112 FERC ¶ 61,207
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

City of Vernon, California — Docket Nos. EL00-105-008

California Independent System Operator Corporation — ER00-2019-016

OPINION NO. 479-A

ORDER ON REHEARING

(Issued August 23, 2005)

1. This case concerns the establishment of the appropriate base Transmission Revenue Requirement (TRR) for the City of Vernon, California (Vernon), a New Participating Transmission Owner in the California Independent System Operator Corporation (ISO or CAISO). In Opinion No. 479,[1] the Commission affirmed, as modified, the Initial Decision issued in this proceeding.[2] Various parties seek rehearing of Opinion No. 479 on several different grounds. In this order, we clarify certain aspects of our decision, and deny the requests for rehearing.

Background

2. This proceeding determined the appropriate base TRR for Vernon, a new Participating Transmission Owner in the CAISO. Vernon is reimbursed for its TRR by the ISO through the ISO's collection of a Transmission Access Charge (TAC) from all

[1] *City of Vernon, California*, Opinion No. 479, 111 FERC ¶ 61,092 (2005).

[2] *City of Vernon, California*, 109 FERC ¶ 63,057 (2004) (Initial Decision).

users of the ISO grid. The TAC rate is a formula rate based on the TRRs of all Participating Transmission Owners.[3]

3. On August 30, 2000, Vernon filed a petition for declaratory order requesting that the Commission determine that its TRR was acceptable for the purpose of becoming a Participating Transmission Owner in CAISO.[4] Vernon proposed an annual TRR of $13,080,189. In an order issued on October 27, 2000, the Commission found that Vernon's proposed rate methodology and resulting high voltage TRR were just and reasonable subject to certain modifications.[5] Vernon then re-filed its TRR on November 9, 2000, incorporating the Commission's required modifications. On March 28, 2001, the Commission accepted Vernon's filing and the modified TRR of $10,216,178 as consistent with the methodology previously approved by the Commission.[6]

4. Pacific Gas and Electric Company (PG&E) appealed the Commission's orders to the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit). On October 15, 2002, the D.C. Circuit issued a decision[7] remanding to the Commission the question of whether the review conducted by the Commission of the TRR of a non-jurisdictional entity – Vernon – which is a part of the rate of a jurisdictional independent system operator – CAISO – was sufficient to ensure that the CAISO's rates will be just and reasonable under section 205 of the FPA.[8]

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[3] *See California Independent System Operator Corporation*, Opinion No. 478, 109 FERC ¶ 61,301 (2004).

[4] Because Vernon is a municipality not subject to the Commission's jurisdiction under the Federal Power Act (FPA), its submission was voluntary, pursuant to a modification of the CAISO Tariff directed by the Commission. *California Independent System Operator Corp.*, 93 FERC ¶ 61,104 (2000).

[5] *City of Vernon, California*, 93 FERC ¶ 61,103 (2000) (*October 2000 Order*), *order on reh'g*, *California Independent System Operator Corp.*, 94 FERC ¶ 61,148 (2001).

[6] *City of Vernon, California*, 94 FERC ¶ 61,344, *order on reh'g*, 95 FERC ¶ 61,274 (2001).

[7] *Pacific Gas & Electric Co. v. FERC*, 306 F.3d 1112 (D.C. Cir. 2002) (*PG&E*).

[8] 16 U.S.C. § 824d (2000).

5. On December 23, 2003, the Commission initiated settlement procedures in response to the Vernon remand.[9] On February 17, 2004, negotiations having fallen through, the Commission set Vernon's TRR for hearing.[10]

6. In the Initial Decision, the presiding judge held that: (1) Vernon's TRR should be subject to a "section 205 like" review, in order to ensure that its inclusion in the TAC results in just and reasonable TAC rates; (2) the Mead-Adelanto Project (MAP) and Mead Phoenix Project (MPP) should be included in Vernon's TRR only as of January 1, 2003, the date on which the CAISO actually assumed operational control of those facilities; (3) Vernon is not entitled to increase its asset accounts for Allowance of Funds Used During Construction (AFUDC); (4) the California-Oregon Transmission Project (COTP) facility entitlement must be depreciated beginning in March 1993; and (5) Vernon's overall rate of return should be 9.29 percent.

7. In Opinion No. 479, the Commission held that, <u>under the specific facts of this case, it is necessary to subject</u> Vernon's TRR, voluntarily submitted as a component of a jurisdictional rate, to a full and complete section 205 review. We further determined that because Vernon itself was not subject to section 205 of the FPA, the judge had properly excused Vernon from the Commission's regulatory filing requirements.

8. Opinion No. 479 also affirmed the Initial Decision that the CAISO did not assume operational control over the MAP and MPP capacity until January 1, 2003, and consequently, that the costs of the facilities should not be included in the Participating Transmission Provider's TRR. However, the Commission held that this policy would be applied only a prospective basis, so that Vernon could still collect this component of its TRR for the period the ISO retained control.

9. On the issue of Vernon's rate of return and return on equity, the Commission concluded that that the Discounted Cash Flow (DCF) model for a non investor-owned entity such as Vernon is appropriate. The Commission explained that although Vernon does not have securities that are traded in the marketplace, companies with similar bond ratings can and do serve as an appropriate proxy for Vernon's cost of common equity. Additionally, Opinion No. 479 stated that Vernon's bond rating should be used as a basis to develop a group of proxy companies that have a similar level of risk. Finally, we found that for the "beginning period" or test period, the proxy group used by Vernon and Trial Staff was reasonable given the S&P bond return for Vernon. In addition, Opinion No. 479 stated that Vernon is similar in risk to SoCal Edison.

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[9] *City of Vernon, California*, 101 FERC ¶ 61,353 (2002) (*Remand Order*).

[10] *City of Azuza, California*, 106 FERC ¶ 61,143 (2004) (*February 2004 Order*).

10. Opinion No. 479 also held that that Commission precedent supports updating of Vernon's return on equity. The Commission updated the return on equity by adjusting for the yields on 10 Year Treasury Notes. Based on the record evidence, Opinion No. 479 stated that Vernon's return on equity for the period from January 1, 2001 (the effective date of Vernon's TRR) through the day before the date of issuance of this opinion should have been 10.72 percent. The Commission found that Vernon's updated return on equity on a prospective basis shall be 10.72 percent, based on the updating of the data. However, we found that the question of what, if any, remedy may be necessitated by the updating of Vernon's rate of return could be addressed in the compliance phase of this proceeding.

11. Finally, the Commission summarily affirmed the Initial Decision's findings that (1) Vernon is not entitled to increase its asset accounts for AFUDC; and (2) the COTP entitlement must be depreciated beginning in March 1993.

12. Timely requests for rehearing of Opinion No. 479 were filed by Vernon, the Transmission Agency of Northern California (TANC),[11] jointly by Southern California Edison Company (SoCal Edison) and PG&E (collectively, the Companies), the California Department of Water Resources State Water Project (SWP), and the Cities of Anaheim, Azusa, Banning, Colton and Riverside, California (Southern Cities). On June 3, 2005, Vernon filed an answer to the Companies' request for rehearing. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d)(1) (2005), prohibits an answer to a request for rehearing and we reject Vernon's answer on this basis.

Discussion

I. Standard of Review

A. Opinion No. 479

13. On the issue of the appropriate standard of review for Vernon's TRR, Opinion No. 479 affirmed but modified the Initial Decision. The Commission saw no need to establish a formal standard for all non-jurisdictional cases, preferring to deal with the issue on a case-by-case basis. In the present case, we agreed with the presiding judge that, in view of the court's mandate in *PG&E*, the Commission could not "ensure that the

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[11] The Cities of Santa Clara and Redding California and the M-S-R Power Agency jointly filed a request for rehearing which incorporated by reference the arguments and positions taken by TANC in its request for rehearing.

TAC rate is just and reasonable without reviewing the individual components of a non-jurisdictional Participating Transmission Owner's TRR by means of a section 205 review."[12]

14. While the Commission concurred with the presiding judge and Vernon that, as general matter, we had no FPA authority over Vernon's rates, we concluded that "the TRR is subject to our section 205 jurisdiction and both can and must be reviewed thereunder."[13] However, we did not adopt the presiding judge's concept that this was a "section 205 like proceeding."[14] Rather, Opinion No. 479 made clear that "the Commission is performing here a section 205 review of Vernon's TRR."[15] In so doing, the Commission rejected the contention of Vernon and TANC that this course was beyond our statutory authority or foreclosed by the court's mandate in *PG&E*.

