Turlock”), Utility Reform Network, (“TURN”), Western Area Power Administration (“WAPA”), Williams Energy & Marketing Company (“Williams”). Imperial Irrigation District (“IID”) filed a Motion to Intervene Out-of-Time on June 30, 2000. Untimely motions to intervene were filed by Dynegy Power Marketing, Inc., the U.S. Department of Energy Oakland Operations Office and the California Large Energy Consumers Association. The California Department of Water Resources in the course of the proceedings has indicated that the interests represented are those of the function know as the California Department of Water Resources - State Water Project (“SWP”).

Notices of withdrawal from the proceeding were provided to the Commission by LADWP (January 15, 2003), Turlock (January 23, 2003), Glendale (January 28, 2003), Burbank (January 28, 2003), IID (January 30, 2003), SMUD (January 27, 2003), and City of Redding (February 2, 2003).

Commission accepted the interventions as well the untimely motions to intervene. The Commission found good cause to accept the Answer filed by the ISO, but rejected the reply filed by SCE and Vernon's opposition to the reply. The Commission accepted for filing, suspended, and set for hearing the proposed Access Charge methodology and related tariff revisions, but held the hearing in abeyance pending efforts at settlement under the auspices of a Settlement Judge. *California Indep. Sys. Operator Corp.*, 91 FERC ¶ 61,205 (2000) ("May 31st Order"). The May 31st Order also provided guidance regarding a number of specific aspects of the Access Charge proposal, finding some reasonable, rejecting some, and suggesting further investigation of others.

B. Settlement Judge Proceedings and Certain Related Amendments

On June 1, 2000, the Chief Judge issued an order scheduling the first settlement conference. This conference convened June 9, 2000, and on that date the Chief Judge issued a Protective Order in this proceeding. Efforts at settlement would continue for the next two and a half years.⁹

⁹ The parties convened under the auspices of Settlement Judge procedures on July 12–13 & 14, 2000; August 10–11, 2000; November 2–3, 2000; December 11–12, 2000; March 7–8, 2001; April 5–6, 2001; June 20–21, 2001; August 27–28, 2001; October 25–26, 2001 and October 31, 2002. The Chief Judge filed interim Progress Reports on August, 28, 2000; November 30, 2000; January 29, 2001; March 38, 2001; June 7, 2001; August 9, 2001; October 18, 2001; December 18, 2001; March 6, 2002; May 6, 2002; July 18, 2002 and September 30, 2002. On November 2, 2000, the Chief Judge permitted the late intervention of the City of San Diego.

On December 9, 2002, Chief Judge Wagner declared that “the differences among the parties appear to be too great and impossible to overcome.” *California Indep. Sys. Operator Corp.*, 101 FERC ¶ 63,024 at P 5. Judge Wagner terminated the Settlement Judge procedures, designated Bobbie J. McCartney as Presiding Administrative Law Judge and required a Track 2 procedural schedule.

During the course of settlement negotiations the ISO filed four amendments to the ISO Tariff. The ISO filed Amendment No. 34 to its Tariff in Docket No. ER01-819-000. On February 21, 2001, the Commission permitted Amendment No. 34 to become effective as of January 1, 2001, and consolidated that docket with Docket No. ER00-2019-000 for purposes of hearing and settlement discussions.¹⁰ *California Indep. Sys. Operator Corp.*, 94 FERC ¶ 61,147 (2001).

On June 28, 2002, the ISO filed Amendment No. 45. The Commission accepted the filing on August 27, 2002, requiring minor modifications, and made Amendment No. 45 effective July 1, 2002. *California Indep. Sys. Operator Corp.*, 100 FERC ¶ 61,209 (2002). The ISO made a compliance filing on September 11, 2002, which the Commission accepted. Letter Order in Docket No. ER02-2192-001 (January 1, 2003).

¹⁰ By order issued April 19, 2001, the Commission granted clarification, upon request of SWP, that “the issues relating to the appropriate rate design of the [L]ow [V]oltage [A]ccess [C]harge for each Participating Transmission Owner are to be addressed in the proceeding established in Docket No. ER01-831-000, *et at* [sic].” *California Indep. Sys. Operator Corp.*, 95 FERC ¶ 61,090 at 61,268 (2001).

On July 15, 2002, the ISO filed Amendment No. 46 to the ISO Tariff. The Commission conditionally accepted Amendment No. 46 by order issued August 30, 2002. *California Indep. Sys. Operator Corp.*, 100 FERC ¶ 61,234, *reh'g denied*, 102 FERC ¶ 61,146 (2003). The ISO submitted its compliance filing on September 27, 2002, which the Commission accepted. Letter Order in Docket No. ER02-2321-003 (January 1, 2003).

The ISO filed Amendment No. 47 to the ISO Tariff, which the Commission approved without modification by order issued January 24, 2003. *California Indep. Sys. Operator Corp.*, 102 FERC ¶ 61,061 (2003).

The City of Vernon joined the ISO, effective January 1, 2001, and thereby triggered the process of blending the Participating TOs' Transmission Revenue Requirements in accordance with the framework set forth in Amendment No. 27. *California Indep. Sys. Operator Corp.*, 94 FERC ¶ 61,141 (2001).

On October 18, 2002, the Cities of Anaheim, Azusa, Banning and Riverside filed to join the ISO effective January 1, 2003. *City of Azusa California*, 101 FERC ¶ 61,352 (2002), *clarified*, 102 FERC ¶ 61,153 (2003).

C. Hearing and Further Amendments

The Presiding Judge convened the first pre-hearing conference in the litigation phase of this proceeding on December 17, 2002. Following the hearing, the Presiding Judge issued an order promulgating a procedural schedule.

The ISO filed Updated Direct Testimony on February 14, 2003.

On March 11, 2003, the ISO filed Amendment No. 49 to the ISO Tariff in Docket No. ER03-608-000 and requested that it be made effective June 1, 2003. In Amendment No. 49, the ISO proposes certain modifications to the methodology it proposes in Amendment No. 27. On April 4, 2003, in response to a request from the parties, the Chief Judge revised the Track 2 procedural schedule so that the Intervenors could file answering testimony on June 2, 2003, thus allowing them time to address the ISO's modified proposal.

The Commission noticed the filing of Amendment No. 49 on March 13, 2003, as Docket No. ER03-608. Numerous parties filed motions to intervene, protests, or comments.¹¹ On April 16, 2003, the ISO and SCE filed answers to the protests. On May 30, 2003, the Commission accepted the interventions and the answers, and accepted in part, suspended in part, and rejected in part Amendment No. 49. *California Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,260 (2003). The Commission set for hearing those portions of Amendment No. 49 that it suspended and consolidated them with ongoing proceeding in Dockets No. ER00-2019-006 and No. ER01-819-002.

¹¹ The following parties filed timely unopposed motions to intervene and comments or protests: SWP, CMUA, Southern Cities, Cities of Santa Clara and Palo Alto, Vernon, CAC/EPUC, MWD/State Water Contractors ("SWC"), MID, NCPA, PG&E, SDG&E, SCE, TANC, WAPA, and Williams. The following parties filed timely unopposed motions to intervene that raised no substantive issues: CEOB; Dynegy, El Segundo Power, LLC, Long Beach Generation LLC, Cabrillo Power I LLC and Cabrillo Power II LLC. On April 2, 2003, the San Francisco filed an untimely motion to intervene that raised no substantive issues.

On May 30, 2003, SCE, and on June 2, 2003, NCPA, MID, TANC, Vernon, Southern Cities, SWP, MWD/SWC, PG&E, SDG&E, and CEOB filed Answering Testimony.

On July 10, 2003, the Commission issued an Order on Rehearing on Amendment No. 27. *California Indep. Sys. Operator Corp.*, 104 FERC ¶ 61,062 (2003).

Commission Staff filed Direct and Answering Testimony on August 4, 2003.

On August 18, 2003, the ISO filed Amendment No. 57 to the ISO Tariff. On October 17, 2003, the Commission conditionally approved Amendment No. 57, subject to the outcome of this proceeding.

On August 27, 2003, SCE filed a Motion for Partial Summary Disposition regarding the types of facilities that will be placed under the ISO's Operational Control and included in the Participating TO's Transmission Revenue Requirements. PG&E and SWP filed answers on September 11, 2003. On October 21, 2003, Judge McCartney issued a Partial Initial Decision granting this motion. *California Ind Sys. Operator Corp.*, 105 FERC ¶ 63,008 at P 16 (2003). The Partial Initial Decision is now pending before the Commission.

NCPA, MID, Vernon, Southern Cities, SWP, PG&E, SCE, SDG&E, and CEOB filed Cross-Answering Testimony on September 10, 2003.

On the same date, the ISO filed Supplemental Testimony regarding

phantom Congestion.

On October 9, 2003, the Presiding Judge issued an order, among other things, approving and adopting a joint stipulation of CAC/EPUC, SCE and the ISO regarding the definition of Gross Load.

The ISO filed Rebuttal Testimony on October 2, 2003.

SWP and MWD/SWC filed testimony responding to the ISO's Supplemental Testimony on October 20, 2003.

The hearing commenced on October 21, 2003, and concluded on November 14, 2003.

Due to the length of the hearing, the Chief Judge issued an order on November 10, 2003, further extending the Track 2 procedural dates such that initial briefs are due December 17, 2003, reply briefs are due January 13, 2004, and the initial decision is due March 11, 2004.

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SUPPLEMENTAL PROCEDURAL HISTORY AND BACKGROUND

The development of the revised Access Charge was a substantial undertaking involving extensive consultation with all affected stakeholders. The ISO began by soliciting proposals from Market Participants in December 1998. Twenty-two entities submitted proposals. Exh. ISO-1 at 30:15 – 31:6. The ISO then formed a large working group of stakeholders, the Transmission Access Charge Work Group ("TACWG"), to evaluate these proposals. Dozens of utilities and their consultants participated in the TACWG. *Id.* at 33:1 – 34:6. The ISO collected extensive amounts of data from all California utilities, and, with the assistance of its consultant the Brattle Group, performed numerous analysis of various rate proposals, including the cost shifts and of benefits which it shared with the TACWG. *Id.* at 36:8-20.

When it became apparent in the fall of 1999 that the TACWG was not moving toward consensus, the ISO Board appoint a negotiating group from among its members. The negotiating group had six members, two representing each of the stakeholder sectors that would be most directly affected by an Access Charge

methodology: the Original Participating TOs; the Non-Participating TOs, including publicly owned utilities and governmental entities that could become Participating TOs, but had elected thus far not to do so; and the End-Users who ultimately pay the costs recovered through the Access Charges. *Id.* at 49:4-9. That group was able, working with the ISO, to develop the compromise Access Charge methodology proposal. At the ISO Board level, the End-Users proposed to revise the methodology to increase the cost-shift cap to its current proposed level of \$72 million. *Id.* at 49:9-12. The ISO Board approved the proposal as revised by a vote of 16–5. *Id.* at 18:17-20; Exh. ISO-2. That proposal became Amendment No. 27.

In the May 31st Order, the Commission stated:

We find generally that the two-tiered rate approach [for the Low Voltage Access Charge and the High Voltage Access Charge] is reasonable. This evolution in rate design away from the utility-specific zone to a high voltage grid-wide methodology ensures a uniform grid-wide rate.

91 FERC ¶ 61,205 at 61,722 (footnote omitted).

In addition (as summarized in the Order on Rehearing):

To assist settlement efforts, the Commission provided guidance on major issues of contention. The Commission specifically set for hearing or found the record inadequate to determine: (1) whether a 10-year transition period and proposed limits on cost shifts are the proper ones to mitigate cost shifts; (2) whether Cal ISO's exception from gross load billing for existing QF facilities are applied on a non-discriminatory basis; and (3) the details of Cal ISO's plans for FTR conversion. The Commission chose not to address

other remaining issues in order to afford the parties and the settlement judge flexibility to reach in an overall settlement.

104 FERC ¶ 61,062 at P 9. The Commission rejected provisions that would have authorized governmental Participating TOs to establish Transmission Revenue Requirements without Commission review and would have required New Participating TOs, during the Transition Period, to apply any benefits from reduced transmission rates to reduce their Transmission Revenue Requirements. 91 FERC at 61,724 and 61,728.

The Joint Procedural History identifies, but does not describe, subsequent amendments to the ISO Tariff that have modified the Access Charge proposal included in Amendment No. 27. When the City of Vernon joined the ISO, effective January 1, 2001, and thereby triggered the process of blending the Participating TOs' Transmission Revenue Requirements in accordance with the framework set forth in Amendment No. 27, the ISO filed Amendment No. 34 to revise the ISO Tariff to reflect that the City of Vernon had joined the ISO. The ISO's revisions included both definitional changes to reflect Vernon's joining the ISO and changes to clarify and revise billing provisions to implement the new Access Charge rate design. *California Indep. Sys. Operator Corp.*, 94 FERC ¶ 61,147 (2001).

Amendment No. 45 modified the process for updating the High Voltage Access Charge to provide for revisions any time the Commission accepts a modified Transmission Revenue Requirement from a Participating TO and

clarified who pays the Wheeling Access Charge. *California Indep. Sys. Operator Corp.*, 100 FERC ¶ 61,209 (2002). Amendment No. 46 modified the ISO Tariff concerning the operational relationship of Metered Subsystem Operators to the ISO. The provisions allowed certain vertically integrated utilities to continue to operate in a fashion that adhered to their vertically integrated utility status, minimized the Ancillary Service requirements of the ISO, and required the Metered Subsystem to pay certain ISO charges based upon the actual use of the ISO Controlled Grid. *California Indep. Sys. Operator Corp.*, 100 FERC ¶ 61,234 (2002).

When the four Southern Cities filed to join the ISO effective January 1, 2003, the ISO filed Amendment No. 47 to the ISO Tariff to make it consistent with the provisions of the Transmission Control Agreement that were being amended to allow the Southern Cities to become Participating TOs. Amendment No. 47 changed definitions and added new sections to address issues concerning Southern Cities preservation of tax exempt status. *California Indep. Sys. Operator Corp.*, 102 FERC ¶ 61,061 (2003).

In Amendment No. 49, the ISO proposes certain modifications to the methodology it filed in Amendment No. 27 in order to address concerns raised in settlement negotiations and problems identified in the course of administering this methodology during the intervening years. In its order on Amendment No. 49, the Commission set for hearing only five issues: (i) removal of new High Voltage transmission investments from the calculation of the cost shift cap, (ii) allocation

of costs between High and Low Voltage transmission facilities, (iii) revisions to the definition of Transmission Revenue Credits, (iv) conversion of Existing Rights to Firm Transmission Rights, and (v) the treatment of behind-the-meter Load. *California Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,260 at PP 6-7 (2003). Among the provisions of Amendment No. 49 approved by the Commission was the elimination of the Revenue Review Panel, an option for review of the Transmission Revenue Requirement of governmental Participating Transmission Owners (subject to appeal to the Commission). *Id.* at P 21. Amendment No. 57 corrects an omission from Amendment No. 49 to address revenue disbursement to a Participating TO that has no End-Use Customers. *California Indep. Sys. Operator Corp.*, 105 FERC ¶ 61,071 (2003).

On July 1, 2003, based on the Commission's orders on Amendments No. 27 and No. 49, the ISO filed a motion seeking a determination that certain issues were outside of the scope of this proceeding. Subsequently SCE and MID filed motions addressing the appropriate scope of issues and Vernon filed a motion to strike certain testimony regarding the effect of the Commission's rejection, in its order on Amendment No. 27, of the "buy down" provision, which would have required New Participating TOs, during the Transition Period, to apply any benefits from reduced transmission rates to reduce their Transmission Revenue Requirements. PG&E, SCE, SDG&E, Staff, Southern Cities, NCPA, TANC, MID and the ISO filed answers regarding the inclusion of certain issues. On July 16, 2003, the Presiding Judge convened a conference to address these motions. The

Presiding Judge excluded from the scope of the hearing the following issues: (1) whether a postage stamp rate, as opposed to license stamp rates, was just and reasonable; (2) whether the requirement that Participating TOs offer to turn all of their transmission facilities over to the ISO's Operational Control is just and reasonable; (3) whether the cost of reliability services should be included in a Participating TO's Transmission Revenue Requirement; (4) issues regarding Commission review of the Transmission Revenue Requirement of governmental entities. She rejected requests to exclude from the scope of the hearing the following issues: (1) whether a cost shift cap was just and reasonable in principle, as opposed to whether the level and duration was just and reasonable; (2) issues of whether phantom Congestion exists, how it is caused, and alternative methods of resolving phantom Congestion; (3) issues concerning the revisions to Section 3.2 of the ISO Tariff in Amendment No. 49; and (4) issues concerning the types of facilities that may be turned over to the ISO's Operational Control. The Presiding Judge rejected Vernon's motion, ruling that the Commission's ruling on the buy down provision would go to the weight, rather than the admissibility, of the evidence in question. The parties revised testimony accordingly prior to, and during, the hearing.

