UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	**Docket Nos. ER01-313-000** **ER01-313-001**
Pacific Gas and Electric Corporation	)	**Docket Nos. ER01-424-000** **ER01-424-001**

REPLY BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

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Dated: February 22, 2002

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THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

To: The Honorable Bobbie J. McCartney

The California Independent System Operator Corporation ("California ISO" or "ISO") hereby submits its Reply Brief in this proceeding.

I. ARGUMENT

Issue I.A: Is the ISO's proposed revenue requirement for the 2001 Grid Management Charge just and reasonable?

A brief preface before addressing the few objections that parties attempted to raise concerning the revenue requirement. Although the burden of proof is upon the filing party under Section 205, it is well settled that utility expenditures are generally presumed to be prudent and that the initial burden of proof is upon the entity challenging the prudence of a utility's decision or expenditure. *Minnesota Power & Light Co.*, 11 FERC ¶ 61,312 at p. 61,645 *modified in part,* 12 FERC ¶ 61,264 (1980); *see also West Ohio Gas Co. v. Public Utilities Commission of Ohio,* 294 U.S. 63, 72 (1935) (good faith of utility is presumed). In *Indiana and Michigan Municipal Dist.*

Assoc. and City of Auburn, Indiana v. Indiana Michigan Power Co. 62 FERC ¶ 61,189 (1993), the Commission (quoting *Minnesota Power*, *supra*) elaborated upon the initial burden of proof borne by a challenging party:

> Thus, in the prudence review process, the initial burden of proof as to whether a utility's costs are excessive rests with the party making the allegation. Only when an opposing party raises "serious doubts" does the burden shift to the utility to dispel those doubts.

Id. at 62,239. In determining whether "serious doubt" has been raised, the Commission has held that "[b]are allegations are not enough to support a claim of imprudence." *Minnesota Power and Light* 11 FERC at 61,645. Rather, "the party seeking to call the prudence of an expenditure into question must do so by adducing evidence or citing to material of which the Commission may take official notice," 11 FERC at 61,645 fn.45, and the evidence adduced must be substantial. *Wisconsin Electric Power Co.,* 73 FERC ¶ 63,109 (1995).[1]

A very limited number of parties have made general attacks on the ISO's overall revenue requirement: that it represents a substantial increase over the prior year's revenue requirement and continues a recent trend of increases, CPUC Br. at 6; TANC

[1] In *Wisconsin Electric*, the Commission recently summarized the settled practice as follows:

> By now it must be axiomatic that a regulated utility enjoys a rebuttable presumption that it has conducted its operations prudently, in good faith, and consistent with principles of efficiency and economy… .These presumptions have inspired a Commission practice that excuses a utility seeking a rate increase from demonstrating in its case-in-chief that all expenditures were prudent. It is only when the evidence of another participant casts doubt on the prudence of an expenditure that the applicant utility incurs the double burden of dispelling that doubt and affirmatively establishing the prudence of the expenditure. Of course, any participant may object to costs and raise the issue of their prudence but, if it fails to establish its position with "reliable, probative and substantial evidence," the utility will be permitted to recover those costs.

73 FERC at 65,225 (1995) (footnotes omitted), *citing* Section 7(c), Administrative Procedure Act, 5 U.S.C. § 556(d).

Br. at 8; SMUD Br. at 2); and that, according to one exhibit, the ISO's costs are higher than those of PJM, another independent system operator , CPUC Br. at 7; TANC Br. at 10. Neither of these attacks is sufficient to rebut the presumption of reasonableness of the ISO's revenue requirement. Each is nothing more than a bald assertion that simply *because* cost *X* is higher than cost *Y* , *therefore* cost *X* is unreasonable.[2] No party cited precedent establishing that such a bald assertion meets the burden of adducing substantial evidence that establishes a *serious question* about the reasonableness of costs. Precedent firmly establishes the challenger's burden and it has not been met. *See, e.g.*, *Medina Power Co.*, 76 FERC ¶ 63,013, at 65,058-59 (1996) (citing *Minnesota Power*, *supra*, for proposition that "bare allegations are insufficient to support a claim of imprudence," and rejecting a claim based solely on the fact that actual project costs of $13.6 million exceeded an estimate of $5 million).

The reason such bald assertions do not rebut the presumption of reasonableness is that they amount to comparisons of apples and oranges – sort of like saying that because an orange is not red like an apple, there's something wrong with the orange. That the ISO's costs for 2001 indeed represent a substantial increase over those for 2000 says nothing about the reasonableness of any specific investment or activity in 2001, or its cost. The revenue requirement is simply the sum of the costs of specific

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2 TANC also notes that, according to one witness, Mr. Hairston, the ISO's costs in the Control Area Services ("CAS") category are much higher than were PG&E's costs of performing allegedly similar services before turning that function over to the ISO. TANC Br. at 8. While TANC does not assert that this, in and of itself, indicates that the ISO's costs of performing CAS are unreasonable, TANC's reference to the comparison does reflect the same kind of reasoning as the bald assertions concerning increases in the overall revenue requirement and the ISO's costs relative to PJM's. We would note that the party sponsoring Mr. Hairston's testimony, the San Francisco Bay Area Rapid Transit District, did not challenge the reasonableness of the ISO's revenue requirement. *See* BART at 12-13.

investments and activities. Significantly, no one has disputed that the ISO's workload has increased, *see, e.g.*, CPUC at 8, and no one has even attempted to show that any specific investment or activity is unnecessary or could be efficiently accomplished at less cost.

The comparison of the ISO's costs to PJM's set forth in Exhibit SMD-16 similarly fails to raise any serious question about any specific costs. The exhibit, an ISO data response, makes clear that it represents but "a very limited comparison of high-level measures," and most certainly not a "formal benchmarking study" such as the ISO had previously provided in discovery. *See also* Tr. 501: 9-12; Exh. ISO-23 at 8 (listing a representative sample of 11 benchmarking and "best practices" studies undertaken or commissioned by the ISO "to find ways to perform our work in the most efficient, cost-effective manner"). True benchmarking, such as the ISO had done in earlier years (but had been unable to do in 2001 due to the demands of this proceeding), requires delving into the numbers to understand the reasons for the differences and "to insure [*sic*] that what you are comparing is truly comparable." Tr. 236: 4-13; 240: 4-11. At the very high level of comparison in Exhibit SMD-16, it is impossible to know whether one is comparing apples to apples. Tr. 236:11-15. Mr. Leiber noted that PJM is different from the ISO in many respects (although similar enough to obtain useful information in a true benchmarking study), and that the one-line comparison in Exhibit SMD-16 does not reflect any of them. Tr. 236:4-6; 238:22-24. Moreover, that simple one-line comparison is of dubious merit. It was prepared by an administrative assistant at one of the independent system operators who simply plugged in numbers without any attempt to determine that the numbers were comparable, complete or accurate. Tr. 501:13-21. Exhibit SMD-16 is useless for determining anything meaningful, or raising any serious question, about any of the ISO's costs.[3]

Other than the two specific areas addressed under subparts I.A.1 and I.A.2, below, parties challenge a very limited number of specific costs. The California Public Utilities Commission ("CPUC") (but *not* the California Electricity Oversight Board ("EOB"), which otherwise joined the brief) challenges costs for the new Energy Management System ("EMS"), redesign of the Open-Access Same-Time Information System ("OASIS"), and the Scheduling Applications/Scheduling Infrastructure ("SA/SI") migration. CPUC Br. at 9-11. The Transmission Agency of Northern California ("TANC") alleges that higher than reasonable amounts were budgeted for incentive compensation and employee salaries and benefits. TANC Br. at 13-15. None of these allegations justifies a reduction in the revenue requirement.

The CPUC presented no testimony or other evidence concerning EMS, OASIS, or SA/SI. It addressed a limited number of questions to ISO witnesses, but its brief does not even question the reasonableness of the ISO's having undertaken any of these projects -- indeed, it expressly *disclaims* doing so. CPUC Br. at 8-9. The

[3] Moreover, the CPUC and SMUD appear to have misread the exhibit. The CPUC suggests that even leaving aside the costs of the MCI contract, the ISO's operating expenses would be almost twice PJM's operating expenses of $100 million (as recalled by Mr. Leiber, following PJM's mid-year budget increase, Tr. 235:17-24). CPUC Br. at 7, fn. 2. In fact, the ISO's operating expenses as shown on Exhibit SMD-16 ($171.8 million), minus the cost of the MCI contract ($34 million), would be only a little over one-third more than PJM's ($137.8 million vs. $100 million). SMUD states that PJM's "*current budget* of $100 million is substantially less than the ISO's." SMUD Br. at 4 (Emphasis added). In fact, $100 million is not PJM's entire budget, but rather only its operating expenses.

CPUC's sole argument is that the ISO did not adequately justify the associated costs. CPUC Br. at 8. But this casual approach falls well short of raising a serious question sufficient to overcome the presumption of reasonableness. Moreover, there is plenty of evidence in support of the projects and in justification of the presumption.

While the CPUC *has not challenged the reasonableness of any of these projects*, it bears emphasis that each of them, as the CPUC itself notes, was undertaken to improve the ISO's ability to perform absolutely essential functions.[4] Like all other projects, each was subjected to multiple levels of review within the ISO, not only during the budgeting process but even afterwards, before actual implementation. Exh. ISO-7 at 21:19 - 23:17; Tr. 498:6-22. That review included rigorous cost-benefit analyses. Tr. 485:21-24; Tr. 487:18-19. Because neither the CPUC nor any other party challenged the need for or costs of any of these programs in its own pre-filed testimony and exhibits, *i.e.*, because *no question was raised about them*, the ISO did not enter those analyses into the record; nor was it required to do so. When questioned, however, Mr. Leiber (who had reviewed the various analyses), Tr. 487: 10-18, provided quite sufficient justifications for each of the programs. EMS is essential to "the core of the ISO's operations," Tr. 181:13, and the previous system lacked important functionality, the vendor no longer supported the software, and continuing with the old system would have required more ISO support personnel. Tr. 184:11-23;

[4] "The EMS is the ISO computer system that monitors the electric grid and matches power supply and demand minute-by-minute. . . . OASIS is computer software utilized by the ISO to fulfill the Commission requirement that transmission providers have an open access system that provides certain information to potential users of the transmission system. . . . The SA system is the applications used by the ISO's scheduling personnel to assess the state of the transmission system and includes congestion and transmission management software.

475: 4-13; 476: 2-9. The CPUC contends that some witness should have been able to elaborate on the functionality problems or specify the additional employees that the old system needed, but that certainly was not necessary *since no party, not even the CPUC, challenged the project*. Mr. Leiber noted that such details did exist, as there had been “a very comprehensive review process.” Tr. 476:14-17. The ISO had concluded that a redesign of OASIS was necessary “to meet the minimum standards that had been set by the FERC.” Tr. 477: 6-10. The CPUC baldly asserts that more details should have been provided about the problems with the old system, but again, that was not required *since no party, not even the CPUC, challenged the project*. Finally, SA/SI is “the core of the ISO’s software that enables it to do all of the various things that it does”. Tr. 478:5-6. The ISO had determined that migrating to a new platform was necessary to save costs over the long term, due to the difficulty experienced in maintaining and administering the existing systems and the high cost charged for service by the original sole source vendor. Tr. 479: 3-19. The CPUC notes that the SA/SI migration was not accomplished in 2001 (due to the press of other matters, Tr. 483: 3-7), but that does not undermine the reasonableness of the ISO’s having budgeted for it.

TANC’s challenge to the amount budgeted by the ISO for incentive compensation similarly lacks merit. TANC Br. at 12-13. That the ISO acknowledges that a programming oversight resulted in “over-budgeting” of this single item does not jus-

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The SI system provides information management services needed by the scheduling system and includes hardware, software and databases.” CPUC Br. at 8-10.

tify a disallowance; many others turned out to have been under-budgeted, *see* Exh. ISO-21 at 23:12-17; Tr. 245:18 – 246:11. Disallowing part of this item while taking no account of the under-budgeted items would not be justified. *See* fn. 10, *infra.* Moreover, the item was only "technically" over-budgeted, based solely on the historical average of the percentage pay-out of incentive compensation; what the actual pay-out for 2001 will be is yet unknown (although the intended-for result is that all employees will qualify in full), and if it is less than 100%, any savings will flow through the reserve account to rate payers. Finally, TANC is incorrect in arguing that the budgeted amount for incentive compensation should be further reduced because the employee count during 2001 did not reach the budgeted number. As noted below, the estimate of employees in the budget was reasonable when made; therefore, the estimate for incentive compensation based on the budgeted number of employees was also reasonable.

TANC's argument for a reduction in the budgeted amount for employee salaries and benefits is misguided – or, perhaps, disingenuous. TANC Br. at 13-15. Based on the actual number of ISO employees at various dates during 2001, TANC concludes that the ISO's estimate in its budget was unreasonable when made. TANC's statistics about actual employee levels, however, establish nothing about the reasonableness of the ISO's estimate when made (toward the end of 2000). Rather, they show the impact of events such as the turmoil in the California markets and resulting uncertainty concerning the ISO's future which made retaining and recruiting employees more difficult during 2001 than the ISO had anticipated. Exh. ISO-21 at

27:13-17; *see also* Exh. ISO-26. TANC has produced *no* evidence supporting its bare allegation that the estimate was unreasonable. For example, TANC has not challenged the reasonableness of the ISO's estimate of its workload for 2001, upon which the estimate of the number of employees was based. *See* Tr. 503:22 – 504:17; Exh. ISO-23 at 14-15, 23, 25-27.[5]

Since the ISO's estimate of the number of employees was reasonable when made, TANC's argument concerning whether the ISO adequately established that contractors substituted for the absent ISO employees is beside the point. It also is wrong. Mr. Leiber, the ISO Treasurer and therefore intimately familiar with the relative costs of employees and contractors, testified that "the budget was prepared with the assumption that more costly contracted resources would be converted to full-time ISO staff, to save money." Exh. ISO-21 at 20:12-14. Mr. Leiber's statement, while sufficient evidence in itself, is supported by other evidence in the record. *See, e.g.* Exh. ISO-19 at 10; *see also* Exh. TNC-1 at 9 (table showing inverse relationship between employee and contractor costs, as portion of budget).