15. On the issue of deference to local authority, Opinion No. 479 concluded that the judge had appropriately excused Vernon from the Commission's regulatory filing requirements, as there was a sufficient record compiled here to permit review of the TRR. However, we also agreed with the judge that the Vernon City Council was not due any deference with respect to its review of the TRR, in view of Vernon's status as an interested party in this proceeding. This conclusion was governed, in our view, by "[f]undamental concepts of due process" as well as our statutory responsibility.[16] Thus, a complete rate review under section 205 was necessary.

B. Requests for Rehearing

16. Vernon and TANC seek rehearing on this issue. Vernon takes issue with Opinion No. 479's conclusion that the only way to ensure that the ISO's rate was just and reasonable was for the Commission to examine each component of Vernon's TRR under this standard. Vernon attacks the Commission's logic as "circular" and "an unsupported bootstrap," inconsistent with judicial and Commission precedent, as well as "representations made to the D.C. Circuit in *PG&E* through its Solicitor."[17]

[12] Opinion No. 479 at P 38.

[13] *Id.* at P 42.

[14] *Id.* at P 44.

[15] *Id.*

[16] *Id.* at P 41.

[17] Vernon Request for Rehearing at 49 (footnote omitted).

17. Vernon goes on to assert that Opinion No. 479 reverses Commission precedent specifically establishing that the agency does not have section 205 authority to review the rates of a non-jurisdictional entity.[18]

18. With respect to *PG&*E, Vernon argues that the Commission "errs when it takes the court's ruling . . . to give it discretion to set the rates of a municipality under the FPA."[19] According to Vernon, the decision left open various methods for the Commission to determine whether the ISO rate is just and reasonable when it incorporates Vernon's TRR which would avoid a strict section 205 review. These include assessing whether costs included in Vernon's TRR were prudently incurred,[20] using the record developed on remand by Vernon to review the ISO's rate with Vernon's TRR included,[21] or simply acknowledging that Vernon's TRR did not require close scrutiny because it would "be a small part of any ISO rate."[22]

19. Vernon reiterates its argument that Commission counsel conceded to the court in *PG&E* that the agency could not perform a section 205 review of Vernon's TRR, and that the court relied on this concession. While Opinion No. 479 dismissed this argument based on *Florida Power & Light Co. v. FERC,*[23] Vernon reads that case as holding only that a court cannot rely on *post hoc* representations of counsel.[24]

20. Vernon next contends that the Commission should not have asserted jurisdiction pursuant to section 205 on the ground that Vernon voluntarily submitted its TRR for

[18] *Id.* at 50, citing *California Independent System Operator Corp.*, 91 FERC ¶ 61,205 at 61,724 (2000) (*May 2000 Order*) and *Central Hudson Gas & Electric Corp.*, 88 FERC ¶ 61,138 at 61,403 (1999) (*Central Hudson*). On this point, Vernon also relies on language in *California Independent System Operator Corp.*, 104 FERC ¶ 61,062 at P 22 (2003) (*2003 CAISO Order*). *Id.* at 56.

[19] *Id.* at 58.

[20] *Id.*

[21] *Id.*, citing Ex. VER-7 at 38-49; Ex. VER-16 at 52.

[22] *Id*.

[23] 85 F.3d 684, 689 (D.C. Cir. 1996).

[24] Vernon Request for Rehearing at 57.

review. Vernon cites the recent court decision in *Columbia Gas Transmission Corp. v. FERC* (*Columbia Gas*),[25] in which the court:

> determined that the Commission could not assert [Natural Gas Act] authority over the nonjurisdictional activities of a jurisdictional pipeline, even though the pipeline had "voluntarily" made tariff provisions governing that activity part of a Commission jurisdictional tariff. By the same logic, the Commission would not be able to apply FPA Section 205 to Vernon on the grounds that Vernon "voluntarily made its TRR part of a jurisdictional rate."[[26]]

In any event, Vernon contends, it "did not volunteer to have its TRR directly" subject to a section 205 review, and "the Commission did not require Vernon to sign away its exempt status under the FPA" in order for it to become a Participating Transmission Owner.[27]

21. Finally, Vernon complains that Opinion No. 479 did not give the Vernon City Council the deference appropriately owed to a local ratemaking authority. Vernon argues that the Commission's concern that Vernon could increase its TRR at the expense of other ratepayers is purely speculative, and that Opinion No. 479 provides no explanation of why the agency "would not be able to police any action by Vernon . . . under an arbitrary and capricious standard" to ensure that this did not occur.[28]

22. TANC likewise contends that in Opinion No. 479, "[t]he Commission exceeded its statutory authority by asserting Section 205 jurisdiction over the TRR of a non-jurisdictional entity."[29] TANC makes essentially the same arguments as Vernon on this issue, and cites the same or similar precedent. TANC further argues the authority question by posing an analogy: "The fact that Vernon's TRR is a component of a jurisdictional rate gives the Commission no more authority to review Vernon's rates than it does to review the rates charged by suppliers of [a] new conductor for replacement parts included in the TRR of a jurisdictional utility."[30]

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[25] 404 F.3d 459 (D.C. Cir. 2005).

[26] Vernon Request for Rehearing at 55.

[27] *Id.*

[28] *Id.* at 59.

[29] TANC Request for Rehearing at 9 (footnote omitted).

[30] *Id.* at 13 (footnote omitted).

23. TANC goes on to assert that the "fundamental flaw" in Opinion No. 479 is that it looks solely to Vernon's TRR, but "never reviews the justness and reasonableness of the TAC rate," either with the inclusion of Vernon's originally-filed TRR, or as to the TRR with the revisions required by the Commission.[31]

24. TANC next argues that the Commission's exercise of section 205 authority unnecessarily interferes with the rate-setting authority of local regulatory bodies. Thus, TANC states, "the Commission should have implemented a more reasonable framework, such as TANC's proposed Order No. 888-like standard," that avoids such unnecessary intrusion while ensuring just and reasonable rates."[32] Such alternatives as TANC would deem reasonable include employing an "end-result" test for the ISO's TAC rate,[33] or Order No. 888's comparability standard.[34] With regard to the former, TANC observes that the Commission is not limited to performing a mathematical review of the TAC filing: "Nothing in the TAC precludes the Commission from challenging any component of the ISO's TAC rate."[35] Concerning Order No. 888, TANC contests Opinion No. 479's conclusion that it provides no model for the instant situation. Rather, TANC asserts,

> [b]oth Order [No.] 888 and this proceeding address the costs to a jurisdictional utility for use of the transmission facilities of a non-jurisdictional entity. The [non-jurisdictional] rate paid by a public utility pursuant to an Order [No.] 888 reciprocity tariff produces a cost recoverable through jurisdictional rates of a public utility transmission customer. Order [No.] 888 is extremely similar to the TAC in that the [non-jurisdictional] costs, like the non-jurisdictional TRR, are inputs to a jurisdictional rate.[[36]]

Thus, TANC concludes, Order No. 888 provides a model for the Commission to ensure that costs produced by a non-jurisdictional rate result in a just and reasonable jurisdictional rate, without performing a section 205 review on a non-jurisdictional entity.

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[31] *Id.* at 14.

[32] *Id.* at 26.

[33] *Id.* at 29, citing *New York Independent System Operator, Inc.*, 105 FERC ¶ 61,108 (2003); *Kansas Gas and Electric Co.*, 42 FERC ¶ 61,204 (1988).

[34] *Id.* at 30-31, citing Order No. 888 at 31,460-63; 31,780.

[35] *Id.* at 32.

[36] *Id.* at 34-35.

25. Finally, TANC complains that the deference standard applied by Opinion No. 479 is "impossible for municipal utilities to satisfy" in that "every municipal utility filing a TRR to be included in the ISO TAC will be an interested party in the proceeding."[37] Rather, TANC maintains that the Commission should defer to any TRR established by "proper process at the local level," i.e., one which gives parties adequate opportunity to participate, establishes a record for review, and articulates the basis for the TRR.[38]

C. Commission Determination

26. The Commission denies rehearing on this issue. To begin, we reject the claim advanced by both Vernon and TANC that we are overreaching with respect to our statutory authority by reviewing Vernon's TRR under section 205 of the FPA. Much of the argument here stems from a fundamental disagreement about the meaning of the court's opinion in *PG&E*. As we made clear in Opinion No. 479, we read the court's opinion as fully endorsing – though not necessarily requiring – the Commission's performing a section 205 review of Vernon's TRR to ensure that the ISO's TAC rate, of which it is a component, is just and reasonable.

