

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

**The Nevada Hydro Company, Inc.) Docket Nos. ER06-278-000
) ER06-278-001**

**REPLY COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

Pursuant to the Commission’s November 17, 2006 order in this proceeding, *The Nevada Hydro Company, Inc.*, Order on Rate Request, 117 FERC ¶ 61,204 (2006) (“November 17 Order”), the California Independent System Operator Corporation (“CAISO”)¹ submits its reply comments in response to the filings submitted by The Nevada Hydro Company, Inc. (“TNHC”) and Devine Tarbell & Associates (“DTA”) in this proceeding on June 14, 2007. To the extent the Commission determines that leave is required to submit these reply comments, the CAISO respectfully requests such leave.²

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

² The CAISO believes that it does not require leave to submit these reply comments. As explained below, the CAISO submitted comments in this proceeding pursuant to directives contained in a Commission order, and parties, including TNHC and DTA, subsequently filed responses to the CAISO’s comments. Therefore, those responses constituted reply comments, despite TNHC’s styling of its filing as an “answer” and DTA’s failure to characterize its filing. Section 213(a)(3) of the Commission’s rules permit the filing of further reply comments or answers in response to reply comments without the need to seek leave. See 18 C.F.R. § 385.213(a)(3) (permitting an answer without permission of the decisional authority to any pleading other than a protest, a motion for oral argument, or a request for rehearing). However, to the extent that the Commission considers the instant filing to be an answer to an answer, the CAISO requests waiver, pursuant to Rule 212, 18 C.F.R. § 385.212, of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make this filing. Good cause for this waiver exists here because the instant answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case. In particular, the instant filing addresses certain new arguments that TNHC raises in its pleading. See, e.g., *New York Independent System Operator, Inc. v. Astoria Energy LLC*, 118 FERC ¶ 61,216, at P 29 (2007); *Columbia Gas Transmission Corp.*, 116 FERC ¶ 61,191, at P 19 (2006); *Northern Natural Gas Co.*, 113 FERC ¶ 61,060, at P 11 (2005).

I. INTRODUCTION³

On December 1, 2005 (as amended on December 22, 2005), TNHC submitted in this proceeding a proposal for completing the development, financing, construction, and operation of a project consisting of the planned Lake Elsinore Advance Pump Storage (“LEAPS”) facility and the Talega-Escondido/Valley-Serrano 500 kV Interconnect (“TE/VS Interconnection”) (collectively, “the combined Project”). TNHC proposed that the costs of LEAPS and the TE/VS Interconnection, including a return on equity, should be recovered from CAISO Market Participants through the CAISO’s rolled-in transmission rate (called the transmission Access Charge or “TAC”), and that the CAISO should assume Operational Control over LEAPS.

A number of parties, including the CAISO, raised concerns regarding TNHC’s proposal. On November 17, 2006, the Commission issued its Order on Rate Request in this proceeding. As relevant here, in the November 17 Order, the Commission found that LEAPS is an “advanced transmission technology” under Section 1223 of the Energy Policy Act of 2005 (“EPAAct 2005”), but stated that “we do not have sufficient information to determine whether inclusion of the LEAPS facility in the CAISO’s TAC is appropriate and whether the rate incentives requested by [TNHC] are justified and would result in just and reasonable rates for California ratepayers.” *Id.* at P 27. The Commission deferred ruling on the merits of the operational and cost recovery issues raised by TNHC’s proposal,

³ This section provides an abbreviated introduction to this proceeding. The CAISO’s May 1, 2007 filing in the proceeding (at pages 2-13) contains more extensive background information.

pending submission of additional information that the Commission deem necessary to complete its evaluation of the proposal. *Id.* at PP 1, 28, 32. In order to obtain some of the required information, the Commission directed the CAISO to (1) convene a stakeholder process for the purpose of considering the operational and cost recovery issues raised by TNHC's proposal and (2) submit a filing to the Commission that related the outcome of discussions with stakeholders and provided information in response to directives contained in the November 17 Order. *Id.* at PP 30-31.

Pursuant to the November 17 Order, the CAISO conducted a thorough stakeholder process that included publication of a pair of white papers by the CAISO and discussions concerning TNHC's proposal. Following the stakeholder process, on May 1, 2007, the CAISO submitted the filing required by the November 17 Order.⁴ The Commission initially established a May 22, 2007 comment date regarding the May 1 Comments; the Commission later extended the comment date to June 14, 2007 pursuant to a motion for extension of time filed by TNHC. A number of parties submitted filings in response.⁵ All of these

⁴ Comments of the California Independent System Operator Corporation in Response to the November 17, 2006 Order on Rate Request, Docket Nos. ER06-278-000 and ER06-278-001 (May 1, 2007) ("May 1 Comments").

⁵ The following parties submitted filings in response to the May 1 Comments: DTA; California Department of Water Resources State Water Project ("SWP"); California Municipal Utilities Association ("CMUA"); Modesto Irrigation District ("MID"); M-S-R Public Power Agency and the City of Santa Clara, California ("City/M-S-R"); Northern California Power Agency ("NCPA"); and TNHC.

filings were in support of the May 1 Comments, except for the filings submitted by TNHC and its contractor, DTA.⁶

II. SUMMARY

In its May 1 Comments, the CAISO made three primary points regarding the appropriate rate treatment for LEAPS: (1) EPC Act 2005 did not require that pumped storage be rolled into transmission rates; (2) there were strong policy reasons for precluding TAC recovery for LEAPS, and the CAISO should not have operational control of LEAPS; and (3) there is nothing so unique about LEAPS that requires its costs to be included in TAC: the products and services that LEAPS provides (*e.g.*, energy, ancillary services, and capacity) can also be provided by other resources in the CAISO's competitive marketplace. Nothing in TNHC's filing undermines the arguments made by the CAISO in its May 1 Comments.

TNHC's contends that LEAPS and the TE/VS Interconnection must be included in the TAC, the CAISO's rolled-in transmission rate. TNHC's position is based primarily on the Commission's finding in the November 17 Order that LEAPS is an "advanced transmission technology," as defined in Section 1223 of EPC Act 2005. TNHC contends that this finding mandates the inclusion of the cost of LEAPS in the TAC. TNHC is wrong: the finding that LEAPS is an advanced transmission technology represents the beginning of the relevant inquiry, not its conclusion. As the Commission recognized in the November 17 Order, TNHC

⁶ DTA states that it is a supplier of engineering, regulatory, and environmental consulting services "for pumped storage projects such as the Lake Elsinore Pumped Storage project ('LEAPS')." DTA at 1.

must also show both (1) that its proposed rate treatment for the costs of LEAPS in the rolled-in TAC transmission rate is an appropriate means of encouraging its deployment, and (2) that its proposal would result in TAC rates that are just, reasonable, and not unduly discriminatory or preferential. November 17 Order at P 27. If TNHC's position were correct, then the inquiry into these issues required in the November 17 Order would be superfluous, because the result would be foreordained.

As the Commission recognized in the November 17 Order, while Section 1223 of EAct 2005 requires the Commission to encourage the deployment of advanced transmission technologies, Congress left it to the Commission's discretion to determine *how* to encourage a particular advanced transmission technology in each case and did not override the fundamental requirement that rates for jurisdictional transmission service be just, reasonable, and not unduly discriminatory or preferential. Contrary to TNHC's position, Section 1223 does not require that the costs of every pumped storage hydroelectric facility be treated as transmission costs for rate purposes. Further, treating the costs of a pumped storage facility as transmission costs is not the only way to encourage its deployment.