ARGUMENT

I. **Relevant Factors: What are the factors that should be considered in determining whether the ISO's transmission Access Charge proposal is just, reasonable and not unduly discriminatory?**

A. **The First Consideration Must Be Whether Amendments 27, 34, and 49, as Proposed by the ISO, Are Just and Reasonable and Not Unduly Discriminatory under Commission Principles and Precedent, Not Whether Alternative Proposals Might Be Preferable.**

Amendments 27, 34, and 49 to the ISO Tariff together propose the ISO's transmission Access Charge, which is a formula rate design for the recovery of the Participating TOs' Transmission Revenue Requirements. It is that proposal, and not alternatives proffered by others, that must, as a first step, be adjudged. The Presiding Judge must determine whether the ISO's proposal is just, reasonable, and not unduly discriminatory. 16 U.S.C. § 824d. For the rate design proposal to be acceptable, it need be neither perfect nor even the most "desirable"; it need only be reasonable. *See New England Power Co.*, 52 FERC ¶ 61,090 at 61,336 (1990), *reh'g denied*, 54 FERC ¶ 61,055, *aff'd Town of Norwood v. FERC*, 962 F.2d 20 (D.C.Cir. 1992); citing *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C.Cir. 1984), *cert. denied*, 469 U.S. 917 (1984) (utility need establish that its proposed rate design is reasonable, not that it is superior to alternatives); *OXY USA, Inc. v. FERC*, 64 F.3d 679, 692 (D.C.Cir. 1995) ("[T]he Commission may approve the methodology proposed in the settlement agreement if it is 'just and reasonable'; it need not be the only reasonable methodology or even the most accurate.").

Until and unless the Presiding Judge determines that the ISO's proposed transmission Access Charge methodology is unjust, unreasonable, or unduly discriminatory, alternative proposals are not appropriate factors to consider. The Commission's authority to prescribe a rate arises from section 206 of the Federal Power Act ("FPA"), and under section 206 the Commission can only exercise that authority following a finding that the rates proposed are unjust, unreasonable, or unduly discriminatory. 16 U.S.C. § 824e; *Sierra Pacific Power Co. v. FPC*, 350 U.S. 348 (1956).

In addition, it follows from these principles that the ISO's burden of coming forward with evidence that its proposal is just and reasonable is limited to those features of the transmission Access Charge that represent a change from the previous transmission rate. If a party wishes to challenge a feature of the Access Charge that is unchanged from the previous rate that the Commission approved as just and reasonable, then that party bears the burden of coming forward with evidence sufficient to establish that the feature in question is unjust or unreasonable. *See Public Service Comm'n of New York v. FERC*, 642 F.2d 1335, 1345 (D.C. Cir. 1980). Therefore, unless parties come forward with such evidence, the Presiding Judge should limit her consideration to factors that are relevant to features of the Access Charge that represent changes from the previous rate design.

B. The Presiding Judge Should Consider Whether the ISO's Proposal Is Just, Reasonable, and Not Unduly Discriminatory According to Commission Precedent and Policy, Including the Commission Transmission Pricing Policy, Cost Causation Principles, and the Commission's Order Setting the ISO's Proposal for Hearing.

In evaluating whether the ISO's proposal is just, reasonable, and not unduly discriminatory, the Presiding Judge must, of course, be guided by Commission policy and precedent. Where relevant, the Presiding Judge should consider the Commission's Principles of Transmission Pricing, which the ISO will discuss as appropriate.

Also where relevant, the Presiding Judge should consider principles of cost causation. As the ISO will discuss in connection with time-of-use and coincident peak pricing, the Presiding Judge should apply cost causation principles consistent with Commission precedent, that costs be assigned to those using and benefiting from the facilities in question. In testimony, certain witnesses argued that cost causation principles dictate that costs should be borne by those who initially caused a cost to be incurred, and not also by those that continue to benefit from expenditure in question. This is not a distinction the Commission endorses.

California Indep. Sys. Operator Corp., 103 FERC ¶ 61,114 at P 26.

Finally, the Presiding Judge has available in this proceeding specific guidance from the Commission in the order setting this matter for hearing. While much of the Commission's guidance addressed specific issues, and will be discussed to the extent relevant, certain considerations have relevance to many

issues. First, the Commission concurred with the “ISO's objectives of creating an equitable balance of costs and benefits among the various affected classes of stakeholders and the treatment of all Participating TOs on the same basis.”

California Indep. Sys. Operator Corp., 91 FERC ¶ 61,205 at 61,722 (2000).

Although the Commission altered somewhat the proposed balance, it did so acknowledging concerns that the balance could be disturbed. *Id.* at 61,723.

Second, the Commission endorsed as desirable the goal of a uniform grid-wide high voltage rate. *Id.* at 61,722. Third, the Commission found that incentives for New Participating TO's were a positive step as part of an effort to expand the ISO Controlled Grid. *Id.* Nothing that has transpired since the Commission's decision has undermined the validity of these conclusions, and they should serve as guideances to the Presiding Judge's deliberations.

C. **The “Balance of Benefits and Burdens” Established by the ISO's Transmission Access Charge Proposal Is a Relevant and Important Consideration, but Only as to Whether the Different Treatment Accorded Different Participating Transmission Owners During the Transition Period Constitutes Undue Discrimination**

Throughout this proceeding, the ISO has stressed that the transmission Access Charge proposal represents a “delicate balance of benefits and burdens.” Exh. ISO-1 at 8:10. As described by Ms. Le Vine in her testimony, the balance recognizes the benefits of expanded participation in the ISO through reduced charges for the recovery of the ISO's expenses, reduced Congestion costs from the elimination of phantom Congestion, and the potential for lower Energy and

Ancillary Services prices due to the increased supply from the availability of new Market Participants at unpancaked rates. *Id.* at 12:9-14. Toward this end, the proposal encourages increased participation because the move toward a grid-wide rate ensures lower transmission costs for high-cost potential New Participating TOs, and a hold harmless provision protects any low-cost potential New Participating TOs from an increase in rates. *Id.* at 15:21 – 16:6. New Participating TOs receive an additional incentive, Firm Transmission Rights (“FTRs”) commensurate with the transmission capacity turned over to ISO Operational Control. *Id.* at 66:15 – 67:3. The benefits of increased participation are, however, accompanied by costs. The lower transmission rates for high-cost New Participating TOs mean higher transmission rates for Original Participating TOs. *Id.* at 12:17-21, 60:14 – 61:6. As discussed further below, these additional costs for Original Participating TOs are potentially significant. Part of the balance in the ISO’s proposal is therefore to place a \$72 million cap on the additional costs to Original Participating TOs during the ten-year Transition Period. *Id.* at 61:15 – 62:15. This balance of benefits and burdens was acknowledged by the Commission, 91 FERC ¶ 61,205 at 61,725-26, and should be a factor in the Presiding Judge’s considerations. As the Presiding Judge has ruled, the eventual adoption of a grid-wide rate, however, is not at issue in this proceeding. Therefore, the balance of costs and benefits discussed by the ISO is primarily a factor in the consideration of cost caps, phantom Congestion, and FTRs.

Moreover, the question of the balance of costs and benefits should not provide an avenue for parties to litigate through this proceeding any and every grievance against the ISO Tariff. For example, the fact that the transmission Access Charge is designed to increase participation in the ISO does not make the general costs and benefits of participation in the ISO an issue or give parties license to advocate new incentives to participation unrelated to the Access Charge.

II. Phantom Congestion

As the Commission has found, phantom Congestion Is a Real Problem, a “Market Inefficienc[y]” that Results from “Scheduling Timelines that Do Not Conform with the Timelines of the Overall Markets.” Phantom Congestion Imposes Significant, Although Not Precisely Quantifiable, Costs on Market Participants, and Its Elimination Would Benefit All Participating Transmission Owners.

A. Whether phantom Congestion exists.

There Is No Question that the ISO Must Refrain from Scheduling What Would Be Available Transmission Capacity in Anticipation of the Potential Use of That Capacity by Existing Rights Holders, and that, Consequently, This Capacity Frequently Is Unused

ISO witness Lonnie Rush explains that phantom Congestion describes a problem where “there appears to be Congestion on the ISO Controlled Grid following the submittal of Day-Ahead and Hour-Ahead Schedules even though the actual planned use of the ISO Controlled Grid would not cause that Congestion.” Exh. ISO-26 at 2:13-16. This occurs because the ISO must honor Existing Contracts; under current procedures for honoring Existing Contracts, the ISO reserves this amount of capacity in the forward markets; does not make capacity covered by Existing Contracts available for Scheduling Day-Ahead and Hour-

Ahead; and, consequently, there appears at times to be Congestion on the system in forward markets when no physical Congestion exists.

Dr. Keith Casey of the ISO performed a study that demonstrates the reality of phantom Congestion. This study contains estimates of the extent of phantom Congestion for the most heavily used paths in the ISO's market during a period from January 1999 through December 2002. *See* Exh. ISO-23 at 4:12-15. Dr. Casey shows on a monthly basis the total amount of market schedules actually curtailed in the ISO's Day-Ahead Congestion management market and estimates the level of curtailments that would have been needed in the absence of phantom Congestion. *Id.* at 4:15-22. He concludes that if the full integration of the capacity held by Existing Rights holders and subject to phantom Congestion were fully integrated into the ISO's Day-Ahead Scheduling, it would eliminate Congestion on the California-Oregon Intertie ("COI") and significantly reduce Congestion on the Nevada-Oregon Border path ("NOB"), Path 15 (both directions), Path 26 and Palo Verde. *Id.* at 6:17 – 7:2.

In addition, Mr. Rush included with his testimony two charts, Exhibit No. ISO-28, which clearly demonstrate that phantom Congestion is a real problem. These charts show persistent unmet demand and associated Usage Charges in the Day-Ahead market on COI and Palo Verde despite many multiples of unscheduled ETC capacity in the Day Ahead market. If, on occasion, even a fraction of this ETC capacity is never scheduled in real time, phantom Congestion exists. Indeed,

this data alone demonstrates that there was most likely a serious and persistent phantom Congestion problem at COI and Palo Verde in 1999.

No Intervenor in this proceeding disputes the fact that increased participation in the ISO would not make additional capacity available to the ISO for scheduling Day-Ahead and Hour-Ahead and that, conversely, under current procedures the ISO cannot schedule new firm use on a Day-Ahead and Hour-Ahead basis on capacity that is subject to Existing Contracts. Neither does any Intervenor deny that Congestion appears Day-Ahead and Hour-Ahead when transmission users schedule more capacity on a given path in a given hour than is available on that path in that hour, regardless of whether the capacity on that path subject to Existing Contracts is scheduled. Yet some Intervenors inexplicably resist the logical conclusion from those facts that Congestion that appears in the Day-Ahead or Hour-Ahead Markets may not be real, i.e., that if the unscheduled Existing Contract capacity on which the ISO could not schedule is sufficient to accommodate the ISO's curtailed transactions, then the path is not fully utilized. Whether one calls it phantom Congestion or something else, it is a phenomenon that cannot be denied.

It is also a phenomenon that the Commission has unambiguously recognized as real. Indeed, the resolution of this issue is virtually *res judicata*. In the May 31st Order, the Commission stated, “‘Phantom Congestion’ is a market inefficiency that must be addressed and rectified as quickly as possible.”

California Indep. Sys. Operator Corp. 91 FERC ¶ 61,205 at 61,727. The

Commission reaffirmed this position in its recent order on the ISO's Market Redesign proposal ("MD02"). *California Indep. Sys. Operator Corp.*, 105 FERC ¶ 61,140 at P 201-02 (2003).

Consistent with the Commission's prior orders, the Presiding Judge should conclude that phantom Congestion is a real problem, the resolution of which would be a benefit to all Market Participants.

B. What is the cause of phantom Congestion?

1. Phantom Congestion Is Caused by a Significant Disparity Between the ISO's Scheduling Timelines in the Day Ahead and Hour Ahead Markets and the Scheduling Timelines Accorded to Existing Right Holders in Their Pre-ISO Contracts

As Mr. Rush explained, phantom Congestion arose because of certain characteristics of California's market restructuring: the separation of transmission control from generation ownership; the decision to use markets to manage Congestion and to assign the use and cost of constrained interfaces to those that value it the most; and the decision to honor Existing Contracts and their often incompatible contract provisions and Scheduling time lines. Exh. ISO-26 at 5:7-13.

Under the previous paradigm, the Original Participating TO could Redispatch their own Generation to manage Congestion to accommodate the requirements of Existing Contracts. Without Generation of its own, the ISO must Redispatch others' Generation in order to do so. To accomplish this task on a market basis, the ISO needs to know the magnitude and direction of Congestion

sufficiently in advance for the ISO effectively to use its auction markets to manage the Congestion. Accordingly, the ISO must have deadlines for the submission of Schedules. *Id.* at 5:15-20.

Phantom Congestion is specifically caused by a significant disparity between the Day-Ahead and Hour-Ahead scheduling timelines that the ISO requires for its tasks and the scheduling timelines accorded to Existing Rights holders in their pre-ISO contracts. As discussed above, at times this causes the system to appear congested or significantly more congested in the Day-Ahead or Hour-Ahead Markets than would be the case if all existing transmission capacity could be fully utilized. *Id.* at 3:1-20.

There are sound reasons why the ISO Operations personnel need a longer period than 20 minutes before the trading hour to perform Scheduling functions. As Mr. Rush explains, such a practice would not allow for enough time to “run” the market and publish results. It would also leave Market Participants and the ISO insufficient time to coordinate changes in Schedules. The ISO typically has 1300 Schedule changes in the Hour-Ahead Market, requiring significant computing time to produce Final Hour-Ahead Schedules. Even if those schedule could be provided to Scheduling Coordinators within the twenty minutes prior to the Trading Hour, that time would be too short for Market Participants to modify and coordinate their Schedules. *Id.* at 6:3-12.

Moreover, as Mr. Rush explains, changes to schedules up to 20 minutes before the Trading Hour “would be incompatible with Control Area interchange

Scheduling within the Western Electric Coordinating Council (“WECC”) and would thus work at cross-purposes with region-wide Scheduling processes.” *Id.* at 6:12-16. Mr. Rush states:

The WECC practice is to confirm Control Area interchange schedules twenty minutes prior to the start of each hour. Typically, changes to Schedules after 30 minutes prior to the hour cause Control Area checkout problems because of the communication that must take place to implement a Schedule. This is the reason why the ISO’s notifications of Supplemental Energy Schedules are issued during non-emergency situations no later than 30 minutes before the hour. Control Areas (including the transaction’s source and sink), marketers, and transmission providers must be informed of the Scheduled change. To initiate a Schedule change or request, the Purchasing and Selling Entity must create an Electronic Tag (E-Tag) describing the transaction. Each entity in the transaction must approve the tag. Tag approval or denial is based on available transmission as well as other factors in the Control Area. Each E-Tag must be evaluated by all Control Area Operators, transmission providers, and Scheduling Entities on the path and must be completed by 20 minutes prior to the top of the hour to be considered on time. E-Tags submitted later than 20 minutes prior to the top of the hour are considered late and will not become Schedules unless all entities are able to approve the tag in time. If the approval of one or more of the entities cannot be obtained, the E-Tag goes into a state of passive denial and the Schedule may not be awarded. Control Area checkouts are typically completed 20 minutes prior to the top of the hour. Control Areas ramp Generation 10 minutes before the hour to meet the next hour’s Load requirements so each Schedule discrepancy found during checkouts must be resolved between 20 minutes and 10 minutes before the start of the hour. Each unresolved discrepancy in Schedule checkouts results in frequency deviations on the system. Reliability is

jeopardized as the volume of Scheduling increases closer to the operating hour.

Id. at 6:19 – 7:22. Mr. Rush concludes that under the circumstances he describes, “allowing changes up to 20 minutes before the operating hours is simply bad operating practice.” *Id.* at 8:1-2. Mr. Rush’s description also indicates why accommodating Existing Contracts imposes a heavy burden on the ISO and how it would ease demands on the ISO’s resources if more capacity became subject to the ISO’s existing Scheduling timelines.