Finally, as has been discussed at length during this proceeding, to the extent any actual cost is higher or lower than budgeted, the difference flows to the operating reserve and affects the level of the next year's revenue requirement. That process has already worked during 2001 and the net result of over- and under-budgeting (as well as differences from anticipated levels of billing determinant volumes) has been factored into the revenue requirement for 2002. It is not possible to allow the operating

[5] It turned out that the ISO *under*-estimated its workload for 2001. Exh. ISO-21 at 20:17 – 21:4.

reserve mechanism to function and, at the same time, reduce the filed revenue requirement for 2001 due to alleged over-estimates of costs and require refunds. If over-collections in 2001 are used to reduce the 2002 budget *and* the ISO is ordered to refund based on over-collections, the ISO will have returned the amount of any over-collections to rate payers *twice* and as a result, the ISO will systematically fail to recover its costs. To avoid this, the Commission could allow the ISO to restate the 2002 revenue requirement upwards by any amount it orders the ISO to refund for 2001. The ISO submits, however, that a preferable outcome is to allow the operating reserve to function as intended, and avoid ordering any refunds. There is no significant problem, from a rate making standpoint, in relying on the operating reserve mechanism instead of refunds. *See* Tr. 508:4 – 509:01, 2686:2-11.

Sub-Issue I.A.1: Should forecasted O&M expenses be reduced by amounts discussed in ISO Management's November 9, 2001 memorandum?

Only the CPUC and TANC suggest reductions should be made in the revenue requirement based on this memorandum. CPUC Br. at 11-13 and TANC Br. at 15-17. Neither's arguments have merit.

Each party's fundamental argument is that potential reductions identified in the memorandum should be made simply because they were identified by management as potential cost savings.[6] In other words, according to these parties, the memorandum

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[6] The CPUC notes that the memorandum resulted from direction by the Finance Committee of the Board that management identify potential reductions and that the memorandum "does indeed make specific recommendations to curtail certain Corporate Expenses." CPUC Br. at 12. TANC argues that the memorandum shows "when the ISO managers are requested to find cost savings they are able to do so," and that "the Memorandum provides substantial evidence that there is room for reduction in the ISO's proposed budget." TANC

shows – more or less *ipso facto* – that the identified items were imprudently included in the budget. This argument turns the correct approach to a rate case on its head and would make a negative out of a laudatory undertaking. The relevant facts are simple and undisputed. The Finance Committee, upon initially reviewing the proposed budget, asked management to take another hard look to identify any areas where cost savings might conceivably be realized. Management did so. The Finance Committee reviewed the written product of the exercise and discussed it fully with management. Ultimately, the Finance Committee and the Board decided not to reduce the budget by any of the identified amounts, not only because of the potential negative effects on ISO performance (in some cases affecting transmission-system reliability) from many of the reductions,[7] but also because severe problems had already appeared in the California markets and it was difficult to foresee the extent of the additional demands that might be placed on the ISO in 2001. *See* Exh. ISO-21 at 21:23 – 22:16; TNC-8 at 3-6 (detailed listing of negative impacts from potential departmental cost reductions). What could be a better example of a prudent approach to budgeting than this exercise? The CPUC's and TANC's argument would turn prudence on its head and certainly discourage the boards of directors of public utilities from ever asking management to

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Br. at 17.

[7] TANC characterizes the memorandum's identification of the potential negative impacts as "self-serving doomsday statements" and argues that potential negative impacts "do not diminish [the memorandum's] value for demonstrating that cost reductions are possible." TANC Br. at 17. There is, of course, no basis whatsoever for discounting management's recitation of potential negative effects as "self-serving"; management is presumed to be acting in good faith unless it is shown otherwise. Wisconsin Electric Power Co, 73 FERC ¶ 63, 109 (1995), discussed at fn. 1, *supra*. TANC's argument is breath-taking in its implication – that every potential cost-saving measure should be implemented *regardless of the consequences for performance of the ISO's obligations to the public.* Such an approach to budgeting would be the height of imprudence.

"scrub" a budget for potential savings, lest the product of the exercise be used against them.[8]

The CPUC contends that any costs identified in the memorandum that the ISO ultimately did not incur should be disallowed, and that the ISO should not be able to defend against the disallowance by pointing to other areas in which costs turned out higher than budgeted or to the under-realization of estimated billing-determinant volumes. CPUC Br. at 12. Such a policy would eviscerate the established precedent that a budget's reasonableness should be judged as of the time it is adopted[9] and turn rate cases into a "heads I win, tails you lose" undertaking, by allowing opponents to seek disallowance of budgeted amounts based on subsequent developments but not affording proponents any offsetting ability to use subsequent developments to show that other budgeted amounts were too low. *See* n. 10, *infra.* That approach would lead to systematic under-collection of costs by public utilities.

[8] The danger to prudent budgeting processes is starkly apparent from TANC's concluding paragraph: that the Board's decision to retain the budget items "is not dispositive," that the justness and reasonableness of the budget "is undermined" by the memorandum, that the ISO "erred in budgeting for costs ISO management identified as affording potential cost savings," and that *therefore* inclusion of the costs "was unreasonable when the filing was made." TANC Br. at 17. TANC's argument, clearly, is that a Board is imprudent if it does not adopt every potential cost-cutting measure identified by management, regardless of the circumstances (here, the uncertainties in the markets) or the potential consequences (here, the negative effects on performance and even reliability).

[9] *See, e.g., Papago Tribal Utility Authority v. FERC*, 773 F.2d 1056 (9th Cir. 1985). In *Papago*, the reviewing court stated "…the FERC determines whether the test year estimates were reasonable when they were made. If so, the FERC will follow the estimates unless they are substantially in error and would yield unreasonable results." Id. at 1059. "The Commission rightly does not require that history prove the accuracy of the utilities' estimates." *Indiana & Michigan Municipal District v. FERC*, 659 F.2d 1193, 1198 (D.C.Cir.1981).

Sub-Issue I.A.2: Should forecasted costs associated with the new ISO debt the ISO assumed it would issue in 2001 be eliminated?

TANC's challenges to this item are facially insubstantial. TANC Br. at 18-20. TANC first argues that the ISO should have known before its filing of the 2001 revenue requirement that it would not be able to issue bonds in early 2001. This argument is based on one "fact" and one presumption.

The one "fact" is that the ISO learned in late December 2000 that its debt rating would be downgraded. There are two problems with this "fact." First, it is contrary to the evidence. Contrary to TANC's assertion, Mr. Leiber did *not* testify that the ISO became aware of an impending debt downgrade in late December 2000. Rather, Mr. Leiber *clearly denied* that the ISO learned in late 2000 that its financial condition would not allow it to issue new debt, *clearly stated* that it did not learn of the impossibility of issuing new debt until January 2001 when its debt rating was in fact reduced all the way from A level to D level, and *clearly stated* that the ISO may well have had no notice *that its debt rating was even under review*, but "*if* there was any at all, it *would have been* in late December." Tr. 272:2-15 (emphasis in quoted passage, from lines 14-15, added). Second, this alleged "fact" proves nothing. The ISO filed the GMC on December 15. Any information gained in late December would not have been available. Further, there is no way that the ISO would have known that the debt rating would be downgraded so much as to make issuance of new debt impossible. TANC's one presumption is that, because of notice periods and potential protests, the ISO would have filed under section 204 before the end of 2000 if it really had intended to issue bonds in the first quarter of 2001. This presumption has no basis. The ISO could well have intended to file under section 204 before the end of 2000 or shortly after the beginning of 2001, but delayed the filing when it learned its debt rating was under review, pending the outcome of that review. Moreover, preparation of a section 204 filing does not take long, the notice period is only 20 days , and the ISO had no reason to anticipate protests, so TANC's estimation of the necessary lead time is simply unfounded. Even if the ISO had no notice of the debt downgrade until it occurred in January 2001, the ISO would not have had to have filed under section 204 before then, in order to have been able to issue debt in the first quarter.

That the post-rate filing downgrade of the ISO's debt in fact made issuance of new debt impossible says nothing about the reasonableness of having included this item at the time of budgeting and filing; thus it provides no basis for disallowance. Moreover, the budgeted amount was used to fund capital projects directly, "pay as you go." Exh. ISO-21 at 24:7-10.[10] TANC's point that the revenue requirement filing did not include a proposal to, in effect, expense capital items is irrelevant; at the time of filing, the intent – reasonable at the time – was to fund capital projects through new debt, so there would have been no reason to propose expensing them.

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[10] TANC suggests that the downgrade was a subsequent event that shows the ISO's estimate for new debt service costs was unreasonable and justifies a spot adjustment. TANC Br. at 21. Courts and the Commission have made clear that to justify a spot adjustment, a challenger has the burden of showing that in the absence of a spot adjustment the overall rate would be unreasonable, for example, because there were no other considerations to offset the proposed spot adjustment. *Southwestern Public Service Company v. FERC*, 952, F.2d 555, 562 (D.C. Cir. 1992); *Indiana & Michigan Municipal Distributors Ass'n v. FERC,* 659 F.2d 1193, 1198 n.14 (D.C. Cir. 1981). The fact the ISO needed to proceed with at least some of the capital projects that the new debt would have supported, and therefore had to apply the debt service funds to pay directly for those projects, is

Finally, TANC's contention that Mr. Leiber's statement that funds earmarked for new debt would be spent on capital projects is an unsupported assertion, and its suggestion that the ISO should be required to identify the projects on which the funds were spent, are both nonsensical. A sworn statement by the ISO's Treasurer as to the manner in which specific funds will be spent is certainly more than an "unsupported assertion" – it is a fact, undisputed by any party. Indeed, Mr. Leiber testified at length on this subject, far beyond a simple statement that the funds would be spent to expense capital projects. *See* Exh. ISO-21 at 23:21 – 26:19. There simply is no requirement that the ISO identify specific capital projects on which the funds will be spent.[11]

Issue I.B: Is the ISO's unbundling of the GMC into the three proposed service categories just and reasonable?

Only the Modesto Irrigation District (" MID") and TANC challenge the ISO's unbundling effort. TANC's arguments, regarding self-provision of CAS are related to the gross v. net issue, and are discussed in connection with Issue I.E. TANC's improper attempt to introduce new issues at this stage is discussed below.

MID's fundamental contention is that the ISO's billing determinant for the CAS charge, Control Area Gross Load and exports, is focused narrowly on the recovery of the ISO's costs to enable the ISO to fulfill its mission of reliably operating the grid, and (unlike MID's own proposal, presented by Dr. Kirsch) does not encourage

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certainly an offsetting consideration that makes any spot adjustment inappropriate.

[11] Nonetheless, the projects are largely identifiable from the record. Mr. Leiber noted that due to the inability to issue debt the ISO was reducing capital spending from the budgeted \$37.7 million to \$23 million, mainly through deferral of the Comprehensive Market Reform/Congestion Management Reform efforts. Exh. ISO-21 at 24:16-18; 25:2-4. From the table of budgeted capital items for 2001, Exh. ISO-18 at 42, one can readily deduce where the amount budgeted for new debt service (along with a portion of the operating reserve, *see* Exh. ISO-21 at 25:11-15) was spent.

behaviors by Market Participants that would reduce costs to consumers. MID Br. at 6-8. The ISO is unaware, however, that an impact on market behavior is a pre-requisite to a rate being just and reasonable. The ISO's concept of a billing determinant based on load and exports reflects basic principles of cost-causation and evolved from an intensive stakeholder process (in which no one presented Dr. Kirsch's proposal); even Dr. Kirsch has acknowledged that there is a relationship between load and the costs of CAS, Tr. 1674:4-6, 1716:15-17. The ISO's choice of a load-based billing determinant is thus not unreasonable. As the ISO noted in its initial brief, ISO Br. at 48-49, it is not opposed to a full consideration of other ways to recover the costs of CAS, but the need to fully vet other proposals and ensure the availability of necessary information to implement another proposal dictates their consideration during the full stakeholder review of the GMC that many parties have proposed for 2003.[12]

MID makes the point that the ISO's billing determinant spreads CAS costs alike to entities that make heavy use of the ISO's grid and markets, and to those that do not. MID Br. at 8-18. This is a variation on the arguments for "net" load billing instead of "gross" load billing, and much of what the ISO said in response to those arguments in its initial brief, ISO Br. at 21-32, and says in this brief, *infra* under part I.E and I.F, is applicable in response to MID's argument as well. As discussed there, the ISO has to plan and otherwise be prepared to accommodate transmission flows and energy imbalances caused by *all* load in the Control Area, not just the load that

[12] The ISO must take issue with MID's unsupported characterization of the ISO as a bureaucracy devoted to command-and-control instead of efficient markets. TANC Br. at 6. Even the most cursory review of the ISO's activities and its filings at FERC over the past several years (*many* of which, based on the activities of its

most often causes flows and imbalances, and therefore *all* load both causes CAS costs and benefits from CAS to some extent. While the CAS category may well be refined later into more "granulated" service categories, or analyses may be done to support charging less than the full CAS rate to some load, *at this stage of the unbundling process* charging CAS to all load equally is not unreasonable; it was not *practicable* to refine CAS charges further. As the cases relied upon by MID point out, cost causation principles require only that rates match costs to serve classes of customers and individual customers "as closely as practicable," not that they do so perfectly. *See Alabama Elec. Coop., Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).[13]

MID also makes a subsidiary argument that the ISO's billing determinant does not provide incentives for Market Participants to provide generation to meet their own load, in both the short and longer terms. MID Br. at 18-22. As noted, however, a billing determinant need not accomplish every desirable goal of economic efficiency in order to be just and reasonable; if the ISO's billing determinant is based on cost causation principles, as it is, it is appropriate even if, in an economist's perfect world, it might fail to further efficiency goals as well as another determinant might. There are many goals to be furthered in choosing a billing determinant, including simplicity, ease of administration, transparency, and so forth – economic efficiency is just one goal. Tr. 1671:19 – 1672:8. Straightforward billing based on load certainly meets those other goals. In addition, the costs of CAS are and will remain exceedingly mi-

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Department of Market Analysis, aimed to improve the functioning of markets), belies that characterization.

[13] Moreover, it should be noted that the ISO does not agree with Dr. Kirsch that CAS costs depend primarily on energy imbalances and transmission flows; so, it is far from clear that MID's proposal is even sup-

nor in comparison to the costs to a Market Participant of having to procure Imbalance Energy if it does not balance its load and generation; therefore, any "incentive" of charging CAS on the basis of imbalances would be inconsequential.[14] Additionally, the incentive to fully meet load with generation is an incentive in the ISO's rate structure—parties that rely on the ISO's imbalance energy market are assessed that component of the GMC.