Moreover, even assuming *arguendo* that the costs of an advanced transmission technology are considered transmission costs for rate purposes, Section 1223 does not require the Commission to include the costs of all advanced transmission technologies in *rolled-in* transmission rates, such as the CAISO's TAC. Long-standing Commission policy and precedent excludes the

costs of some transmission facilities from rolled-in transmission rates based on the Commission's determination that inclusion of those costs would render the rates unjust and unreasonable. Nothing in Section 1223 creates a mandatory, automatic exemption from these policies. Nor does Section 1223 require the Commission to include the cost of LEAPS in the CAISO's rolled-in transmission rates where doing so would: (a) unduly discriminate against other CAISO Market Participants who provide the same products as LEAPS would provide – Energy and Ancillary Services – but who do not receive the subsidy that TNHC seeks; (b) skew the operation of the CAISO's markets for Energy and Ancillary Services by subsidizing the provision of those services from LEAPS and encouraging the submission of bids that do not reflect the marginal cost of supplying those products from LEAPS; and (c) compromise the CAISO's independence by requiring the CAISO to exercise Operational Control over one supplier of products sold in the markets it operates. The requirements of Section 1241 of EPCRA 2005, which TNHC also references, likewise offer no support for TNHC's position, since that section, too, does not require the Commission to roll-in the costs of pumped hydro storage into transmission rates or otherwise award incentives that result in unjust, unreasonable, or unduly preferential transmission rates.

TNHC's assertion that LEAPS will perform functions that are unlike those the CAISO procures from other Market Participants is unfounded. TNHC recognizes that LEAPS combines features of a load, when it consumes Energy to pump water into storage, and a generator, when it produces Energy or Ancillary

Services from the stored water. Nevertheless, it contends that the combination of these functions results in a unique facility that does not participate in the CAISO's markets. This is fundamentally incorrect. The operation of LEAPS, as described by TNHC, will result in the consumption and production of products traded in the CAISO's markets, just as the operation of existing pumped storage facilities and other generators does today. LEAPS should be treated like other participants in the CAISO's markets. In particular, TNHC, like other Market Participants, should obtain revenues from the sale of the products LEAPS produces through participation in the CAISO's markets and from bilateral transactions with willing purchasers; it should obtain financing by demonstrating to prospective investors and lenders its ability to provide products that customers value.

TNHC's proposal to shift the market risks of LEAPS to the CAISO's transmission customers through the inclusion of LEAPS' costs and a return on equity in the TAC would be inconsistent with the Commission's pro-market policies. It would also be inconsistent with the treatment of other suppliers of Energy and Ancillary Services, who must operate under market conditions and who are not assured of cost recovery from transmission customers via the TAC. TNHC's proposal would not only require the CAISO to give unduly preferential treatment to LEAPS, but would also turn back the clock to the days before the Commission's reliance on market forces, rather than cost-based regulation, to promote reliable, affordable, and efficiently provided electric service whenever possible.

TNHC presents new testimony purporting to show that the combination of LEAPS and the TE/VS Interconnection will produce significant net economic benefits. This analysis, even if valid, is irrelevant to the issues the Commission directed the CAISO to address in the May 17 Order. Even if TNHC's analysis that LEAPS will produce economic benefits is correct, those benefits, which come from the supply of Energy and Ancillary Services in the CAISO's markets, should be more than sufficient to support LEAPS on a market basis. Allowing TNHC to retain those benefits should provide strong encouragement for the development of LEAPS in a manner consistent with the requirements of the FPA and the Commission's pro-competition policies. Though TNHC eschews reliance on market revenues (despite its analysis of LEAPS' projected economic benefits), this could constitute a key component of an approach that satisfies the requirements of Section 1223 of EAct 2005 without presenting the serious problems raised by TNHC's proposal for the recovery of LEAPS costs in the TAC. In any event, TNHC's claim that its project has enormous economic value undermines its fundamental claim that the CAISO's transmission customers must subsidize LEAPS through the TAC.

The issue of whether the TE/VS Interconnection, standing alone, would qualify for inclusion in the TAC is beyond the scope of this proceeding. Further, any benefits associated with the TE/VS Interconnection cannot serve as a basis for rolling the costs of the separate LEAPS facility into transmission rates. The CAISO notes that it has existing processes in place in the ISO Tariff for the planning and approval of transmission lines, such as the TE/VS Interconnection,

and for the inclusion of their costs in the TAC. TNHC has not submitted a proposal for the rate treatment of the TE/VS Interconnection on a stand-alone basis and, moreover, has not shown that the CAISO's existing processes are inadequate to support the development of needed transmission lines.

In the May 1 Comments, the CAISO reported that most stakeholders indicated strong opposition to the TNHC proposal concerning LEAPS. The same is true of filings submitted in response to the CAISO's filing: all support the CAISO's position, except for TNHC and its contractor, DTA. TNHC's effort to minimize the importance of the stakeholders' input directly contradicts the Commission's emphasis on the need for a stakeholder process to address TNHC's proposal.

TNHC has failed to satisfy its burden under the FPA, as modified by EPCRA 2005, and the Commission's November 17 Order, of demonstrating that its proposed inclusion of the costs of the LEAPS in the rolled-in TAC transmission rate is appropriate, and will result in just, reasonable, and not unduly discriminatory or preferential transmission rates, as the FPA and the Commission's November 17 Order require. It is ultimately for the Commission to decide, as a matter of policy, whether it is appropriate to encourage the deployment of pumped storage projects in an organized wholesale market such as the CAISO's, by including the costs of pumped storage projects in rolled-in transmission rates, such that transmission customers must bear the costs and risks of such projects. It is clear, however, that the record in this proceeding would not support an affirmative answer to that question. TNHC could propose

other means of encouraging the development of LEAPS that satisfy the standards of the FPA and EAct 2005, which could include retaining the revenues it earns from market sales of Energy and Ancillary Services from the project. If TNHC submits such a proposal, the Commission must then determine whether it satisfies the statutory standards.

III. REPLY TO THE FILINGS OF TNHC AND DTA

A. TNHC Is Incorrect That the Classification of LEAPS as an Advanced Transmission Technology Mandates the Inclusion of Its Costs in the CAISO's TAC Rates.

The foundation of TNHC's position is its contention that the plain meaning of Sections 1223 and 1241 of EAct 2005, coupled with the Commission's finding that LEAPS is an advanced transmission technology, require the Commission to treat LEAPS as a transmission facility and that, therefore, its costs must be included in the CAISO's rolled-in TAC rates.⁷ Thus, TNHC essentially takes the position that the answers to the policy questions the Commission posed in the November 17 Order are mandated by the statute, *i.e.*, there is no need to consider whether inclusion of LEAPS' costs in the TAC is appropriate and results in just, reasonable, and not unduly discriminatory or preferential rates, because the mere finding that LEAPS is an advanced transmission technology is all that is required. TNHC is wrong; its position is not supported by the provisions of EAct 2005; and the Commission's questions are not, as TNHC would have it, irrelevant.

⁷ TNHC at 5-9.