Although some Intervenors contend that phantom Congestion is just an ISO software problem, Mr. Rush has explained that alternative design of the ISO’s software could not solve the phantom Congestion problem unless “the ISO discontinued reservation of Existing Contract capacity or abandoned the practice of managing Congestion on a forward basis, or the Existing Contracts were modified.” *Id.* at 8:14-19.

In addition, the Intervenors’ position has been explicitly rejected by the Commission:

Software that perpetuates the non-conforming schedules will not fix this problem of “Phantom Congestion.” . . . [T]his approach simply suggests an iterative scheduling process that will not allow sufficient time for the market to respond and will leave the ISO with insufficient time to manage the grid reliably.

91 FERC ¶ 61,205 at 61,727.

Therefore, the Presiding Judge should find, as did the Commission, that phantom Congestion is a “market inefficienc[y]” that results from “scheduling time lines that do not conform with the time lines of the overall markets.” *Id.*

C. What is the economic impact of phantom Congestion?

Phantom Congestion Facilitates the Exercise of Market Power, Interferes with the Price Signals Sent by Congestion Charges, and Imposes Unnecessary Congestion Costs on Market Participants.

1. Phantom Congestion Distorts the Energy Markets by Creating Artificial Obstacles Between Potential Buyers and Sellers, Reducing Liquidity and Increasing the Potential for the Harmful Exercise of Market Power

The most serious problem with phantom Congestion is its harmful distortion of Energy markets. Phantom Congestion puts an artificial barrier between potential buyers and sellers in the market which reduces liquidity and artificially enhances the market power of certain sellers. Phantom Congestion over interties used to import Energy raises the cost of that transmission usage and thus causes an increased reliance on local Energy even though the local Energy may be more expensive to produce. Exh. ISO-23 at 8:1-13. Customers have less opportunity to import lower cost Energy from other Zones within the ISO or from neighboring Control Areas. *Id.*

In the course of performing a study of the benefits that would result in the year 2005 from upgrading Path 15 (“Path 15 Study”), Dr. Casey also obtained “some indication of the potential order of magnitude of the impacts.” *Id.* at 9:9-10. In this study, Exh. ISO-25, Dr. Casey assessed the impact of additional

capacity over Path 15 on electricity costs to Northern California Load taking into account how such additional capacity would reduce the ability of suppliers in the California market to exercise market power. Exh. ISO-23 at 9:14-18. This required the application of a regression analysis to determine the relationship between market power and market conditions. Exh. ISO-30 at 4:3-14. With the application of this relational model to differing potential market conditions, Dr. Casey, among other things, estimated the extent to which system constraints attributable to phantom Congestion artificially boosts sellers' pricing power.

Dr. Casey found in the Path 15 Study a compelling demonstration "that eliminating phantom Congestion could be a very powerful means to structurally reduce the ability of suppliers to exercise market power." Exh. ISO-23 at 11:19-21. Specifically, he found that the costs of the harmful effects of phantom Congestion on Path 15 and the California-Oregon Intertie could range from \$67 to \$130 million in 2005 depending upon certain assumptions about resource availability. Based upon his detailed study of this example, Dr. Casey concludes that, when considering similar potential market power impacts to Load in Southern California from phantom Congestion on other paths (e.g. Palo Verde, NOB, Path 26), "it is reasonable to expect that the potential annual cost impact of phantom Congestion could well be in the hundreds of millions of dollars order of magnitude." *Id.* at 11:12-17.

Dr. Casey and Mr. Rush also explain how this market power could be deliberately exploited. Exh. ISO-26 at 12:1-22; Exh. ISO-23 at 8:20 – 9:3. For

example, it would be possible to create phantom Congestion by over-reserving Existing Contracts and to exploit the consequent market power in Congestion management markets. *Id.* Dr. Casey provides the example of how an Existing Rights holder that also owns FTRs “could drive up Congestion prices by creating phantom [C]ongestion and then realize the profits from this strategy through its FTR position.” *Id.*

Other detrimental effects also may flow from the bidding strategies that phantom Congestion may encourage. Mr. Rush points out that Scheduling Coordinators aware that additional capacity will be available in real time “may . . . under-Schedule Load in order to reduce exposure to Usage Charges (Congestion costs).” Exh. ISO-26 at 12:6-10. Others may try the opposite and over-schedule in order to receive Day-Ahead Congestion payments (a.k.a. Enron’s “Fat Boy” or “Inc’ing Load” strategy). *Id.* at 12:10-13. Another trick is to Schedule a non-firm export with no intention to complete the transaction and fish for Congestion payments before canceling it. *Id.* at 12:15-22. There may well be tactics as of yet undiscovered for exploiting phantom Congestion. Given the creativity demonstrated thus far, the prudent course is to address the fundamental vulnerability.

SCE witness Bert Hansen questions the validity of Dr. Casey’s estimates of the order of magnitude of costs. He argues that these costs are overstated because (i) market suppliers will be less likely to exercise market power, (ii) the use of data from the year 2000 results in a significant overstatement of costs in future years

because Congestion is no longer as severe and (iii) the study fails to consider the offsetting impacts of higher costs that consumers in southern California may experience. Exh. SCE-5 at 11-12. Dr Casey explained that these criticisms fail to recognize that his study develops a relational model and applies it to different potential market conditions. Whether the costs are “overstated” depends upon the conditions considered most likely. EXH. ISO-30 at 5:10-20.

Mr. Hansen argues that milder conditions are likely and that the consequent economic harms will be less, Exh. SCE-5 at 7:5-11, but he does not show that, even under his assumptions, no significant economic harm from phantom Congestion will occur. More to the point, Mr. Hansen does not show that the economic harms his assumptions would allow are not reasonably commensurate with participation incentives offered in the ISO’s proposal that would reduce or eliminate that harm.

2. **Phantom Congestion Sends Faulty Economic Signals Regarding Where New Investment in Transmission Facilities and Upgrades Are Most Needed.**

Phantom Congestion by its nature imposes charges for Congestion when the system is not actually congested. This confounds a primary function of Congestion management, which is to allow market signals to guide the efficient expansion of the grid.

In the short run, phantom Congestion leads to the inefficient dispatch of Generation resources as higher cost generation is unnecessarily substituted for

lower cost Generation to relieve a fictitious constraint. Exh. ISO-23 at 7:18-21.

This raises total production costs unnecessarily. *Id.*

In the long run, phantom Congestion creates a false conception of the system's capabilities that sends incorrect price signals for investment in transmission upgrades and the location of new Generation capacity. *See Id.* at 8:14-19. This leads to less than optimal investment and higher costs to consumers. *Id.* For example, phantom Congestion at the California-Oregon Border puts upward pressure on prices in northern California that may in turn lead to over investment in new Generation when there is sufficient capacity to allow for more economic importation of Energy. *Id.*

For as long as phantom Congestion exists, it will interfere with the accurate communication of grid capabilities and the need for additional investment to the market.

3. **Phantom Congestion Imposes Significant Congestion Costs When There Is No Actual Congestion on the ISO Controlled Grid**

The principal near-term cost of phantom Congestion is the cost of the unnecessary Congestion itself. In the course of managing Inter-Zonal Congestion, the ISO must reduce the use of the Inter-Zonal Interface by paying Scheduling Coordinators users to adjust their Schedules within the Zones according to their bids. *See* ISO Tariff § 7.2.4, Exh. J-2. The users of the Inter-Zonal Interface pay these costs through Usage Charges. *Id.* at § 7.3.1, Exh. J-2. The ISO has shown that phantom Congestion-related charges were over \$34 million at COI in 1999.

Exh. ISO-28. As ISO witness Lonnie Rush explains: “Most or all of this Congestion cost, as well as the related higher cost of Energy in the ISO Control Area, could have been avoided had the unscheduled Day-Ahead Existing Contract capacity been released for the Day-Ahead Market.” Exh. ISO-26 at 11:7-10.

Mr. Rush also observes, even when capacity does become available in real time, it often cannot be efficiently used because of various operational factors, such as Control Area interchange time lines and Ramping limits of some Generating Units.” *Id.* at 11:15-18. Also, he notes that phantom Congestion “prevents Market Participants from realizing gains from trading Energy between California and other Control Areas.” *Id.* at 11:18-20. Essentially, phantom Congestion is a terrible waste in that it forces the ISO to operate the grid as though expensive installed transmission assets do not exist.

The ISO concedes that the original Participating TOs will not receive a significant “direct” benefit because Participating TOs credit the revenues from Congestion charges against their Transmission Revenue Requirements. Exh. ISO-30 at 14:7-9. However, the ISO disagrees with SCE witness Hansen’s claim that the “indirect benefits” for Original Participating TOs are minimal. *See Id.* at 14:22 – 15:23. This conclusion is based on a faulty assumption that the reduction or elimination of phantom Congestion would have no impact on bidding behavior. *Id.* at 15:3-23. On the contrary, one of the major benefits of eliminating phantom Congestion is that it reduces the ability of Market Participants to exercise market power on both sides of the transmission constraint. *Id.* at 15:7-9. Moreover, Mr.

Hansen assumes that lower spot market prices will only affect that modest fraction of the Original Participating TOs' Load actually purchased on the spot market. *Id.* at 16:16 – 17:9; Tr. at 2423:2-5. This fails to recognize that the prevailing and projected spot market prices will heavily influence the price agreed upon in future supply contracts. *Id.* Future market conditions and the implication for the costs of phantom Congestion are unknown at this time, but the inability to precisely quantify the impact of phantom Congestion on market prices does not nullify the benefit of eliminating it, particularly in light of the order of magnitude of the economic harm described in the ISO's analysis.

The Presiding Judge should therefore conclude that the elimination of phantom Congestion would be beneficial to Market Participants, including Participating Transmission Owners, because phantom Congestion facilitates the exercise of market power, interferes with the price signals sent by Congestion charges, and imposes unnecessary Congestion costs on Market Participants.

D. Whether there are alternative means to address phantom Congestion and, if so, the impact on the issues in this proceeding.

1. Phantom Congestion Is Only Relevant in this Proceeding As It Relates to the ISO's Transmission Access Charge Proposal: Whether the Special Incentives to Expanded Participation in the ISO Included in this Proposal (i.e. Section 9.4.3 FTRs) Are Not Unduly Discriminatory Because They Will Confer a Significant Benefit in the Form of Reduced Phantom Congestion

Phantom Congestion reflects a wasteful failure to use transmission capacity that exists but is unused regardless of the precise significance of the problem.

That the ISO cannot establish to the precise size and scope of the problem does not diminish the reality, recognized by the Commission, that the elimination of phantom Congestion would benefit all Market Participants. 91 FERC at 61,727; 105 FERC ¶ 61,140 at PP 201-02.

The ISO has raised the issue of phantom Congestion in the context of benefits and burdens, its elimination being a reason for the Commission to approve incentives to expanded participation in the ISO, despite the additional costs that these incentives impose upon the Original Participating TOs. The elimination of phantom Congestion is not the only benefit brought by participation of New Participating TOs. Other examples include the elimination of seams, the access to new supplies at nonpancaked transmission rates, and potential savings in Ancillary Services. *See, e.g.*, Exh. ISO-1 at 40:2-22; Exh. ISO-36 at 33:10 – 35:9; Tr. 752:23-25. The evidence is incontrovertible, however, that the addition of New Participating TOs would reduce phantom Congestion. The Presiding Judge should find that the reduction in phantom Congestion is a benefit to all Market Participants that weighs in favor of incentives to New Participating Transmission Owners.

2. **The Alternatives Cited by Intervenors Are Not Appropriately Considered in this Proceeding. The Commission Is Considering Proposals to Reduce Phantom Congestion as Part of its Consideration of the ISO's MD02 Market Redesign Proposals.**

Alternative solutions to phantom Congestion are not relevant to this proceeding, which concerns the ISO's transmission Access Charge, and the

propriety in the Access Charge of incentives for additional participation in the ISO in reasonable proportion to the public benefits that would flow automatically, immediately and completely from such participation.

In the proceeding the ISO promotes a solution that circumvents the phantom Congestion problem. In MD02, as discussed above, the ISO attempts to grapple with the problem head-on in its ISO ETC proposal. The Commission specifically recognized this proposal as an “integral part of the Revised MD02 filing.” 105 FERC ¶ 61,140 at P 203. The Commission has welcomed in that proceeding the ISO’s “efforts to find a workable solution” and “proposal to engage in a further consultation process.” *Id.* at P 202. There is ample opportunity for interested parties to raise alternative solutions that would also directly address the phantom Congestion problem in the consultative process encouraged in that proceeding by the Commission. *See Id.* The Presiding Judge should find that the Market Redesign Proceeding, and not this proceeding, is the appropriate forum for the consideration of alternative or additional solutions to phantom Congestion.

III. “Cost Shift”

- A. **Whether the ISO’s proposal for the inclusion of a “cost shift” cap for ten years in the transmission Access Charge proposal is just, reasonable and not unduly discriminatory.**

The Cost-Shift Cap Is Simply One Part of a Just and Reasonable Transition Mechanism that, Particularly When Considered in the Context of the Entire Balance of Benefits and Burdens, Does Not Unduly Discriminate Against Any Party

As described by Ms. Le Vine, “[T]he Access Charge proposal as filed included a number of other transition mechanisms to mitigate cost shifting among Participating TOs and to facilitate the entry of New Participating TOs. The ISO considered these transition mechanisms to be integral parts of the balanced compromise proposal adopted by the ISO Governing Board.” Exh. ISO-1 at 59:22 – 60:2. The cost shift cap is one of those mechanisms. As Ms. Le Vine further explained:

The proposed methodology recognizes that the adoption of the TAC Area approach and the phased introduction of a single ISO Grid-wide High Voltage Access Charge would cause considerable cost shifting among Participating TOs. To limit the potential magnitude of these cost shifts, the proposed Access Charge methodology includes a cap on the amount by which the Access Charge responsibility payable for the withdrawal of Energy within the Service Area of each Original Participating TO can increase during each year of the ten-year transition period due to the adoption of the Access Charge methodology and the GMC/Access Charge “hold harmless” provision for new Participating TOs.

....

If the total cost shift exceeds this cap, the customers of the New Participating TOs with net benefits would

contribute part of their net benefit in order to limit cost shifts to this level. . . . [T]his mitigation measure would be implemented through the Transition Charge.

Id. at 61:17 – 62:15. The cost-shift cap is set at \$72 million, \$32 million to be borne by SCE and PG&E each and \$8 million by SDG&E.

A number of New Participating TOs and potential New Participating TOs assert that the cost shift cap is unduly discriminatory. Undue discrimination is the unjustified differential treatment of similarly situated classes. *See El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 115 (2003). As discussed below, the proposed Access Charges does treat New Participating TOs differently; it also treats some New Participating TOs differently than others; and it treats Original Participating TOs differently; and it treats some Original Participating TOs differently than others. This treatment is justifiable, however, because these groups are not all similarly situated, but rather bring to the ISO different circumstances. Moreover, to the extent that they are similarly situated, the goals of expanding the ISO Controlled Grid while avoiding abrupt cost shifts justify transitional distinctions. Indeed, the differential treatment afforded certain New Participating TOs carries with it not only the cost cap, but also benefits; if differential treatment were not justified, then the benefits would be impermissible. The cost shift cap is simply part of this overall balance.

1. **The Cost Shift Cap Is Just One Aspect of the Transition Charge Mechanism, Which Can Apply to Any Participating TO According to Its Circumstances**

New Participating TOs are not the only parties that may be subject to a Transition Charge as part of the overall balance of costs and benefits during the Transition Period. Another feature of the balance is that the costs to be borne by the Original Participating TOs must at all times reflect the same proportionality as the cost cap: 32:32:8. Thus, ever since Vernon became a Participating TO, PG&E and SDG&E have been paying a Transition Charge, and SCE has been receiving a Transition Charge benefit. This is illustrated in Exh. No. ISO-21 at 17.

A third feature of the balance is the “hold harmless” provision, reflected in Section 8.6 of the ISO Tariff. If the Transmission Revenue Requirement of a New Participating TO results in a utility-specific rate that is less than the Access Charge it would pay, the hold harmless provision ensures that the New Participating TO will only pay the utility-specific rate. The difference is made up by the Original Participating TOs through the Transition Charge as the first priority payment. ISO Tariff § 8.6, Exh. J-2. This is illustrated in Exh. ISO-21 at 20. Thus, in effect, New Participating TOs, just like Original Participating TOs, enjoy the benefit of a cost shift cap. The difference is that the cost shift cap for New Participating TOs is \$0.