TANC contends that the ISO's assessment of MO charges to Existing Rightholders that self-provide Ancillary Services violates Existing Contracts. It states:

> The ISO contends that Existing Rightholders that self-provide Ancillary Services under the terms of an Interconnection Agreement do not satisfy their Ancillary Services obligation under the ISO Tariff. Tr. 3143:15-22 (Menzel). Self-providing Ancillary Services under an Interconnection Agreement, according to the ISO, does not meet the requirements of the ISO Tariff. Tr. 3143:15 - 3149:13 (Menzel). Therefore, the ISO contends that it is obligated to purchase Ancillary Services for Existing Rightholders. Tr. 3148:5 - 3149:13 (Menzel). The ISO bases its allocation of Market Operations costs to Existing Rightholders on the Ancillary Services it claims to purchase on behalf of Existing Rightholders. Tr. 3141:19-22 (Menzel). The ISO errs in its contention that it is obligated or entitled to purchase Ancillary Services on behalf of Existing Rightholders that self-provide Ancillary Services and that it is proper to allocate Market Operations charges based on those purchases.

TANC Br. at 2-3.

As an initial matter, the Presiding Judge should disregard this argument entirely. The allocation of the MO charge is *not* among the issues included in the Joint

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portable on its own merits. *See* Exh. ISO-29 at 19:16 - 20:8.

[14] Note that Dr. Kirsch himself testified that imposition of CAS costs should *not* be used to discourage Market Participants from running imbalances, as running imbalances could ultimately save consumers money. Exh. MID-4 at 14:13-15. On cross-examination, Dr. Kirsch seemed to disclaim any intent that his proposal be used to encourage or discourage certain behavior; rather, it was intended to recover the ISO's costs more fairly.

Stipulation of Issues. The ISO did not, accordingly, address it in its testimony. Moreover, the testimony cited by TANC occurred in Phase II of the proceeding, leaving the ISO no opportunity to respond. TANC's effort to raise the issue at this stage is inexcusable, and should be dismissed by the Presiding Judge.

Moreover, TANC's complaint is without basis. The MO charge is only assessed for Ancillary Service procured through the ISO Markets. ISO Tariff (Exh. J-2) § 8.3.3. A Scheduling Coordinator's responsibility for Ancillary Services is reduced by any self-provision of Ancillary Services. *Id.* § 2.5.20.2. Thus, the ISO does not have the authority to procure Ancillary Services for the amount self-provided or to charge the MO charge in conjunction with those services.

Of course, the ISO must be informed of the extent to which Ancillary Services are being provided. *Id.,* § 2.5.20.5. Moreover, the Ancillary Services as defined under the Commission-approved ISO Tariff and, by reference, under the Responsible Participating Transmission Owner Agreement cited by TANC, must meet certain criteria, based on Control Area reliability requirements and WSCC requirements. *See, e.g., id.* § 2.5.2.1. It is unclear whether TANC is suggesting that the ISO must accept at face value, without any notice, that Ancillary Services will be self-provided in connection with Existing Contract schedules and must ignore its reliability criteria in accepting such Ancillary Services. Such an argument, however, would make a mockery

Tr. 1675:12 – 1676:7. It is unclear why MID now makes the argument it does, which seems contrary to the intent of its own expert.

of the ISO's Commission-acknowledged responsibilities as Control Area operator. *Pacific Gas and Electric Co., et al.,* 81 FERC ¶ 61,122 (1997).

TANC cites no evidence that the ISO is indeed charging the MO "to entities that satisfy their full Ancillary Services requirements under the terms of their Interconnection Agreement." Rather, TANC cites hypothetical testimony by a Pacific Gas and Electric Company ("PG&E") witness that Ancillary Services self-provided under the interconnection agreement might not meet the ISO's criteria. If, however, TANC believes that the ISO has rejected self-provided Ancillary Services in violation of its authority or of its criteria, TANC has appropriate recourse under Section 206 of the Federal Power Act. TANC's attempt to raise this issue at this time, in this proceeding, offends the Commission's rules and procedures as well as fundamental fairness.

Sub-Issue I.B.1: Should the ISO's proposed service categories for recovering the GMC be supplemented or replaced by other methodologies or service categories?

The CPUC and EOB do not contend that any of the ISO's cost categories or billing determinants, *including the determinant for CAS,* is unjust or unreasonable. They do offer an alternative way to recover the costs of CAS. They recommend that CAS costs be divided into fixed and variable costs, with the former to be recovered through a demand charge and the latter through an energy charge. CPUC/EOB at 15-18. As the CPUC and EOB note, the concept of a demand charge was not considered during the stakeholder process on unbundling of the GMC; the closest concept that was considered at all was a customer charge. The ISO does not oppose full consideration of a demand charge, but there is certainly insufficient information on its pros and cons or how it might be structured to move to that type of rate design now.[15] This is another matter that could be taken up fully during a stakeholder review of the GMC in 2003.

Southern California Edison's ("SCE") arguments that certain exemptions from the CAS charge are necessary to make the three categories reasonable, SCE Br. at 5-6, are addressed *infra*, at part I.E.

MID offers Dr. Kirsch's proposal as an alternative to the ISO's method of allocating the costs of CAS. MID Br. at 23-33. The problems with Dr. Kirsch's proposal were discussed by the ISO, Staff and the California Department of Water Resources ("CDWR") in their initial briefs. *See* ISO Br. at 13-14; Staff Br. at 10-14; CDWR Br. at 13-15. MID's statement that "Dr. Kirsch's proposal is simple to implement," MID Br. at 3, is belied by Dr. Kirsch's own testimony and admissions during cross-examination. Implementation would in fact be costly, time-consuming, difficult -- and very contentious.

Sub-Issue I.B. 2: If changes to the service categories are ordered, should the changes be effective prospectively (i.e. from the effective date of the decision), or retroactively (i.e. from the date of ISO implementation)?

CPUC/EOB and MID contend that any changes to the categories should be effective as of the date the Commission accepted the ISO's filing "subject to refund." CPUC Br. at 18; MID Br. at 33-34.[16] Neither discusses any policy considerations,

[15] Note that when the health club analogy arose at hearing, Dr. Kirsch acknowledged that the time frame over which to measure a demand charge could vary. Tr. 1727. This is only an example of the types of issues that would have to be explored before deciding whether a demand charge is appropriate, and certainly before implementing one.

[16] MID makes clear that its primary concern is not with retroactivity, but with ensuring "that the ISO's

relying instead on a rote application of the Commission's authority. As the ISO noted in its initial brief, however, this is a clear case in which the Commission should exercise its discretion not to order any refunds and to make any changes prospective only. *See* ISO Br. at 14-15. Doing otherwise (unless the ISO were granted surcharge authority) would subject the ISO to under-recovery of its costs, would depart from the Commission's normal practice when it orders a change in rate design, and would fail to give appropriate weight to the nature of unbundling as a work in progress.[17]

Issue I.C: Is the ISO's proposed GMC allocation just and reasonable?

TANC contends that the ISO's allocation is unjust and unreasonable because it uses headcount as an allocator in some instances and relies on the judgment of managers. TANC Br. at 28-30. The ISO noted in its initial brief that it has used a labor cost analysis, not headcount, in allocating the GMC for 2002. Thus, TANC's concern with headcount as an allocator is not an ongoing issue. The ISO moved to a labor cost analysis *not* because it thought allocations using headcount were flawed, as TANC suggests, but as part of the continuing evolution and refinement of the unbundling process. Use of headcount for 2001 was just and reasonable. Contrary to TANC's suggestion, it is irrelevant that in using headcount the ISO did not rely on particular

unbundling methodology and billing determinants are correct going forward." MID at 34.

[17] SCE supports prospective application of any change in the cost categories, but contends for retroactive application of any change to the billing determinant for CAS. SCE at 6 and fn. 7. The ISO notes that it has been billing all parties a CAS rate that was calculated with Control Area Gross Load and exports as the denominator. This means the rate has been *lower* than it would have been had "net" load been the denominator. In this particular instance, the ISO agrees that any order that the ISO bill based on net load (or anything less than CAGL and exports) should be applied as of January 1, 2001, with clear Commission guidance that the ISO may recalculate and re-bill the CAS charge at the higher rate. Similarly, any order finding that the ISO lacks authority to bill certain parties for the CAS charge should be accompanied by clear guidance that the ISO may recalculate and re-bill a higher CAS rate for other parties. These steps are absolutely essential to enable the ISO to recover

governmental or industry regulations; TANC cites no such regulations indicating headcount is improper, or for that matter, that a labor cost analysis is appropriate. TANC's concern that headcount does not reflect the late-2000 ISO reorganization, TANC Br. at 28-29, is similarly irrelevant; a labor cost analysis would not have reflected the reorganization, either. The concern that using headcount produces skewed results because of differences in ISO salaries, *Id.* at 29, is misplaced; Mr. Leiber prepared a labor cost analysis for the 2001 budget as a check on the headcount method (and produced it to TANC in discovery) and that showed the two methods yielded virtually identical results. Tr. 280:5-10 Finally, as the CPUC and EOB note, the Commission has approved the use of headcount as a methodology. *See* CPUC Br. at 19 (citing *California Power Exchange Corporation*, 89 FERC ¶ 61,279, at 61,905-06 (1999).[18]

TANC recognizes that management's judgment must play a role in allocations. TANC Br. at 30. TANC's real argument appears to be that the judgment should be applied based on a labor cost analysis and time records. As noted, the ISO has moved to a labor cost analysis for 2002 and beyond. The ISO is prepared to consider implementing some sort of time records system, but believes it must be studied carefully to avoid unnecessary complexity, negative effects on employee morale, and unintended consequences. *See* ISO Br. at 16-17.

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its costs.

[18] TANC's suggestion that the ISO used 1999 headcount to allocate 2001 costs is mystifying. The ISO used 1999 headcount for allocating 1999 costs, Exh. ISO-9, and 2001 headcount for allocating 2001 costs, Exh. ISO-18.

Sub-Issue I.C.1: Does the ISO's Cost Allocation Matrix Provide a Reasonable Basis for Allocating costs?

TANC's argument concerning the matrix is simply that errors it alleges elsewhere are reflected in the matrix. TANC Br. at 30-31. No separate response is necessary. No other party challenges the adequacy of the matrix.

Sub-Issue I.C.2: Is the ISO's Allocation of Cost Center 1424 Just and Reasonable?

TANC contends that the ISO should directly allocate non-labor costs of cost center 1424, rather than using the allocation of the employees (headcount) to do so. TANC Br. at 30-31. As the ISO noted in its initial brief, this is an example of the evolving nature of the unbundling process. *See* ISO Br. at 18-19. Although the ISO - and Staff, *see* Staff Br. at 14 - believe the allocation can be improved, and the ISO is doing so for 2002, the allocation for 2001 is just and reasonable. As the CPUC notes, *see* CPUC Br. at 19, the Commission has recently approved the use of headcount to allocate similar costs in a cost center that resembles cost center 1424 very closely. *California Power Exchange Corporation, supra*.

Sub-Issue I.C.3: Is the ISO's allocation of MCI contract costs just and reasonable?

TANC contends that the costs of the MCI contract should be directly assigned, and presumably believes that most of the costs should be assigned to Market Operations. TANC Br. at 33. As the ISO noted, however, it has not been able to obtain the information from MCI necessary to perform a detailed direct assignment. Exh. ISO-21 at 49:1-15; Tr. at 49:10-15. Absent such information, several of the ISO's telecommunications experts devoted attention to the issue of how best to assign these costs. The ISO has used a modified headcount method, with a portion of the costs assigned using total ISO headcount, another portion using the headcount of the departments that use the MCI network significantly, and a third portion assigned directly to Market Operations. The ISO submits that this is a just and reasonable assignment of costs, and that the care with which the ISO approached the assignment based on the information available to it indicates that it gave appropriate attention to this important cost center. The cost center is used by all segments of the ISO and it undergirds the entire ISO operations – not just Market Operations. One must remember that in the California model, markets support *all* of the ISO's activities to some extent, including Control Area Services, so that it is appropriate to assign more of the costs of the MCI contract to categories other than Market Operations than TANC would perhaps like. *See generally* Exh. ISO-21 at 47:3 – 49:15.

Sub-Issue I.C.4: If changes to allocations are ordered, should the changes be effective prospectively or retrospectively?

CPUC/EOB, TANC and MID contend that any changes should be effective retroactively to the January 1, 2001 date on which the Commission made the ISO's filing effective "subject to refund." CPUC at 20; TANC Br. at 34; MID Br. at 34-35. This issue is similar to Issue I.B.2, and the ISO's reply to these parties is similar as well. The Commission has discretion as to when to offer refunds, and it should not order refunds here. As Staff notes, making any changes to the allocations *prospective* recognizes that unbundling is a work in progress and avoids the issue of surcharges.

Staff Br. at 15. It should also be noted that one of the contending parties, MID, candidly states (as it did under issue I.B.2) that its primary concern is with the allocations going forward. *See* MID Br. at 35. Finally, *if* the Commission should make any changes effective as of January 1, 2001, or any other retroactive date, it *must* also grant the ISO surcharge authority so that the ISO can recover from some parties any amounts that the reallocation requires it to refund to others.[19]

Issue I.D: Should the ISO assess GMC undercollections to other creditworthy GMC customers?

CDWR states that while Section 8.4 and Appendix B adjustments "may be unavoidable," they should only be made prospectively and notice should be required. CDWR Br. at 17. The ISO does not contend that these provisions authorize retroactive increases in rates; they authorize prospective increases to make up for previous shortfalls in collections. Parties will receive notice through the ISO's market notices and through FERC's processes.

Issues I.E: Is the assessment of the Control Area Services Charge based on Control Area Gross Load just and reasonable and not unduly discriminatory as to load not served by on-site generation?

The arguments against allocation of CAS charges to behind-the-meter Load fall into four categories: that such allocation is inconsistent with the Commission's order on Amendment No. 2 to the ISO Tariff, *California Independent System Operator Corp.*, 82 FERC ¶ 61,312 (1998); that the ISO has misapplied cost-causation prin-

[19] TANC suggests that reallocation retroactively would not adversely affect the ISO. TANC Br. at 30. This is true *only* if the ISO is permitted to surcharge those parties that should have been paying more under reallocation.

ciples; that the allocation violates cost causation principles; and that the allocation violates contractual agreements.

1. <u>The Commission's Order on Amendment No. 2 Neither Bars Nor Has a Precedential Effect on the Proposed Allocation of CAS Charges</u>

The Sacramento Municipal Utility District ("SMUD") and TANC argue that, in light of the Commission's decision on Amendment No. 2, allocating CAS to Load that is not served over the ISO Controlled Grid is contrary to the ISO Tariff.[20] SMUD Br. at 5, 7-18, TANC Br. at 36-40. Regardless of whether the Amendment No. 2 order concerned GMC, this argument is completely illogical. This proceeding concerns a tariff *amendment.* The amendment provides the necessary authority. Such an allocation, absent the amendment, would be of course contrary to the ISO Tariff; otherwise, there would be no reason to file the amendment. If the Commission approves the amendment, the allocation will not be contrary to the ISO Tariff. Nothing in the Commission's order on Amendment No. 2 prohibits the ISO from seeking further amendments regarding the GMC.