Section 1223 of EAct 2005 consists of two subsections. Subsection (a) lists various types of facilities, devices, and other technology that qualify as advanced transmission technologies. Subsection (b) states that, “[i]n carrying out the Federal Power Act (16 U.S.C. 791a et seq.) and the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. 2601 et seq.) [‘PURPA’], the Commission shall encourage, as appropriate, the deployment of advanced transmission technologies.”⁸ Congress thus made it clear that Section 1223 does not supersede the requirements of the FPA (or PURPA). Rather, Congress directed the Commission to encourage the development of advanced transmission technologies in the course of carrying out the requirements of those statutes. Moreover, Section 1223’s directive to encourage the deployment of advanced transmission technologies “as appropriate” reflects an explicit acknowledgement that the Commission retains discretion as to how to encourage those technologies in a manner consistent with the requirements of the FPA and PURPA.

The discretion that Congress gave the Commission under Section 1223 to decide whether a proposed means of encouraging the deployment of advanced transmission technologies is appropriate necessarily includes the discretion for the Commission to allow different means to encourage the deployment of different advanced transmission technologies in different circumstances. Indeed, as the CAISO explained in the May 1 Comments, it would not make sense for the Commission to treat all advanced transmission technologies in the same way,

⁸ Pub. L. No. 109-58, § 1223, 119 Stat. 594, 953 (2005).

given that Section 1223 lists types of technologies that range from items that clearly are transmission (such as superconducting cables) to items that clearly are not transmission (such as distributed generation). Therefore, qualification as an advanced transmission technology cannot automatically lead to the conclusion that a project's costs must be rolled into transmission rates because that would lead to transmission customers subsidizing the costs of every type of advanced transmission technology, which would not be appropriate in every circumstance.⁹ Notably, Section 1223 does not expressly mandate rolled-in rate treatment for all advanced transmission technologies, and TNHC points to nothing in Section 1223 requiring that result. Indeed, its latest pleading adds nothing to the presentations of the same argument in earlier submissions to the Commission and in the CAISO's stakeholder process.

Although Congress did not mandate the treatment of any particular advanced transmission technology in any particular way, Congress did specify that the means the Commission approves to encourage the deployment of an advanced transmission technology must be consistent with the requirements of

⁹ May 1 Comments at 15-16. TNHC's assumption that rolling the costs of LEAPS into the TAC transmission rates is the only way that its development can be encouraged is unfounded. Where, as in the case of LEAPS, the project produces Energy and Ancillary Services that can be sold bilaterally or in organized markets (see Section III(B), below), the revenues from those sales can encourage the development of the project without requiring transmission customers to bear its costs and market risks. For example, the CAISO's operation of markets for Energy and Ancillary Services encourages projects such as LEAPS because they (1) should incur lower Energy and Congestion costs to pump water during off-peak hours, and (2) can sell the Energy and Ancillary Services they produce during peak periods, when prices are higher. This type of encouragement was discussed in the stakeholder process as a component of one alternative approach to encouraging new pumped hydro facilities. The transparency of prices in the CAISO's markets also facilitates the formation of bilateral contracts, should TNHC prefer to sell LEAPS' products on that basis. In any event, it is TNHC's obligation to propose a means of encouraging the development of its project that satisfies the requirements of the FPA and does not present the problems inherent in its proposal here.

the FPA and PURPA. As relevant here, Congress's directive means that the Commission may not apply Section 1223 in a way that is inconsistent with the requirements of Sections 205 and 206 of the FPA, or the policies the Commission has developed under Sections 205 and 206, to ensure that transmission rates are just, reasonable, and not unduly discriminatory or preferential.

The Commission's policies under Sections 205 and 206 recognize that including the costs of some transmission facilities in rolled-in transmission rates would not result in just and reasonable rates, because those facilities do not form part of the integrated network from which transmission customers benefit. For example, the Commission has found that generation step-up transformers ("GSUs") should be excluded from rolled-in transmission rates for this reason.¹⁰ The Commission has also excluded the costs of radial generator leads from rolled-in transmission rates, even though they are transmission facilities.¹¹ The Commission's finding in the November 17 Order that LEAPS qualifies as an advanced transmission technology therefore does not lead inexorably to the conclusion that its costs must be included in the CAISO's rolled-in TAC, as TNHC contends. As explained in the CAISO's May 1 Comments, the information

¹⁰ See *Kentucky Utilities Co.*, 85 FERC ¶ 61,274, at 62,111-13 (1998). The Commission stated that GSUs support generation and the provision of Ancillary Services. As such, the costs of GSUs should be directly assigned to the generator (and ultimately be borne by the users of such facilities via power sales rates) and should not be assigned to transmission customers. Likewise, TNHC should recover the costs of LEAPS, which is used to provide Energy and Ancillary Services, from customers procuring these services from LEAPS either through the market or in bilateral contracts; LEAPS' costs should not be charged to all transmission customers.

¹¹ See *Nevada Power Co.*, 100 FERC ¶ 61,077, at PP 13-14 (2002); *Cambridge Electric Light Co.*, 95 FERC ¶ 61,339, at 62,275 n.5 (2001).

developed during the stakeholder process, as well as the CAISO's own independent analysis, identified several respects in which inclusion of the LEAPS costs in the TAC would have unreasonable and unjust consequences. The qualification of LEAPS as an advanced transmission technology neither requires nor permits the Commission to disregard those consequences.

The FPA and the Commission's policies also place the utmost importance on the prohibition of undue discrimination or preference. Section 205(b) of the FPA expressly forbids public utilities from "mak[ing] or grant[ing] any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage," and the Commission's policies reflect the same requirement.¹² The need to prevent the exercise of undue discrimination or preference is particularly strong with regard to ISOs and RTOs, because any act that compromises – or even appears to compromise – the independence of an ISO or RTO undermines its ability to perform its Commission-mandated functions, including its operation of the transmission grid and oversight of markets in a non-discriminatory manner.¹³ The CAISO's analysis, as well as

¹² 16 U.S.C. § 824d(b). See also, e.g., *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, 68 Fed. Reg. 49846 (Aug. 19, 2003) and 68 Fed. Reg. 69599 (Dec. 15, 2003), FERC Stats. & Regs., Regs. Preambles ¶ 31,146, at P 18 (2003) ("Order No. 2003") ("The Commission must ensure that the rates, contracts, and practices affecting jurisdictional transmission do not reflect an undue preference or advantage for non-independent Transmission Providers and are just and reasonable.").

¹³ "[T]he principle of independence is the bedrock upon which the ISO must be built." *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. & Regs., Regs. Preambles ¶ 31,089, at P 153 (1999) ("Order No. 2000"). "[A]n ISO must be independent in both reality and perception." *Id.* at P 205. "[A]n RTO will not be successful unless all market participants believe that the RTO will operate the grid and provide transmission service to all end-users on a non-discriminatory basis." *Id.* "[A]n RTO must be independent of any entity whose economic or commercial interests could be significantly affected by the RTO's actions or decisions. Without such independence, it will be difficult for an RTO to act in a non-discriminatory manner." *Id.* at P 195.

stakeholders' comments, indicates that TNHC's proposals for the inclusion of the costs of LEAPS in the TAC and the CAISO's assumption of Operational Control over the LEAPS project would be unduly preferential and discriminatory. Section 1223 provides no license for unduly preferential and discriminatory transmission rates.