Thus, the Access Charge proposal exposes every Participating TO to a potential Transition Charge in order to achieve the balance of costs and benefits

during the transition period. The degree of exposure varies according to each Participating TO's circumstances, according to when it becomes a Participating TO and the level of its Transmission Revenue Requirement. This is to be expected—the purpose of a transition period is to reduce abrupt costs shifts while preserving incentives for New Participating Transmission Owners, and this purpose cannot be accomplished without making rate adjustments according to the specific circumstances of particular participants. It cannot be said, however, that the ISO's proposal singles out any one class to bear the burdens of the transition period; at any particular time, that burden may fall on a different group.

2. **The Cost Shift Cap Does Not Economically Disadvantage New Participating TOs**

Witnesses for a number of New Participating TOs or potential New Participating TOs¹² have argued that the cost shift cap denies them the ability fully to recover their Transmission Revenue Requirements. *See, e.g.*, Exh. TNC-1 at 10:12-14; Exh. SC-1 at 12:15-18. When presented with testimony that any shortfalls would always be recovered from ratepayers and that the ISO always pays out a Participating TO's entire Transmission Revenue Requirement (except for minor variations due to inaccurate Load forecasts), they modified the argument to contend that they could not recover the Transmission Revenue Requirement from the ISO on a net basis; i.e., that the appropriate consideration is the

Participating TO's Transmission Revenue Requirement net of the Transition Charge paid by its ratepayers (in its role as a Utility Distribution Company ("UDC")). There are two significant shortcomings to this argument.

First, if one accepted this analysis, one would have to conclude that PG&E and SDG&E, who already pay a Transition Charge, are not recovering their Transmission Revenue Requirements from the ISO on a net basis. Under such circumstances, it is difficult to understand how the possibility that a New Participating TO might at some point be in the same situation constitutes discrimination.

Second, and more importantly, this analysis only looks at one part of the "net" picture. One can either do a gross analysis or a net analysis, but a partial net analysis has no logic. On a gross basis, there is no dispute that the ISO pays out every Participating TO's full Transmission Revenue Requirement. *See* ISO Tariff Appendix F, Schedule 3, § 10.1, Exh. J-2.

A net analysis recognizes that the ISO settles with Participating TOs that are also UDCs or Metered Subsystems ("MSS") on a net basis. *Id.* Appendix F, Schedule 3, § 10.2. The net settlement, however, includes not only the Transmission Revenue Requirement payment and the Transition Charge, *but also the Access Charge. Id.* If the Transmission Revenue Requirement payment

¹² Although all positions discussed in this brief were taken by witness for parties, the ISO may refer to a party, rather than the witness, when referring to a position rather than a specific statement or assertion.

(going to the Participating TO) is considered a positive amount, and the Transition Charge and Access Charge (coming from the UDC or MSS) are considered negative amounts, it becomes apparent that *no* Participating TO receives its full Transmission Revenue Requirement from the ISO on a net basis. On a net basis, *every* Participating TO that is a UDC or MSS must collect all or a portion of its Transmission Revenue Requirement from the ratepayers of the UDC or MSS. Indeed, the only issue in a net analysis is whether the Participating TO will be paid by the ISO or will have to pay the ISO.

A complete net analysis underscores the hollowness of the arguments against the cost caps. Before the cost cap is reached, Participating Transmission Owners with below average utility-specific rates (except for New Participating TOs, who are protected by the hold harmless provision) will, on a net basis, make payments to the ISO. *Compare* Exh. ISO-17, col. 1 with Exh. ISO-17, cols. 20 and 32. *See also* Tr. 1576:1-14. Participating Transmission Owners with above average utility-specific rates will, on a net basis, receive payments from the ISO. *Id.* Once the cost cap is reached, the Transition Charge will simply reduce those payments; even in the hypothetical broad participation case analyzed by ISO witness Mr. Pfeifenberger, the New Participating TOs will continue to receive payments from the ISO—payments they did not receive before becoming New Participating TOs—while the Original Participating TOs will continue to make payments to the ISO. *See* Exh. ISO 21. Under such circumstances, it is difficult

to understand how the cost shift cap, as part of the overall balance of benefits and burdens, could render the ISO's proposal unduly discriminatory.

3. **Regardless of Whether It Is "Necessary," the Cost Shift Cap Is a Reasonable Element of the Balance of Benefits and Burdens and a Just and Reasonable Transition Mechanism**

In evaluating rates, the Commission does not seek to determine the most appropriate rate, but rather its responsibility is to ensure that the rates fall within a "zone of reasonableness." An analogous approach is appropriate in evaluating the inclusion of a cost shift cap in the ISO's Access Charge proposal.

Since the May 31st Order, the Commission has approved a number of Regional Transmission Organization proposals that would retain zonal or utility-specific rates for a transition period in order to avoid cost shifts. *See, e.g., Arizona Pub. Serv. Co., et al.*, 101 FERC ¶ 61,033 (2002); *Cleco Power LLC, et al.*, 101 FERC ¶ 61,008 (2002); *Avista Corp., et al.*, 100 FERC ¶ 61,274 (2002). In one instance, the transition period was justified because the rates of the highest cost transmission owner were twice those of the lowest cost. *Cleco Power LLC, et al.*, 101 FERC at P 106. In another instance, the rates differed by a multiple of four. *Arizona Pub. Serv. Co., et al.*, 101 FERC at P 134. In the ISO's case, the highest cost actual (or potential) New Participating TO has a utility-specific rate that is 4.5 times greater than that of the lowest cost Original Participating TO. Exh. ISO-21 at 5. Under Commission precedent, this type of rate differential would justify the maintenance of utility specific rates throughout a transition period.

The ISO nonetheless has proposed, and the Commission has approved, an immediate move from utility-specific to intermediate zonal rates and the immediate commencement of a transition to a single grid-wide rate. The cost shift cap portion of the Transition Charge, if it were to become effective, would merely slow somewhat the cost shift involved for each Participating TO. Because the ISO's proposal is a more moderate form of transition than others approved by the Commission, but fully as justified, it falls within the "zone of reasonableness."

Commission Staff, noting that the Commission in the May 31st Order, directed examination of the impact on retail rates, contends that the cost shift cap is not justified because the likely impact is minimal. Exh. S-1 at 29:6-13. Although the Commission did indeed direct examination of the overall impact on retail rates, it did not suggest that the impact on retail rates should be determinative. Indeed, fairly read, the May 31st Order contemplated that the transmission Access Charge would include some sort of transition period and limit on cost shifts:

In conclusion, we reiterate that, at this juncture, we are not able to ascertain whether the ten year transition period and proposed \$72 million annual cap provides *the proper compromise of costs and benefits*. Additionally, we recognize that our rulings on other issues may impact this compromise. Therefore, we instruct the parties, with the assistance of the appointed settlement judge, to further evaluate and consider all relevant costs and benefits and the proper context of such amounts in the selection of an appropriate transition period.

91 FERC at 61,725-26 (emphasis added).

The overall balance, as affected by the May 31st Order, remains the appropriate context in which to examine the cost shift cap. The Commission's willingness in the cases cited above to accept utility-specific and zonal rates during a transition period based solely on disparities in participants *transmission* costs or rates indicates that the impact on retail rates is *not* determinative. When the ISO's proposal is considered not only in the context of the disparity in the Original and potential New Participating Transmission Owner's costs, but also in the overall balance, including the immediate commencement of the transition (and thus of the cost savings to New Participating Transmission Owners), the hold harmless provision, and the Section 9.4.3 FTRs, the impact of retail rates should bear little weight.

Another witness has suggested that a cost cap is not necessary because it is not likely to be reached. Tr. 1586:16 – 1587:2. This is somewhat analogous to arguments that one need not carry insurance because one is a good driver. The difference is that the good driver will have to pay for the insurance even if he or she never has an accident. In contrast, if the cost cap is never triggered, it will have no impact on the New Participating TOs whatsoever. The only downside that has been suggested—that it would establish a bad precedent—is frivolous. Every cost-shift mitigation program accepted by the Commission requires that another party bear some additional costs. The proposed cost-shift cap is no different.

The issue with which the Commission was concerned was the length of the Transition Period and the amount of the cost-shift cap. The length of the Transition Period, however, is not included on the Joint Issues list and thus not being challenged by the parties to this proceeding. Moreover, the ISO's proposed Transition Period is also similar to that approved by the Commission in two of the cases cited above (8 years).

The ISO has acknowledged that the level of the cost cap was proposed by the End Users as part of the compromise within the ISO Board. Exh. ISO-1 at 54:3-15. Although the End Users may have done so, the ISO has not attempted to support the cap with specific calculations. Nonetheless, the ISO submits that the level selected by the negotiating group is just and reasonable. There is very little Commission precedent on the level of rate increase that would justify a cap, but in the context of its restructuring of the natural gas industry, the Commission determined that rate increases in excess of 10 percent required mitigation. The ISO's proposed cost shift cap of \$72 million represents a 19% to 20% increase in the 2003 High Voltage transmission rates (relating to Existing Transmission Facilities) of the Original Participating TOs (and a larger portion of the 2000 rates). *See* Exh. ISO. 21 at 9. In contrast, with two exceptions (WAPA and MWD), even after the cost cap is reached, New Participating TOs, under the full membership scenario, would enjoy rates that are approximately 10% to 40% less than their utility specific rates (relating to Existing Transmission Facilities). The ISO's proposal thus tolerates a greater cost shift than what the Commission has

allowed in other circumstances and does not tip the balance of benefits and burdens away from New Participating TOs. It is squarely within the “zone of reasonableness,” and the Presiding Judge should find it acceptable.

The Presiding Judge should therefore find that the \$72 million cost-shift cap is an important part of a just and reasonable transition mechanism that, when considered in the context of the benefits and costs received by and imposed on New and Original Participating Transmission Owners, does not unduly discriminate against any party.

- B. If the proposed “cost shift” is unjust, unreasonable and unduly discriminatory, whether a different “cost shift” cap or transition period is just, reasonable and not unduly discriminatory.**

Because the Cost Shift Cap Is Just, Reasonable, and Not Unduly Discriminatory, this Issue Is Not Applicable.

- C. Whether it is just, reasonable and not unduly discriminatory to exclude New High Voltage Facilities from the calculation of the Transition Charge.**

Exclusion of New High Voltage Facilities from the Calculation of the Transition Charge Does Not Discriminate Against Any Class of Participating Transmission Owner and Also Serves Valid Policy Purposes

- 1. Exclusion of New High Voltage Facilities From the Calculation of the Transition Charge Is Not Discriminatory in that Utilities Proposing to Build New High Voltage Facilities Are Not Similarly Situated to Utilities with Existing High Voltage Facilities.**

Under Amendment No. 49, New High Voltage Facilities are excluded from the calculation of the cost shift and the Transition Charge. A number of parties assert that this discriminates against Participating Transmission Owners whose

facilities were built more recently than those of other Participating Transmission Owners. There is no basis for this assertion because the ISO's proposal makes no such distinction.

The only distinction made by this provision of Amendment No. 49 is between Existing High Transmission Facilities, *i.e.*, those built before January 1, 2001, and New High Voltage Transmission Facilities, *i.e.*, those built after January 1, 2001. ISO Tariff, Appendix A, Definitions of New Facility and Existing Facility, Exh. J-2. The only two classes, then, would be those who build New High Voltage Transmission Facilities and those who own only Existing High Voltage Transmission Facilities. All Participating TOs who build New High Voltage Transmission Facilities are treated the same, *i.e.* the facilities are excluded from the calculation, and all Participating TOs who own Existing High Voltage Transmission Facilities are treated the same, *i.e.*, their facilities are included in the calculation.

There are, however, differences between the two classes of Participating TOs. Participating TOs who build New High Voltage Transmission Facilities do so in conjunction with the ISO and with the approval of the ISO, as part of the ISO planning process. The facilities are built to benefit the entire ISO-Controlled Grid. Exh. ISO-33 at 13:1-5. The Existing High Voltage Facilities of Participating TOs, however, generally were not built to benefit the entire ISO-Controlled Grid or as part of the coordinated ISO planning process. *Id.* at 13:5-7. Existing Facilities may already have heavy use, and may have Encumbrances. *See* Tr. at 867:24 –

868:3. New Facilities do not. The two classes, therefore, are not similarly situated, and differential treatment is not discriminatory..

2. **Even If the Exclusion of New High Voltage Facilities from the Calculation of Transition Charge Could Be Seen As Treating Similarly Situated Persons Differently, the Difference in Treatment Is Justified.**

Even if some class could establish differential treatment, however, the exclusion of New High Voltage Facilities from the calculation of the cost shift and the Transition Charge would be justified. The exclusion is necessary to encourage and facilitate the financing of transmission expansions. As explained by Mr. Pfeifenberger, unless New High Voltage Facilities are excluded from the calculation, the costs would generally not be borne in proportion to Gross Load, but would greatly depend on who constructs the facilities and the size of the overall cost shifts. In essence, the cost of New High Voltage Transmission facilities would interfere with the calculation of the Transition Charge such that the Transition Charge counter-acts the immediate ISO-wide roll-in of transmission upgrades in often unpredictable ways. Exh. ISO-36 at 36:19 – 37:8. In an example presented by Mr. Pfeifenberger, under the Amendment No. 49 methodology, in every scenario, the costs of a transmission upgrade were allocated to the Participating TOs according to Gross Load.

In contrast, if the costs of the New High Voltage Facilities were not excluded from the calculation, the costs borne by New Participating TOs varied from 0% to 100% and the costs paid by the Original Participating TOs varied to

the same degree. *Id.* at 39:19-23. Because these allocations could create significant barriers to the efficient upgrade of the transmission system—providing disincentives for transmission investments by Participating TOs with a disproportionately high allocation of the costs, while not providing proper incentives for Participating TOs with an under-proportionate (or even zero) allocation of new transmission costs—the exclusion of the costs of New High Voltage Facilities from the calculation of cost shifts and Transition Charges would justify a minor distinction in treatment of similarly situated classes, if such a distinction could be established. *Id.* at 40:5-12.

The Presiding Judge should therefore find that the exclusion of the costs of New High Voltage Facilities from the calculation cost shifts and Transition Charges does not treat New Participating Transmission Owners dissimilarly from Original Participating Transmission Owners and, further, serves to encourage the construction of new transmission by ensure that the costs are properly allocated among Participating Transmission Owners.

- D. New Facilities: Whether the immediate inclusion of New High Voltage Facilities in the grid-wide component of the High Voltage Access Charge is just, reasonable and not unduly discriminatory.**

The Immediate Inclusion of New High Voltage Facilities in the Grid Wide Component of the High Voltage Access Charge Does Not Discriminate Against Any Class of Participating Transmission Owner and Also Serves Valid Policy Purposes

Although some New Participating TOs also assert that the immediate inclusion of New High Voltage Facilities in the ISO Grid-wide component of the

Access Charge is unduly discriminatory, there is no basis for this complaint. This treatment of New High Voltage Facilities does not distinguish between the New High Voltage Facilities of New Participating TOs and those of the Original Participating TOs. As explained by Ms. Le Vine, the distinction made between New and Existing High Voltage Facilities in connection with the ISO Grid-wide component does not affect the Participating TOs' recovery of their transmission costs. Exh. ISO-33 at 11:11-14. Although the distinction does affect rates—during the transition period only—it does not do so in a manner that treats New Participating TOs differently from Original Participating TOs. Rather, it affects the rates of one TAC Area differently from those of another TAC Area. For example, if an Original Participating TO in the Northern TAC Area builds a New High Voltage Facility and the New High Voltage Facility is immediately included entirely in the ISO Grid-Wide component of the High Voltage Access Charge, the High Voltage Access Charges for all Participating TOs will increase by the same amount. If the New High Voltage Facility were not immediately included in the ISO Grid-wide component of the High Voltage Access Charge and instead were to be included in the TAC Area component, the High Voltage Access Charges of both New Participating TOs and Original Participating TOs in the Northern TAC Area would increase equally, but by a greater, amount; similarly, the High Voltage Access Charges of both New Participating TOs and Original Participating TOs in the other two TAC Areas would increase equally, but by a lesser, amount due to

the split between TAC Area rates and ISO Grid-wide rates during the Transition Period. Exh. ISO-33 at 11:16–12:10.