27. Perhaps the clearest way to deal with petitioners' arguments is to quote the court's clearest statement on the matter:

> The only remaining question is what standard of review should apply, and on this point it is clear that § 205 imposes a "just and reasonable" standard. FERC acknowledges that it is required under § 205 to determine that the rate ultimately charged by an ISO is "just and reasonable." . . . Yet the Orders on review reveal, as noted, no method for ensuring this, neither specifying what approach nor defining the standard FERC applied in determining that the CAISO's rates were "just and reasonable" after the inclusion of Vernon's TRR. . . . While FERC's approach might be acceptable if FERC tested the final ISO composite rate (which included Vernon's requirements) to determine whether it was just and reasonable, FERC acknowledged at oral argument that the CAISO's rate is filed without such review. . . . [A] remand is required so that FERC can articulate with clarity what approach and standard are governing its review and how both ensure the CAISO's rates are just and reasonable under § 205[[39]]

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[37] *Id.* at 39.

[38] *Id.* at 40.

[39] 306 F.3d at 1118-19 (citations and internal quotation marks omitted).

The Commission interprets this, as well as other language in the court's opinion discussed in Opinion No. 479, as expressly upholding the Commission's authority to conduct a section 205 review of Vernon's TRR to ensure that the ISO's TAC is just and reasonable.

28. None of the various theories Vernon and TANC advance in support of their position that the *PG&E* decision could not possibly authorize the Commission to review Vernon's TRR under section 205 comes to terms with the court's actual language.

29. Certainly, the petitioners are unable to point to judicial precedent that is inconsistent with or changes the impact of *PG&E*. For example, both petitioners claim the recent decision in *Columbia Gas* case is controlling. There, the Columbia Gas Transmission Corporation (Columbia) contested a Commission order requiring it to install meters on certain of its gathering facilities. The Commission, while conceding that it had no Natural Gas Act jurisdiction over construction of gathering facilities, nonetheless concluded that jurisdiction under the Act attached because Columbia had voluntarily included the matter in its tariff. The court reversed, finding that that "as a statutory entity, the Commission cannot acquire jurisdiction merely by agreement of the parties before it."[40]

30. In Vernon's case, however, the Commission is not claiming jurisdiction over a non-jurisdictional activity of Vernon. The Commission has jurisdiction over the ISO's TAC rate, of which Vernon's TRR is a component. It is not Vernon's voluntary submission of its TRR (or its voluntarily decision to become a Participating Transmission Owner) which gives the Commission jurisdiction, but the fact that the TRR is an integral part of an admittedly jurisdictional rate. To put it another way, the tariff provision in *Columbia Gas* was not a component of a jurisdictional rate, but a completely independent matter that happened to be referenced in a jurisdictional tariff.

31. In view of our interpretation of the *PG&E* decision, any past pronouncements by the Commission on the statutory authority issue are neither here nor there. Nonetheless, it is worth pointing out that none of the Commission precedent on which petitioners rely stands for the proposition that by evaluating Vernon's TRR under section 205, we are impermissibly expanding our jurisdiction over a municipality.

32. For example, in the *May 2000 Order*, accepting the ISO's TAC filing, we recognized that "[a]n important and difficult issue" was raised because the filing required non-public utility entities such as municipalities to submit their TRRs to the ISO's Revenue Review Panel.[41] The order went on to review the parties arguments concerning

[40] *Columbia Gas*, 404 F.3d 459, 462 (2005), quoting *American Mail Line Ltd. v. FMC*, 503 F.2d 157, 170 (D.C. Cir. 1974) (citations omitted).

[41] *May 2000 Order*, 91 FERC ¶ 61,205 at 61,723.

whether review of a non-jurisdictional entity's TRR was within the Commission's statutory authority. However, contrary to the position of petitioners here, the *May 2000 Order* explicitly did not decide this issue, observing only that it presented "a complex and evolving question," and referring to the Commission's need to "remain flexible to resolutions within the bounds of the FPA."[42] The Commission did caution that, in any event, we "must be able to determine that the pass through of costs by the ISO to its customers [are] just and reasonable."[43]

33. Nor does *Central Hudson* support petitioners' position. There, the Member Systems of the New York Independent System Operator Inc. (NYISO) proposed language in their tariff that applied to certain operations of the Long Island Power Authority (LIPA), a non-jurisdictional entity. The Commission accepted the proposal, but noted that "we cannot review LIPA's rates under the section 205 just and reasonable standard, but will apply the comparability standard we use when evaluating non-jurisdictional" transmission tariffs.[44] However, the tariff provisions affecting LIPA were separate and independent from the jurisdictional rate governed by the NYISO's tariff, unlike Vernon's TRR, which is actually, as we have repeatedly explained, incorporated into a jurisdictional rate.

34. The Commission rejects, once again, Vernon's claim that representations of agency counsel to the court during the course of *PG&E* are of any relevance to our decision. First, Vernon has cited no precedent for the proposition that agency counsel's representations concerning a legal issue can bind a federal agency, and we know of none. In any event, as we understand Vernon's position, it purports to rely on a position taken by counsel – i.e., that the Commission has no authority to review Vernon's TRR under FPA section 205 – which was *rejected* by the court's decision.

35. TANC's theory that the Commission's action here is akin to our reviewing how much the supplier of electric conductors can charge a public utility is also untenable. Here, Vernon's TRR is an actual component of a jurisdictional rate, which must be reviewed in order to ensure that the rate itself is just and reasonable.

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[42] *Id.* at 61,724. The *May 2000 Order* did, however, eliminate the ISO's proposal that the Revenue Review Panel's decisions would be final and non-appealable as "inconsistent with our statutory responsibilities." *Id.* The Revenue Review Panel was subsequently retired by the ISO.

[43] *Id.* Similarly, as we observed in Opinion No. 479, the *2003 CAISO Order* specifically abstained from deciding the issue. Opinion No. 479 at n.54.

[44] *Central Hudson*, 88 FERC ¶ 61,138 at 61,403.

36. This brings us to TANC's contention that the Commission could have, consistent with its statutory authority, employed a less intrusive form of review of Vernon's TRR, such as employing Order No. 888's comparability standard. First, as we described in *Central Hudson*, the comparability standard is applied to non-jurisdictional rates. We reiterate that the comparability standard is therefore an inappropriate standard to apply to the component of a jurisdictional rate that will not be subject to further section 205 review. Second, we are aware of no instance in which the end result test was applied to a discrete element of a rate, rather than the rate itself. Finally, while the entire TAC mechanism could have been structured in a different manner, allowing for a review of the final rate itself, the fact is that it was not.

37. In sum, the Commission holds that a section 205 review of Vernon's TRR is necessary here to ensure that the TAC rate is just and reasonable.

38. Finally, the Commission rejects TANC's contention that it will be impossible for municipalities submitting a TRR to be included in the TAC to receive more deference than that given to Vernon. We reiterate that our decision here, including the level of deference to the Vernon City Council, is based solely on the specific facts presented by this case.

II. AFUDC

A. Opinion No. 479

39. The purpose of AFUDC is to compensate a utility for the costs of financing during construction.[45] Opinion No. 479 summarily affirmed the Initial Decision's finding that Vernon is not entitled to increase its asset accounts for AFUDC, largely due to the fact that Vernon did not incur any financing costs during the period of construction for its contribution towards its entitlement in the COTP, MAP and MPP facilities. However, we will clarify further our position in response to issues raised on rehearing.

40. In the Initial Decision, the presiding judge found that Vernon was not entitled to the AFUDC costs it sought in its third TRR filing based on its share in the COTP, MAP and MPP facilities, primarily because Vernon financed the construction of these facilities with cash instead of debt.[46] Thus, the judge determined, Vernon did not pay interest or

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[45] AFUDC is defined by Electric Plant Instruction No. 3.A (17) as "the net cost for the period of construction of *borrowed* funds used for construction purposes and a reasonable rate on other funds when so used." 18 C.F.R. Part 101 (2005) (emphasis added). Based on the Commission's formula for calculating AFUDC, "other funds" refers to preferred stock and common equity.

[46] Initial Decision at P 69, citing Ex. S-11; Ex. VER-1 at 3.

carrying costs and "never recorded AFUDC on its books."[47] The presiding judge also found that the record was unclear as to whether Vernon's rates during the period of construction included a flow through of the finance costs. If finance costs were flowed through Vernon's existing rate during the period of construction, she concluded, "capitalizing the AFUDC amount Vernon proposes would result in double recovery of the same costs[,] once through the rates charged during the construction period and again through the TRR."[48] The presiding judge went on to state that "it is presumed Vernon recovered these 'alleged' costs in its rates and thus need not double recover them now as AFUDC. This is supported by the fact that Vernon never increased its rates until the California energy crisis."[49] Moreover, the judge observed that Vernon had not sought a rate increase during the time frame the projects in question were under construction (from 1985 through March 1996).