Indeed it is not even possible to argue Amendment No. 2 as precedent for the proposition that the Commission refused to allow the ISO to allocate GMC to Load that is not served over the ISO Controlled Grid, and that there is no reason to modify

[20] SMUD and TANC also cite the Arbitrator's decision in *Pacific Gas & Electric Company v. California Independent System Operator Corporation*, Case No. 711980071100 (December 13, 2001) for a similar proposition. The Presiding Judge has ruled that this decision is irrelevant and will not be considered. In light of the Presiding Judge's ruling, and the general policy that motions to strike briefs are disfavored, *Stabilisierungsfonds Fur Wein v. Kaiser*, 647 F.2d 200 (D.C. Cir. 1981), the ISO will not address these argument and will not move to strike them.

that decision.[21] Such an argument distorts the Commission's order and rewrites history.

In the order on Amendment No. 2, the Commission noted that the requirement that all Load in the Control Area be scheduled would result in allocation of the GMC to those Loads. In rejecting Amendment No. 2, however, the Commission did not address the issue of financial responsibility for those services that the ISO must, as Control Area operator, perform or conclude that such financial responsibility would be inappropriate. Rather, its rejection of Amendment No. 2 was based exclusively on operational issues and burdens place on the Participating Transmission Owners:

> [W]e find that these changes are unjust and unreasonable because they would broadly expand ISO control over non-jurisdictional facilities which are not being transferred to the ISO's control. As drafted, proposed Amendment No. 2 is also inconsistent with our prior orders and would improperly impose additional obligations on Participating Transmission Owners. We also share intervenor concerns about the lack of time to determine the full impact of Amendment No. 2 at this late date. Because of these problems, we do not consider acceptance of the proposed Amendment No. 2 subject to the outcome of a hearing to be a viable option. Moreover, we are persuaded by the that the proposed changes contained in Amendment No. 2 are not necessary for ISO operations.
>
> Indeed, the Commission *explicitly* reserved the GMC issue:
>
> We also note that the issue of whether the GMC should apply to entities that deliver energy over facilities that are not part of the ISO Controlled Grid, but which are within the ISO Control Area, is within the scope of the proceeding in Docket No. ER98-211-000, *et al.*

California Ind. Sys. Oper. Corp., 82 FERC ¶ 61,312 at 62,241 (1998).

[21] In addition to SMUD and TANC, WAPA (in connection with issue I.I) and SDG&E (in connection with the assessment of MO charges for transactions on the Southwest Power Link argue that the ISO proposal is contrary to the Amendment No. 2 order.

Tellingly, only one party bothers to acknowledge this limitation on the ruling, and only in a footnote. San Diego Gas and Electric Company ("SDG&E") contends that the Commission did not reserve the issue, but was giving guidance to its resolution in Docket No. ER98-211-000. SDG&E Br. at 13, fn. 13. This reading not only distorts the plain meaning of "pending," but also ignores subsequent Commission action in this regard. On March 31, 1998, four days after its order on Amendment No. 2, the Commission issued an order clarifying the scope of Docket No. ER98-211-000. The Commission stated, again *explicitly*:

> We hereby clarify that the scope of the hearing established in the December 17 order includes the issue of whether the GMC should apply to all loads in the ISO control area, or only to the loads served by the ISO Controlled Grid.

California Ind. Sys. Oper. Corp., 82 FERC ¶ 61,348 at 62,357 (1997). Obviously, the Commission did not consider the issue resolved.

More recent orders confirm that the Commission does not view its rejection of Amendment No. 2 as controlling questions of the ISO's authority to assess charges in connection with Control Area transactions that do not use the ISO Controlled Grid. The Commission has required the ISO to submit tariff amendments to require that all Generators in the ISO Control Area offer their available Generation to the ISO, regardless of whether the Generator is a Participating Generator or its Generating Unit is directly connected to the ISO Controlled Grid. *San Diego Gas and Electric Co. v. Sellers of Energy and Ancillary Services, et al.* 95 FERC ¶ 61,115 at 61,355-56 (2001). Most recently, as noted in the ISO's Initial Brief, ISO Br. at 30-31, the Commission approved a billing determinant of Control Area Gross Load for emissions and start-up costs incurred by Generators dispatched under the must-offer obligation. *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, et al.*, 97 FERC ¶ 61, 293 (2001). Apparently the Commission does not read its order on Amendment No. 2 in the same manner as the parties making these arguments.

2. <u>The ISO Has Properly Applied Cost Causation Principles</u>

Some parties, however, contend that the ISO has violated cost causation principles by allocating CAS charges to behind-the-meter Loads on the basis the Loads benefit from CAS. See TID Br. at 7-10, SMUD Br. at 18-24, CAC Br. at 18-22. The argument that cost causation principles preclude the consideration of benefits in determining the allocation of costs is based on an artificial distinction that has never been adopted by the Commission. Evaluation of benefits is merely the flip-side of the evaluation of causation. For example, if an interconnection request requires transmission system upgrades that benefit all users of the grid, the Commission generally requires that the costs be assigned to all users of the Grid, not just to the entity requesting the interconnection. *See, e.g., Western Mass. Elec. Co*., 66 FERC ¶ 61,167 (1994), aff'med *Western Mass. Elec. Co. v. FERC*, 165 F.3d 922 (D.C. Cir. 1999). Citing *Western Massachusetts* for the proposition that "[e]ven if a customer can be said to have caused the addition of a grid facility, the addition represents a system expansion used by and benefiting all users due to the integrated nature of the grid," the Commission has explicitly noted, "This treatment does not violate cost causation principles." *Removing Obstacles to Increased Electric Generation And Natural Gas*

Supply In The Western United States, 96 FERC ¶ 61,155 at 61,674 (2001). Similarly, the Commission approved the assignment of costs for the ISO's 2001 Summer Demand Relief Program to Scheduling Coordinators according to metered Demand (and exports), despite protests from entities including TANC, Silicon Valley Power, and Modesto Irrigation District that pro rata assignment of costs is improper since it assigns costs to entities that were not instrumental in costs being incurred. The Commission concluded, "[T]he costs of the Summer 2001 Program are properly allocated on a system-wide basis to all Scheduling Coordinators because the Demand Relief Program benefits all parties by providing a means to maintain grid reliability." *California Ind. Sys. Oper. Corp.*, 97 FERC P 61,149 at 61,648 (2001). The same principle is applicable to the GMC.

3. The ISO's Allocation of CAS Charges is Consistent with Cost Causation Principles

Various parties argue that allocation of CAS charges to behind-the-meter Load violates cost causation principles because serving the Load does not involve the ISO Controlled Grid, TID. Br. at 7, or because the parties responsible for serving that Load self-provide Ancillary Services, Energy, and Control Area Services, TANC Br. at 36, MID Br. 30, SMUD Br. at 6, TID Br. at 6.[22] These arguments are fully addressed in the Initial Briefs of the ISO, Commission Staff, SCE, and CDWR. The response can be summarized as follows. Whether a contract path involves the ISO Controlled Grid

[22] TID also suggests that the ISO's reliable operation of the Control Area in the absence of information on Control Area Gross Load is somehow related to the question of whether the ISO provides reliability services for the entire Control Area. TID Br. at 11-12. As discussed *infra*, in connection with Issue I.F, this proceeding does not concern the ISO's metering policies and the ISO's use of net or gross information does not change the

is irrelevant to the provision of CAS. The CAS described in the ISO's testimony apply to the whole Control Area. Exh. ISO-29 at 12:11 – 13:9. As just one example, if Generation fails or Load rapidly increases *anywhere* in the Control Area, the ISO's systems respond. Exh. ISO-29 at 13:1-9, 33:7-12. The self-provision of Ancillary Services is also irrelevant, because this proceeding – as the Presiding Judge recently recognized in her Order Rejecting Motion to Lodge or, in the Alternative, Take Official Notice of Arbitration Order, February 6, 2002 – does not concern the costs of Ancillary Services. Neither does it involve the costs of Energy. What it does involve is the cost of Control Area Services. By definition, these cannot be self-provided; they can only be provided by the Control Area operator. Exh. ISO-29 at 24:9-12. Various entities have responsibilities and can provide services that relieve the burden on the Control Area operator, Tr. at 894:14-19, but this is as equally true of the utility distribution company ("UDCs") as it is of Governmental Entities ("GEs") with behind-the-meter Load. *See* SCE Br. at 9-10. These services cannot substitute for Control Area Services. Tr. at 956:20 – 957:4.

TANC argues that GEs that assist the ISO's fulfillment of its responsibilities through self-provision of certain reliability services should, consistent with cost-causation principles, pay a lesser CAS charge.[23] The ISO has acknowledged that, over time, it may be possible to breakdown the CAS component in a manner that re-

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nature of the CAS provided.

[23] TANC makes this argument in section I.B, in the context of the reasonableness of the ISO three proposed categories. As the ISO noted in its Initial Brief, many of the arguments offered by GEs against the ISO's proposed allocation of CAS to behind-the-meter Load are, indeed, arguments for further unbundling. Consistent with the organization of its Initial Brief and of other briefs on this issue, the ISO is responding to TANC's

flects the differing contributions to reliability of various entities. Exh. ISO-34 at 5:4-8. The analysis and data to do so, however, is not yet available. *Id.* at 4:19 – 5:4; Tr. at 1537:21-24. There is no evidence that would allow the ISO, or the Commission, to evaluate the relative contributions to Control Area reliability of TANC, SMUD, SCE, PG&E, or any other Market Participant. Under such circumstances, treating all Load the same is just and reasonable.[24]

The Commission recently confronted, and rejected, arguments very similar to those made by GEs in this proceeding. In *Midwest Independent Transmission Operator, Inc.*, 98 FERC ¶ 61,141 (2002), certain utilities protested the inclusion of bundled and grandfathered Loads in the calculation of a cost adders based on the Commission's finding that the Loads would benefit from the Midwest ISO's operational and planning responsibilities and from the increased reliability of the grid. The utilities asserted that the bundled Loads are served by Generation located on their system, and therefore did not use the facilities controlled by the Midwest ISO. The Commission concluded:

> Intervenors fail to consider the benefits all users of the regional grid will receive when that grid is operated and planned by a single regional entity instead of multiple local entities whose goals may often conflict. As a result of this move to unified planning and operation of the regional grid, we expect to see more efficient siting of transmission facilities from the regional perspective; i.e., siting that follows need rather than arbitrary boundaries such as individual local service territories. This will result in enhanced reliability which will

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argument in this section.

[24] TANC quotes Ms. Le Vine to the effect that the full CAS charge should not be allocated to those that self-supply part of CAS and that the ISO's proposal will not comply with cost causation until the charges to those entities are reduced. TANC Br. at 29. Read in context, however, Ms. Le Vine's testimony clearly refers to a goal of better compliance with cost causation principles; it does not imply that the current proposal is violative of those principles. *See* Tr. at 1537:21 – 1538:2.

> benefit all loads. This is because the non-Midwest ISO-operated facilities, such as those connected to local generation, in this region are integrated with the facilities operated by the Midwest ISO. It is established Commission policy that an "integrated transmission grid is a cohesive network moving electricity in bulk." Thus all customers using that grid share in all costs of the grid, because they all benefit. This policy has been affirmed in court. Thus, load served from generation located on an individual transmission owner's system (i.e., located on low-voltage transmission facilities that have not been transferred to Midwest ISO) can not be served reliably without the facilities operated by Midwest ISO. If those Midwest ISO-operated facilities were to disappear, service to all loads, including bundled retail loads, would suffer greatly. Similarly, more efficient operation of the regional grid, including an effective congestion management scheme, should result in the ability of the regional grid to accommodate greater power flows, and thus more transactions than otherwise possible. This should increase the supply of competing generation available to load-serving entities.

Id., slip op. at 8 (footnotes omitted). The same principles support the ISO's proposed allocation of CAS charges.

That the GEs may have contracted with PG&E to provide Control Area Services, *see* TANC Br. at 21 - 24, is irrelevant to the allocation of the CAS charges. [25] PG&E is not now the Control Area operator, and does not provide the Control Area Services. This ISO does. The ISO charges PG&E, as Scheduling Coordinator for the GEs, for the CAS. Whether PG&E can pass those charges through to the GEs, or whether such pass through would constitute double billing, is the subject of Phase II of this proceeding. The Commission faced a similar situation in *Midwest ISO.* In ruling that transmission owning-members of the Midwest ISO would be exempt from

[25] SMUD's contention that the ISO "is fully aware of the inherent unreasonableness of this approach" is misleading. In support, it pulls together two unrelated – and sixty pages apart in the transcript – portions of Ms. Le Vine's testimony. Her testimony that SMUD should not be double charged related to the possibility of SMUD being paying both the CAS charges and its charges under the existing agreement with PG&E. Tr. at 1539. This, of course is a pass-through issue. Her earlier testimony about the possibility for greater granularity at a later point, Tr. at 1479, had nothing to do with double billing.

rates for services provided pursuant to existing agreements, *except for the cost adder*, the Commission left open the question of recovery of the cost-adder. The Commission noted that the pass-through to retail customers should be taken up by state commissions. With regard to the grandfathered transmission agreements, the Commission stated any modifications should first be the subject of negotiation. In neither case did the Commission find that the existing agreement preclude the allocation of the cost-adder. 98 FERC ¶ 61,141, slip op. at 10-11.

4. <u>The ISO Is Not Contractually Barred from Allocating the CAS Charge to SMUD's Behind-the-Meter Load</u>

SMUD contends that, under its Interconnection Agreement with PG&E, it is required to self-provide Control Area services, obviating the need for the ISO to supply those services. SMUD Br. at 18-26. According to SMUD, the ISO's obligation to honor Existing Contracts prohibits the ISO from allocating CAS charges to SMUD's Load that is not served over the ISO Controlled Grid. *Id.*.

The fundamental flaw with SMUD's argument is that its Interconnection Agreement does not require it to self-provide CAS. Actually, the only reference to "control area services" is in connection with services that PG&E is to provide. Exh. SMD-24 at § 4.1. SMUD is obligated to self-provide a number of services, many of which affect reliability and resemble the CAS that the ISO provides. Exh. ISO-29 at 17:18 – 19:3. These are not CAS, however, because they are provided on a service area, not a Control Area, basis. Tr. 957:1-4. *See also* SCE Br. at 8-10, Staff Br. at 16-18, CDWR Br. at 20. They are more appropriately called "service area territory services." Tr. 957:2-3 Only the Control Area operator can provide CAS. 957:1 – 958:14. Accordingly, nothing in SMUD's Interconnection Agreement is inconsistent with the allocation of CAS charges to SMUD Load that is not served over the ISO Controlled Grid.