The only relevant distinction regarding the inclusion of facilities in the ISO Grid-wide rate is between Participating TOs, as owners of Existing High Voltage Transmission Facilities, are not similarly situated to Participating TOs as owners of New High Voltage Facilities. For the reasons discussed above, Participating TOs, as owners of Existing High Voltage Transmission Facilities, are not similarly situated to Participating TOs as owners of New High Voltage Facilities. With regard to the inclusion of New High Voltage Facilities in the grid-wide component of the High Voltage Access Charge, however, another factor is significant. Those that constructed Existing High Voltage Facilities built them with no expectation that the costs would be recovered from anyone other than their own ratepayers. *See* Tr. 1584:9 – 1585:1. Even during the period of the TAC WG, and particularly after Amendment No. 27 was filed, they could have no other expectation. *See* Tr. 1585:2 – 1586:15. Those that construct New High Voltage Transmission Facilities, of course, have every reason to believe that the costs will be fully incorporated in the ISO Grid-wide rate. There is simply no basis for finding these groups similarly situated.

Moreover, the immediate inclusion of New High Voltage Facilities in the ISO Grid-wide component is justified as appropriate policy. As also noted by Ms. Le Vine, the TAC Area rates exist solely to facilitate a transition to the ISO Grid-wide rate for High Voltage Facilities. The inclusion of New High Voltage

Facilities in the TAC Area rates would inflate that portion of the rate, slowing the transition. It would also potentially reduce the effectiveness of the transition by magnifying the increase that would occur at the end of the transition period. Exh. ISO-33 at 12:17-22. The inclusion of New High Voltage Facilities in the TAC Area rates is thus an important part of the balance incorporated in the ISO's transmission Access Charge proposal and, to the extent that it may affect individual parties differently according to whether they chose to build facilities before or after January 1, 2001, it is justified.

The Presiding Judge should therefore find that the exclusion of the costs of New High Voltage Facilities from the calculation cost shifts and Transition Charges does not treat New Participating Transmission Owners dissimilarly from Original Participating Transmission Owners and, further, serves to advance the Transition from zonal to grid-wide rates.

IV. FTRs

- A. **Whether it is just, reasonable and not unduly discriminatory to treat the Original Participating TOs' FTRs differently than New Participating TOs in Section 9.4.3 of the ISO Tariff.**

The Section 9.4.3 Treatment of FTRs Is a Just, Reasonable, and Not Unduly Discriminatory Inducement for Participation in the ISO.

Section 9.4.3 of the ISO Tariff, as proposed by Amendment No. 27, provides that, during the ten-year transition period (or a shorter period representing the term of an Existing Contract), a New Participating TO that converts Existing Rights to ISO transmission service will receive FTRs

represented by those rights directly, without the necessity of participating in the ISO's FTR auction. As Commission Staff witness Patterson has noted, the Commission has already approved this proposal. Exh. S-5 at 41:7-16. In the May 31 Order, the Commission stated:

Generally, we find that the ISO's proposed treatment of FTRs is reasonable. As explained by the ISO, the proposal to exempt [N]ew Participating TOs from the auction process during the transition period is a feature that has been offered as an inducement to encourage participation in the ISO. The proposal will afford [N]ew Participating TOs protection against cost increases during the [T]ransition [P]eriod.

91 FERC ¶ 61,205 at 61,726.

The Commission's decision was fully supported then, and remains so. As Ms. Le Vine described, during the negotiations related to the ISO's proposal, representatives of some potential New Participating TOs expressed concern that replacing their Existing Rights, one-for-one, with FTRs acquired through the ISO's auction process would impair their ability to continue to serve their customers economically. Exh. ISO-1 at 66:15-19. Section 9.4.3 was therefore added to provide a temporary inducement and to remove a potential barrier to New Participating TOs. The FTRs provide New Participating TOs with a financial hedge against Congestion and a Scheduling priority in the Day-Ahead Market without which Existing Rights holders might delay such participation until their Existing Rights expire. Thus, although Section 9.4.3 does treat Original Participating TOs differently than New Participating TOs, this temporary

distinction is justified, as the Commission found, by the benefits of expanding participation in the ISO.

The Presiding Judge should therefore find that, consistent with the Commission's prior order, the Section 9.4.3 treatment of FTRs for New Participating TOs is just, reasonable, and not unduly discriminatory.

- B. Whether the provisions of the ISO Tariff relating to the netting of Usage Charges against Usage Charge revenues associated with FTRs received under Section 9.4.3 (specifically the definitions of New FTR Revenue and Transmission Revenue Credit) are just, reasonable and not unduly discriminatory.**

The ISO Tariff Apportions Revenues Associated with Section 9.4.3 FTRs in a Manner Carefully and Appropriately Tailored to Their Limited Purpose

The ISO proposes in Amendment No. 49 to revise the definition of Transmission Revenue Credit and Net FTR Revenue such that the recipients of Section 9.4.3 FTRs must credit against their Transmission Revenue Requirement the positive difference between the Usage Charges paid and the Congestion revenue received for each hour. This revision ensures that the New Participating TOs receive the full benefit of the hedge against Congestion that is provided by Section 9.4.3 FTRs, but not more than that amounts. SWP witness Jones (sponsoring testimony originally submitted by Mr. Harrison Call) and TANC witness Brozo challenge the proposed change as insufficient, arguing it is an unreasonable limitation on the ability of New Participating TOs to credit ISO transmission charges against FTR revenues. Exh. SWP-72 at 64:23 – 65:10; Exh. TNC-1 at 36:17 – 38:3. These witnesses complain that Usage Charges may

exceed FTR revenues in a given hour, and that the Usage Charge balance should carry over. *Id.*

As explained *supra* Section IV.A., the ISO included provision for Section 9.4.3 FTRs to allow potential New Participating TOs participants to preserve benefits of their Existing Rights after conversion of those rights. Section 9.4.3 FTRs are designed to provide New Participating TOs a financial hedge against Usage Charges that they would not have paid under their Existing Contracts. Exh. ISO-1 at 82:7-18. Ms. Le Vine noted the ISO's agreement (Exh. ISO-33 at 27:1-3) with SCE's witness Cullier's explanation that Section 9.4.3 FTRs are not intended to confer a benefit beyond this particular and limited purpose. Exh. SCE-13 at 27. The purpose of Section 9.4.3 is not to protect New Participating TOs from all market risk or all Congestion cost, but only to reflect that which they enjoy under their Existing Contracts. *Id.*

To the extent that a New Participating TO is Scheduling on the paths that were subject to its Existing Rights, at or below the capacity of those Existing Rights, the fact that it, as FTR holder, receives, pro rata, the Usage Charge (FTR) revenues associated with the path means that the Usage Charge (FTR) revenues should almost always cover the Usage Charges it pays. The exception would be the derate of a transmission line. SCE-13 at 27:9-15. As Mr. Cullier explains, however, a line derate may have caused a pro rata reduction in the potential New Participating TOs firm rights to schedule under its Existing Contract. Exh. SCE-13 at 27. The proposal put forth on behalf of SWP and TANC would thus confers

a financial advantage beyond the more proportionate benefit that Section 9.4.3 should convey. *Id.* at 29:11-13.

The Presiding Judge should therefore find that the proposed provisions in Amendment No. 49 for netting Usage Charges against FTR Revenues are appropriately designed to implement the purpose of Section 9.4.3 FTRs.

- C. **Whether it is just, reasonable and not unduly discriminatory that the provision of FTRs to New Participating TOs under Section 9.4.3 terminates at the earlier of the end of the transition period or termination of an Existing Contract.**

As Recognized by the Commission, the Limited Purpose of Section 9.4.3 FTRs—to Confer an Initial Inducement to New Participating TOs—Corresponds Precisely With the Proposed Termination.

As noted above, the ISO recognizes that the provision of Section 9.4.3 FTRs is discriminatory, but contends that it is justified because of its purpose and because it is temporary. The Commission has already so concluded:

With respect to the ISO's proposal that the FTRs be limited to lesser of the ten-year [T]ransition [P]eriod or the life of the contract if its term is less than ten years, we find that this proposal is also reasonable. The holders of contract rights that become [N]ew Participating TOs must recognize that this election will fundamentally change their current status, and consistent with that change, the [New] Participating TOs should have to participate in the auction process for the purchase of FTRs in the same manner as the [O]riginal Participating TOs after the [T]ransition [P]eriod.

91 FERC ¶ 61,205 at 61,726.

TANC witness Brozo, however, perhaps to avoid this Commission finding, proposes a complete overhaul of the FTR program, recommending that FTRs be allocated to all Load, and noting that the ISO has made such a proposal, to which the Commission has given initial approval, in the ISO Market Redesign. Exh. TNC-1 at 33:1-14. TANC's proposal is, of course, well beyond the scope of this proceeding. It would require the Presiding Judge to find that the ISO's entire FTR auction program, which the Commission approved as just and reasonable in its order on Amendment No. 9, 91 FERC ¶ 61,205 at 61,726, which the ISO has not proposed to change in this proceeding, and on which there has been no testimony, is unjust and unreasonable. *See Public Service Comm'n of New York v. FERC*, 642 F.2d at 1345. There is, of course, no basis for such a finding.

That the ISO is itself proposing to revise its treatment of transmission rights in a different proceeding does make the issue ripe for resolution here. As is apparent from the Commission's order, the ISO's Market Redesign is an integrated packet, which continues to evolve, and which the Commission is carefully monitoring. There is no cause to pre-empt that process in an unrelated proceeding.

The Presiding Judge should therefore find that, consistent the with Commission's prior order, it is just, reasonable and not unduly discriminatory that the provision of FTRs to New Participating TOs under Section 9.4.3 terminates at the earlier of the end of the transition period or termination of the applicable

Existing Contract and that the ISO's FTR program should not otherwise be revised.

- D. Whether Amendment No. 27 is unjust, unreasonable and unduly discriminatory because it does not specify the methodology for the allocation of FTRs pursuant to Section 9.4.3 of the ISO Tariff.**

The Varying Nature of Existing Rights under Existing Contracts Precludes a Fixed Formula for the Allocation of Section 9.4.3 FTRs. Whether a Particular Allocation is Just and Reasonable and Not Unduly Discriminatory Can Be Adjudged at the Time the Allocation Is Filed with the Commission.

Proposed Section 9.4.3 provides that a New Participating TO will be provided FTRs commensurate with the transmission capacity that it places under the ISO's Operational Control. Under proposed Section 4.5 of Schedule 3 of Appendix F, In making that determination, the ISO will consider the amount of contracted transmission capacity, the firmness of the contracted transmission capacity, and other characteristics of the contracted transmission capacity to determine the amount of FTRs. The provisions provide potential New Participating TOs and other Market Participants with notice of the factors that the ISO will consider, while providing the ISO some flexibility in negotiating the number of FTRs with potential New Participating TOs. Exh. ISO-33 at 24:5-8. To ensure that Market Participants have a full opportunity to litigate the proposed award of FTRs, the ISO has stated that it has no objection to a tariff requirement that it file the proposed award with the Commission simultaneously with an

amendment to the Transmission Control Agreement regarding a New Participating TO. *Id.* at 24:15-19.

SWP witness Jones, PG&E witness Weingart, and Staff witness Patterson contend that the ISO Tariff should set forth a specific, transparent, methodology for allocating FTRs to New Participating TOs. Exh. SWP-70 at 14:25 – 15:2, SWP-72 at 61:8-23, PGE-1 at 29:3-13 and S-5 a 46:8-15. The difficulty with this proposal is, as Ms. Le Vine explained, that every Existing Contract brings different circumstances to the table. Exh. ISO-33 at 23: 19-20. For example, it has been necessary to establish PG&E as a “Path Facilitator” and establish a special operating procedure just to handle all the different priorities on Path 15. *Id.* at 23:21 – 24:1. As another example, SWP has devoted significant testimony to explaining the in-kind reliability support that it believes it supplies, in a unique manner, under its Existing Contracts. Exh. SWP-72 at 65:11 – 67:18.¹³ As an ISO representative intimately involved in the resolution of these issues with the existing New Participating TOs, Tr. at 614:2 – 619:19, Ms. Le Vine concluded that “It would be difficult, if not impossible It would be difficult, if not impossible, to set forth a methodology that would accommodate” all the different circumstances. Exh. ISO-33 at 23.

¹³ SWP witness Jones’ objection to a “one-size-fits-all approach” and his emphasis on the special attributes that he believes SWP has under its Existing Contracts appears somewhat inconsistent with his advocacy of inflexible criteria. Exh. SWP-70 at 16:1–26.

The Commission uses a “rule of reason,” to determine the amount of detail required in a tariff. *See Automated Power Exch.*, 85 FERC ¶ 61,232 at 61,972-73 (1998). In this case, the Presiding Judge is presented with provisions that provide notice to Market Participants of the factors that the ISO will consider when negotiating FTR awards to New Participating TOs. Significantly, provisions regarding the award of FTRs to New Participating TOs will *not* affect any Market Participants until they are awarded, and *before that occurs*, every Market Participant will be provided notice of the proposed award and the opportunity to challenge it (under the tariff amendment the ISO has stated it would find appropriate). Thus, the lack of additional detail does not prejudice any Market Participant or deny the Commission full review.

The ISO’s proposal does, however, allow the ISO to tailor the award of FTRs to the particular circumstances presented by each Existing Contract. Absent this flexibility, for example, because the contracted capacity of Path 15 exceeds the physical capacity, the ISO may not have been able to fashion the particular award of Path 15 FTRs to Southern Cities. *Id.* at 23:21 – 24:1. The flexibility plays a significant role in ensuring the Section 9.4.3 allocation of FTRs fulfills its purpose as an inducement to expanded participation in the ISO.

Accordingly, the Presiding Judge should find that, due to differences in Existing Contracts, the ISO requires a degree of flexibility in determining the appropriate number of FTRs to award under Section 9.4.3 and, therefore, under the

rule of reason, Section 9.4.3 and Section 4.5 of Appendix F, Schedule 3, provide sufficient detail regarding the award of FTRs to New Participating TOs.

- E. Whether FTRs should be allocated pursuant to Section 9.4.3 of the ISO Tariff for transmission built by a New Participating TO after it becomes a Participating TO.**

The award of Section 9.4.3 FTRs to New Participating TOs Who Construct New HV Transmission Facilities Would Be Inconsistent With the Limited Purpose of Section 9.4.3 FTRs—to Confer an Initial Inducement to Participation—and May Unduly Discriminate Against the Original Participating TOs

As discussed above, Section 9.4.3 FTRs are designed to provide a hedge to New Participating TOs against Usage Charges that they would not have paid under their Existing Contracts (as well as a limited scheduling priority). Exh. ISO-1 at 8:7-18. Section 9.4.3 serves to emulate the status quo during the transition period. FTRs are not intended to confer a benefit beyond this particular and limited purpose. Exh. SCE-13 at 27. The ISO has not proposed to award FTRs to New Participating TOs in connection with New High Voltage Facilities and questions whether the Commission might find such discrimination against Original Participating TOs justifiable. The May 31st Order only approved an award to FTRs at the time of the execution of the Transmission Control Agreement.

SCE witness Cullier believes that Section 9.4.3 is not sufficiently clear that FTRs are not awarded in connection with New High Voltage Facilities. The ISO has no objection to clarifying Section 9.4.3 in that regard.

The Presiding Judge should find that New Participating TOs should not be awarded Section 9.4.3 FTRs for New High Voltage Facilities and should direct the ISO to clarify Section 9.4.3 in that regard.

- F. Whether Section 7.3.1.6 of the ISO Tariff should be modified to address the situation in which a New Participating TO has been allocated FTRs pursuant to Section 9.4.3 of the ISO Tariff over a jointly-owned interface with an Original Participating TO.**

The ISO Supports Revision to the Definition of Transmission Revenue Credits in Order to Appropriately Clarify the Treatment of Section 9.4.3 FTRs in the ISO Tariff

SCE witness Cuillier has pointed out that the formula for disbursement of Usage Charge revenues to FTR holders and Participating TOs included in ISO Tariff Section 7.3.1.6 fails to account for a situation where a New Participating TO has been provided Section 9.4.3 FTRs over an interface owned jointly with another Participating TO not entitled to Section 9.4.3 FTRs (i.e. an Original Participating TO). *See* SCE-1 at 32:29 – 33:15. Because the New Participating TO's holds Section 9.4.3 FTRs for all of its capacity at the interface, it will be fully compensated in the initial disbursement of Usage Charges to FTR holders (or by sales revenue if it sells the FTRs). Consequently, in this circumstance, the New Participating TO should not participate in the disbursement of Usage Charges based on capacity for which the ISO has not issued FTRs. *Id.* The ISO supports the revisions to ISO Tariff Section 7.3.1.6 proposed by SCE witness Cuillier that appropriately clarify this point. *See* Exh. ISO-33 at 22:19 – 23:10, Exh. SCE-1 at 33:17 – 34:12.