TNHC also points to Section 1241 of EPOA 2005, which it claims supports its demand for the inclusion of LEAPS costs in the TAC as an incentive for the development of LEAPS as an advanced transmission technology.¹⁴ However, Section 1241 does not advance TNHC's flawed statutory justification for its proposal. By its terms, Section 1241 applies to facilities "for the transmission of electric energy in interstate commerce by public utilities."¹⁵ Therefore, that section applies to transmission facilities generally rather than to advanced transmission technologies in particular. Moreover, Congress made it clear in Section 1241 that any incentive awarded by the Commission was subject to the FPA's general requirements respecting transmission rates. Specifically, Section 1241(d) expressly states, "[a]ll rates approved under the [Commission] rule adopted pursuant to this section . . . are subject to the requirements of sections 205 and 206 [of the FPA] that all rates, charges, terms, and conditions be just and reasonable and not unduly discriminatory or preferential." Therefore, Section 1241, like Section 1223, must be applied in a manner that is consistent

¹⁴ Pub. L. No. 109-58, § 1241, 119 Stat. 594, 961-62 (2005) (codified at Section 219 of the FPA, 16 U.S.C. § 824s).

¹⁵ Section 1241(a).

with Sections 205 and 206 of the FPA and that does not foster any undue discrimination or preference.

The Commission implemented Section 1241 in Order No. 679, where, as relevant here, it determined that the application of incentives to advanced transmission technologies would be decided on a case-by-case basis and specifically declined to make “generic determinations regarding the applicability of incentives to particular technologies.”¹⁶ In the November 17 Order, the Commission, consistent with the policy it enunciated in Order No. 679, directed the CAISO to conduct a stakeholder process to assist it in making the case-by-case determination with respect to LEAPS. TNHC’s position suggests that Section 1241 makes this inquiry irrelevant where advanced transmission technologies are concerned. This collateral attack on the Commission’s contrary conclusion in Order No. 679 is as unfounded as it is untimely.

TNHC misconstrues the true plain meaning of Sections 1223 and 1241. There is nothing in these provisions that compels the Commission to encourage the deployment of LEAPS as an advanced transmission technology by (i) mandating the treatment of LEAPS’ costs as transmission costs for accounting and ratemaking purposes; (ii) mandating the inclusion of those costs in the CAISO’s rolled-in TAC rates; and (iii) disregarding whether rolling LEAPS’ costs into the TAC rates causes those rates to violate long-standing Commission policies that ensure just and reasonable rates and prevent undue discrimination

¹⁶ *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 71 Fed. Reg. 43294 (July 31, 2006), FERC Stats. & Regs., Regs. Preambles ¶ 31,222, at PP 288-89, 298-99 (2006) (“Order No. 679”), *order on reh’g*, Order No. 679-A, 72 Fed. Reg. 1152 (Jan. 10, 2007), FERC Stats. & Regs., Regs. Preambles ¶ 31,236 (2006).

or preference. Rather, the plain meaning of these provisions is that the Commission has discretion to determine whether a proposed means of encouraging the deployment of an advanced transmission technology is “appropriate,” so long as that encouragement is consistent with the FPA and the Commission’s policies. As the CAISO will explain in the next section, the CAISO strongly believes that it would in fact be unjust, unreasonable, and unduly discriminatory and preferential for the Commission to require the LEAPS costs to be treated as transmission costs and rolled into the TAC rates.

B. LEAPS Would Be a Participant in the CAISO’s Markets that Should Not Receive Unduly Preferential Treatment as Compared with Other Participants in Those Markets.

TNHC and DTA argue that the Commission and the CAISO should consider LEAPS to be a unique device which the CAISO should treat differently from other types of participants in the CAISO’s markets by permitting the costs of LEAPS, including a premium return on equity, to be recovered through the CAISO’s rolled-in TAC rates.¹⁷ TNHC and DTA’s basic premise is unsupported. LEAPS would supply the same products that the CAISO procures from other suppliers through competitive markets. Likewise, LEAPS would “consume” energy just like other loads in the CAISO’s footprint. In other words, LEAPS would be a participant in the CAISO’s markets just like any other Market Participant, and as such TNHC has provided no basis for the CAISO to favor LEAPS to the detriment of any other Market Participants.

¹⁷ TNHC at 9-11, 20-31; DTA at 1-3.

1. LEAPS Would Be a Participant in the CAISO's Markets.

TNHC and DTA portray LEAPS as a novel, unique energy storage device that, they assert, would supply no net energy, but instead would merely balance load and power flow. The purported distinction between the service of “balancing load and power flow” and the provision of Energy and Ancillary Services in fact is no distinction at all. The way the CAISO balances load and power flow is through its Energy and Ancillary Services markets. Participants bid to purchase and supply Energy and the CAISO clears those markets, schedules other market transactions, and procures reserves to maintain the reliability of the ISO Controlled Grid.¹⁸ LEAPS would fit neatly within this existing CAISO market structure. It would essentially combine the attributes of a Participating Load, when it consumes Energy to pump water into storage, and the attributes of a Participating Generator, when it produces Energy and Ancillary Services by using the stored water to run turbines.¹⁹ Likewise, TNHC's statement that LEAPS production of Energy could relieve congestion²⁰ does not distinguish it from other

¹⁸ See *California Independent System Operator Corp.*, 105 FERC ¶ 61,406, at P 7 (2003); *Turlock Irrigation District and Modesto Irrigation District v. California Independent System Operator Corp.*, 100 FERC ¶ 63,016, at PP 144-45 (2002), *notice of finality*, 100 FERC ¶ 61,341 (2002); *California Independent System Operator Corp.*, 90 FERC ¶ 61,006, at 61,011 n.7 (2000).

¹⁹ Under the ISO Tariff, a Participating Load is defined as “[a]n entity providing Curtailable Demand, which has undertaken in writing to comply with all applicable provisions of the ISO Tariff, as they may be amended from time to time.” A Participating Generator (also known as a Participating Seller) is defined as “[a] Generator or other seller of Energy or Ancillary Services through a Scheduling Coordinator over the ISO Controlled Grid from a Generating Unit with a rated capacity of 1 MW or greater, or from a Generating Unit providing Ancillary Services and/or submitting Supplemental Energy bids through an aggregation arrangement approved by the ISO, which has undertaken to be bound by the terms of the ISO Tariff, in the case of a Generator through a Participating Generator Agreement.”

²⁰ TNHC at 22.

generators or equate its operation with that of a transmission line: the operation of any new generator in a congested area could relieve the congestion.

TNHC states that it agrees with the CAISO's recognition that LEAPS "has attributes of both a 'generator and a load,'"²¹ but then TNHC fails to reach the obvious and logical conclusion stemming from that recognition: that LEAPS would be a hybrid device in that it would have the characteristics of *both* a generator *and* a load. Instead, TNHC reaches an entirely different and unwarranted conclusion – that LEAPS would be a unique storage device that should be treated as transmission and the costs of which should be rolled into the TAC rates. Under the CAISO's Commission-approved tariff, the CAISO does not categorize either Participating Generators or Participating Loads as transmission, and the CAISO does not include the costs of either Participating Generators or Participating Loads in its TAC rates.²² Rather, they provide their services and products through the CAISO's markets.