SMUD also contends that the Restated Interim Agreement prohibits the ISO from allocating CAS to SMUD Load that is not served over the ISO Controlled Grid. SMUD Br. at 28. SMUD goes into great detail explaining the various sections of the Restated Interim Agreement and the manner in which they distinguish Grid and non-Grid transactions. *Id.* at 28 – 30. Conveniently, however, SMUD ignores one critical provision. Section 4.3 provides:

> If FERC issues any rulings or orders with respect to issues included in this Agreement, including the Grid Management Charge settlement, other ISO charges and Scheduling Coordinator requirements, the impacted Parties agree to abide by such rulings or orders once they are finalized.

Exh. SMD-23. The determination of charges under the Restated Interim Agreement is thus subject to a Commission decision that different charges are appropriate. SMUD points to nothing in the Restated Interim Agreement – and a review of the agreement reveals nothing – that prohibits the ISO from seeking tariff authority, and Commission approval, of any differing charges. Accordingly, there is no basis for finding that the allocation of CAS charges to SMUD internal Load violates the Restated Interim Agreement.

Issue I.F: Retail Customer-Owned Generation Issues.

Sub-Issue I.F.1: Is the assessment of (I) the Control Area Services Charges and/or (ii) the Market Operations Charge on the basis of a retail customer's load and served by generation located behind the site boundary meter just and reasonable and not unduly discriminatory?

Three parties argue against the ISO's proposal to allocate CAS Charges to retail behind-the-meter Load: Cogeneration Association of California and Energy Producers and Users Coalition CAC/EPUC, SCE, and the CPUC. The ISO addresses CAC/EPUC's and SCE's arguments below. CPUC's discussion primarily concerns its proposal for a different rate methodology, without any specifics regarding how it should be implemented. CPUC Br. at 21-22. As the ISO has discussed in its Initial Brief, the evaluation of alternative rate methodologies may be appropriate in future years. Nonetheless, the arguments presented by the ISO and Commission staff in their Initial Briefs, and the further discussion below, demonstrate that the ISO's current proposal is just and reasonable. That is all that is required.

1. <u>Behind-the-Meter Load Served by QFs Benefits from CAS</u>

Both CAC/EPUC and SCE contend that the ISO does not incur CAS costs for behind-the-meter Load served by QFs because the Load does not draw Energy from the ISO Controlled Grid.[26] CAC/EPUC Br. at 18-22; SCE Br. at 19-22. Both argue that the ISO performs CAS on a net basis, and lacks data on gross Load. This issue does not, however, concern whether the ISO should or should not use data on the Demand of Control Area Gross Load or whether that data would enhance reliability.

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[26] As previously discussed, causation and benefits are just two ways of looking at the same principle.

The issue is whether the use of the Control Area Gross Load billing determinant is justified because the ISO incurs CAS on behalf of behind-the-meter Load. That the ISO *uses* net data does not in any manner imply that the ISO *performs* CAS only for net Load, or that behind-the-meter Load does not cause the ISO to incur CAS costs.

Thus, while the ISO only receives schedules for net Load, Tr. 1185: 5- 14, the coordination of schedules increases the likelihood that sufficient transmission capacity will be available to serve behind-the-meter Load in the event of a Generation failure, Exh. ISO-10 26: 17- 28: 13, Tr. 1986: 8- 10. Although the EMS monitoring system can only account for net Generation, it will nonetheless detect a failure of a Generator serving behind-the-meter Load (without knowing where the failure occurred), and the units providing Regulation service will respond to serve the gross Load. Exh. ISO-29 at 15:15 – 16:4. Similarly, with regard to each of the CAS cited by CAC/EPUC, the service improves the reliability of the Control Area transmission grid, and increases the likelihood that imbalances between behind-the-meter Load and behind-the-meter Generation can be addressed both on a moment-to-moment basis and in the event of a complete failure of the Generation. Exh. ISO-10 15:4 –16: 4. The ISO is thus performing the service on behalf of behind-the-meter Load, even though it uses data on the Demand of net Load.

CAC/EPUC's assertion that "if load cannot be measured at the customer's site boundary, that customer has not caused the use of the ISO controlled grid for the de-

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CAC/EPUC's argument that the ISO has failed to demonstrate consistency with cost causation principles because the ISO has focused on benefits, CAC/EPUC Br. at 18, is thus unavailing.

livery of its energy requirements," CAC/EPUC Br. at 20, is entirely correct, but not particularly relevant. The charges in question are not for the delivery of Energy. They are for the assurance Energy will be available and delivered if and when needed. Exh. ISO-29 at 15:5 – 16:8.

Finally, SCE argues that there is no "reliability basis" for assessing CAS charges to behind-the-meter Load served by QFs, SCE Br. at 26-28, and CAC/EPUC argues the outcome of this proceeding will not affect reliability. CAC/EPUC Br. at 23-24. Both are correct. The issue is much more simple. The ISO is doing the best it can to operate the grid reliably – and, it believes, fairly successfully – despite the lack of information it considers necessary to do the job properly. *See*, *e.g.*, Tr. 1412:1 – 1415:8. The issue is whether behind-the-meter Loads served by QFs benefit from the job the ISO is doing and should pay their fair share.

2. <u>The Allocation of CAS Charges to Behind-the-Meter Load Served by QFs Does Not Discriminate Against QFs</u>

CAC/EPUC and SCE contend that the ISO's allocation of CAS charges to retail behind-the-meter Load is discriminatory. CAC\EPUC asserts that the ISO charges SCs that do not represent self-generation according to "actual load," charges SCs who represent Generators with station Load according to "actual Load," and charges SCs who represent retail customers with self-generation according to "potential load." [27] CAC Br. at 13. The fallacy of this argument is that it rests entirely CAC/EPUC's er-

[27] CAC/EPUC's definition of these classes is imprecise. CAS is billed to SCs according to Control Area Gross Load, which is defined as Demand for Energy in the Control Area. *See* ISO Tariff (Exh. J-4), Appendix A at First Revised Sheet 308 - Original Sheet No. 308A. Control Area Gross Load includes Energy consumed by Load served by QFs, but exempts Energy consumed by Auxiliary Load. *Id.* It has nothing to do with the

roneous characterization of behind-the-meter Load served by QFs as "potential load." *Id*. The only basis offered for this characterization is testimony by Mr. Leiber and Mr. Lyon.[28]

Mr. Leiber agreed that retail customers without self-generation are billed not on what they could potentially operate, but on what they actually operate and draw from the system, and that "those rules" would not apply to customers using self-generation. Mr. Lyon's testimony (that CAS charges for Loads served by QFs would not be based on the reading of a meter at the site boundary, while charges for other Loads would) is to the same effect. This testimony is accurate: customers served by self-generation would not be billed CAS according to the Energy that they draw from the ISO Controlled Grid (or the distribution system). *See* ISO Tariff (Exh. J-4), Appendix A, First Revised sheet No. 308 – Original Sheet No. 308A (definition of Control Area Gross Load). This does not mean that such customers are billed according to "potential load." That conclusion requires a definition of "load" limited to times when it draws energy from the transmission grid. Nothing in the record supports such a limitation.

Indeed, Mr. Lyon explicitly testified that retail behind-the-meter Load is not "potential" load, but is actual load. Exh. ISO-29 at 33:7-12; Tr. at 1202:25 – 1204:11. If a behind-the-meter Load served by QF Generation has the potential to consumer

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Generators that an SC represents.

[28] Although it is not cited in CAC/EPUC's opening brief, counsel during the hearing made much of a NERC definition of "load" that was limited to energy measured on a "system," with "system" defined in a manner that would exclude End-Users. The use of these definitions is discussed in the ISO's Initial Brief at 24, n. 19. Moreover, even if such definitions were relevant for reliability purposes, they have no bearing on rate

100 MW, and is consuming 50 MW, it has 50 MW of actual Load and 50 MW of potential Load. It would be billed CAS charges for the 50 MW of actual Load and not for the 50 MW of potential Load. In that manner, it is treated identically to customers without self-generation. Exh. ISO-29 at 36:12 - 16.

SCE similarly argues that the ISO's proposal would charge self-served retail customers based on the potential that their end-use devices might place a demand on the system. SCE contrasts such customers with a factory load that is not operating, and therefore is not charged. SCE Br. at 22. The self-served retail customer, however, has a Demand; it is a Load. The factory does not and is not. The QF-served retail customer is much more akin to the customer discussed by Judge Grossman in the decision cited in the ISO's Initial Brief, *Pacific Gas and Electric Co.*, 88 FERC ¶ 63,007 at 65,072-73 (1999), which is served by a distributed generator located on the same portion of a utility's distribution system, such that it draws only an unappreciable amount of Energy from the ISO Controlled Grid.[29] It is that customer – which would be charged CAS based on its full Demand – and not the idle factory that is similarly situate to the retail customer served by a QF.

CAC/EPUC's and SCE's arguments that the ISO is "imputing" additional Load to customers using self-generation, CAC/EPUC Br. at 14, SCE Br. at 23, are thus inapt. The Load being served by QF Generation is just that – Load. Whether one, two, or three QFs fail simultaneously, may affect the amount of Imbalance Energy that the

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making principles or the determination of discrimination.

[29] Of course, as with a QF serving a customer, the ISO would regularly provide small amounts of Imbalance Energy to address fluctuations of Generation and Load.

ISO must provide; it does not affect the amount of Load for which the ISO must provide reliability services.[30]

The ISO's proposal does treat station auxiliary Load differently from behind-the-meter Load served by QFs, but also from other Loads. The difference in treatment, however, is justified by the unique characteristics of self-provided station auxiliary Load.

First, the Energy consumer by station auxiliary Load equipment generally reduces to minimal levels when the Generating Unit trips. Tr. 1196 – 1198:12. CAC/EPUC challenges this characteristic by arguing that the ISO has proffered no evidence that (1) the Demand from station auxiliary Load equipment is a smaller percentage of a generator's output than a self-generator's on-site Load or (2) that a greater proportion of the Demand from station auxiliary Load equipment declines coincident with Generation loss than that of the on-site Load of a thermal unit. CAC/EPUC Br. at 16. SCE similarly notes evidence that retail behind-the-meter Load may also reduce when a Generating Unit trips and that at least 2-3 MW would continue to be served when a large merchant Generating Unit trips, while the average retail behind-the-meter Load is under 2 MW. SCE Br. at 24.[31]

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30 CAC/EPUC's quotation regarding the amount of backup facilities a utility must provide for standby customers does not assist its case. This proceeding does not, of course, involve the cost of transmission facilities or capacity reserves necessary to provide backup and maintenance power. Those issues, however, do illustrate the fallacy of CAC/EPUC's arguments. For example, if the ISO planned for the simultaneous outage of all QF, it would have to maintain operating reserves equivalent to 100% of behind-the-meter Loads served by QFs. Instead, the ISO only contends that it must maintain reserves equivalent to 5% - 7% of those Loads. Exh. ISO-29 at 28:21 – 29:3.

31 Contrary to SCE's claim, Mr. Lyon did not admit that at least 2 – 3 MW would need to be served if a large Generating Unit fails. He stated a typical station Load was 2 or 3 MW and would diminish upon failure. He also said 2 or 3 MW "could" be left, but it would depend on the unit and equipment. Tr. 1197:14 – 1198:19.

It is logically impossible for the total Load served by a QF Generating Unit with behind-the-meter Load to reduce, in the event of Generating Unit failure, in the same proportion as that of the Generating Unit without behind-the-meter Generation. A QF, like any other Generating Unit, has station auxiliary Load equipment. Thus, if a QF fails, the ISO must serve *both* the auxiliary Load equipment and the behind-the-meter Load. If other Generating Units fail, the ISO must serve *only* the auxiliary Load equipment. In the latter case, the ISO must serve x% of the total Generating Unit output in the former the ISO must serve x% + y%. The self-served auxiliary station equipment Load of QFs reduces similarly to that of other Generating Units in the event of Generating Unit failure; the ISO Tariff allows auxiliary Load to be netted from Control Area Gross Load in both cases. Behind-the-meter Load adds an additional remaining Load, which the ISO Tariff accordingly treats differently.

The ISO's second basis for distinguishing station auxiliary Load is that the Energy consumed by stationary auxiliary Load equipment, as an input to Generation, is not ordinarily considered Demand from Load. Tr. 389:18-19; 1200:15-18. SCE contends that the Commission has rejected this distinction, citing *Rumford Power Ass., L.P.*, 97 FERC ¶ 61,173 (2001) and, indirectly, *PJM Interconnection, LLC, et al.*, 94 FERC ¶ 61,251(2001), *reh'g denied*, 95 FERC ¶ 61,333 (2001) ("*PJM I*"). These holdings, however, dealt with entirely different circumstances. The auxiliary station power in question was provided *remotely*. The issues concerned the Commission's jurisdiction over the sales of the Energy and rates for transmission of the En-

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SCE also comparing "average" QF Load with a "large" Generating Unit.

ergy. In light of the Energy being sold by one entity to another, and transmitted from one facility to another, it is not surprising that the Commission would find irrelevant the fact that the Energy was an input to Generation. In contrast, the ISO Tariff only allows netting of Energy consumed by auxiliary load equipment electrically connected at the same point as the Generating Unit.[32]

In other circumstances, the Commission has found the fact that station auxiliary power is used for the production of Energy highly relevant. As the Commission Staff discusses in its Initial Brief, the Commission noted in *PJM I* that station power, if supplied by the Generating Unit and if less than the Generating Unit gross output, has historically been viewed as "net generation" or "negative generation." Staff Br. at 19. It is an internal cost of operating the facility and enabling it to generate electricity. Consistent with that approach, Energy used to serve station Load is not included in the maximum output that a QF is permitted to sell under Commission regulations; being consumed in the production of Energy, it does not displace Energy on the system. *See Penntech Papers*, 48 FERC 61,120 (1989).