41. In addition, the presiding judge expressed concern that Vernon's AFUDC proposal had not been mentioned in Vernon's first two TRR filings. In this regard, the judge rejected testimony by Vernon witness Somoano attempting to explain this. Moreover, the Initial Decision noted an inconsistency between Somoano's methodology for calculating AFUDC in the previous TRR filings and that of Clay in the third TRR filing. Indeed, the judge found Vernon witness Clay conceded that "Vernon did not carry AFUDC on its books as a component of Gross Plant and [that] he had to 'compute' AFUDC" in order to include it in the TRR calculations.[50] In this regard, the record also established that Vernon's AFUDC proposal was not certified by independent auditors.

42. As the judge summed up her findings:

> It appears inequitable to allow Vernon recovery of AFUDC on money spent many years ago (19), which was never recorded in its books, appears to have been created solely for purposes of the TRR, and may have been previously recovered in retail rates. Accordingly, it is found that Vernon may not recover an amount for AFUDC in its TRR.[[51]]

43. Finally, the Initial Decision considered and rejected Vernon's argument that "cash could be the equivalent of equity, and that its ratepayers may have given up opportunity

[47] *Id*.

[48] *Id.* at P 71.

[49] *Id.* at P 71, citing Tr. at 333-38.

[50] *Id.*, citing Ex. VER-7 at 33.

[51] *Id.* at P 74 (footnote omitted).

costs by its use of this cash," as the record was "devoid of any evidence as to what [these ratepayers] might have given up or any quantification thereof."[52] On this point, the Initial Decision further indicated that because one of Vernon's stated primary goals in setting its retail rates was to remain competitive with SoCal Edison, its rate design was "evidently following a not entirely cost base rate design approach," and thus "may not be comparable to a regulated utility" with respect to this matter.[53]

B. Request for Rehearing

44. Vernon initially complains that while Opinion No. 479 "purports to apply" a section 205 standard to its TRR, "no investor-owned utility would be denied recovery for AFUDC for pre-operational investments it has turned over to ISO Operational Control."[54] Vernon maintains that it is the victim of undue discrimination, as it owns COTP with PG&E and other utilities, and "PG&E is allowed by the Commission to recover AFUDC in its TRR for its share of COTP."[55] In this regard, Vernon relies on the *May 2000 Order*, where the Commission disallowed the ISO's proposed "buy down" provision because it would have treated PG&E differently from NCPA, with whom it shares COTP entitlements.[56]

45. Vernon next argues that if a section 205 standard was applied, then the Commission should have determined the justness and reasonableness of Vernon's AFUDC proposal. Instead, Vernon states that the Initial Decision, as adopted by Opinion No. 479, simply states that allowing Vernon AFUDC recovery "appears inequitable."

46. Vernon additionally argues that in *California Independent System Operator Corporation*, 109 FERC ¶ 61,153 (2005), the Commission determined that the Western Area Power Administration (Western) was entitled to recover its project investment for the Path 15 Upgrade Project with interest to compensate Western for the time value of

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[52] *Id.* at P 70.

[53] *Id*.

[54] Vernon Request for Rehearing at 4.

[55] *Id.* at 6.

[56] *Id.*, citing *May 2000 Order*, 91 FERC ¶ 61,205 at 61,728. Vernon also takes what appears to be a contradictory position, asserting that the Commission erred by never having undertaken a review of municipal accounting or ratemaking in order to develop and promulgate accounting or ratemaking requirements to be applied to municipal utilities. *Id.*

money. Vernon claims that the same standard should apply to both Western's and Vernon's TRRs.

47. Vernon asserts that the age of its facilities should not be a basis for denial. Vernon claims that SoCal Edison and PG&E recover for AFUDC in their TRRs for money spent long before any of the sums spent by Vernon. Vernon contends that it "may have spent money years ago, but it is now all ISO customers that are using facilities on which that money was spent."[57] Vernon further contends that it recorded "cash calls" on its books "when ever it paid a contractor" with respect to construction of these facilities.[58]

48. Next, Vernon attacks the Initial Decision's determination that authorizing AFUDC would involve unrecorded transactions. On the contrary, Vernon observes, the judge "specifically recognized" that Vernon recorded "cash calls" on its books whenever it paid a contractor.[59] While conceding that "AFUDC did not appear as an account in Vernon's audited financial statements," Vernon believes that Commission has long recognized that section 205 ratemaking is not determined by accounting principles.[60] In any event, according to Vernon, the AFUDC costs are no different from other costs allowed in its TRR, other than timing: "Vernon's overall return is a current cost of funds included in current rates, whereas AFUDC relates to investments made prior to operations."[61]

49. Vernon contends that AFUDC for its facilities should be calculated under the formula set out in Commission Plant Instruction 3A(17), providing that AFUDC shall contain "a reasonable rate on *other funds* so used."[62] According to Vernon, this language means that, contrary to the holding of the Initial Decision, AFUDC may be provided for cash investments. And to the extent that its calculation was in excess of AFUDC permitted by the Commission's regulations, Vernon argues that its AFUDC recovery

[57] *Id.* at 10.

[58] *Id.* at 11.

[59] *Id.* at 13.

[60] *Id.* at P 71, citing Tr. at 333-38.

[61] *Id.* at 17.

[62] *Id.* at 17, quoting 18 C.F.R. Part 101 (2005) (emphasis Vernon's).

should not be eliminated, but merely subject to a correction in accordance with the regulations.[63]

50. Vernon also refutes the notion that it created AFUDC solely to maximize rate recovery under its TRR. Vernon states that its last full retail cost-of-service rate design was in 1984, long before investment was made in any of the transmission facilities at issue. Thus, there was no occasion to determine bundled retail customer charges for such facilities in tandem with the TRR. Once the ISO assumed operational control of Vernon's facilities, Vernon claims that such costs became applicable to Vernon's TRR for ISO purposes, not its retail rates.

51. Vernon also denies that AFUDC costs may have previously been recovered in retail rates. Vernon asserts that the record acknowledges that "[it] never increased its rates until the California energy crisis," which supports Vernon's claim that transmission construction work in progress costs (CWIP) were not collected in Vernon's retail rates, as Vernon's rates were not changed until long after investments in that transmission began.[64] With respect to the COTP, the largest of the three projects, Vernon states that it had to commit to this transmission project to obtain high voltage transmission access, knowing that the facilities could not be used and useful to Vernon customers upon the in-service date. Moreover, Vernon argues that CWIP in current rates is not the norm. The Commission's own policy, according to Vernon, is to add AFUDC to the utility's rate base to be charged in rates starting when the facility goes into service.

52. Alternatively, Vernon argues that, even if retail recovery of CWIP occurred, the Commission's ratemaking is not bound by the accounting or ratemaking utilized at the retail level. Vernon cites to a number of cites which affirm that the Commission "follow[s] its own precedents or, alternatively, provide[s] reasoned explanation for a material departure therefrom."[65] Vernon contends that, "[i]n any event, if Vernon retail customers had paid all CWIP in rates years ago, they bore the costs of facilities that are now unquestionably being used, not by those Vernon retail customers alone, but instead

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[63] In this regard, Vernon relies on *SFPP, L.P.*, Opinion No. 435, 86 FERC ¶ 61,022 at 61,095 (1999) (*SFPP*), *aff'd in part*, *BPW Coast Products v. FERC*, 374 F.3d 126 (D.C. Cir. 2004), where the Commission stated that "a complete denial of AFUDC [recovery] would be an inordinately harsh result" in response to an oil pipeline's deficient accounting records. Vernon also cites *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122 (1991) (*Kuparuk*).

[64] Vernon Request for Rehearing at 23

[65] *Id.* at 26, citing *Union Electric Co.*, 40 FERC ¶ 61,046 at 61,131 (1987) (Opinion No. 279).

to serve all ISO customers."[66] Thus, "it would be appropriate to include AFUDC in Vernon's TRR now so the customers that are using the facilities are paying the costs of those facilities in rates and Vernon retail customers that previously paid those costs are benefited."[67]

53. In response to the presiding judge's assertion that AFUDC was not mentioned by Vernon in the first and second TRR filings, Vernon takes issue with efforts to discredit Vernon witness Somoano's testimony, who testified and prepared workpapers supporting these filings. Vernon argues that Somoano's testimony is mathematically correct and the basis for Vernon witness Clay's AFUDC presentation in the third TRR filing. Accordingly, Vernon finds that there is no basis for the presiding judge to question whether Vernon's gross plant contains AFUDC in the earlier filings. While Vernon admits that its August 30, 2000 filing utilized a different rate for AFUDC than did witness Clay in his AFUDC presentation in the third TRR filing, this was because, on remand, Vernon decided that the rate established by Instruction 3A(17) was more appropriate for calculating AFUDC.