LEAPS is far from unique in being both a generator and a load; this is a characteristic it shares with other pumped storage facilities. Indeed, the Commission has recognized that pumped storage facilities function as both loads and generators.²³ The Commission has also recognized that pumped storage

²¹ TNHC at 10-11 (quoting May 1 Comments at 15).

²² In the markets the CAISO will operate pursuant to its Commission-approved Market Redesign and Technology Upgrade ("MRTU"), pumped storage facilities will be treated as Participating Loads that the CAISO will model as generators with negative generation capabilities and schedules and will settle at nodal prices. See *California Independent System Operator Corp.*, 116 FERC ¶ 61,274, at PP 133 n.104, 230, 699 (2006). In any event, pumped storage facilities will not be modeled as transmission or be rolled into the TAC rates under MRTU.

²³ *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,236, at P 187 n.160 (2004) ("At times, usually during periods of low system demand, a pumped storage plant is

facilities are participants in electricity markets, including the CAISO's markets.²⁴ Further, there is nothing unique in the fact that LEAPS would consume more energy in its pumping mode than it would produce in its generating mode, and thus would supply no net energy; this merely indicates that LEAPS would not be perfectly efficient, which is a feature of other pumped storage facilities, as well.²⁵ In any event, the fact that LEAPS would not produce any net energy is wholly irrelevant to a determination of whether LEAPS' costs should be recovered in transmission rates. What is relevant is that the specific services LEAPS would provide are services that are provided through the CAISO markets by Participating Loads and Generators.

Both Participating Loads and Participating Generators participate in the CAISO's markets by buying and selling Energy and Ancillary Services, respectively. The fact that LEAPS would do both of those things in a single corporate entity, as parts of the same facility, does not change the fundamental fact that it will be consuming and selling products in the CAISO markets. Other Loads and Generators, including other pumped storage facilities, do exactly the

a load, and draws power from other generators to pump water back into its upper reservoir."); *California Independent System Operator Corp.*, 105 FERC ¶ 61,140, at P 34 n.26 (2003) (noting that, under the CAISO's proposed market redesign, one category of entities whose loads will not be aggregated will be "entities that can operate as either loads or generators (e.g., cogeneration and pumped-storage hydro facilities will be treated as generators and will bid and settle at location prices").

²⁴ *Enron Power Marketing, Inc. and Enron Energy Services Inc.*, 115 FERC ¶ 61,377, at P 5 (2006) ("Because Met Water's pumping plant load averages 2400 gigawatt-hours annually with a full aqueduct, Met Water participates significantly in western energy markets."); see also May 1, 2007 Comments at 18, n.20.

²⁵ See *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,236, at P 187 n.160 ("Because pumping is not perfectly efficient, there are performance losses associated with moving water to the upper reservoir. Thus it takes more power to move the water to the upper reservoir than is created when the plant is releasing water to generate power.")

same thing today. Therefore, the attempts of TNHC and DTA to distinguish LEAPS from other participants in the CAISO's markets fail.

2. LEAPS Should Not Receive Unduly Preferential Treatment as Compared with Other Participants in the CAISO's Markets.

Once it is recognized that LEAPS will supply the same products that other Market Participants trade in the CAISO's Energy and Ancillary Service markets on a competitive basis, it becomes clear that TNHC should bear a heavy burden to justify its demand for preferential treatment. In the opinion of the CAISO and the overwhelming majority of the participants in its stakeholder process, TNHC has not met that burden. To the contrary, allowing LEAPS, alone among the Participating Loads and Participating Generators, to recover all of its costs through rolled-in transmission rates, would create a number of problems which the CAISO discussed in detail in its May 1 Comments.²⁶ The CAISO will not repeat that discussion here, but it will highlight concerns regarding three obvious and unavoidable problems that TNHC's proposal regarding LEAPS would cause. These three problems alone strongly suggest that the Commission should not require the CAISO to grant LEAPS the special rate treatment that TNHC requests.

First, as explained above, Sections 205 and 206 of the FPA forbid undue discrimination or preference, and Sections 1223 and 1241 of EPAct 2005 state that they are subject to the requirements of the FPA, including Sections 205 and 206. It would be unduly discriminatory to permit LEAPS to recover its costs

²⁶ May 1 Comments at 18-34.

through the CAISO's rolled-in transmission rates, because other Market Participants, including pumped storage facilities that existed prior to EAct 2005, do not receive the same guarantees of recovery from Market Participants. TNHC's response to this objection is that, if it is discrimination to treat LEAPS differently, it is "lawful and proper discrimination, and cannot be said to violate Section 205."²⁷ In that regard, TNHC states that because EAct 2005 intended to encourage the development of certain new technologies through tax breaks (for renewable resource generation) and attractive returns on equity, the different treatment to be accorded such technologies cannot be unlawful. But this assumes, incorrectly, that Section 1223 of EAct 2005 condones and even requires undue discrimination. As shown above, this is not the case. Moreover, the fact that LEAPS would be newer than other Participating Generators and Participating Loads is an extremely weak basis for singling LEAPS out for guaranteed cost recovery from transmission customers, considering that LEAPS would be supplying the same services as other pumped storage facilities (and generators) that do not have guaranteed cost recovery

A second problem with allowing LEAPS to recover its costs and a return on equity through the CAISO's rolled-in transmission rates is that doing so would distort the CAISO's markets. For example, with its costs recovered through and subsidized by transmission rates, the Energy generated by LEAPS – unlike the Energy generated by other resources – would not be priced at marginal cost. Instead, under TNHC's proposal, the Energy from LEAPS would be bid into the

²⁷ TNHC at 21-22.

CAISO's markets at zero dollars.²⁸ This would give LEAPS an economic advantage vis-à-vis other generators. The Energy bid in from LEAPS would invariably be the lowest-priced Energy available in the bidding process and therefore the LEAPS Energy would always be selected in that process whenever it was offered. This would lead to inappropriate use of LEAPS, especially when use of other resources might be more efficient. It would also reduce the revenues available to suppliers that compete with LEAPS, and whose marginal cost-based bids may be undercut by LEAPS' zero-dollar bids, which are not based on its marginal costs.²⁹ Over time, zero bids from LEAPS would artificially depress market prices, thereby discouraging entry by other suppliers who do not have access to the subsidy that TNHC is seeking from the CAISO's transmission customers. This could lead to shortages or to other suppliers seeking similar subsidies. The result would be a giant step backwards from the Commission's current policies, which promote competition among generators to encourage efficiency and innovation. Instead, prospective suppliers would compete on the basis of their ingenuity in claiming subsidies from transmission customers. This is not the kind of innovation that the Commission's pro-competition policies are intended to promote.

A third problem with TNHC's proposal is that it would require the CAISO either to exercise Operational Control over LEAPS or to exert indirect control

²⁸ TNHC at 25.