Citing *Mid-American Energy Co.*¸ 94 FERC ¶ 61,340 (2001), CAC/EPUC argues that the Commission found net billing arrangements appropriate for QFs, and compared the situation to its treatment of self-served station power in *PJM I*. The relevant *PJM I* discussion concerned the question of whether the provision of Energy

[32] SCE properly points out that the Commission has found permissible exclusions of station auxiliary Load from transmission charges and Ancillary Services charges. SCE Br. at 16, *PJM I*; *PJM Interconnection, LLC*, 95 FERC ¶ 61,470 (2001). The Commission provided no indication, however, that these exemptions should extend to retail behind-the-meter Load served by QFs. Indeed, the Ancillary Services exception applied to remotely served station Load, and was based on billing complications. The only time the Commission has

for station Load is a sale of Energy; The Commission determined that when a Generating Unit supplies the Energy to serve its own station Load, that Energy is "negative generation" that should be netted against Generation, and is not a sale of Energy. Neither *Mid-American* nor *PJM* provides a basis for reaching any conclusion about the ISO's proposal. Both of the cases concern the sale of Energy; it is eminently logical that the provision of Energy for one's own use is not a sale of the Energy. This logic does not apply to the assessment of charges for Control Area reliability. QFs and other distributed Generators are not providing Control Area reliability for their own use. The ISO is providing it for them.

Moreover, that the Commission considered on-site Load and station Load analogous for the purpose of sales does not imply that the Commission would do so for other purposes. Indeed, the Commission very specifically differentiates between on-site Load and station Load in the context of QFs. As discussed above, under Commission rules, a QF cannot sell power in excess of its net output, and the net output is the facility's gross output less station Load. On-site Load is *not* netted for that purpose, and is thus treated differently from station Load. *See Connecticut Valley Electric Co. v. Wheelabrator Claremont Co.*, 82 FERC ¶ 61,116 at 61,416-19 (1998). Finally, in *Mid-American*, the Commission merely indicated that the decision whether to allow net billing – in retail sales circumstances – was within the jurisdiction of state

analogized station auxiliary Load and retail behind-the-meter Load, to the ISO's knowledge, is with regard to net billing of Energy sales.

commissions. It did not require states to adopt such procedures; neither did it make any conclusions about matters within its own jurisdiction. 94 FERC at 61,264.

3. The Allocation of CAS Charges Based on Control Area Gross Load, including Behind-the-Meter Retail Load, Is Consistent with PURPA.

Although CAC/EPUC contends that the allocation of CAS charges to behind-the-meter Load would violate the Public Utility Regulatory Policies Act ("PURPA"), it fails to articulate any supportable argument for that proposition. Instead of using reasoned legal analysis, CAC/EPUC makes its case for illegality based on the legal opinions and unsupported factual assertions of its witness, *non sequiturs*, and irrelevant observations.

CAC/EPUC first observes that the ISO's witnesses did not review or consider PURPA or state laws on QFs in preparing the ISO's case. From this, it concludes that the ISO cannot claim that its proposal was designed to comply with the law. CAC/EPUC Br. at 4. Putting aside the absurdity of assuming that a utility must present as witnesses any lawyers or others that considered the legal implications of a rate filing, the fact remains that what the ISO did or did not consider or review has nothing to do with the legality of a rate. That legality is determined by the relevant laws and regulation, not by the testimony or actions of witnesses.

CAC/EPUC next contends that the ISO's policy is contrary to PURPA because it discourages self-generation, and Section 210 of PURPA requires the Commission to encourage cogeneration. CAC/EPUC Br. at 6. The ISO has shown in its Initial Brief the lack of evidence that the ISO's proposal unreasonably, or even significantly, discourages cogeneration.[33] CAC/EPUC appears to believe, however, that any policy that imposes additional costs on cogenerators is *per se* illegal. This proposition – that the Commission must eschew any policy that might reduce in any degree the incentives for cogeneration – is simply implausible. Section 210, as quoted by CAC/EPUC, requires the Commission to establish "such rules *as it deems necessary* to encourage cogeneration." *Id.* (Emphasis added.) The statute vests in the Commission the discretion to determine what rules are necessary. It does not require the Commission to take every possible step to maximize the profits of cogenerators; neither does it require the Commission to advance cogeneration at the expense of all other considerations, such as system reliability. It also does not override the Commission's other responsibilities, such as ensuring just and reasonable rates, as through the avoidance of cost-shifts. *See* 16 U.S.C. § 824d. Even PURPA itself recognizes limits on "encouraging" cogeneration. *See* 16 U.S.C. § 824a-3 (limiting rate to utilities incidental costs). That the ISO's proposal, by holding cogenerators responsible for a share of the costs of CAS, will impose additional costs on those cogenerators does not render the policy illegal.

CAC/EPUC next asserts that PURPA requires net treatment of QFs. In support, however, CAC/EPUC cites only Commission regulations that "implicitly" require net treatment. Those rules distinguish between supplementary power (provided

[33] CAC/EPUC's assertion that the CPUC has found that the ISO's proposal unreasonably discourages self-generation is without support. CAC/EPUC cites CPUC witness Ramirez. Mr. Ramirez, however, simply stated that *in his mind*, his testimony was in furtherance of the statutory requirement that the CPUC oppose proposals that would discourage cogeneration. There is no evidence that the CPUC has even considered the ISO's GMC proposal. CAC/EPUC also cites CPUC Decision 01-07-027 (Exh. J-7). That decision opposes the ISO's

to a facility as a supplement to its QF generation) and back-up and maintenance power (provided when the QF generation is unavailable). According to CAC/EPUC, the only way to harmonize these rules is to require net treatment for the allocation of costs. This is a *non sequitur*. The cited rules pertain only to the availability of and rates for the provision of Energy. They do not address the allocation of the costs of maintaining Control Area reliability. Moreover, unlike the costs of providing Energy that are determined by amount and frequency of use, while the CAS costs are primarily fixed, Tr. 303:14-21, and remain the same whether a customer uses the grid daily, weekly, or potentially at any moment. There is no "inconsistency" between allocating reliability costs to behind-the-meter Load and a rule that distinguishes between the supplementary and back-up power. There is no need to "harmonize".

CAC/EPUC next asserts, "Contrary to FERC Rules and CPUC retail tariff, the ISO assumes the simultaneous outages of QFs during system peak hours for the purpose of allocating CAS charges for back-up and maintenance power." CAC Br. at 9. This statement reveals the underlying fallacy of CAC/EPUC's argument about assumed outages. The ISO does *not* allocate CAS charges *for back-up and maintenance power.* The ISO allocates CAS charges for maintaining reliability. It allocates them to Control Area Gross Load because these services are provided at all times, not just when a unit is receiving back-up and maintenance power. ISO Br. at 24. That the CPUC might decide to allow Scheduling Coordinators to pass these rates through to

metering policies, not the allocation of the GMC. The ISO's metering policies are not at issue in this docket.

QFs in back-up and maintenance rates does not change this fact.[34] The CPUC rate-making principles for back-up and maintenance power are not relevant to this service.

CAC/EPUC also cites an ISO statement that it assumes a given QF could fail completely, and asserts that, when applied to all QFs, the ISO has assumed a 100 percent outage of QFs. CAC Br. at 10. Again, this is a *non sequitur*. That the ISO assumes that a given QF could fail completely merely means that it has the potential for failure and therefore needs reliability services. It does not imply an assumption that, at any given time, the QF will fail. Thus, the ISO assumes that 100% of QFs have the potential to fail completely and therefore need reliability services. It does not follow that the ISO assumes that they all will fail completely.

CAC/EPUC also argues that the ISO's estimation methodology for behind-the-meter Load served by QFs assumes a simultaneous outage of 100 % of QF Generation. CAC/EPUC Br. at 11. The ISO's methodology, however, makes no assumption and the cited testimony does not support a conclusion that it does. CAC/EPUC counsel asked Mr. Price how he would calculate Control Area Gross Load if all QF Generation were simultaneously unavailable. Mr. Price acknowledged that the calculation would be the same as that proposed for calculating Control Area Gross Load. Tr. 849:8 – 852:16. CAC/EPUC errs when from that fact it infers that the ISO's methodology makes an assumption that all QF Generation is unavailable.

[34] The CPUC is, of course, able to choose another allocation for passing these costs through. CAC/EPUC only asserts what Scheduling Coordinators will seek to do, and moreover only cites the opinion of an ISO witness elicited on cross-examination – certainly not the best authority of what the Scheduling Coordinator will seek – in support of that assertion. CAC Br. at 11.

Mr. Price's calculation of behind-the-meter Load reaches the same result if he assumes that all QF Generation serving that Load is unavailable for the simple reason that the calculation is the same regardless of the availability of the QF Generation. The ISO methodology does not rely upon *any* assumption about the availability of QF Generation. The calculation is based on Demand, not Generation. Control Area Gross Load is defined as "all Demand for Energy within the Control Area" (with minor exceptions). ISO Tariff (Exh. J-2) First Revised Sheet 308 – Original Sheet 308A. It matters not whether the Load creating the Demand is served by on-site Generation or any other source of Generation. The calculation is the same whether one assumes that all QF Generation is available or whether one assumes that it is all unavailable. It can be said as easily that the ISO's estimation process results in an assumption that eighty percent, or fifty percent, or zero percent, of QF Generation is unavailable as that it results in an assumption that 100 percent is unavailable. CAC/EPUC's conclusion is, once again, a *non sequitur*.[35]

4. <u>Approval of the ISO's Proposal Would Not Constitute "Discriminatory Treatment of Control Area Operators"</u>

CAC/EPUC also argues that approval of the ISO's proposal would involve selective lack of enforcement of PURPA and would discriminate against California as a Control Area. Apparently CAC/EPUC believes that, if you advance enough arguments, however implausible, one of them will stick.

[35] Because the ISO does not assume that 100% of QF Generation would fail simultaneously, there was no reason for it to provide evidence for such an assumption. CAC/EPUC's complaint about the lack of such evidence, CAC/EPUC Br. at 11, is thus irrelevant.

As an initial matter, CAC/EPUC's argument assumes that the ISO's proposal violates PURPA and its approval would mean that the Commission is not enforcing PURPA uniformly.[36] The former assumption, as shown above, is incorrect. There is no basis for the latter assumption – no party has shown that the Commission has ever issued an inconsistent ruling on these issues.[37]

Moreover, CAC/EPUC's assertion of disadvantage is at best questionable. CAC/EPUC cites Mr. Leiber's testimony that, all other things being equal, a Generator with self-generation would locate where costs are assessed on a net, rather than gross, basis and infers therefrom that California will be significantly disadvantaged in attracting co-generation. CAC Br. at 17-18. This is truly a stretch. It requires neither testimony nor evidence to recognize that all other things are rarely equal, and there is no basis for assuming that the costs of self-generation is even frequently the primary basis for choosing a location.[38] The on-site Loads at issue here are industrial processes, Tr. 2033:3 – 2035:1. Obviously, therefore, they will locate primarily according to their need for resources and customers. For example, an industrial process that uses steam for oil extraction would logically locate where the oil is. Only once located would the industrial process examine the value of cogeneration.

5. CAC/EPUC's Arguments Regarding the ISO's Gross Metering Policy Are Irrelevant As Well As Unfounded

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36 The need for uniform interpretation of WSCC requirements is a different issue. Record correspondence between the WSCC and Edison suggest that that issue is being addressed. Exh. ISO-50, ISO-51.

37 The Commission has, however, made it very clear that the implementation of PURPA is primarily a matter of state concern, and that states are given wide latitude if conforming with statutory requirements. *Policy Statement*, 23 FERC ¶ 61,304 (1983).

38 If necessary, the Presiding Judge could take official notice of these facts.

CAC/EPUC devotes four pages to the argument that the ISO's "gross metering policy" is bad public policy because it will discourage cogeneration. CAC Br. at 26-29. It points to the cost implications of the Commission's adoption of a "gross load" policy, including the costs of metering, telemetry, ancillary services, and transmission access charges. *None of these costs are at issue in this proceeding.* The *only* issue with regard to retail behind-the-meter Load is whether it should pay a fair share of the costs of CAS. The same principles that dictate that wholesale behind-the-meter Loads should share those costs – as discussed in the ISO's Initial Brief and above – dictate that retail behind-the-meter Load should also.

Nonetheless, it bears noting that CAC/EPUC's assertion, citing its witness, that the ISO's policies will "eliminate most, if not all" of the cost reductions associated with self-generation, CAC/EPUC Br. at 28-29, is totally without foundation. As noted in the ISO's Initial Brief, the *only* evaluation of the cost impacts done by CAC/EPUC's witness ignores entirely the savings in Energy costs, savings that overwhelm the costs identified by the witness. ISO Br. at 29.

6. <u>There Is No Basis for Finding the Control Area Gross Load Billing Determinant Difficult to Implement As Applied to Behind-the-Meter Retail Load</u>

CAC/EPUC argues that charging CAS according to Control Area Gross Load is "impractical" because it is inconsistent with state historical practice, state law, and existing contracts terms. It asserts that the ISO's proposal will lead to market inefficiencies, such as cost shifting, double billing, and prolonged litigation. The conclusion that market inefficiencies will result is at best questionable. Moreover, the existence of the first two identified inefficiencies – cost shifting and double billing – is completely within the control of the California state legislature and the CPUC. With regard to the third inefficiency, the concept that the Commission should reject a tariff revision or policy because it might lead to prolonged litigation is novel indeed. It would give protestors enormous leverage. It would also have halted entirely the development of open access transmission and a restructured electricity market.

CAC/EPUC cites five reasons for its conclusion. The first two address the ISO's lack of meter data regarding behind-the-meter Load.[39] The ISO has unambiguously stated its preference for such data. *See*, *e.g.*, Tr. 1151:21 – 1152:3; 1180:1-4. The ISO's proposal, however, does not require such data; it allows for the use of an estimate. *See* Exh. ISO-1 at 32:14 - Accordingly, the lack of such data presents no obstacle to use of the Control Area Gross Load billing determinant. Further, the Commission rejected similar arguments regarding the ISO's proposal to bill start-up and emissions charges in connection with the must-offer requirement according to Control Area Gross Load. *California Ind. Sys. Oper. Corp.*, 97 FERC ¶ 61,293 at 62,363-64 (2001).

CAC/EPUC next argues that standby rates are based on net Load. The basis for standby rates, however, is totally within the jurisdiction of the CPUC. That the CPUC is required to oppose ISO actions that unreasonably discourage self-generation[40] does not imply that it would allow cost-shifts if the ISO's proposal is ap-

[39] The assertion that the ISO's gross metering policy was "rejected" in Docket ER98-977 is, as is typical, only half the story. The matter remains pending for the Commission on exceptions.

[40] As discussed elsewhere, there is no evidence that the ISO's proposal would unreasonably discourage

proved. As the CPUC noted in its brief, if CAS is allocated to behind-the-meter retail Load:

> [T]he CPUC /EOB would support allocation of a corresponding amount of [CAS] charges to the UDC for that retail customer. The CPUC/EOB would expect the UDC to apply to the CPUC for authorization to pass these [CAS] charges through in rates to the retail customer, whether as a surcharge on energy rates . . . or as an increase in the demand charge . . . .

CPUC/EOB Br. at 24.