C. Commission Determination

54. As the presiding judge stated in the Initial Decision, the Commission's regulations define AFUDC as including "the net cost for the period of borrowed funds used for construction purposes and a reasonable rate on other funds when so used."[68] Vernon contends that in stating that "other funds" may be included in the calculation of AFUDC, the Commission's regulations allow for recovery of AFUDC on cash paid for construction. Thus, Vernon argues that if a section 205 standard of review was applied to its proposed recovery of AFUDC, the Commission should have accepted its proposal as just and reasonable. For the reasons set forth below, we disagree.

55. First of all, it is undisputed that Vernon chose not to borrow funds to finance the construction of the MAP, MPP, or its portion of the COTP, but rather financed these facilities with cash and recorded "cash calls" whenever it paid a contractor. As a result of this choice, Vernon did not carry AFUDC in its books as a component of gross plant and, in fact, had to compute AFUDC in order to include it in its TRR calculations.[69] The record does not contain any evidence as to the costs of construction for which Vernon should be compensated. Therefore, Vernon is attempting, as an out-of-period adjustment,

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[66] *Id.* at 27.

[67] *Id*. at 27-28.

[68] 18 C.F.R. Part 101, Electric Plant Instruction No. 3.A (17) (2005).

[69] *See* Ex. VER-16 at 65.

to impute AFUDC where there is no record of its existence. Without record evidence to the contrary, we must assume that Vernon recovered the costs for construction of its facilities.

56. In this respect, the presiding judge was unable to ascertain whether Vernon's retail rates represented a flow through of pre-operational costs for the MAP, MPP and COTP facilities. When asked directly how Vernon's retail rates were designed, Vernon's witnesses were unable to provide testimony regarding the derivation of these rates, including whether or not they included a return on construction costs. In a prior order, the Commission held that a "return and AFUDC are alternatives to each other . . . [o]ne or the other, but not both simultaneously, can be applied" to a facility.[70] Therefore, Vernon can only earn either a return or AFUDC.

57. Vernon contends that the provision that AFUDC shall contain "a reasonable rate on other funds so used" allows the provision of AFUDC for cash investments. Vernon also cited to *SFPP* to argue that to the extent that its calculation was in excess of AFUDC permitted by the Commission's regulations, recovery should not be eliminated, but merely subject to a correction in accordance with the regulations. In *SFPP*, the Commission stated that "[i]n essence, the [AFUDC] allowance compensates the pipeline for the return that would otherwise be earned on funds that have been committed for utility purposes but have not yet been included in rate base."[71] In that case, the Commission allowed recovery of AFUDC even though SFPP did not use a proper methodology for computing AFUDC and did not keep proper records. However, SFPP, unlike Vernon, requested recovery of AFUDC initially and did not wait until years after the fact to create an AFUDC computation solely for the sake of a rate case. In addition, it was clear that SFPP had not yet included these amounts in rates base, which is not the case in this proceeding. Finally, SFPP, unlike Vernon, did not have to go back and recalculate a portion of its rate. Therefore, although in the SFPP proceeding the Commission found that a complete denial of AFUDC would be an inordinately harsh result, SFPP and Vernon are not similarly situated in regard to the AFUDC analysis.[72]

58. Vernon contends that the fact that its facilities were built years ago should not be a basis for denial of AFUDC. In addition, Vernon argues that, "even if it could be shown that Vernon's retail customers had picked up the costs, that does not reduce the value of the facilities to ISO customers and Vernon or its retail customers should not bear the costs."[73] Vernon misses the point. ISO customers pay for their use of the facilities

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[70] *Southern California Edison Company*, 37 FERC ¶ 63,014 at 65,141 (1986).

[71] *SFPP*, Opinion No. 435, 86 FERC ¶ 61,022 at 61,094.

[72] *Id*. at 61,095. The same situation was presented in *Kuparuk*.

[73] Vernon Request for Rehearing at 28.

through the TRR, therefore the current value of these facilities is not inappropriately subsidized by Vernon or its retail customers.

59. Whether or not Vernon is allowed to include AFUDC in its TRR rests on whether or not Vernon has actually incurred these costs and, if so, whether it has not already recovered them. There is no record evidence to indicate that Vernon has actually incurred the costs or that Vernon did not include construction costs in its rates. The ISO should not have to absorb the imputed costs of construction of these facilities, for which there is no evidence. We agree with the presiding judge's finding that "it is presumed Vernon recovered these 'alleged' costs in its rates and thus need not double recover them now as AFUDC."[74] Vernon's assertion that the presiding judge erred in determining that authorizing AFUDC would not involve unrecorded transactions because it recorded the "cash calls" is untenable. It is true that, in the strictest sense of the word, the transactions involved were recorded. However, they were not recorded as AFUDC, therefore, for the purposes of calculating AFUDC, these transactions are not recorded.

60. Vernon claims that the Commission's denial of its requested recovery of AFUDC is discriminatory because PG&E is allowed to recover AFUDC in its TRR for its share of the COTP. Vernon further argues that the Commission has previously allowed Western recovery of project investment costs to compensate for the time value of money. These contentions are unfounded. The Commission is not basing its decision on the fact that PG&E is an investor-owned utility and Vernon is not. Regardless of the fact that PG&E and Vernon are co-owners of the COTP, they are not similarly situated in regard to AFUDC. PG&E financed its portion of the COTP with debt financing, while Vernon did not. Further, both PG&E and Western provided the Commission with evidence that it had computed these costs all along, not specifically so that they could recover them through their TRRs.

III. Updating the Return on Equity

A. Opinion No. 479

61. The Initial Decision found that the appropriate return on equity for Vernon should be set at the level established by the Commission in *Opinion No. 445* for SoCal Edison. Because a substantial amount of time had passed since Vernon first filed its case-in-chief in this proceeding, *Opinion No. 479* concluded that Commission precedent required Vernon's return on equity to be updated.[75] Thus, the Commission's updating method effectively reduced Vernon's return on equity to 10.72 percent, applicable on a

[74] *Id.* at 23, citing Tr. at 333-38.

[75] The Commission relied on *System Energy Resources, Inc.*, 92 FERC ¶ 61,119 (2000) (*System Energy*) in making this determination.

prospective basis, by adjusting the yields on 10-Year Treasury Notes for the period January 1, 2001 (the effective date of Vernon's TRR) through the day before the date of issuance of *Opinion No. 479*. This rate represents the low end of the zone of reasonableness found by Trial Staff witness Green and Vernon witness Hanley, consistent with Commission precedent that requires updates to be within the zone of reasonableness in the record.[76] The Commission deferred "the question of what, if any, remedy may be necessitated by the Commission's updating of Vernon's rate of return [to] the compliance phase of this proceeding."[77]

B. Request for Rehearing

62. Vernon requests rehearing with respect to the Commission's decision to update its return on equity. According to Vernon, "[i]f the Commission's approval of Vernon's TRR had not been remanded by the DC Circuit the Commission would not assert authority to change [its] [return on equity]."[78] It follows, reasons Vernon, that

> [i]t is arbitrary and capricious and not reasoned decisionmaking for the Commission to determine that the procedural process of *affirmance* of its original determination cause its original determination to be reduced by reference to data for periods after the original determination. To so hold would be to determine that its original determination could *never* effectively have been affirmed on remand, because some change in Treasury bond rates is always likely to have taken place in the time period between the end of the test period and a court remand to the Commission.[[79]]

C. Commission Determination

63. The Commission denies rehearing on this issue. As Opinion No. 479 indicated, the Commission's policy is to update prospective rates of return when there has been a

[76] Trial Staff's calculation employs a comparison between the average yield on ten-year U.S. Treasury bonds for the six-month period covered by the DCF analysis at issue (base-line) and the period the rates were in effect, resulting in a reduction of 1.13 percent, which, when subtracted from the 11.60 percent, would yield a result that is outside the zone of reasonableness.

[77] *See* Opinion No. 479 at n.105.

[78] Vernon Request for Rehearing at 45.