Therefore, the Presiding Judge should direct the ISO to amend Section 7.3.1.6 consistent with the amendment proposed by SCE witness Cullier.

- G. Whether the definition of Transmission Revenue Credits for Original Participating TOs should be revised to 1) reflect the fact that Original Participating TOs often have two roles, Transmission Owner and Energy supplier and 2) address the subtraction of “any charges attributable to the Participating TO (but not those attributable to the FTR Holder) pursuant to Section 7.3.1.7.”**

The ISO Supports Revision to the Definition of Transmission Revenue Credits in Order to Appropriately Clarify the Treatment of Section 9.4.3 FTRs in the ISO Tariff

In addition to the proposed change to the crediting process for Section 9.4.3 FTRs, discussed *supra* in Section IV.B., that has generated some controversy, SCE witness Cuillier proposes to revise the definition of Transmission Revenue Credits in two respects that the ISO agrees are necessary and should not raise any special concern. Exh. ISO-33 at 21:21 – 22:11. The proposed revisions would, consistent with the treatment adopted for New Participating TOs¹⁴, account for the two roles of Original Participating TOs as Transmission Owners and Load serving entities. In their role as Load serving entities, Original Participating TOs may choose to purchase FTRs that earn Usage Charge revenue that is not appropriately reflected in the Transmission Revenue Credit, as would be the case for Usage Charge revenues obtained in their role as Participating TO. *See* Exh. ISO-33 at 21:21 – 22:11, Exh. SCE-1 at 30:7 – 31:12. These dual roles can also apply to New

Participating TOs. The proposed revisions would make this explicit, achieve consistency in the text applicable to Original and New Participating TOs, and thereby avoid confusion.

The Presiding Judge should therefore direct the ISO to amend the definition of Transmission Revenue Credits consistent with the recommendation of SCE witness Cullier.

V. Treatment of Existing Contracts

- A. **Whether the ISO's transmission Access Charge proposal is unjust, unreasonable and unduly discriminatory because it fails to compensate in-kind reliability support provided under Existing Contracts if the Existing Rights holder were to become a Participating TO.**

The ISO's transmission Access Charge Proposal Need Not Provide for Specific Compensation for In-Kind Reliability Support in Order to Be Just, Reasonable and Not Unduly Discriminatory

SWP asserts that it provides in-kind reliability support under its Existing Contracts for which it would not be compensated if it were to become a Participating TO. Exh. SWP-72 at 65:11 – 67:18. SWP asserts that, as a result, the ISO's transmission Access Charge proposal is unjust, unreasonable, or unduly discriminatory and must be revised to allow for the unbundling of SWP's in-kind reliability services. *Id.* at 66:2-3.

¹⁴ See Exh. No. ISO-33 at 22:7-9. See *City of Vernon*, 102 FERC ¶ 63,009 (2003), approved by Comm'n, 102 FERC ¶ 61,141 (2003).

The response to SWP's complaint depends upon the reason that SWP seeks compensation. If SWP can establish that the in-kind reliability services constitute a quantifiable cost that SWP pays for transmission under its Existing Contracts, then the ISO Tariff already accommodates SWP's concerns. As PG&E witness Weingart pointed out, SWP could seek recovery of those costs through its Transmission Revenue Requirement, Tr. at 2305:10-14.

If, on the other hand, SWP is asserting that it deserves compensation because, if it became a Participating TO, it would be providing a benefit to the ISO through the in-kind services under its Existing Contract for which it is no longer compensated, then its argument is unrelated to the transmission Access Charge and beyond the scope of this proceeding. Under Section 2.4.4.3 of the ISO Tariff, when a party to an Existing Contract that has transmission rights ("Existing Rights") turns those rights over to the ISO's Operational Control and becomes a Participating Transmission Owner the transmission rights, which are in effect assigned to the ISO, are thereafter denominated "Converted Rights." Although Section 2.4.4.3.2 of the ISO Tariff encourages the parties to the Existing Contract to negotiate changes to the Existing Contract to avoid inconsistencies with the ISO Tariff, or to seek such changes from the Commission, the ISO Tariff effects no changes other than to the Scheduling rights. The underlying Existing Contract remains intact. The ISO transmission Access Charge does not propose to make any change to the Existing Contracts. Indeed, the ISO cannot make such a

proposal because the ISO is not a party to the Existing Contracts.¹⁵ “Unbundling” of the services providing under SWP’s Existing Contracts is simply not an issue in this proceeding. The Access Charge, as defined, and Converted Rights concern on transmission and do not address any additional services that may have been negotiated as part of the consideration in Existing Contracts..

Moreover, even if unbundling of services were at issue, the record would not support a conclusion that SWP is providing services that, were SWP not otherwise obligated to provide them under its Existing Contract, the ISO would want or need them. For example, the record establishes that SWP cannot meet any of the ISO’s current Reliability Must Run needs. Exh. SWP-5B at 5. It also shows that, in the event that termination of SWP’s in-kind reliability support services created additional Reliability Must Run needs, the ISO would seek to fulfill those needs competitively. Tr. 1856:7-16; 1858:25 – 1859:13. Similarly, the record demonstrates that the ISO does not currently procure the Voltage Support services that SWP wishes to sell, Exh. ISO-33 at 26:2-9, but would also procure them competitively if it needed them. Tr. 1856:7-16; 1858:25 – 1859:13. This proceeding is simply not the appropriate forum for SWP to seek to reform its Existing Contracts, and the Presiding Judge should not allow SWP to accomplish that result through the rubric of the balance of benefits and burdens.

¹⁵ Indeed, the Commission has even prohibited the ISO from interpreting Existing Contracts. *See Pacific Gas & Electric Co.*, 81 FERC ¶ 61,122 (1997).

The Presiding Judge should therefore find that issues concerning SPW's compensation for in-kind reliability support services through reform of its Existing Contracts or the creation of new services under the ISO Tariff are outside the scope of this proceeding.

B. Whether the ISO's transmission Access Charge proposal is unjust, unreasonable and unduly discriminatory against entities who would become New Participating TOs through conversion of Existing Contracts alone.

Arguments that the ISO's Transmission Access Charge Proposal Is Unjust, Unreasonable and Unduly Discriminatory Against Entities Who Would Become New Participating TOs Through Conversion of Existing Contracts Alone Are Collateral Attacks on a Previous Commission Order.

SWP contends the ISO's transmission Access Charge proposal is unjust, unreasonable, or unduly discriminatory because it lacks specific provisions to address New Participating TOs that own no transmission facilities but have Existing Rights that the desires to turn over to ISO Operational Control. SWP has previously argued to the Commission that, as a transmission customer, not a transmission provider, it should not be required to establish a Transmission Revenue Requirement, Transmission Balancing Account, and TO Tariff.

California Indep. Sys. Operator Corp., 88 FERC ¶ 61,156 at 61,527. After the initial orders, SWP requested clarification, and the Commission granted the request, finding:

With regard to [SWP's] concern that because [SWP] is a transmission customer and not a transmission provider certain provisions do not apply to it, we clarify that any Participating Transmission Owner that

has no transmission customers need not develop a Transmission Revenue Balancing Account, a Transmission Revenue Requirement, nor an Access Charge. We direct the ISO to modify its tariff accordingly.

88 FERC at 61,528.

The ISO requested rehearing, explaining that SWP would in fact have transmission customers if it joined the ISO because transactions would be Scheduled using SWP's Converted Rights and SWP would received payment for those Converted Rights. In a second order on rehearing the Commission stated, "[I]f [SWP] joins the ISO by assigning its contract rights, it must, in order to comply with ISO ratemaking, develop a transmission Access Charge with a Transmission Revenue Requirement derived from the rates [SWP] pays to Southern California Edison Company and Pacific Gas & Electric [sic] under its existing contracts." *California Indep. Sys. Operator Corp.*, 94 FERC ¶ 61,393, at 62,269. The rehearing order also concluded that [SWP] must have a TRBA to credit Usage Charge revenues, wheeling revenues, and FTR auction revenues against its Transmission Revenue Requirement. *Id.* In short, the Commission has decided that the ISO Tariff requirement that SWP file a Transmission Revenue Requirement, based on its payments under its Existing Contracts, and a Transmission Revenue Balancing Account is just and reasonable.

That should be the end of the matter. SWP nonetheless contends that more is required. The only specific suggestion that SWP suggests is an ISO Tariff provision concerning the treatment of SWP if it renegotiates its Existing Contracts

such that it pays nothing to the other contractual party, but only pays the ISO transmission Access Charge. In other words, SWP contends that the ISO Tariff treatment of Participating TOs with no transmission facilities, which has been approved by the Commission, is nonetheless unjust, unreasonable, or unduly discriminatory because it does not address hypothetical circumstances regarding which there is no evidence that it might ever arise. The Presiding Judge should dismiss this collateral attack on the Commission's orders.

The Presiding Judge should therefore find that the Commission has already determined that the ISO's provisions regarding the Transmission Revenue Requirement, Transmission Revenue Balancing Account, and Transmission Revenue Credits are just and reasonable as they apply to SWP's circumstances.

VI. High-Low Split: Whether the ISO's proposed procedure for the allocation of the costs of transmission facilities between High Voltage and Low Voltage is just, reasonable and not unduly discriminatory.

The ISO's Allocation Is Just, Reasonable and Not Unduly Discriminatory As Proposed. It Need Not Incorporate a Functional Analysis, a Treatment of Transformers Consistent with Other Equipment, or Assignment of All System Interconnections As High Voltage.

The ISO's proposal includes a methodology for allocating costs between each Participating TOs' High Voltage and Low Voltage Transmission Revenue Requirements ("HVTRR" and "LVTRR," respectively). *See* Exh. ISO-16.

Intervenors have argued for several modifications, however, including that the Commission (i) require the ISO to file the methodology as part of the ISO Tariff (Exh. S-1 at 16:9-28), (ii) alter the methodology for splitting the costs of

substations and transformers (Exh. SWP-67 at 50:9 – 52:19, Exh. S-1 at 12:14-27), and (iii) carve out an exception for certain lower than 200 kV facilities described as “system interconnections” (Exh. PGE-6 at 3:15 – 4:30).

The ISO does not believe that, under the “rule of reason” discussed above, the ISO Tariff must contain a level of detail represented by this procedures. Moreover, the ISO is concerned that a New Participating TO may bring unique circumstances that would introduce new allocation issues that have not been addressed, and the necessity of a tariff amendment would complication the resolution of those issue. Nonetheless, the ISO will not object to an order directed the ISO to incorporate it directly into the ISO Tariff.

Under the ISO’s proposal, except in the case of transformers, when a Participating TO lacks information on equipment by voltage, but has information by facility, the cost of the facilities and equipment is allocated based on the ratio of gross substation investment allocated to the HVTRR to that allocated to the LVTRR. If the Participating TO lacks information on both, the cost of the facilities and voltage is allocated to the HVTRR and the LVTRR according to the Participating TOs transmission system-wide gross plant ratio. Transformers are split evenly between the HVTRR and the LVTRR.

SWP witness Wilson, in the adopted testimony of Mr. Call, objects to this allocation, recommending that the equipment be designated high voltage or low voltage according to a functional analysis. Exh. SWP-67 at 50:9-23, 51:18-52:8. Mr. Wilson’s recommendation would add an unnecessary degree of complexity to

the allocation, as well as open up fertile ground for dispute. Exh. ISO-33 at 29:5-9. Indeed, it is not even clear how it should apply. Mr. Wilson suggests, for example, that transformers should be deemed low voltage because they would not have been built but for the need to deliver Energy to the low voltage system. From a “functional” standpoint, however, every part of the transmission system was built to bring Energy to a low voltage system. As explained by PG&E witness Filippi, the ISO’s proposal is just and reasonable because substations generally receive bulk power and distribute it among lower voltage facilities better able to interconnect with the distribution system. *See* PGE-6 at 2:27 – 3:4. There is no more reason to attribute these facilities to the origin of the power flow than to the destination. A proportional allocation is therefore justified. When information to allocate costs is not readily available, the Commission is willing to accept surrogate methodologies rather than insist on overly complex analyses. *See Utah Power & Light Co.*, 44 FERC ¶ 61,166 at 61,549 and n.11 (1988). The ISO’s proposal is consistent with that approach.

Staff does not object to the ISO’s methodology. Rather, Staff simply contends that the ISO should allocate transformers in the same manner as the remainder of substations. Because transformers are the actual dividing point between the high voltage and low voltage transmission systems voltage systems, that can fairly be described as equally high voltage and low voltage. *See* Exh. ISO-33 at 27:18 – 28:4, Exh. PGE-6 at 3:24 – 4:30. Under such circumstances, it does not appear appropriate to use a surrogate. Although the ISO’s treatment of

transformers may be inconsistent with its treatment of the remainder of substations, the allocation is consistent with the equipment's usage, i.e., the conversion of Energy from high voltage to low voltage. The consistency Staff seeks is not a requirement for a just and reasonable rate.

PG&E witness Filippi argues for an exception treating system interconnection rated significantly lower than 200 kV as high voltage. Mr. Filippi proposes that any transmission facility that links the ISO's High Voltage bulk transmission system to another Control Area, and is used to permit transfers between the two, should be deemed high voltage regardless of its voltage rating.

Mr. Filippi offers no evidence that the ISO's bright-line test is not just, reasonable and not unduly discriminatory, which is a necessary prerequisite for the Presiding Judge to adopt his proposal. Moreover, although Mr. Filippi has shown that the system interconnections in question connect separate bulk transmission systems, he has not shown that any of the facilities listed in Exhibit No. PGE-6-1 are regularly used for, or capable of, bulk transmission. Moreover, Mr. Filippi's exception to the "bright line" test would invite other exceptions; the same justification could be used for interconnections between Zones. Mr. Filippi has not demonstrated that the facilities merit special treatment.

The Presiding Judge should therefore find that the ISO's proposed procedure for the allocation of the costs of transmission facilities between high voltage and low voltage is just, reasonable and not unduly discriminatory.

VII. Time-of-Use Rates

- A. **Whether the ISO's proposed transmission Access Charge methodology is just, reasonable and not unduly discriminatory without employing time-of-use or coincident peak rates.**

The ISO's Transmission Access Charge Methodology, in Combination with the ISO's Congestion Management and Transmission Losses Charges, Is a Just, Reasonable, and Not Unduly Discriminatory Rate Design

As will be shown below, the ISO's proposed rate design is fully consistent with Commission transmission rate-making policy and principles, and previous Commission decisions have so found. Witnesses for SWP and MWD/SWC, however, have contended that the ISO's transmission Access Charge methodology is not just, reasonable, and unduly discriminatory because it fails to employ a time-of-use or coincident peak methodology. They have made three, somewhat overlapping, classes of arguments: first, that the ISO's transmission Access Charge is inconsistent with cost causation principles; second, that the ISO's transmission Access Charge is inconsistent with transmission rate making principles, in particular, the Commission's Transmission Pricing Policy; and third, that the ISO's transmission Access Charge fails to send appropriate price signals.

1. **The ISO's Transmission Access Charge Is Consistent with Cost Causation Principles.**

The ISO's transmission Access Charge proposal is consistent with cost causation principles because the fixed costs of the ISO Controlled Grid are borne by those who benefit from it, i.e., regardless of the time of day, the day of the month, or the month of the year when they use it. Dr. Wilson and Mr. Russell,

however, contend that cost causation requires that costs must be borne by the class of customers that caused them to be incurred in the first instance. Exh. SWP-65 at 7:9-8:2; Exh. SWC-1 at 21:1-22:12. They concluded from this principle that *all* (via coincident peak pricing) or *most* (via time-of-use rates) of the fixed transmission costs should be assigned to on-peak end use customers.¹⁶ Tr. at 2059:22 – 2060:9.