²⁹ LEAPS would essentially be bidding below its costs by submitting zero dollar bids. For example, LEAPS must buy energy to pump water uphill.

over the supply of products from LEAPS bid into the CAISO's market.³⁰ The CAISO's exercise of such control would violate the prohibition under the FPA and the Commission's policies against undue discrimination or preference, especially by ISOs and RTOs (described above). TNHC implicitly acknowledges that its original proposal, under which the CAISO would be responsible for bidding LEAPS' output into the market, raised serious independence concerns. As noted above, it has modified its proposal to provide for the project's output to be bid into the markets at zero, but that raises problems of its own, as discussed above. Moreover, it does not address the concerns its original proposal raised with respect to the CAISO's independence. TNHC would have the Commission believe that by TNHC's entering zero as the bid price for generation from LEAPS, the independence issue is resolved because there are no other decisions to be made with respect to the operation of the pumped hydro facility. That is wrong. Even if LEAPS' output is bid into the market at a price of zero, the CAISO would still have to decide when LEAPS would operate and how much Energy it would produce, as well as when to operate the pumps to store water for future generation. The Commission approved the CAISO as the *independent system operator* for California. Even TNHC acknowledges that the Commission has directed the CAISO to avoid preferential treatment of participants in its markets.³¹ If the Commission were to approve the special treatment TNHC seeks, it would be eroding the CAISO's independence. TNHC's desire to shift market risks to

³⁰ May 1 Comments at 30.

³¹ TNHC at 22 (citing *California Independent System Operator Corp.*, 98 FERC ¶ 61,335, at 62,426-27, *order on reh'g*, 101 FERC ¶ 61,241, at P 24 (2002)).

the CAISO's transmission customers provides an inadequate basis for this momentous step.

C. TNHC's Arguments that the Commission Treats Natural Gas Storage as Transmission Are Inapposite.

TNHC attempts to analogize pumped storage facilities to natural gas storage facilities: it argues that the CAISO's opposition to treating pumped storage facilities such as LEAPS in the same manner as what TNHC calls "traditional" transmission facilities, and the CAISO's opposition to allowing LEAPS to receive rolled-in cost recovery through the TAC, ignore the Commission's designation of natural gas storage as part of the gas transportation network.³² As explained above, pumped storage facilities – including LEAPS – consume and supply Energy and Ancillary Services in the CAISO's markets; they do not transmit energy or facilitate the transmission of energy to a location distant from where it is produced. As such, pumped storage facilities are not transmission facilities ("traditional" or otherwise). Therefore, TNHC's analogy must fail.

TNHC also ignores fundamental differences between the Commission's regulation under the Natural Gas Act of natural gas companies, including those who provide gas storage service, and its regulation under the FPA of public utilities' interstate transmission and wholesale sales of electric energy. The Commission has long recognized that its regulation of the two industries may differ and, indeed, must differ as necessary to take account of fundamental differences between them. The concept of "storage" is one area in which the

³² TNHC at 2, 11-13.

natural gas and electricity industries differ. For example, natural gas storage facilities must be certificated by the Commission pursuant to Section 7(c) of the Natural Gas Act. No similar provision exists in the FPA. In the case of natural gas, there is no change in the physical state of the energy: the energy content of natural gas is not the result of “generation.” Instead, when natural gas is gathered, it already contains all of its energy. In the case of electricity, in contrast, energy undergoes a change of form. The chemical or kinetic energy in natural gas, sunlight, wind, or water is converted to electric energy. For this reason, the Commission’s regulation has traditionally treated hydroelectric facilities, including pumped storage facilities, as part of the generation function. TNHC’s assumption that storage in the two industries should be regulated on the same basis is groundless.

Even assuming for the sake of argument that pumped storage facilities such as LEAPS would provide service analogous to gas storage, rather than consuming Energy and producing Energy and Ancillary Services, TNHC’s reliance on gas industry cases is misplaced. TNHC asserts that pumped storage facilities are analogous to gas storage but ignores important Commission policies regarding the appropriate treatment of such storage. In that regard, in Order No. 636, the Commission required gas pipelines to unbundle gas transportation services from gas storage services.³³ The Commission also required gas pipelines to unbundle the transportation and sales components of their bundled,

³³ *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, 57 Fed. Reg. 13267 (Apr. 16, 1992), FERC Stats. & Regs., Regs. Preambles ¶ 30,939, at 61,230 & n.140 (1992) (“Order No. 636”).

city-gate firm sales services. The costs associated with the storage used to provide unbundled merchant service and unbundled storage service were removed from transportation rates. In particular, the Commission stressed that the costs associated with the pipeline's merchant storage capacity "*must be recovered by the pipeline solely as part of its market-based sales rate.*"³⁴

The thrust of TNHC's proposal is precisely the opposite: TNHC wants to bundle recovery of the costs for what TNHC describes as LEAPS storage service with the rate for transmission service on the ISO Controlled Grid. The Commission should not countenance this combination of regulated transmission service with a service that, taking TNHC's characterization at face value, is a *merchant* storage service. LEAPS is most closely akin to merchant storage in the gas pipeline context because it will be used to produce and sell Energy and Ancillary Services in the CAISO markets. In Order No. 636, the Commission recognized the unfair competitive advantage that pipeline merchants with storage have vis-à-vis other sellers of natural gas (including the ability to buy gas at less costly off-peak prices and sell it later on). The Commission accordingly modified its policies to require that all gas supplies (including the pipeline's sales gas) be treated and transported on equal terms – so that all sellers of natural gas could compete on an equal footing. TNHC seeks the opposite treatment: it seeks to have its Energy and Ancillary Services treated differently than those of other suppliers. That is clearly inconsistent with Order No. 636.

³⁴ *Id.* at 30,425-27(emphasis added).

TNHC's attempted analogy breaks down in another respect as well. TNHC seeks rolled-in rate treatment for a new facility, LEAPS, but Commission precedent precludes new gas pipeline or storage facilities from receiving rolled-in rate treatment in most circumstances. In its *Policy Statement on Certification of New Interstate Natural Gas Pipeline Facilities*, the Commission stated that a threshold requirement for a pipeline proposing a new project is that the pipeline must be prepared to financially support the project without relying on subsidization from existing customers. The Commission noted that "[e]liminating the subsidization usually inherent in rolled-in rates recognizes that a policy of incrementally pricing facilities sends the proper price signals to the market."³⁵ Even assuming *arguendo* that LEAPS should be treated as a new storage facility analogous to a new gas storage facility, pursuant to the Gas Policy Statement, TNHC must show that LEAPS would be financially viable without subsidies from existing customers; otherwise LEAPS should not receive rolled-in rate treatment. In this respect, too, the rate treatment TNHC demands in this proceeding is diametrically opposed to the policies the Commission has established for new natural gas facilities, including storage facilities. LEAPS has no contracts with any load-serving entity. The *raison d'être* of TNHC's proposal is to obtain

³⁵ *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227, at 61,746 (1999) ("Gas Policy Statement"), *order clarifying statement of policy*, 90 FERC ¶ 61,128, at 61,392 (2000). The Commission did state that its requirement that a new project must be financially viable without subsidies does not eliminate the possibility that, in exceptional circumstances, the project costs should be rolled into the rates of existing customers. These exceptional circumstances are "inexpensive expansibility that is made possible because of earlier, costly construction" and "where a pipeline has vintages of capacity and thus charges shippers different prices for the same service under incremental pricing, and some customers have the right of first refusal (ROFR) to renew their expiring contracts." Gas Policy Statement at 61,746. Neither of the exceptional circumstances described by the Commission is applicable here.

subsidies for its project from the CAISO's transmission customers. That is precisely what the Gas Policy Statement forbids.