[79] *Id.* (emphasis in original).

passage of time between the original determination and a final agency decision.[80] Vernon does not dispute precedent which announces this policy. Rather, Vernon seems to argue that the policy cannot be applied after a judicial remand arising from other issues. Our precedent for updating, however, makes clear that it is the passage of time that requires this action to ensure that the prospective rate of return is as accurate as possible. Contrary to Vernon's argument, the reason for the delay, including the intervening action by a court, is simply not relevant.[81]

IV. Refunds

A. Opinion No. 479

64. The Initial Decision, in discussing the operational control issue, rejected Vernon's argument that the Commission did not have refund authority in this proceeding on the equivocal ground that refunds were not actually at issue:

> Suffice to state that "refunds" are not being ordered in this case. The decision above means that the ISO over collected concerning Vernon's TRR. Consequently, this overage can be netted out in the ISO's balancing account. *But cf. San Diego Gas & Electric*, 96 FERC ¶ 61,120 (2001) (refunds in the California spot markets ordered by the Commission).[[82]]

65. Vernon faults the Initial Decision's analysis, asserting that refunds were indeed at issue in this case, and that the Commission was without authority to require any such refunds.

66. Opinion No. 479 did not reach the issue. As discussed above, with respect to the operational control issue, we imposed a policy that would require a remedy only on a prospective basis. The question of appropriate remedy was also brought to the fore by Opinion No. 479's determination that Vernon's rate of return must be updated. However, we postponed consideration of "what, if any, remedy" might be imposed as a result of the "compliance phase of this proceeding."[83]

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[80] Opinion No. 479 at P 109.

[81] *See System Energy*, 92 FERC at 61,447.

[82] Initial Decision at P 58 n.41.

[83] Opinion No. 479 at P 110 n.5.

B. Requests for Rehearing

67. Vernon asserts that the Commission has no authority to order that it make refunds in this proceeding, and that, assuming the agency did have such authority, refunds would be inequitable under the circumstances presented. The Companies argue that the Commission is not only authorized to employ a refund remedy, but also should order refunds to reflect reductions in Vernon's TRR required by this case. SWP argues that the Opinion No. 479's resolution of the operational control issue requires refunds of the costs of the relevant transmission entitlements.

68. Vernon advances essentially two reasons why "the Commission has no authority, direct or indirect, to order that Vernon make refunds in the current circumstances, whether or not FPA Section 205 is applied to Vernon."[84] First, Vernon contends that, under section 205 the filing of its TRR "would have been an initial rate filing" and as such, not subject to refund.[85] Second, Vernon asserts that even if its filing were for a jurisdictional rate change, the filing cannot be subject to refund "because it was not suspended and made subject to refund by the Commission before it went into effect."[86] As Vernon explains, "[a] suspension period, whether nominal or longer, is an absolute prerequisite to refund exposure."[87]

69. Vernon also takes issue with arguments made below by the Companies that Vernon acceded to refund liability in its August 30, 2000, Petition for Declaratory Order, or by signing onto the ISO's Transmission Control Agreement.

70. In the alternative, Vernon urges the Commission to employ its discretion not to order refunds in this case. As Vernon elaborates:

> This proceeding, involving the first ever nonjurisdictional [Participating Transmission Owner] TRR filing, has involved uncertain and changing standards during its course, and matters that involve actions taken during past periods when Vernon was not even arguably within section 205.[[88]]

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[84] Vernon Request for Rehearing at 37.

[85] *Id.* at 38 (footnote omitted). In this context, Vernon relies *Middle South Energy, Inc. v. FERC*, 747 F.2d 763 (D.C. Cir. 1984), as well as on the testimony of Trial Staff witness Tingle-Stewart. Tr. at 1020.

[86] *Id.* at 40.

[87] *Id.* at 41 & n.76, citing *Municipal Light Boards v. FPC*, 450 F.2d 1321 (D.C. Cir. 1971).

[88] *Id.* at 35-36.

71. The Companies assert that the Commission should decide the refund issue presently, rather than defer it to a later phase of the proceeding. They argue strenuously that the Commission has authority to order Vernon to make refunds in this proceeding, and that such refunds are appropriate for any impermissible costs Vernon included in its TRR.[89] SWP also seeks rehearing on this issue.

72. The Companies additionally request that the Commission clarify that Opinion No. 479 intended to provide refunds with respect to the improperly included AFUDC costs and Vernon's proposed COTP deferral costs, thereby reflecting the Commission authorized TRR as of January 1, 2001. If the Commission does not so clarify Opinion No. 479, the Companies request rehearing on this issue.

73. With respect to the Commission's authority to require Vernon to pay refunds, the Companies rely on section 16.2 of the ISO's Transmission Control Agreement, pursuant to which Vernon "unambiguously promised that it [would] provide the refunds ordered by the Commission as a result of a reduction of its TRR to the ISO."[90]

C. Commission Determination

74. The Commission agrees that it should not postpone deciding the refund issue, and grants the Companies' rehearing to that extent.

75. We first address the question of authority. The Commission denies Vernon's request for rehearing on the issue of our authority to order refunds in this proceeding. We agree with the Companies that the issue is decided by the terms of section 16.2 of the ISO's Transmission Control Agreement, to which Vernon is a signatory. Section 16.2 provides:

> Each Participating [Transmission Owner] whether or not it is subject to the rate jurisdiction of FERC under section 205 and section 206 of the Federal Power Act shall make all refunds, adjustments to its Transmission Revenue Requirement, and adjustments to its [Transmission Owner] Tariff, and do all other things required of a Participating [Transmission Owner] to implement any FERC order related to the ISO Tariff, including any FERC Order that requires the ISO to make payment adjustments or pay refunds to, or receive prior period overpayments from, any Participating [Transmission

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[89] Companies Request for Rehearing at 10-17.

[90] *Id.* at 11.

> Owner]. All such refunds and adjustments shall be made, and all other actions taken, in accordance with the ISO Tariff, unless the applicable FERC order requires otherwise.[[91]]

It is difficult to read this provision as anything but an explicit agreement by non-jurisdictional Participating Transmission Owners to make refunds arising from any Commission order to the ISO, from which they would otherwise be immune by statute.

76. As the Companies explain, if the Commission determines that a previously-authorized TRR of any Participating Transmission Owner is excessive, the ISO would have to recalculate its TAC, and refunds would have to be made to the transmission customers who overpaid. However, because the ISO is a non-profit entity with no funds of it own, such refunds must be the responsibility of the Participating Transmission Owner "that received the excessive revenues collected by the ISO under the [TAC] that are subject to recalculation."[92] Thus, the Companies conclude, because a non-jurisdictional Participating Transmission Owner would not be bound by Commission orders requiring refunds, specific language was included in section 16.2 of the Transmission Control Agreement to ensure that they would be on the same footing as jurisdictional Participating Transmission Owners with respect to refunds.

77. The Commission's order approving this provision of the Transmission Control Agreement confirms the Companies' explanation.[93] As we explained there, the ISO had proposed section 16.2 specifically to remedy the situation in which a "non-jurisdictional Participating Transmission Owner, such as Vernon, will not be obligated to adjust rates or make refunds in accordance with the ISO Tariff."[94] In approving this provision, we went on to state:

> The ISO explains the need, under Commission precedent, for a contractual provision to bind Vernon to pay refunds. The provision is not intended to, and would not, expand the Commission's jurisdiction to non-public utility entities, such as Vernon. *Rather, the section will create a contractual*

[91] *See* Ex. S-3 in Docket No. ER00-2019 *et al*.

[92] Companies Request for Rehearing at 13 (footnote omitted).

[93] *California Independent System Operator Corp.*, 94 FERC ¶ 61,141 at 61,150 (2001).

[94] *Id*.

> *obligation to contribute to refund payments, should they be required.* On this basis, we find proposed section 16.2 reasonable.[[95]]

78. Vernon agrees that "[s]ection 16.2 is intended to put nonjurisdictional and jurisdictional utilities on the same plain [sic] as to refund exposure relating to their TRRs."[96] Nonetheless, Vernon maintains that section 16.2 has no application here,

> where an investor-owned utility would not be subject to refunds. Section 16.2 simply requires nonjurisdictional [Participating Transmission Owners] to comply with Commission refund orders regardless of their section 205 jurisdictional status. It does not obviate the requirements and policies of FPA section 205/206 and the Commission's regulations, as developed in an extensive body of precedent, as to what the Commission may or should order as to refunds. It provides no basis for ordering a nonjurisdictional utility to make refunds where a jurisdictional utility would not be required to make them.[[97]]

79. The Commission rejects this argument. As we have explained above, while the Commission is reviewing Vernon's TRR filing pursuant to its section 205 authority, in order to assure the justness and reasonableness of the CAISO's TAC, Vernon itself – as it has repeatedly reminded us – is not subject to section 205. Thus, Vernon's TRR filing was not made pursuant to section 205 (for this reason, it was not subject to the requirements for section 205 filings mandated by the Commission's implementing regulations). It follows that the Commission was not governed by the technical requirements of section 205 in accepting the filing and, after the court's remand, setting it for hearing. Vernon's obligation to make refunds in this proceeding does not arise from any statutory requirement, but from the contractual obligation to which Vernon is bound by the Transmission Control Agreement.