As the ISO has previously argued to the Presiding Judge in another proceeding, Docket No. ER01-313, this is not a limitation that the Commission accepts. For example, if an interconnection request requires transmission system upgrades that benefit all users of the grid, the Commission generally requires that the costs be assigned to all users of the Grid, not just to the entity requesting the interconnection. *See, e.g., Western Mass. Elec. Co.*, 66 FERC ¶ 61,167 (1994), *aff'd, Western Mass. Elec. Co. v. FERC*, 165 F.3d 922 (D.C. Cir. 1999). Citing *Western Massachusetts* for the proposition that “[e]ven if a customer can be said to have caused the addition of a grid facility, the addition represents a system expansion used by and benefiting all users due to the integrated nature of the

¹⁶ Under coincident-peak pricing, transmission charges would only be imposed only on customer loads during monthly coincident peak hours (i.e., the particular hour with the highest load in a particular month). No charges would apply to load during any of the other hours in the month. Total charges in any particular month would be based on the customers’ average coincident peak loads of current and previous 11 months. In contrast, under TOU pricing, a greater proportion of total transmission costs would be recovered from each MWh of load during peak load periods (i.e., Monday through Saturday from 6:00 a.m. through 10:00 pm); the charge per MWh during off-peak hours would be less. *See* SWC-19.

grid,” the Commission has explicitly noted, “This treatment does not violate cost causation principles.” *Removing Obstacles to Increased Electric Generation And Natural Gas Supply In The Western United States*, 96 FERC ¶ 61,155 at 61,674 (2001). *See also California Indep. Sys. Operator Corp.*, 97 FERC ¶ 61,149 at 61,648 (2001).

In Docket No. ER01-313, the Presiding Judge rejected the limited readings of cost causation principles, and, in its order on the Initial Decision, the Commission affirmed her analysis:

[Cost causation] principles . . . have authoritatively been described thusly: "Properly designed rates should produce revenues from each class of customers, which match, as closely as practicable, the costs to serve each class of individual customers." While this fundamental idea of matching costs to customers is often referred to in terms of cost causation, it has also often been described in terms of the costs which "should be borne by those who benefit from them." Indeed, in a recent order rejecting arguments that ISO-related costs should not be assigned to PG&E's existing contract customers, the Commission expressly stated:

Concerning the application of cost causation principles . . . enhanced reliability and market development resulting from industry restructuring are benefits that are distributed across the spectrum of Energy participants.

Thus, the Initial Decision accurately characterized cost causation and received benefits as alternate means of expressing the same concept.

California Indep. Sys. Operator Corp., 103 FERC ¶ 61,114 at P 26 (footnotes omitted). The same principles should govern this proceeding. Thus, Dr. Wilson's

and Mr. Russell's arguments are flawed *ab initio* because they have chosen to ignore or reject the Commission-approved interpretation of the cost causation principles and insist upon their own.

Even if one were to accept, *arguendo*, the interpretation of cost causation principles advanced by Dr. Wilson and Mr. Russell, the facts would not support a conclusion that peak end use customers so overwhelmingly drive the need for transmission construction and expansion that they should either bear all transmission costs (via coincident peak pricing) or at least the brunt of them (via time-of-use rates).

As an initial matter, one cannot equate on-peak Energy end use or Demand, with peak transmission usage. For example, if a north-south path has a rated capacity of 3200 MW, and there is a 4500 MW Demand in the South being served by 4500 MW Generation in the North, and a 4000 MW Demand in the North being served by 4000 MW Generation in the South, then there is 8500 MW of peak Energy end use, a net flow of 500 MW, and the path still has 2700 MW of *unused* transmission capacity. There is no Congestion and no problem with utilization of transmission capacity. In contrast, if there is a 4000 MW Demand in the South being served by 4000 MW Generation in the North, and a 500 MW Demand in the North being served by 500 MW Generation in the South, then there is only 4500 MW of peak Energy end use, but the net flow of 3500 is greater than the path capacity. In this case, the path has 0 MW of unused capacity, is congested, and is unable to serve the entire Demand. Additional capacity is

needed to serve the off-peak Demand in the presence of Congestion, but no additional capacity is needed to serve the on-peak Demand in the absence of Congestion. Dr. Wilson recognized and agreed with these facts. *See* Tr. 1975:15 – 1976:22.

Congestion is thus an important and often a more appropriate measure of transmission usage than peak end-use Demand. To evaluate the arguments for time-of-use and coincident peak rates, Mr. Pfeifenberger performed a study of all major transmission paths in California from April 1998 through March 2003 and demonstrated conclusively that there is no correlation between on-peak Demand and Congestion. Exh. ISO-36 at 7:1-11:13; Tr. at 1000:12-19.¹⁷ Although counsel for MWD/SWC showed on cross-examination that there is also no correlation between off peak Energy use and Congestion (Tr. at 966:24 – 970:23),¹⁸ he simply reinforced the conclusion that the need to expand transmission in order to relieve

¹⁷ The data showed that Congestion frequently occurred during off-peak hours and on some paths, such as Path 15 in the North-South direction, Eldorado, Path 26, and Palo Verde, more often during off-peak hours than during peak load hours. The data also showed that Congestion prices frequently were higher during off-peak hours than during peak load hours. For example, in the Hour Ahead Market, the average price of off-peak Congestion consistently has exceeded the average price of on-peak Congestion on Path 15. ISO-36 at 9:1 – 10:8.

¹⁸ Using certain criteria for cost and frequency that he established to define whether Congestion is significant and prevalent, counsel for MWD/SWC showed that Congestion was not significant or prevalent in most of the off-peak periods in which Mr. Pfeifenberger's studies identified Congestion as having occurred. Exh. SWC-31; Tr. at 1000.21 – 1001.1.

Congestion cannot be associated with any level of Energy use, whether peak or off-peak.¹⁹

Mr. Russell attempted to counter these facts by arguing that transmission expansion is driven primarily by reliability concerns, and that reliability concerns are driven by on-peak Demand. Exh. SWC-24 at 5:1 – 7:17. In support of his conclusion, Mr. Russell offered a summary table of the ISO's transmission upgrade projects, Exh. SWC-25, that showed a majority of the ISO's transmission upgrades were for reliability purposes, from which he concluded that transmission upgrades are driven by on-peak Demand. For his conclusion that reliability concerns are driven by on-peak Demand, Mr. Russell relied primarily on his own knowledge, on certain planning documents of the Participating Transmission Owners, and on portions of WECC Planning Criteria. SWC-1 at 26:8-28:21; SWC-24 at 9:6-10:16; Tr. at 2096 at 1721. Mr. Russell has drawn overly broad conclusions from the evidence available to him, which does not in fact support his analysis.

First, the evidence available demonstrates persuasively that peak Demand is not the sole driving force of reliability planning, but only one of many factors in

¹⁹ Using counsel's own criteria, Congestion was neither significant nor prevalent in most of the on-peak periods in which Mr. Pfeifenberger's study identified Congestion as having occurred. Indeed, as Mr. Pfeifenberger explained, based on counsel's criteria, on two major paths (Mead and Path 15) Congestion was never more prevalent during peak periods; and on 4 out of 7 major paths Congestion was never more prevalent during peak hours in the last four years. Exh. ISO-43; Tr. at 1001:19 – 1002:21.

ISO planning for reliability purposes. Ms. Le Vine testified for transmission planning purposes, the ISO studies 8 scenarios for reliability purposes, on-peak and off-peak Load conditions in each of the four seasons. Tr. at 682:17-22. Even the WECC Planning Criteria upon which Mr. Russell relied are clear that transmission planners must consider the reliability of the transmission system at all times. Tr. at 2104:19 – 2105:19; Exh. ISO-58 at 3, 7 and 10. Further, the planning documents of the Participating Transmission Owners upon which Mr. Russell relied plainly establish that significant portions of the transmission systems of the Participating Transmission Owners experience reliability problems during off-peak periods and need to be analyzed from a reliability perspective under both peak and off-peak Load conditions. Tr. at 2092:10 - 2100:24. Moreover, ISO planning documents indicate that enhancing reliability is only one of six considerations in planning for transmission expansion. Exh. ISO-57.

Second, Mr. Russell's analysis of the ISO's transmission expansions is flawed. On cross-examination, Mr. Russell acknowledged that several of the high voltage transmission projects he analyzed in Exh. SWC-25 were projects in areas that had been identified by Participating TOs as areas that are stressed during low Load conditions or are areas that are analyzed under off-peak as well as on-peak Load conditions. Tr. at 2094:8-16, 2095:12-2096:1, 2096:7-12. Mr. Russell admitted he had made no effort to determine whether the need for these projects had been analyzed under low Load or off-peak conditions or to determine whether the need for these project was driven by reliability concerns during on-peak or off-

peak periods. *Id.* Accordingly, there is no basis to conclude that these projects were driven solely or primarily by on-peak Demand. In addition, Mr. Russell stated that he considered as on-peak Demand reliability-driven transmission expansions that were identified as due to Generator Interconnections. Tr. at 2090:21 - 2091:9. Generator Interconnections, however, are generally initiated by Generators, not by the ISO or Participating Transmission Owners. ISO Tariff § 5.7.2, Exh. J-2. The only logical assumption is that Generators investment are mostly economically motivated, and that the decision to enter the market depends more upon the ability to displace more expensive Energy than on a desire to enhance grid reliability. Again, there is no basis to conclude these projects are driven solely or primarily by on-peak Demand. Mr. Russell's count of reliability-related and, by his reasoning, on-peak Demand-driven high voltage transmission projects also included project identified as needed for voltage support. Tr. at 2094:23-24. He later stated, however, that voltage support is primarily an off-peak concern. Tr. at 2106:13-18; Exh. ISO-58 at 34.

Neither SWP nor MWD/SWC has denied that Congestion-driven, or economically driven, transmission expansions constitute a significant portion of the ISO's transmission expansion projects. Major examples include the recent expansion of Path 15, Exh. ISO-36 at 19:6-8, and the planned expansion of Path 26, Exh. ISO-60. As Mr. Pfeifenberger's analysis shows, during a significant portion of the ISO's operational history these two major transmission paths have been heavily congested during off-peak periods. Exh. ISO-37.

Accordingly, the evidence regarding MWD/SCW's cost causation argument can be summarized as follows. First, the majority of ISO transmission expansion projects are driven by reliability concerns; but a significant number are driven by economics, Generator Interconnections, and other reasons that have no correlation to on-peak Demand. The exact split is unclear. Second, some of the reliability driven transmission expansion projects may have been driven by off-peak concerns; the number is unclear from the record, but the existence of such projects further militates against a strong correlation of transmission expansion with on-peak Demand. Third, on-peak Demand is a very significant factor in ISO transmission planning for reliability purposes, but it is only one of many factors. In short, on-peak Demand is *one of many factors* that drives *a portion* of the ISO's high voltage transmission expansion. Based on this evidence, MWD/SWC would have the Presiding Judge conclude that the ISO's transmission Access Charge violates cost causation principles because it is not built *entirely around that one factor*: on-peak Demand. There is no precedent or logic for such a conclusion.

Dr. Wilson, in response to Mr. Pfeifenberger's study, persists in his contention that time-of-use rates are necessary because they assess the cost of transmission expansions to those who cause Congestion.²⁰ In order to support his

²⁰ A significant portion of Dr. Wilson's Reply Testimony is devoted to demonstrating that the ISO's Congestion charges do not accomplish this goal, see, e.g., SWP-87 at 6:5-14, although the ISO has never contended they do. Dr. Wilson also erroneously asserts that the Participating Transmission Owner's recover their Transmission Revenue Requirement entirely through the Access

argument, Dr. Wilson attempts to undercut Mr. Pfeifenberger's study with a number of unsupported and generally irrelevant contentions.

First, Dr. Wilson states his "understanding" that a substantial portion of the off-peak usage of a number of the lines, such as Path 15, represented power returns to the northwest, and is therefore attributable to peak Load. He suggests that such power returns can easily be rescheduled, and states that he is "unaware" of any instances in which off-peak economy Energy transactions have driven transmission investment. Exh. SWP-87 at 12:12-14. As an initial matter, the source of the Congestion makes little difference; at the times in question, additional capacity was necessary. Moreover, Mr. Wilson provides no basis for his understanding. He makes no effort to identify the number of lines affected. In fact, a number of the paths studied by Mr. Pfeifenberger would not be affected by power returns to the northwest. Exh. ISO-41. One must also wonder why Congestion did exist if the Congestion was due to power returns that are easily rescheduled? The ISO's Scheduling process provides Scheduling Coordinators an opportunity to readjust Schedules to avoid Congestion. ISO Tariff, § 2.2.12.8, Exh. J-2. If the power returns were in fact adjusted, then the Congestion was not due to the power returns. If they were not, then either the Scheduling

Charge, when, in fact, they recover it through the Access Charge and Congestion charges (both directly through Usage Charges and indirectly through FTR revenues.). *See* ISO Tariff § 7.1, Appendix A, Definition of Transmission Revenue Credit, Exh. J-2; *see also* Tr. 1988:10 – 1989:19.

Coordinators responsible paid Usage Charges, Section 2.2.12.8.2, or the ISO redispached the Schedule, defeating the purpose of the power return, Section 2.2.12.8.1, options that would obviously not be chosen if the power return could be easily rescheduled. Finally, Dr. Wilson's lack of awareness proves nothing.

Next, Dr. Wilson notes that Mr. Pfeifenberger did not examine the entire system, and that total network transmission loading is greatest at the time of system peak even if certain paths are used more heavily during off-peak. He also suggests that Lower loads during off-peak periods provide greater flexibility to address Congestion. Exh. SWP-87 at 13. This comment reflects the central misunderstanding Mr. Pfeifenberger attempted to address. As Dr. Wilson himself admitted on the stand, transmission capacity utilization is only an issue if there is Congestion. Although, as discussed above, peak Energy Demand is one, but not the exclusive, consideration in planning for system reliability, Exh. ISO-36 at 17:16-26, Mr. Pfeifenberger's study demonstrated that Congestion, which drives economic transmission expansions and will often reflect reliability concerns, Tr. at 939:4 – 940:11 is not correlated with peak Energy Demand. Exh. ISO-36 at 7:6-15.

Dr. Wilson also contends that Mr. Pfeifenberger's study should be disregarded because it is distorted by the California power crisis and market manipulation. SWP-87 at 13. Dr. Wilson is correct that the total amount of Congestion increased during this period. *Id.* At 13:16-20. Dr. Wilson, however, provides no analysis or support to indicate that the power crisis would have any

effect on whether Congestion occurred on-peak or off-peak. In fact, Mr. Pfeifenberger testified, and his data show, that the pattern of Congestion was consistent in its lack of correlation with on-peak Demand throughout the period he studied. Exh. ISO-36 at 7:6-11:8; Exh. ISO-37. Dr. Wilson offers nothing to contradict this conclusion.

Finally, Dr. Wilson points to Mr. Pfeifenberger's failure to take phantom Congestion into account in his study. However, Mr. Pfeifenberger's analysis fully reflects the effect of phantom Congestion and there is Dr. Wilson has provided no evidence to document that the correlation of phantom Congestion with peak and off-peak periods differs from the correlation of actual Congestion with these time periods.²¹

Thus, even if the Presiding Judge were to reject the Commission's broader interpretation of cost causation principles and adopt the narrow interpretation offered by witnesses for SWP and MWD/SWC, there is no basis to conclude that the ISO's proposal must include time-of-use or coincident peak rates in order to be just, reasonable, and not unduly prejudicial.

²¹ As Mr. Pfeifenberger noted, the separate consideration of phantom Congestion in his analysis might leave his conclusions entirely unaffected because he did not think that phantom Congestion was a function of peak versus off-peak periods. Exh. SWP-88 at 4 (excerpt of Pfeifenberger deposition transcript). Although Dr. Wilson claims that phantom Congestion distorts Mr. Pfeifenberger's analysis (Exh. SWP-87 at 14), he has provided absolutely no evidence in support of his assertion.

2. **The ISO's Transmission Access Charge Proposal Is Consistent with the Commission Transmission Pricing Policy**

Witnesses for SWP and MWD/SWC have also asserted that the ISO's proposal is unjust and unreasonable because it violates various economic and policy principles, including those set forth in the Commission's Transmission Pricing Policy.²² Because, as discussed above, the ISO believes that the Presiding Judge must be guided by Commission precedent, the ISO will focus on the Commission's Pricing Policy.²³

In evaluating the ISO's transmission Access Charge against the Commission's Pricing Policy, the Presiding Judge should consider the overall mechanism by which the Participating Transmission Owners recover their Transmission Revenue Requirements: the Access Charge and the Usage Charges (Congestion revenues). ISO Tariff §§ 7.1 – 7.4, Exh. J-2. As described by Mr. Pfeifenberger, the ISO's pricing structure for transmission service reflects these two elements: prices designed to recover short-run marginal costs (Congestion and losses) and a flat, volumetric (i.e., \$/MWh) Access Charge to raise the

²² In Dr. Wilson's adopted testimony of Mr. Call, he referred to the Commission's gas pricing policies, including the need to maximize throughput. Dr. Wilson acknowledged that the mechanics of natural gas transmission were significantly different than the transmission of electricity, and that the Commission's pricing principles could not easily be applied. He also acknowledged that transmission capacity is the most appropriate analogy to throughput, and that transmission capacity is only an issue when there is Congestion. Tr. 1974:9 – 1975:18.