CAC/EPUC also asserts that the ISO's proposal violates section 2827 of the California Public Utilities Code, which provides that retail electric charges to certain customers that employ small solar or wind Generating Units will be based on net usage over a period of a month. Of course, the ISO's proposal cannot "violate" section 2827 because it does not involve retail rates. Moreover, section 2827 on its face represents a conclusion of the California legislature that such customers deserve special treatment, i.e., that public policy justifies a small cost shift for retail rates.

Finally, CAC/EPUC asserts that the adoption of the Control Area Gross Load billing determinant will needlessly propagate additional litigation. In other words, CAC/EPUC believes that intention to challenge in various *fora* any Commission decision not in its favor is an argument against the decision. This proposition does not require a response.

7. SAPB 3.1 Does Not Require Revision

CAC/EPUC contends that language in Settlements and Billing Protocol 3.1, allowing the ISO to use available information or estimates for billing GMC when

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self-generation.

Settlement Quality Meter Data is not available, would allow the ISO to bill SCs for MO based on schedule or estimates. This is simply inaccurate. Under Section 8.1.3 of the ISO Tariff, the MO charge is based on purchases and sales in the ISO's Ancillary Services and Imbalance Energy markets. The ISO Tariff determines Ancillary Services obligations according to metered Demand and firm exports. Accordingly, purchases of Ancillary Services that are attributed to a SC – and therefore the MO charge based on such services – can only be based on metered Demand and . Imbalance Energy is deemed purchased or sold according to the difference between scheduled Generation and Load and metered Generation and Load. ISO Tariff (Exh. J-4) § 2.5.23, SABP 3.1(d) and SABP Appendix D. Because purchases and sales of neither Ancillary Services nor Imbalance Energy can only be based on metered Demand and firm exports, there is no Tariff basis for MO charges based on estimates or other information.

Sub-Issue I.F.2: Is the ISO's proposal to estimate a retail customer's load served by generation located behind the site boundary meter just and reasonable?

1. <u>The Filed Rate Doctrine</u>

SCE and CAC/EPUC argue that the ISO's estimation for behind-the-meter Load violates the filed rate doctrine. SCE Br. at 28-29, CAC Br. at 34-35. The ISO's estimation methodology does not violate this doctrine.[41] The ISO Tariff establishes how the billing determinant for CAS, Control Area Gross Load, is to be determined.

[41] The filed rate doctrine "forbids a regulated entity to charge rates for its service other than those properly filed with the appropriate federal regulatory authority." *See Southern California Edison Co. v. FERC*, 805 F.2d 1068, 1070 n.2 (D.C.Cir. 1986).

ISO Tariff (Exh. J-2) § at First Revised Sheet No. 308 – Original Sheet No. 308A. As part of the calculation of this billing determinant an estimate may be used. Nothing in the filed rate doctrine requires all details of a calculation to be included in an entity's tariff. Examples can be found in the ISO's current Commission approved rates. For instance, the ISO uses a power flow software program to help the ISO determine loses. The details of this software are not, and need not be, included in the Tariff.

2. Station Power Load

SCE argues that because the ISO's estimation for behind-the-meter Load assumes that standby contract demand does not include station power (or "aux" Load), the estimation should be revised to reflect the portion of the standby charge that is station power load. SCE Br. at 29-30. The ISO's treatment of station power Load is addressed above.

3. Discrimination

CAC/EPUC contend that the ISO's estimation methodology is discriminatory because it charges QFs for "potential" Load and metered customers for "actual" Load. CAC Br. at 37-38. This argument is addressed *supra*. SCE argues that the ISO's estimation of behind-the-meter Load is discriminatory because the ISO does not estimate the amount of self-served behind-the-meter Load located in GE service areas. SCE Br. at 30-31. It is the ISO's intention to assess the CAS on Loads that self-provide within a GE's service area. That the ISO does not currently have the data needed to accurately estimate the size of these loads does not make the ISO's estimation methodology discriminatory or provide a basis for other Loads to avoid their cost responsibility

4. PURPA

CAC/EPUC and SCE contend that the ISO's estimation methodology violates the Commission's regulations regarding the sale of backup and maintenance power.[42] This argument is addressed *supra*.

5. Contract Abrogation

CAC/EPUC argues that the ISO's billing determinant for CAS would abrogate the terms of power purchase agreements regarding how QFs are metered and billed for the purchase of power. The power purchase agreements are appropriately named in that they govern the terms of power sales. The CAS charge has nothing to do with the sale of power, its metering or billing. Exh. ISO-29 at 12:11-14. The ISO's estimation method does not, therefore, impact in any way the power purchase agreements mentioned by CAC/EPUC.

Issue I.G: Is it just and reasonable to assess components of the GMC on Mohave Participant Energy?

1. Mohave Participant Energy is an Export from the ISO Control Area and Therefore Properly Assessed the CAS Charge

SCE argues that the portion of the Eldorado transmission system line that transmits Mohave Participant Energy ("MPE") is not a part of the ISO Controlled Grid even though there is no dispute that the rest of the line is a part of the ISO Con-

[42] 18 C.F.R. § 292.305(c) (2001). CAC/EPUC is overly broad in its characterization of the statute as "rates for sales to QFs" when it applies only to the sale of back-up and maintenance power. The CAS charge is not a charge for the sale of energy of any type.

trolled Grid. MPE's use or non-use of the ISO controlled grid is not determinative of whether it is just and reasonable to assess MPE the CAS charge of the GMC. The CAS charge is assessed to Control Area Gross Load *and exports*. ISO Tariff (Exh. J-2) at § 8.3.2. No party has argued that MPE Energy does not fall squarely within the category of an export from the ISO Control Area and receives the benefits from the CAS performed by the ISO. ISO Br. at 35.

SCE's argument that MPE is not part of the ISO's Load Responsibility is irrelevant for the same reason. ISO Tariff (Exh. J-2) at § 8.3.2. In the case of MPE, as is the case with exports by definition, the Load served is outside of the ISO's Control Area. However, as an export that originates in and is transferred through the ISO Control Area, ISO-36 at 4; Tr. 1231, MPE benefits from, *inter alia*, outage coordination; scheduling; the performance of operational studies; and monitoring the entire Control Area. Exh. ISO-29 at 46:16 – 52:25; Tr. 1205:9-12.

While it is not material whether MPE in fact utilizes the ISO grid in determining whether to assess MPE the CAS charge, it is the ISO's position that it is not possible to have only a certain percentage of a given transmission line within under the ISO's Operational Control. SCE argues that if MPE facilities were under the operational control of the ISO, a 203 filing would evidence the transfer. Such a 203 filing was made prior to the start up of the ISO and approved by the Commission. *See Pacific Gas and Electric Company, et al.*, 77 FERC ¶ 61,204 at 61,822-23 (1996). That 203 filing transferred the Eldorado transmission system, which is evidenced by their entry in Appendix A of the Transmission Control Agreement ("TCA") and the ISO

Register. Exh. ISO-33. That the ISO cannot maintain control over only part of a facility. Exh. ISO-36 at 5:7-16, is not only supported by simply logic, but acknowledged by SCE's own witness who testified that SCE exercised operational control of the *entire* Eldorado transmission line prior to the start-up of the ISO. Tr. 2194. Therefore, MPE energy does, in fact, utilize the ISO Controlled Grid.

SCE also argues that, because MPE does not pay the Wheeling Access Charge, it is not possible that the MPE facilities are part of the ISO Controlled Grid. SCE Br. at 33-34. Existing Contracts are listed as Encumbrances of the ISO Controlled Grid in Appendix B to the TCA. The Eldorado system agreements are listed. Ms. Le Vine testified, however, that existing contracts are not charged the Wheeling Access Charge either, and that the ISO has treated SCE's arrangement with the Mohave Participants as existing contracts. ISO Br. 1824:2-4. The absence of a wheeling charge, therefore, proves nothing.

SCE's arguments that attempt to demonstrate that the non-existence of certain contractual relationships between SCE and the Mohave Participants are proof that the ISO does not have Operational Control of the Eldorado transmission facilities, SCE Br. at 33-34, have nothing to do with the ISO's physical control of the Eldorado facilities. That SCE does not include the MP's percentage interest in the Eldorado line in its Transmission Revenue Requirement ("TRR"), only shows that SCE does not have any economic rights to the Mohave Participants' ownership percentage of the line. Similarly, the Mohave Co-owner agreements do not appear in the SCE RPTO agreement simply because SCE is not the SC for the Mohave Participants. Again, this does not affect the fact that the ISO exercises Operational Control of a transmission line over which SCE admitted it once exercised control.

SCE also alleges that the ISO sent a letter to SCE in 1998 stating that MPE shares of Eldorado were not part of the ISO Controlled Grid. SCE Br. at 34. While the letter referenced was not submitted as part of the record and is hearsay, the letter appears to have been authored at a time when the Eldorado system was exempt under the terms of the GMC settlement. The prior GMC settlement is not precedent for the 2001 GMC proceeding. Tr. at 1865:4-9.

Finally, that the ISO cannot require SCE to provide open access over shares of Eldorado that it does not own is irrelevant. The ISO cannot dictate to any entity, including those whose transmission facilities are not disputed to be under ISO Operational Control, what to schedule and when. Tr. 1897:2-5.

2. <u>Assessing the CAS Charge on MPE is Not Discriminatory</u>

SCE argues that assessing the CAS charge to MPE, and not on transactions using the Southwest Power Link ("SWPL"), is discriminatory. SCE Br. at 37-41. As noted in the ISO's Initial Brief, however, neither of the initial elements for a finding of discrimination are shown. *See* ISO Br. at 35 *citing City of Vernon v. FERC* 845 F.2d 1042, 1045-46 (D.C. Cir. 1988).

SCE argues that it is discriminatory to assess the CAS charge to MPE because SWPL exports are not treated differently than MPE by the ISO. SCE Br. at 37-41. However, MPE exports and SWPL Wheel Throughs are not similarly situated. SWPL Energy originates outside of the ISO Control Area and is delivered to a Load outside of the ISO Control Area. Exh ISO-36 at 6:22 – 7:2. The Energy involved in a SWPL Wheel Through transaction is the responsibility of the originating Control Area and the destination Control Area. In contrast, MPE originates in the ISO Control Area and is exported out of the ISO Control Area. *Id*. at 6:11 - 16. Because SWPL and MPE are not similarly situated, they do not receive the same services and create different workloads for the ISO. Exh. ISO-36 at 7:14-15. As stated in the rebuttal testimony of Ms. Le Vine, however, if the Presiding ALJ does determine that SWPL and Mohave are similarly situated and receiving the same services, SWPL should be assessed the CAS charge as well. Exh. ISO-36 at 9:16-19.

SCE also cites the treatment of COTP exports from the CAS as evidence of discrimination, asserting that it is not clear how the ISO will get the data necessary to charge COTP exports the CAS charge. SCE Br. at 41-42. As Ms. Le Vine testified, however, the ISO will assess COTP exports the CAS charge on COTP exports for 2001. Tr. 1991:1-12. The completeness of the ISO's current data regarding COTP exports is not relevant to a claim of discrimination.

Issue I.H: Is it just and reasonable to assess components of the GMC on SWPL Energy?

1. <u>Use of the ISO Controlled Grid</u>

SDG&E argues that assessing SWPL Energy the MO is unjust and unreasonable because SWPL Energy does not use the ISO Controlled Grid. SDG&E Br. at 13-14. To the contrary, SWPL Energy uses facilities that are under the ISO's Operational Control and therefore, are included within the ISO's Controlled Grid. Exh. ISO-36 at

6:11-14. Although SDG&E argues that "merely placing a jointly owned facility on a list" does not confer Operational Control over the whole facility, SDG&E Br. at 15, the "list" is the ISO Registry. SDG&E also included the SWPL in Appendix A of the TCA which expressly states that the transmission line is under the ISO's Operational Control. SDG&E's argument is that the ISO only has operational control of a percentage of a given line over which SWPL Energy flows is no more valid than SCE's. SDG&E at 15. *See* Issue H, *supra.*

Like SCE, SDG&E argues that the ISO cannot have Operational Control of the lines that transmit SWPL Energy because the ISO cannot dictate to APS or IID what it is to schedule and when. SDG&E Br. at 16. That fact is just not relevant to Operational Control. *See* Issue H. As Mr. Lyon testifies, "Operational Control" is not a matter of being able to do whatever the ISO wants with a line, but is limited to certain operations. Tr. at 1234-1235.

Ultimately, whether SWPL transmission facilities are, or are not, a part of the ISO Controlled Grid is not material to whether these facilities may be assessed the MO charge. Transactions assessed the MO charge "…are not limited to transactions using the ISO Controlled Grid." ISO-34 at 17:14-18:2. The MO charge is assessed to "…total purchases and sales of Ancillary Services, Supplemental Energy, and Imbalance Energy." ISO Tariff (Exh. J-2) § 8.3.3. In this case, the MO charge is assessed on small purchases of imbalance energy needed to replace line losses on SWPL Energy in the ISO Control Area.[43]

SDG&E's arguments regarding Amendment 2 are discussed under Issue I.E, *supra*.

Despite the Presiding Judge's admonishment that the GMC settlement can not be used as precedent, Tr. 1865:4-9, SDG&E continues to cite to the settlement as proof that Amendment 2 precluded the ISO from charging SWPL. SDG&E Br. at 7. This argument fails for both the clear reading of the Commission's decision regarding Amendment 2, discussed above, and its inappropriate reliance on the GMC settlement.

2. <u>Discrimination</u>

SDG&E also argues that the assessment of the MO charge on SWPL Energy is discriminatory. First, SDG&E contends that other Control Areas do not charge the ISO for ISO Energy schedules in their Control Areas and that "[t]his evidence further shows that each Control Area operator in the WSCC properly bears the costs attendant to schedules the on [*sic*] transmission rights of the other Control Areas as necessary to interconnected operations." SDG&E Br. at 23. SDG&E claims that there is "proof" that "the ISO is only WSCC Control Area that assess such charges on schedules of third party facilities within its control area". What other Control Area's may

[43] SDG&E argues that "unrebutted is Mr. Yari's testimony that SDG&E in fact self-provides the Imbalance Energy, which should render unnecessary the market operations services (and resulting charges)," SDG&E Br. at 22, but this argument is disingenuous. To the extent SDG&E self-supplies the correct amount of Imbalance Energy, it will not be charged. It is only charged for real-time imbalances that can and do occur. While SDG&E estimates imbalance energy for SWPL, real-time imbalances can and do occur.

or may not do is irrelevant to whether the ISO is treating similarly situated parties differently. SDG&E also argues that the ISO's failure to charge parties such as LADWP, that have reciprocity agreements with the ISO is discriminatory. There was no record evidence, however, that the ISO has denied APS and IID the opportunity to enter into such a reciprocity agreement.