At most, TNHC can point to the fact that pipeline storage service is provided on a cost-of-service rather than a market-rate basis, at least in some cases.³⁶ However, as discussed above, pipeline sales service that utilizes pipeline storage is provided on a market-rate basis. No one is stopping TNHC from selling the output of LEAPS to a wholesale electricity buyer on a cost-of-service basis, if both parties want to transact on that basis. But that is a far cry from requiring the CAISO's transmission customers to bear the costs of LEAPS.

D. TNHC's Proposal Is Contrary to Industry Restructuring Principles and Policies.

TNHC acknowledges that “[t]he regulation of electricity has undergone revolutionary change over the past thirty years” and that this change has “fostered the robust electric generation markets that exist today.” However, TNHC then attempts to turn this well-established history on its head by asserting that its proposal is consistent with the Commission's industry restructuring principles.³⁷ TNHC's assertion could not be further from the truth.

As the Commission knows, over the past three decades, the Commission has sought to promote reliance on competitive forces, rather than cost-based regulation, in order to promote reliable, affordable, and efficiently provided

³⁶ See *Rate Regulation of Certain Natural Gas Storage Facilities*, 115 FERC ¶ 61,343, at PP 98-99, 101 (2006).

³⁷ TNHC at 2, 14-18.

electric service whenever possible.³⁸ This has clearly been the case with regard to the supply of electricity. Transmission service, by comparison, is for the most part provided on a cost-of-service basis because of concerns that transmission providers could otherwise exercise market power.³⁹ Even there, however, the Commission has implemented regulatory changes to allow merchant transmission providers to charge market-based transmission rates when certain requirements are met.⁴⁰ In sum, the overriding thrust of the Commission's policies is to rely on market forces to the greatest extent possible.

TNHC's proposal would reverse this salutary trend. TNHC seeks to compel transmission customers in California to bear the costs of LEAPS, which will produce Energy and Ancillary Services that other suppliers provide in competitive CAISO markets. In so doing, TNHC seeks to shift to transmission customers the risk that the LEAPS project might fail in the market – a risk that other suppliers of power bear with regard to their generating facilities. This shift is directly contrary to the very Commission policies that TNHC cites. TNHC has provided no evidence of market failure or other good reason why the Commission should require the CAISO to change course now and allow LEAPS to shift risks to transmission customers and require them to bear the costs of its

³⁸ See, e.g., *Wholesale Competition in Regions with Organized Electric Markets*, 119 FERC ¶ 61,306, at P 13 (2007); Order No. 2003 at P 702; *Atlantic City Electric Co., et al.*, 86 FERC ¶ 61,248, at 61,902-03 (1999); *Enron Power Marketing, Inc. v. El Paso Electric Co.*, 83 FERC ¶ 61,213, at 61,941-42 (1998); *Pennsylvania-New Jersey-Maryland Interconnection, LLC, et al.*, 81 FERC ¶ 61,257, at 62,253 (1997).

³⁹ *Public Service Co. of New Mexico*, 116 FERC ¶ 61,236, at P 3 (2006); *Midwest Independent Transmission System Operator, Inc.*, 98 FERC ¶ 61075 (2002).

⁴⁰ See *Neptune Regional Transmission System, LLC*, 96 FERC ¶ 61,147 (2001).

project, when other suppliers do not enjoy that same protection against market risks.

E. TNHC's Claim that Its Proposal Is Economically Justified Is Irrelevant.

TNHC includes in its filing an economic analysis that purports to show that the construction of LEAPS and the TE/VS Interconnection in tandem will provide an annual net economic benefit in the hundreds of millions of dollars, and that the construction of the TE/VS Interconnection alone will provide an annual net economic benefit in the tens of millions of dollars.⁴¹ TNHC's economic analysis, however, has no relevance to the issues the Commission directed the CAISO to address in the May 17 Order. In particular, even if LEAPS would produce all of the net economic benefits that TNHC claims for it, that premise does not support TNHC's proposal to include the costs of LEAPS in the rolled-in TAC rate. Further, any benefits associated with the TE/VS Interconnection cannot serve as a basis for rolling-in the costs of the stand-alone LEAPS unit. The TE/VS Interconnection would continue to provide similar benefits even if some other generating unit were connected to the line; so, those benefits cannot be attributed to LEAPS.

As explained above, the effect and evident purpose of TNHC's proposal would be to shift the costs and market risks of the LEAPS project from its developer, TNHC, to the transmission customers of the CAISO. TNHC seems to believe that the substantial economic benefits of LEAPS shown in its economic

⁴¹ TNHC at 2-3, 18-20; Exh. No. TNHC-19 (Testimony of Philippe Auclair); Exh. No. TNHC-21 (Testimony of Mingxia Zhang). TNHC's economic analysis focuses on one study year, 2015, in which the purported benefits and costs are expressed in nominal dollars.

analysis demonstrate that the risks transmission customers would bear would be minimal. But that begs the relevant question, which is whether shifting those risks to transmission customers through the TAC (1) is appropriate to encourage the deployment of LEAPS and similar pumped storage projects and (2) results in TAC rates that are just, reasonable, and not unduly discriminatory or preferential.

In fact, TNHC's economic analysis undermines the foundation of its proposal: the greater the extent to which TNHC is correct that LEAPS would provide a large net economic benefit, the less it makes sense that TNHC would want to or need to recover the costs of LEAPS through the TAC rather than setting out on its own in the market. TNHC's economic analysis of the benefits of LEAPS rests on the forecasted value of the Energy and Ancillary Services products that it believes LEAPS would provide. The CAISO operates markets for those products. If TNHC's analysis is correct, or even close to correct, LEAPS would earn substantial market revenues for TNHC. Those projected revenues should provide the basis upon which LEAPS is developed, either directly or by serving as the basis of bilateral contracts that will support financing of the project. That is how other entities that supply Energy and Ancillary Services to the CAISO have developed their projects and continue to do so. TNHC has presented no evidence of market failure that prevents it from developing its project on the basis of the revenues it could earn from market sales of Energy and Ancillary Services.

TNHC's desire to contribute that stream of revenues to the CAISO's transmission customers in exchange for their forced support of LEAPS' costs raises questions about just how much faith it has in its own economic analysis.

TNHC evidently would prefer to shift the market risk to transmission customers, rather than to bear the market risk itself and enjoy the benefits that TNHC calculates it will receive. This may be because TNHC lacks confidence in its projections of net economic benefits; it may be because TNHC has been unable to convince contract buyers or financial institutions of their validity; it may be that TNHC has not tested the market. Regardless, this preference presents an insufficient basis to require the CAISO's transmission customers to absorb the risk of LEAPS and also to pay the premium return that TNHC seeks. Likewise, TNHC has not demonstrated a valid basis for requiring the CAISO's transmission customers to bear risks that, from all that TNHC presents, neither it nor other Market Participants are willing to assume.