²³ To the extent parties rely upon other economic principles in their briefs, the ISO will address them on reply.

remaining revenue necessary to cover the fixed cost of transmission service. *See* Exh. ISO-36 at 3:9-20.

The fatal flaw with arguments that this combined pricing structure violates the Commission's Transmission Pricing Policy is that the Commission has already ruled that it does not. In its July 17, 1997, order on the Phase II filings regarding the ISO Tariff, the Commission examined the proposed structure, which it described as "1) an access fee designed to recover each Participating TO's revenue requirement; and 2) a Congestion usage charge that will apply only to those users of congested transmission." *Pacific Gas & Elec. Co.*, 80 FERC ¶ 61,128 at 61,428 (1997) (footnote omitted). The Commission concluded, with regard to the Transmission Pricing Policy Statement:

Principle No. 1=Meets the Revenue Requirement.

A conforming pricing proposal must generate revenues that do not exceed the transmission owner's revenue requirement. The ISO's proposal satisfies this principle. The combined revenues received by any transmission owner from access charges and Congestion charges would not exceed its embedded cost revenue requirement. Any Congestion revenues received by a transmission owner would be used to reduce its access fee.

Principle No. 2=Reflects Comparability.

Any new transmission pricing proposal must meet the Commission's comparability standard. All users of the ISO Grid would pay an embedded-cost- based access fee and, to the extent they utilized a congested transmission path, Congestion charges. Therefore, the ISO's proposal satisfies our comparability principle.

Principle No. 3=Promotes Economic Efficiency.

Transmission pricing should promote: 1) efficient expansion of transmission capacity; 2) efficient location of new generation and load; 3) efficient use of existing transmission facilities, including constrained capacity; and 4) efficient dispatch of generating resources. For reasons explained above, the ISO's transmission pricing proposal would promote an efficient use of the existing generation and transmission facilities and promotes efficient expansion.

Principle No. 4=Promotes Fairness.

The ISO's proposal is fair. The ISO's proposed pricing framework does not distinguish between different classes of transmission customers. Secondly, the ISO's proposed transmission pricing proposal mitigates the economic harm imposed on customers by preventing any cost-shifting during the transition period.

Principle No. 5=Pricing Should Be PractiCalifornia

To satisfy this principle we require that a user should be able to calculate how much it will be charged for transmission service. ISO customers will be able to ascertain the cost of transmission service. ISO customers will be assessed a clearly stated access charge. In addition, ISO customers will have access to ISO-posted information and will have the opportunity to adjust their usage based on forecasted Congestion. While the Commission recognizes that Congestion pricing is complex, we believe that the gains in efficiency outweigh the burden of such complexity.

Id. at 61,430.

The ISO fully acknowledges that there have been flaws in the Congestion management portion of this structure. Those flaws, however, are being addressed in another proceeding, and the Commission has strongly endorsed the management system and rate design proposed by the ISO. *See California Indep.*

Sys. Operator Corp., 100 FERC ¶ 61,060 at P 3 (2002). There are therefore no changed circumstances that would justify altering the Commission conclusion about the ISO's pricing structure.

Moreover, SWP and MWD/SWC cannot avoid the fact that the Commission has more recently also approved as just and reasonable a flat, volumetric access charge for the New York ISO. Exh. SWC-23. Although Mr. Russell attempted to distinguish the NY ISO's access charge on the basis that the charge is assessed to net load, rather than gross load, such a distinction bears no relevance to the question of whether time-of-use or coincident peak rates are a prerequisite to a finding that rate structure is just and reasonable.

Finally, although SWP or MWD/SWC might point to the Commission's Proposed Rulemaking on Standard Market Design ("SMD")—which proposed coincident peak transmission rates²⁴—as an intervening factor that would invalidate its previous approval of a flat, volumetric rate combined with a Congestion charge, the SMD is not a factor here. First, the SMD remains only a proposal. Second, and more important, in its subsequent White Paper, the Commission stated that it would not propose to be as proscriptive as in the SMD, would not require strict adherence to all aspects of the SMD, and would leave

²⁴ *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*, FERC Stats. & Regs. ¶ 32,563 at 34,317 n.103 (2002).

room for regional variations in transmission rates. *See White Paper: Wholesale Market Power Platform* at 5-6 (April 28, 2003).

In short, the Commission has already ruled that the ISO's pricing structure of a flat, volumetric transmission Access Charge, combined with Congestion charges, is consistent with the Transmission Pricing Policy Statement. There is no reason to disturb that ruling.

3. **The ISO's Proposed Transmission Rate Structure Provides Appropriate Price Signals**

Witnesses for SWP and MWD/SWC have contended that the ISO's transmission Access Charge proposal, unlike coincident peak and time-of-use rates, fails to send appropriate price signals. They are correct to the extent that the ISO's transmission Access Charge is not, *by itself*, intended to send a price signal, but rather to recover revenue requirements in a fashion that least distorts the market. Exh. ISO-36 at 13:22-14:8. As discussed above, the transmission Access Charge is part of a transmission rate structure that also includes Transmission Losses and Congestion costs. The ISO's Congestion charges provide the necessary price signal to transmission users regarding the use of the grid during the transmission "peak", *i.e.*, congested, period. In economic terms, as described by Mr. Pfeifenberger, Congestion charges reflect the marginal cost of using

constrained transmission paths and thus provide efficient price signals. Exh. ISO 36 at 13:22-23.²⁵

Dr. Wilson and Mr. Russell nonetheless contend that these existing time-differentiated price signals are inadequate because they are too “short term.” In response, Mr. Pfeifenberger explained that the Congestion charges, although technically short terms, will influence long term behavior. The persistence of Congestion over a period of time between two points on the transmission grid signal the potential value of expanding transmission capacity (or generating capacity) to mitigate the constraint. Conversely, if Congestion occurs infrequently on a given path, Market Participants will recognize that expansion of the path is unlikely to be economical. California ISO-36 at 21:19-22:4. In addition, market participants will take short-term Energy, capacity, Ancillary Service and Congestion prices into account when making their investment decisions. The expectation of these short-term price signals in the future will influence any longer-term decisions by Market Participants. *Id* at 22:6-22:9. *See also* Tr. at 917:4 – 918:17. Mr. Hansen also appears to agree with this point when he testifies

²⁵ As Mr. Pfeifenberger also explained, under the ISO’s current Congestion management system, both Inter-Zonal Congestion (across the transmission paths connecting individual zones) and intra-zonal Congestion (within zones) already are time differentiated charges. (Tr. at 910:13-24). From an End User perspective, these time and location differentiated transmission charges combine with a number of other location and time differentiated charges, such as prices for Energy and reserves. Tr. at 907:20 – 908:5.

that Congestion charges “[n]o matter how stable or volatile, ... provide signals that influence current and future decisions” Exh. SCE-29 at 34.

The ISO’s Congestion management system also provides for the determination of long-term Congestion prices. When Market Participants purchase Firm Transmission Rights (“FTRs”) as a financial hedge against the uncertain cost of Congestion charges, they do so at prices that reflect the market’s estimate of annual Congestion costs over the major transmission paths. A rational buyer will not pay more for an FTR than his discounted, present value estimate of the expected cost of future Congestion. Thus, the market is already setting such longer-term Congestion prices through the value of FTRs.

Most importantly, however, when Dr. Wilson and Mr. Russell contend that Congestion prices provide inadequate price signals, they once again reject unambiguous Commission precedent. Although the Commission’s order on the ISO’s Market Redesign proposal was issued during the course of the hearing, it is representative of Commission policy and is particularly apt because it describes the Congestion management that will be part of the rate structure that includes the transmission Access Charge. Regarding the ISO’s proposal to replace its current Congestion management with a Locational Marginal Pricing (“LMP”) system, the Commission concluded:

LMP is supported by the Commission as a Congestion management system because it makes transparent what the true marginal cost of Congestion is to transmission customers. We don’t disagree with CERS that LMP is only one factor that may influence investment.

Because nodal prices will be published by the ISO, i.e., prices will be transparent, *these price signals will, over time, provide a market signal that will serve to enable appropriate decisions concerning investment* in new generation, transmission and demand response. Accordingly, we find the [ISO's] adoption of LMP for managing Congestion in its markets to be appropriate.

We find that the [ISO's] proposal to adopt a Congestion management system based on LMP will promote more efficient use of the transmission grid, promote the use of the lowest-cost generation, provide for transparent price signals, and enable the transmission grid operators to operate the grid more reliably. Therefore, we approve the [ISO's] adoption of LMP for managing Congestion in its markets.

105 FERC ¶ 61,140 at P 50 (2003) (emphasis added).

Moreover, the testimony about the price signals sent by time-of-use and coincident peak Access Charges does not undermine the conclusion that the ISO's proposal is just, reasonable, and not unduly discriminatory. Indeed, as discussed in section I above, even if the price signals had some advantages over that sent by the ISO's Congestion management, it would not be reason to reject the ISO's proposal. In actuality, however, adoption of time-of-use or coincident peak rates would provide no significant improvement in the price signals sent by transmission pricing.

First, the time-of-use and coincident peak rates send a price signal regarding Energy use, not transmission utilization. As discussed above, these price signals are not correlated with Congestion, are unrelated to transmission

investments attributable to generator interconnections, and could affect only one of many factors that influence reliability-related expansions.

Second, most residential customers do not have in place time-of-use meters, so they would be incapable of receiving or responding to the price signal. Tr. at 907:15-19; 908:6-7. Time of use retail residential Energy rates are only experimental in California. Exh. ISO-54; Tr. at 1956:20-21. It is also questionable whether any retail customer would receive the price signal sent by coincident peak rates, to the extent that they do, it is likely a muted price signal. Tr. 2071:13-2072:20. Moreover, transmission constitutes such a small portion of the overall electricity rate²⁶ that any price signal—whether retail or wholesale, residential, industrial or commercial—would add little to the price signal sent by time differentiated Energy rates. Tr. at 918:5-17. Typical retail transmission rates are not time-of-use. See Exhs. ISO-54 – ISO-56. Nonetheless, SWP, for example, who pays time-differentiated Energy rates (*and* whose Existing Contract for transmission is *not* time-of-use) has already transferred as much of its Energy consumption to off-peak as it can. Tr. at 1840:7-15. On redirect, with prompting from his counsel, SWP witness Jones indicated that SWP *might* build another reservoir if given the incentive from time of use rates, but it is difficult to image

²⁶ For example, in the May 31st Order, the Commission noted ISO data showing transmission rates to be 3.1% of the typical residential bill. 91 FERC ¶ 61,205 at 61,725.

that the decision to build a new reservoir would be determined by the relative savings that would result from time-of-use rates.

Third, although Dr. Wilson and Mr. Russell asserted that time-of-use and coincident peak rates would send price signals regarding the location and type of new Generation, they acknowledge that the Access Charge is paid by Load, not Generators, and thus could have no effect on a Generator's decision. The most impact Mr. Russell could described was a price signal about whether base load or peaking Generation was necessary and the generalization that base load Generation tended to be located in remote areas.

Indeed, transmission time-of-use rates or coincident peak rates may even be counterproductive. Mr. Pfeifenberger testified that such rates could degrade the price signal sent by Congestion charges. Tr. at 933:23 – 934:3.

Therefore, the Presiding Judge should find that the ISO's transmission Access Charge proposal is consistent with cost causation in that it assigns the fixed costs of transmission facilities to those that make use of the transmission grid. In addition, consistent with previous Commission decisions, the Presiding Judge should find that the ISO's overall transmission rate design, comprising the Access Charge, Congestion charges, and Transmission Losses, is consistent with the Commission Transmission Pricing Policy Statement and sends appropriate transmission pricing signals.

- B. If the ISO transmission Access Charge proposal is unjust, unreasonable and unduly discriminatory, is a time-of-use or coincident peak methodology just, reasonable and not unduly discriminatory for the transmission Access Charge methodology.**

Because the ISO's Proposal Is Just, Reasonable, and Not Unduly Discriminatory, This Issue Is Not Applicable.

- VIII. Guidelines for Economic Benefit Analysis: Is Amendment No. 49 unjust, unreasonable and unduly nondiscriminatory because it failed to provide guidelines filed with the Commission for the analysis of the economic benefits of proposed transmission expansions.**

The ISO Does Not Object to an Order Directing the Filing of the Guidelines After They Are Finalized

As Ms. Le Vine testified, the ISO has been working with stakeholders to develop appropriate guidelines for the analysis of the economic benefits of proposed transmission expansions. Tr. at 388:4-20. Unfortunately, the ISO has not had the opportunity to test those guidelines on an economically driven transmission project. Tr. at 388:21 – 389:7. The ISO believes it would be premature to file the guidelines prior to a determination that they are workable. Tr. at 389:2-5. The ISO intends to file guidelines once they are finalized. Tr. at 389:8-10.

IX. Definitions

- A. Whether the definition of PTO Service Area is just, reasonable and not unduly discriminatory.**

This Issue Has Been Resolved by Stipulation.

The ISO has agreed to work with the parties to develop a new definition of PTO Service Area and, regardless of whether agreement is reached, to file a new

definition under Section 205 of the FPA within 75 of the close of the record in this proceeding.

B. Whether or not the definition of Transmission Revenue Credit must be revised to be consistent with Opinion No. 458.

Staff's Recommendation to Revise the Definition of Transmission Revenue Credit Is Beyond the Scope of this Proceeding and Its Reliance on Opinion No. 458 Is Inapt

Ms. Patterson, on behalf of Staff, recommends that the definition of Transmission Revenue Credit be revised to reflect the Commission's Opinion No. 458, 100 FERC ¶ 61,156 (2002). Exh. No. S-5 at 39:10 – 40:6. Opinion No. 458 involved the TO Tariffs, not the ISO Tariff.. Ms. Patterson argues that the Commission's rulings in Order No. 458 would make a portion of the definition of Transmission Revenue Credit irrelevant. *Id.* at 40:1-3.

The ISO opposes this recommendation. The ISO has not proposed anything in Amendments No. 27, No. 34, or No. 49 that would affect that aspect of the definition of Transmission Revenue Credit. The Commission has not ordered the ISO to modify the definition and has not commenced a proceeding under Section 206 to modify it. Moreover, the Commission did not conclude that a portion of the definition of Transmission Revenue Requirement was irrelevant. Rather, it concluded that it controlled the ISO's collection of costs, and not a Participating TOs' recovery of its Transmission Revenue Requirement.

Perhaps more significantly, Opinion No. 458 is no longer relevant because Amendment No. 27 had erased entirely the basis for the Commission's Opinion.

Opinion No. 458 was based on the ISO Tariff prior to Amendment No. 27. As noted, in that Order, the Commission concluded that the definition of Transmission Revenue Credit did not control how a Participating TO recovers its Transmission Revenue Requirement, but only how the ISO collected funds. Based on the Commission approval of the grid-wide rate, there is now no question that the ISO Tariff, including the definition of Transmission Revenue Requirement, *does* control a Participating TOs recovery of its Transmission Revenue Requirement. As a result, the Commission's reasoning in Opinion No. 458 and Opinion No. 458-A is no longer applicable.

Therefore, the Presiding Judge should determine that it is not necessary to revise the definition of Transmission Revenue Credits in order to address Opinion No. 458.

X. Issues Resolved by Stipulation

A. Whether the definition of Gross Load is just, reasonable and not unduly discriminatory.

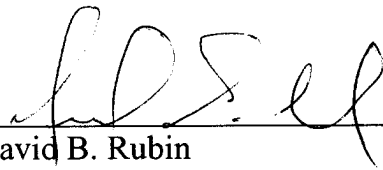
The ISO requests that the Presiding Judge in the Initial Decision direct the ISO to revise the ISO Tariff consistent with her order of October 9, 2003.

B. Whether the ISO's treatment of Metered Subsystems is just, reasonable and not unduly discriminatory.

The stipulation provided generally that issues concerning the treatment of Metered Subsystems were not at issue, and would not be determined, in this proceeding.

Respectfully submitted,

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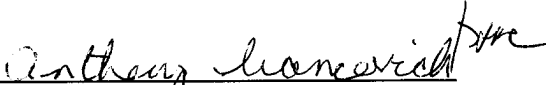


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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the restricted service list compiled by the Presiding Administrative Law Judge in this proceeding.

Dated at Folsom, CA, on this 17th day of December, 2003.


Anthony Ivanovich
Anthony Ivanovich