80. Nothing in the language of section 16.2 of the Transmission Control Agreement or the Commission's approval of the provision supports Vernon's reading that the section is only operative if the Commission makes particular findings pursuant to section 205. Indeed, it is fair to say that, in view of the various uncertainties concerning our review of a non-jurisdictional ISO member's TRR, the Commission would not have approved such a provision which included such restrictions.

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[95] *Id.* (emphasis added).

[96] Vernon Request for Rehearing at 43 n.79.

[97] *Id.*

81. In view of our decision that the Transmission Control Agreement binds Vernon to pay any refund the Commission orders in connection with the over collection of its TRR, we do not need to reach Vernon's arguments concerning section 205 and related precedent, such as whether Vernon's TRR is an initial rate.

82. We now turn to the equitable considerations involved in any refund the Commission may order in this proceeding. At the outset, we look to *Towns of Concord v. FERC*, 955 F.2d 67 (D.C. Cir. 1992) (*Concord*), in which the court explained the relevant standard the Commission should apply with respect to refunds under the FPA:

> Customer refunds are a form of equitable relief, akin to restitution, and the general rule is that agencies should order restitution only when money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it. Because the equitable aspects of refunding past rates are . . . inextricably entwined with the [agency's] normal regulatory responsibility, absent some conflict with the explicit requirement of the core purposes of a statute, we have refused to constrain agency discretion by imposing a presumption in favor of refunds. . . . The agency need only show that it considered relevant facts and . . . struck a reasonable accommodation among them, . . . and that its order granting or denying refunds was equitable in the circumstances of this litigation.[[98]]

83. Applying this standard, we deny the requests for rehearing by both the Vernon and the Companies, affirm Opinion No. 479's conclusion that refunds are inappropriate concerning its over-collection in connection with the operational control of MAP and MPP, but necessary and proper with respect to Vernon's over collection of its TRR in other respects.

84. With respect to the Companies' requested clarification, it appears that no COTP deferral costs had been included in Vernon's TRR.[99] Accordingly, no refunds related to COTP deferral costs are appropriate, and the Companies' requested clarification is denied.

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[98] 955 F.2d at 75-76 (citations and internal quotations omitted), citing *Atlantic Coast Line R.R. v. Florida*, 295 U.S. 301, 309 (1935); *Public Serv. Comm'n v. Economic Regulatory Admin.*, 777 F.2d 31, 36-38 (D.C. Cir. 1985); *Wisconsin Electric Power Co. v. FERC*, 602 F.2d 452, 457 (D.C. Cir. 1979); *Moss v. Civil Aeronautics Board*, 521 F.2d 298, 309-309 (D.C. Cir. 1975); cf. Restatement of Restitution § 1, comment c (1937).

[99] *See, e.g.*, Staff witness Tingle-Stewart, Ex. S-19 at 3 and Tr. 1027-29; SCE witness Cuillier, Ex. SCE-30 at 7.

85. In regard to the refunds arising from issues other than operational control, we begin with the firmly-established fact that the one of the core purposes of the FPA is to ensure that consumers are not charged unjust and unreasonable or otherwise unlawful rates.[100] Here, including elements in Vernon's TRR which should not be incorporated therein would mean that such costs would be shifted to ISO ratepayers who received no concomitant benefit. Obviously, this factor weighs strongly in favor of refunds by Vernon with respect to these issues.

86. The only countervailing consideration Vernon advances is that because this proceeding was the first involving the TRR of a non-jurisdictional Participating Transmission Owner, it "has involved uncertain and changing standards during its course, and matters that involve actions taken during periods when Vernon was not even arguably within section 205."[101] Concerning the latter point, suffice it say that Vernon's proposed TRR was solely created for a jurisdictional purpose, i.e., to be included in the CAISO's TAC. And while the Commission agrees that the court's decision in *PG&E* altered the landscape of this case, the actual items for which we are requiring refunds, such as the updating of the rate of return, are governed by routine FPA precedent. In sum, the equities strongly favor that refunds should be made by Vernon except with respect to the operational control issue, to which we now turn.

V. Operational Control

A. Opinion No. 479

87. In Opinion No. 479, the Commission affirmed the finding of the Initial Decision that the CAISO did not assume operational control over the MAP and MPP until January 1, 2003, so that costs associated with these facilities should not be recovered from CAISO ratepayers through the TAC rate.[102] The Commission agreed with the presiding judge that, with respect to Vernon's MAP and MPP capacity, the record demonstrated that for a period of two years, only Vernon had access to that capacity, in contravention of the Commission's open access policy. We also rejected Vernon's argument that the CAISO's definition of "operational control" supports its position which in our view "could allow the CAISO unfettered discretion as to when to allow open and

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[100] *See* 16 U.S.C. § 824d(a); *Public Systems v. FERC*, 606 F.2d 973, 979 n.27 (1979).

[101] Vernon Request for Rehearing at 36.

[102] Opinion No. 479 at P 73.

non-discriminatory access to facilities over which the CAISO has agreed to take control."[103] Rather, the Commission explained:

> The existence of Operational Control is not determined by what any Market Participant knew or did not know – it is determined by the relevant tariff and the standards and guidance provided by the Commission. Furthermore, the very purpose for which the ISO assumes Operational Control is to provide open access to its transmission facilities. This was not the case with respect to Vernon's MAP and MPP capacity during the period in question.[104]

88. Opinion No. 479 also denied Vernon's contention that the failure to provide scheduling points for the MAP and MPP was not similar to the temporary unavailability of transmission facilities that are out of service because of technical problems or for maintenance. Nor was this a case, as Vernon claimed, of the CAISO removing facilities from its control through action or neglect. "Although the CAISO may not be able to remove facilities from its control through inaction," Opinion No. 479 stated, here "its inaction has proven that it did not have control in the first place."[105]

89. The Commission concurred with the presiding judge that Opinion Nos. 445[106] and 466[107] supported our decision here. Specifically, we agreed with the Initial Decision's assessment that for all practical purposes, the CAISO grid received no additional reliability benefits from the MAP and MPP capacity.

90. In sum, Opinion No. 479 concluded that a Participating Transmission Owner would not be allowed to recover its TRR until the CAISO has established scheduling points and the capacity is available to all market participants. On the issue of remedy, however, the Commission found that while this situation had been caused by the ISO, rather than Vernon, the ISO by its nature could not be held financially responsible for its

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[103] *Id.* at P 74.

[104] *Id.* at P 75.

[105] *Id.* at P 77.

[106] *Southern California Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070 (2000).

[107] *Pacific Gas and Electric Co.*, 104 FERC ¶ 61,226 (2003), *order on reh'g, Pacific Gas and Electric Co.*, Opinion No. 466-A, 106 FERC ¶ 61,144 (2004); *order on reh'g*, *Pacific Gas and Electric Co.*, Opinion No. 466-B, 108 FERC ¶ 61,297 (2004), *appeal docketed sub nom.*, *California Department of Water Resources v. FERC*, D.C. Cir. No. 04-7613 (filed Nov. 22, 2004).

failure to act, whether or not it was the product of negligence.[108] Furthermore, we acknowledged that requiring Vernon to make refunds would have been inequitable in the instant situation, where Vernon had neither notice that its TRR was subject to refund, nor a clear vehicle to pursue questions about the CAISO's inaction. However, we concluded,

> the deciding factor in this equivocal situation is that ISO ratepayers are entitled under the FPA to a just and reasonable TAC rate, which should not, as a matter of regulatory principle, include the cost of facilities which do not benefit them. Thus, in the future, our policy will be to hold the Participating Transmission Owner financially responsible in a situation of this nature.[[109]]

In this regard, the Commission stated that the ISO should take necessary steps to avoid a repetition of this situation, and that Participating Transmission Owners were on notice if the situation did, indeed, recur.

B. <u>Requests for Rehearing</u>

91. The Companies and SWP advance a number of arguments in support of the Commission requiring refunds by Vernon for the TRR excess associated with the MPP and MAP entitlements. SWP maintains that because inclusion of the costs of transmission entitlements not under the ISO's operational control violates the ISO Tariff, "such inclusion violates both the filed rate doctrine and corollary rule against retroactive ratemaking."[110] In this regard, SWP complains that excusing Vernon from paying these refunds violates FPA section 205, in that ISO ratepayers would be paying for facilities from which they derived no benefit.

92. Both the Companies and SWP contend that Opinion No. 479 erred in finding that Vernon did not have notice that its TRR was subject to refund. The Companies additionally claim the Commission erred in holding that this issue was one of first impression. According to the Companies, Opinion No. 445 addressed the issue by "reject[ing] the notion of credits for municipal-owned facilities" which were not under ISO operational control.[111]

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[108] *Id.* at P 80.