F. TNHC Can Seek Rate Treatment for the TE/VS Interconnection Through Established CAISO Processes.

The CAISO notes that the TE/VS Interconnection stands on a different footing than LEAPS. The TE/VS Interconnection would undoubtedly be a transmission line that *might* be eligible for inclusion in the TAC. The ISO Tariff contains established processes through which a proponent of a new transmission line can seek approval of its project through the CAISO's transmission planning process and the inclusion of its costs in the TAC. In order for the TE/VS Interconnection to be included in the TAC, TNHC would need to become a Participating Transmission Owner, would need to ensure that the TE/VS Interconnection satisfies the requirements of the Transmission Control Agreement to allow the CAISO to assume Operational Control over it, and would

need to satisfy the applicable prerequisites for inclusion of the TE/VS Interconnection in the TAC.⁴²

Unlike LEAPS, stakeholders raised no policy concerns as to recovery of the costs of the TE/VS Interconnection through the TAC, and in fact some stakeholders supported the idea, including the investor-owned Participating Transmission Owner to whose facilities the TE/VS Interconnection would be connected.⁴³ However, TNHC should be required to follow the existing CAISO processes to seek inclusion of the costs of the TE/VS Interconnection in rolled-in TAC rates, as TNHC requests.⁴⁴ At this time, TNHC has chosen not to pursue this process for the TE/VS Interconnection, but instead has bundled the TE/VS Interconnection with the LEAPS in its request for special rate treatment. TNHC has failed to demonstrate, however, that the existing CAISO processes are inappropriate for encouraging the deployment of the TE/VS Interconnection (assuming, *arguendo*, that this transmission line qualifies for special treatment on a stand-alone basis).

G. TNHC Grossly Understates the Importance of the Stakeholder Process in This Proceeding.

As the CAISO explained in its May 1 Comments, the CAISO conducted a robust stakeholder process regarding TNHC's proposal in response to the directives in the November 17 Order, and in that process the vast majority of stakeholders expressed their strong opposition to shifting the risk of a generation

⁴² See ISO Tariff, Appendix F, Schedule 3.

⁴³ May 1 Comments at 25-26.

⁴⁴ TNHC at 29-30.

project from the developer to ratepayers by providing cost recovery through the TAC.⁴⁵ The stakeholders included all of the parties who submitted filings in response to the May 1 Comments. Notably, TNHC and DTA are the only parties that submitted filings critical of the May 1 Comments; all of the other parties that submitted filings did so in support of the CAISO.

TNHC attempts to minimize the importance of the stakeholder opposition to its proposal, stating that “[t]he Commission should find it immaterial that stakeholders oppose cost-based rate treatment” for LEAPS.⁴⁶ The Commission, however, is clearly very interested in what the stakeholders have to say. In the November 17 Order, the Commission emphasized the central role that the outcome of the stakeholder process would have in its deliberations regarding TNHC’s proposal. The Commission directed the CAISO to conduct the stakeholder process because

[t]he CAISO has the expertise to determine how best to integrate the LEAPS project into the grid and has processes in place that allow it to meet with all affected stakeholders to determine what role the CAISO should have with regard to the project. Thus, *we believe that the CAISO can provide the best forum for exploring the issues and solutions* and explaining to [TNHC] the options available to it. As mentioned above, [TNHC] has implicated the CAISO in its plans, and *without more information from the CAISO, we are unable to rule.*⁴⁷

Therefore, the Commission determined that the stakeholder process conducted by the CAISO is critical to its decision regarding TNHC’s proposal. The

⁴⁵ See May 1 Comments at 2, 7-13, 23-26.

⁴⁶ TNHC at 22-24.

⁴⁷ November 17 Order at P 30 (emphasis added).

stakeholder process is far from “immaterial” to the Commission’s deliberations, as TNHC contends.

TNHC attempts to dismiss the opposition of stakeholders to its proposal as merely the result of competitors who are voting their own economic interests and seek to block new market entrants. But TNHC disregards the fact that its proposal seeks to conscript transmission customers to support its own entry into the market. TNHC fails to note that its proposal is opposed by stakeholders representing various segments of the market, not just the stakeholders that TNHC considers to be its competitors.⁴⁸ Contrary to what TNHC appears to believe, stakeholders are not out to prevent TNHC from becoming a participant in the CAISO’s markets. Rather, through a careful and robust process, the CAISO and stakeholders determined that TNHC’s proposal to obtain subsidies for its entry into the market from the TAC transmission rates suffers from serious and irremediable flaws.

H. The Commission Will Need to Make a Policy Decision Whether a Proposed Approach to Encouraging the Deployment of Pumped Storage Projects Such as LEAPS Is Appropriate.

In the instant filing, the CAISO has presented its own views and the views of stakeholders regarding the treatment of LEAPS. The CAISO recognizes, however, that ultimately the Commission must decide how to exercise its discretion to encourage the deployment of pumped storage projects like LEAPS in the context of organized competitive markets. The Commission’s decision will necessarily require it to make policy. It must not only evaluate the merits of the

⁴⁸ See May 1 Comments at 9-13.

arguments that the CAISO, TNHC, and other parties have made in this proceeding, but also must determine what course of action would best serve the public interest. It is TNHC's obligation in the first instance to submit a proposal, but the Commission must make its own determination of that proposal satisfies the statutory requirements and therefore is consistent with the public interest. As the United States Court of Appeals famously stated over forty years ago, in another case involving a proposed pumped storage project, the Commission's role in representing the public interest "does not permit it to act as an umpire blandly calling balls and strikes for the adversaries appearing before it; the right of the public must receive active and affirmative protection at the hands of the Commission."⁴⁹

As explained above, the CAISO does not believe that TNHC has satisfied its burden of demonstrating that including the costs of the LEAPS project in the rolled-in TAC transmission rates is an appropriate means of encouraging the development of LEAPS and will produce TAC rates that are just, reasonable, and not unduly discriminatory or preferential. In the first instance, it is TNHC's obligation to propose a means of promoting LEAPS that satisfies the statutory standard, which it has failed to do in this case. However, the inclusion of LEAPS' costs, including a premium return on equity, in the TAC rates is not the only means by which the Commission may satisfy its obligation under EPCAct 2005 to promote the development of LEAPS as an advanced transmission technology. The CAISO discussed some alternatives with stakeholders in the process

⁴⁹ *Scenic Hudson Pres. Conference v. Fed. Power Comm'n*, 354 F.2d 608, 620 (2d Cir. 1965).

mandated by the Commission in the November 17 Order. Indeed, the Commission could view its authorization of the CAISO to operate markets under which LEAPS and similar projects could charge market-based rates and could retain the resulting revenues as providing adequate and appropriate encouragement that satisfies the requirements of Section 1223 of EPCRA 2005. Whatever approach TNHC proposes for the Commission's review, it must submit a proposal that does not require the Commission to authorize unjust, unreasonable, and unduly discriminatory and preferential transmission rates, does not distort the operation of the CAISO's markets, and does not compromise the CAISO's independence.

IV. CONCLUSION

For the reasons explained above, the Commission should consider TNHC's proposal, and the arguments presented by TNHC and DTA, in light of the discussion presented in the May 1 Comments and the instant filing.

Respectfully submitted,

/s/ Anthony J. Ivancovich

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Dated: July 9, 2007



July 9, 2007

The Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

**Re: The Nevada Hydro Company, Inc.
Docket Nos. ER06-278-000 and ER06-278-001**

Dear Secretary Bose:

Enclosed please find an electronic filing of the Reply Comments of the California Independent System Operator Corporation.

Thank you for your attention to this filing.

Respectfully submitted,

/s/ Anthony J. Ivancovich
Anthony J. Ivancovich

Counsel for the California Independent
System Operator Corporation

CERTIFICATE OF SERVICE

I hereby certify that I have this day electronically served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Folsom, CA, this 9th day of July, 2007

/s/ Charity N. Wilson
Charity N. Wilson