Next, SDG&E claims that the assessment of different charges on SWPL and MPE is discriminatory. SDG&E Br. at 24. Without directly addressing the differences between Mohave and SWPL that Ms. Le Vine described in her rebuttal testimony, Exh. ISO-34 at 8 -13, SDG&E simply states that the ISO's position does "not square with the undisputed facts and the plain meaning of the ISO tariff." SDG&E does not identify the facts, and does not make any showing that the ISO's description of the differences between SWPL and Mohave energy are inaccurate. Nevertheless, as stated in the rebuttal testimony of Ms. Le Vine, if the Presiding ALJ does determine that SWPL and Mohave are similarly situated, SWPL should be assessed the CAS charge as well. Exh. ISO-36 at 9:16-19.

Finally, SDG&E states that COTP "bubble transactions" are similarly situated to SWPL in that they take place within the ISO Control Area. SDG&E Br. at 24-35. SWPL and COTP are not similarly situated. COTP is the subject of a dispute that is currently before the Commission on appeal. *California Ind. Sys. Op. Corp.,* Docket No. EC02-45-000, filed January 25, 2000. Until the Commission has determined the outcome of the appeal proceeding, the GMC MO costs are being held in abeyance.

Issue I.I: Is it just and reasonable for the ISO to assess the GMC on "other appropriate parties"?

Various parties challenge the ISO proposal to assess the GMC to "other appropriate parties." The arguments range from cost causation, *see*, *e.g.*, CPUC Br. at 21-23, to contractual privity, *see*, *e.g.*, TANC Br. at 41, to the filed rate doctrine, *see*, *e.g.*, TID Br. at 16. All these arguments, however, assume that the ISO intends to charge entities that have not agreed to be charged. As the ISO discussed in its Initial Brief, this is not the case. ISO Initial Br. at 39. Accordingly, there is no need to respond to these arguments.

Sub-Issue I.I.1: If so, should the ISO be required to make a compliance filing to allow it to assess the GMC on "other appropriate parties"?

The ISO's position on this issue is fully set forth in its Initial Brief.

Sub-Issues I.I.2: If not, should the phrase "other appropriate party" be deleted from the ISO's tariff?

The ISO's position on this issue is fully set forth in its Initial Brief.

Issue I.J: Is it just and reasonable to assess a Scheduling Coordinator the GMC for loads not scheduled pursuant to the ISO Tariff by any Scheduling Coordinator?

The ISO's position on this issue is fully set forth in its Initial Brief.

Sub-Issue I.J.1: Is it just and reasonable for the ISO to allocate in any hour the Control Area Services Charges to a utility distribution company that provides standby service to a retail customer (including the readiness to provide energy to the customer upon demand), to the extent such customer's load is fully self-served during that hour?

SCE contends that the ISO has no evidence that SCE has agreed to be the SC for self-served behind-the-meter Load and that the ISO has no basis to find it responsible for charges allocated to such Load.[44] A good portion of SCE's argument is devoted to the testimony of Mr. Epstein about the ISO's legal basis and the extent of this knowledge of the legal basis. *See*, SCE Br. at 44-45. The ISO's authority, however, is not ultimately determined by testimony, but by the underlying documents and laws.

In its Initial Brief, the ISO set forth the legal basis for charging the GMC allocated to self-served retail behind-the-meter Load to the UDC that schedules standby service for that Load. ISO Br. at 42. As shown in that discussion, it is not "immediately apparent that [the SC Agreement] . . . specifically is limited to the ISO Controlled Grid," SCE Br. at 46 (emphasis omitted). Rather, the SC Agreement holds the SC accountable for all charges attributable to it under the ISO Tariff, and the GMC for self-served retail behind-the-meter Load is just such a charge. Accordingly, the ISO's proposal does not violate the filed rate doctrine and it is appropriate to charge the GMC for self-served retail behind-the-meter Load to the UDC that is the SC for that Load.

If, however, the Presiding Judge finds that the ISO currently lacks the authority to charge the GMC for such Loads to the UDC, the ISO requests that she direct the ISO to file appropriate amendments to the ISO Tariff, effective coincident with the GMC, to provide such authority.

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[44] In connection with Issue I.J., TANC, SMUD, and MID refer to their arguments against the allocation of CAS to behind-the-meter Load of GEs. The ISO does not understand Issue I.J. to concern whether such an allocation is appropriate, but rather the entity to be charged *if* such allocation is appropriate. The ISO's has response to these arguments in connection with Issue I.E.1.

Sub-Issue I.J.2: Is it just and reasonable for the ISO to allocate the Control Area Services Charge (for metered and/or estimated behind-the-meter retail loads) to a UDC that provides for standby service to a customer if such customer does not procure energy from a UDC, but rather procures its energy from a direct access Energy Service Provider (i.e., an entity other than the UDC) for which the UDC is not the Scheduling Coordinator?

The ISO's position on this issue is fully set forth in its Initial Brief.

Sub-Issues I.J.3: Is it just and reasonable for the ISO to assess the GMC to a UDC, when the UDC is acting as a Scheduling Coordinator for a wholesale entity's Existing Transmission Contract, and all or a portion of the load of that wholesale entity is being met by means other than transmission service provided under the terms of the Existing Transmission Contract?

SCE and PG&E both contend that the ISO lacks contractual authority to charge the GMC for behind-the-meter wholesale Loads of GEs to the SCs for those GEs. In its initial Brief, the ISO demonstrates that such charges are authorized by the Responsible Participating Transmission Owner Agreements in conjunction with the SC Agreements. ISO Br. at 45-46.

As in connection with Issue I.J.1, SCE relies in part upon Mr. Epstein's testimony on the relevant agreements. SCE Br. at 48. As with regard to Issue I.J.1, it is not Mr. Epstein's familiarity with the agreements, but the language of the agreements – as described in the ISO's Initial Brief – that is controlling.

PG&E argues that the ISO's proposal is premised on the changes proposed in Amendment No. 2 to the ISO Tariff that would have expanded SC obligations from the "ISO Controlled Grid" to the "ISO Control Area or across transmission facilities forming part of the ISO Control Area," and that the Commission rejected such changes. PG&E Br. at 10. As shown in the ISO's Initial Brief, the ISO's proposal is based on the current language of the SC Agreement. The changes to the SC Agreement proposed in Amendment No. 2, for example, would have required that transactions that do not involve the ISO Controlled Grid be scheduled. *See* Exhibit J-3, Exh. A. The authority here is much narrower, and is directly related to the allocation of GMC charges to GE Load that is not scheduled on the ISO Controlled Grid, an issue which, as discussed in connection with Issue I.E, supra, was expressly left open in the Commissions ruling on Amendment No. 2.

If, however, the Presiding Judge finds that the ISO currently lacks the authority to charge the GMC for such GE Loads that are not served from the ISO Controlled Grid to the SC for the GE, then she should direct that the ISO file appropriate amendments to the ISO Tariff, effective coincident with the GMC, to provide such authority.

Issue I.K: BART Issues

Sub-Issue I.K.1: Is the ISO's Market Operations function necessary and beneficial to BART?

The ISO's position on this issue is fully set forth in its Initial Brief.

Sub-Issue I.K.2: Are the ISO activities and costs accounted for under the ISO's GMC function "Control Area Services" essential or beneficial to BART's network transmission service?

The Bay Area Rapid Transit Authority ("BART") argues that it does not benefit from the ISO's MO services and CAS services because it pays PG&E for Ancillary Services and control area services, which PG&E is obligated to provide, and BART is indifferent to the means by which PG&E obtains the Ancillary Services ensure that the control area services are available. This is akin to arguing that BART pays some-one for Energy and therefore does not benefit from the fact that Generators produce the Energy. BART's real complaint is that it should not both pay for Ancillary Serv-ices and control area services under contract with PG&E and also pay a pass-through of ISO MO and CAS charges. PG&E's pass-through of ISO charges, however, is not an issue in Phase I of this proceeding (Docket No. ER01-313). Accordingly, the ISO need not respond further to BART's arguments.

Issue I.L: What measures are appropriate to track and control the ISO's GMC costs?

Some parties have argued that the Commission should order the ISO to imple-ment new or different methods of tracking or controlling costs, *see, e.g.*,TANC Br. at 44. The ISO will have to meet the applicant's burden in all future Section 205 filings, including its 2002 GMC filing. There is no legal basis to require changes to the ISO's cost controls or tracking of costs, although the ISO welcomes and would respect Commission guidance.

TANC equates the non-use of timeslips with a "lack of incentives to control costs," TANC Br. at 44.[45] See ISO Br. at 45-46. Rather than identify why the ISO's current incentives and cost controls, described in the ISO's Initial Brief at 45-46, are ineffective and why timecards would be, TANC fast-forwards to its conclusion that

[45] Mr. Leiber's observations that lack of incentives would permit an increase in costs, cited by TANC, is obviously true, but establishes nothing about the ISO's current incentives and cost controls.

this is the case.[46] Turlock Irrigation District's ("TID") support of timeslips suffers the same deficiency.

CDWR argues that some sort of labor cost analysis should be undertaken, but that such rigid data would provide an incomplete picture and recommends Department head and manager input. Such input is similar to what the ISO currently has in place. ISO-21 at 32:9-11. TID also argues that the ISO should directly assign tasks to service categories, TID Br. at 21, which the ISO has done to the extent possible in the ISO's 2001 GMC. Exh. ISO-21 at 58.

Finally, SMUD argues for limiting the ISO's ability to increase its revenue requirement until the Commission has definitively approved the ISO's budget. SMUD Br. at 31. This ill-conceived plan re-writes Section 205 of the Federal Power Act, discards the Commission and Federal precedent that a utility's costs are presumed to be prudent and therefore just and reasonable, and could create a situation where the ISO may be unable to collect its needed revenue requirement until a final decision is rendered, possibly several years after the fact. There is no legal basis for SMUD's suggested regulatory revision.

Issue I.M: How often should the ISO be required to make a Section 205 filing?

CDWR and Staff contend that the ISO should make a 205 filing for any increase in revenue requirement above the amount determined to be just and reasonable in the current proceeding. CDWR at 25, Staff at 32-33. Staff suggests that this ap-

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46 While the ISO has identified some of the drawbacks of requiring ISO employees to assign all of their

pears to be a moot point as the ISO has already made a 205 filing for the 2002 GMC. The ISO does support a ruling, however, that would implement, year to year going forward, the proposal by the CPUC that the ISO not be required to make a Section 205 filing unless the revenue requirement for any service category exceeds a 10% or 5 million dollar increase. CPUC Br. at 25-26.

Sub-Issue I.M.1: Should additional cost control measures be implemented by the ISO to avoid Section 205 filings?

See Issue I.L, *supra.*

Sub-Issue I.M.2: Should any modifications to the GMC methodologies, allocations, and structure be allowed without prior FERC review and approval?

CDWR argues that the ISO should also be required to make a Section 205 filing whenever it makes changes to its allocations, even if these changes do not affect the ISO's overall revenue requirement. CDWR Br. at 25. While the ISO does not oppose filing under Section 205 for changes to the structure of theGMC, including, *e.g.*, to Service Categories, Tr. 443:15-24, or to increases in the revenue requirement above reasonable "triggers", CDWR's proposal would require an expensive litigation process whenever allocation methods are improved from one year to the next, even if the ISO revenue requirement remained constant or decreased. The ISO, supported by Staff, Staff Br. at 32, submits that it should be allowed to refine its allocation methodology from year to year without a Section 205 filing if its revenue requirement does not exceed the Commission's triggers.

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time to a given cost center, Exh. ISO-29 at 39:9 – 43:2 the ISO has also committed to further reviewing the

CDWR's argument that the ISO should not be allowed to prospectively change its rates quarterly to compensate for billing determinant volumes that are five percent lower or higher for each service category, CDWR Br. at 27, is discussed in the ISO's Initial Brief at 49.

Issue I.N: Should the ISO be required to undertake a comprehensive re-evaluation of the GMC structure in 2003?

The ISO supports a reevaluation of the GMC in 2003 but believes that any Commission discussion of the details of such a review should be hortatory, not cast in obligatory terms.

Sub-Issue I.N.1: What procedures and time frames should be followed for GMC re-evaluation?

The CPUC argues "that the ISO be ordered to immediately commence a rate redesign" that conforms to the general outline that CPUC/EOB presented in their initial brief. CPUC Br. at 26. If the current rate is found to be just and reasonable, there is no reason to order the ISO to redesign its rate.

Sub-Issue I.N.2: How should customer input be solicited and incorporated

CAC/EPUC argues that to the extent the Commission orders the ISO to re-evaluate the GMC in the future, the Commission should order a technical conference in which "all participants will have the opportunity to submit proposals, request discovery… ." CAC Br. at 40-41. CAC/EPUC does not indicate how such a technical conference would be superior to the stakeholder processes used for the initial unbun-

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costs and benefits of a time tracking system. Tr. at 463:14-23.

dling, and certainly does not give justification for the use of potentially burdensome discovery.

Sub-Issue I.N.3: Should the ISO be required to file the results of future evaluations of the GMC with the FERC for review and approval?

TID argues that the ISO should file the results of all future GMC evaluations. TID Br. at 23. The ISO concurs with CPUC/EOB, CPUC Br. at 27, and Staff, Staff Br. at 34, that unless there are changes made to the GMC which require a filing under Section 205 of the FPA, there is no basis for a filing to be made.

Issue I.O: Is the ISO's formula rate specific enough to operate as a formula under the Commission's regulations?

The ISO has no further discussion of this issue.

Sub-Issue I.O.1: Should the ISO be required to make a Section 205 filing if the results of its formula exceed the revenue requirement caps for each GMC component?

See Issue I.M, *supra.*

Sub-Issue I.O.2: Should the ISO's GMC components have revenue requirement ceilings and if so, what is the appropriate level of such ceilings?

TANC and TID argue that the appropriate ceiling to trigger a Section 205 filing is the revenue requirement found to be just and reasonable in the 2001 proceeding, as proposed by Mr. Pointer of Staff. TANC Br. at 48; TID Br. at 24. This argument is discussed with Issue I.M, *supra*.

Sub-Issue I.O.3: Should the ISO's formula rate be replaced by either of the options proposed by Mr. Pointer in his testimony or the option presented by Mr. Ramirez in his testimony?

See Sub-Issue I.O.2.

II. CONCLUSION

WHEREFORE, for the reasons discussed above, the Presiding Judge should find that the ISO's GMC is just and reasonable.

Respectfully Submitted,

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Dated: February 22, 2002