[109] *Id.* at P 82 (footnote omitted).

[110] SWP Request for Rehearing at 5.

[111] Companies Request for Rehearing at 5, citing *Southern California Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070 (2000), *reh'g denied*, 108 FERC ¶ 61,085 (2004).

93. The Companies also contend that the equities in this case plainly lie with the ISO ratepayers. They observe that, because of the lack of scheduling points, the MAP and MPP facilities were used exclusively by Vernon in calendar years 2001 and 2002. Thus, Vernon's ratepayers enjoyed the benefit of those facilities and will suffer no harm if the Commission orders refunds in connection with the these facilities.

94. The Companies further argue that ISO and Vernon had reached a private agreement that Vernon would continue to use the MAP and MPP entitlement much as it had prior to joining the ISO, so that Vernon was a willing participant in the decision made by the ISO not to disclose the failure to establish scheduling points for these facilities. They also assert that Vernon should have taken steps to mitigate this situation such as requesting the ISO to expedite establishment of scheduling points, informing the Commission and the market participants about the failure of the ISO to establish scheduling points, or requesting guidance from the Commission regarding the appropriateness of Vernon's continued exclusive use of these MAP and MPP entitlements.

95. The Southern Cities also filed a request for rehearing on this issue. The Southern Cities argue that the Commission erred in finding that Participating Transmission Owners may be denied recovery of their TRR for facilities or entitlements turned over to operational control of the ISO if the Commission finds that the ISO has not properly implemented such control. Specifically, the Southern Cities argue that by denying cost recovery to Participating Transmission Owners if the ISO fails to properly implement operational control over facilities, the Commission inequitably exposes then to cost disallowances for actions or inactions over which they have no greater control than any other market participant.

96. Finally, the Southern Cities complain that it is "unclear" what actions Participating Transmission Owners "are now obligated to take to ensure that the ISO properly establishes scheduling points."[112] Thus, the Southern Cities believe that Opinion No. 479 creates uncertainty for existing and prospective Participating Transmission Owners concerning what actions are necessary to transfer operational control and Entitlements to secure recovery of TRRs. Furthermore, the Southern Cities observe that Participating Transmission Owners have little recourse if the ISO has not assumed full operational control, as they lack the ability to withdraw the facilities from the ISO control and resume control themselves.

C. <u>Commission Determination</u>

97. Based on the arguments raised on rehearing, we will provide clarification as to the required action by a Participating Transmission Owner in the event that certain of its

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[112] Southern Cities Request for Rehearing at 8.

facilities are not under full operational control of the ISO. This clarification should remove the potential uncertainty cited by the Southern Cities, while ensuring that in the future, market participants will not pay for unavailable facilities. We will otherwise deny the requests for rehearing on this issue.

98. At the outset, it is important to recognize that our finding that Vernon was not required to make refunds with respect to the operational control was based on a finding of the equities presented by the particular facts of this case. We also note that no party has argued on rehearing that the Commission erred in its finding that the facilities in question were not under the operational control of the CAISO during the calendar years 2001 and 2002.

99. We begin by putting the situation in context. First, Vernon was the first entity to join the ISO as a new Participating Transmission Owner. Vernon joined the ISO effective January 1, 2001, at a time when the California markets were in extreme turmoil. Thus, Vernon became the first new Participating Transmission Owner when the ISO's attention was focused elsewhere on very critical market issues.

100. Second, we emphasize that Vernon fulfilled all of the requirements that the ISO had in place for new entities who wished to become new Participating Transmission Owners. No party to this proceeding has argued that Vernon did not fulfill its obligations in this regard.

101. Turning to the legal arguments of the petitioners, the Commission rejects the argument that the filed rate doctrine was violated. In support of that argument, SWP cites to ISO tariff language that states, in relevant part, that the TRR is specifically defined in the ISO Tariff as "the total annual authorized revenue requirements associated with transmission facilities and Entitlements turned over to the Operational Control of the ISO by a Participating TO."[113] As already discussed, Vernon did turn over operational control of the facilities in question. The problem was that the ISO was not able to effectuate such control. Thus, there was no violation of the ISO Tariff, which is silent on what measures are required if the ISO is unable to take operational control of facilities that have been turned over to it. The Commission finds that that a violation of the ISO Tariff in this context would have only occurred if Vernon had not, for whatever reason, actually turned over the operational control of its facilities, but was nevertheless allowed to include the cost of those facilities in its TRR.

102. PG&E and SoCal Edison argue that Vernon was a "willing participant" in a private agreement with the ISO to continue to use the MAP and MPP facilities in a manner similar to before they became a Participating Transmission Owner. The Commission finds that there is simply no record evidence to support this claim.

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[113] ISO Tariff, App. A, Substitute Third Revised Sheet No. 354.

Furthermore, while Vernon had no legal obligation to inform market participants of the situation, it is unclear that the result would have been any different had it done so, as only the ISO could establish the delivery points for MAP and MPP. Nor is the record clear on what information or instructions, if any, the ISO gave Vernon regarding the status of these facilities during the two year time period at issue.

103. This brings us to the Companies' contention that since Vernon did, in fact, continue to use the MAP and MPP facilities as it did prior to becoming a Participating Transmission Owner, there would be no harm to Vernon's ratepayers if refunds are required. The Commission rejects this argument. First, Vernon did pay the ISO's TAC charge for its usage of the ISO grid facilities. Second, Vernon entered into a regulatory bargain with the ISO and complied with all the legal requirements of that bargain. While Vernon did not have total assurance that its proposed TRR would be that which it ultimately would be permitted to collect, it certainly did not have notice that its TRR could be diminished if the ISO did not establish scheduling points for all of its transmission facilities.[114] We note that the amounts in question are not insignificant, as these refunds would reduce Vernon's proposed TRR of approximately $10.2 million by approximately $2.2 million or approximately 22 percent of its TRR for each of year of the two year period.

104. The petitioners correctly argue that the FPA protects ratepayers from footing the bill for facilities they do not use. However, the harm to the ISO ratepayers here is mitigated by the unique facts of this case. Under the arrangement by which Vernon joined the ISO as a new Participating Transmission Owner, it received an incentive in the form of not being subject to the auction process for Firm Transmission Rights (FTRs). This was to assure entities newly joining the ISO that they would be able to continue matching their resources with load, without incurring significant congestion costs. Thus, even if the ISO had properly taken control of the facilities in question, Vernon would have been likely to continue to use these facilities, by employing its rights to FTRs, as it had previously. While ISO control would have allowed for other parties to use the unused capacity on these facilities, and there would have additional reliability benefits from alternative transmission paths being created, we can nonetheless conclude that the benefit of these facilities to the ISO's ratepayers would have been limited.

105. In sum, the Commission finds that, based on the equities presented by this issue, Vernon should not be required to make refunds for the portion of the TRR representing the costs of the MAP and MPP facilities. Thus, we reject the requests for rehearing on this issue.

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[114] The Commission agrees with the Companies, however, that Vernon had notice it might have to pay refunds for over collection of its TRR.

106. With respect to prospective requirements for new Participating Transmission Owners who join the ISO, the Commission makes the following clarifications. First, within thirty days after an entity has become a new Participating Transmission Owner, the ISO must inform the new Participating Transmission Owner of the status of the facilities for which operational control has been transferred. If the ISO fails to do so, the Participating Transmission Owner must file a notice informing the Commission of this lapse within fifteen days of the thirty day deadline. Furthermore, if the ISO informs the new Participating Transmission Owner that it has not established scheduling points for any facilities which have been turned over to its control, within fifteen days the Participating Transmission Owner must file a notice apprising the Commission of this fact. If the Participating Transmission Owner follows these instructions, it will not be liable for refunds concerning the portion of the TRR representing the costs of the facilities in question. If it does not file the required notice in these situations, however, it will be liable for such refunds. We believe that this procedure will eliminate future uncertainty regarding the availability of facilities without imposing onerous burdens on new Participating Transmission Owners.

The Commission orders:

(A) The requests for rehearing of the Companies with respect to refunds, as discussed in the body of this order, are hereby granted in part.

(B) All other requests for rehearing are of Opinion No. 479 are hereby denied, as discussed in the body of this order.

(C) Vernon is hereby ordered to make a compliance filing and refund report reflecting the conclusions contained in the body of this order, within 30 days of its issuance, unless any request for rehearing of this order is filed, in which case the compliance filing and refund report should be made within 30 days of the issuance of a final order in this proceeding.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.