California Independent System Operator Corp., Exhibit No. ___ (ISO-3)
Docket No. ER00-_____-000

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)))	Docket No. ER00-_____-000

PREPARED DIRECT TESTIMONY OF
DEBORAH A. LE VINE
ON BEHALF OF THE
CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Deborah A. Le Vine and I am the Director of Contracts & Compliance for the California Independent System Operator (ISO). My business address is 151 Blue Ravine Road, Folsom, California 95630.

Q. IN WHAT CAPACITY ARE YOU EMPLOYED?

A. As the Director of Contracts & Compliance, I am responsible for negotiation and administration of all *pro forma* agreements executed by Market Participants. The compliance portion of the job includes compliance with the obligations cited in the agreements, and the ISO Tariff including the ISO Protocols.

Q. DO YOU HAVE ANY OTHER RESPONSIBILITIES AT THE ISO?

A. Yes. Since October 1998, I have been the project leader for the ISO's development of a new transmission Access Charge.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL QUALIFICATIONS.

A. I received a Bachelor of Science degree in Electrical Engineering from San Diego State University in San Diego, California in May 1981. In May 1987, I received a Master in Business Administration from Pepperdine University in Malibu, California. Additionally, I am a registered Professional Electrical Engineer in the State of California.

Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?

A. Yes. I have previously submitted testimony on behalf of the ISO in Docket No. ER98-1057-000, et al. concerning the ISO's Responsible Participating Transmission Owner Agreements, in Docket No. ER98-992-000, et al. pertaining to the ISO's Participating Generator Agreements, and in Docket No. ER98-1499-000, et al. involving the ISO Meter Service Agreements for Scheduling Coordinators and ISO Metered Entities.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of this testimony is to describe the extensive stakeholder process used by the ISO to develop a revised Access Charge methodology and to explain the new Access Charge proposal in some detail.

Ultimately, after a 15 month stakeholder process that included participation by the ISO Governing Board, a compromise proposal was developed, supported by the End-User representatives of the Board that calls for a 10 year transition, at a rate of 10% per year, from "TAC Area" rates to ISO Grid-wide rates for high voltage transmission facilities. TAC Area rates blend each of the Participating Transmission Owner's ("Participating TOs") Transmission Revenue Requirement in the previous WSCC Control Areas into an area-wide rate immediately. All new capital additions to existing high voltage facilities and new high voltage facilities will be included immediately in the ISO Grid-wide component.

Q. AS YOU TESTIFY, WILL YOU BE USING ANY SPECIALIZED TERMS?

A. Yes. I will be using terms defined in the Master Definitions, Appendix A of the ISO Tariff.

I. THE CURRENT ISO TRANSMISSION ACCESS CHARGE

Q. WHAT IS THE ACCESS CHARGE?

A. The Access Charge is a charge paid by entities serving Loads on the transmission and distribution systems of Participating TOs to recover the large portion of those Participating TOs' transmission-related revenue requirements. These are the operating and carrying costs associated with the Participating TOs' transmission facilities and Entitlements. (The costs of operating the ISO itself are not recovered through the Access Charge; these costs are recovered through the Grid Management Charge.)

Q. PLEASE DESCRIBE THE CURRENT MANNER IN WHICH THE ACCESS CHARGE IS ASSESSED?

A. Currently, in accordance with California's electric restructuring legislation (AB 1890) and as approved by the Commission, the Access Charge is implemented on a "utility-specific" basis. The three current, or "original", Participating TOs are Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company ("SCE"), and San Diego Gas & Electric Company ("SDG&E"). Each has filed with the Commission to establish rates for their specific Service Area based on their individual Transmission Revenue Requirements and their individual end-use Load. The three utilities bill these rates to their End-Use Customers and wholesale customers not served under Existing Contracts. In addition, the ISO bills Scheduling Coordinators for Wheeling charges that are based on Scheduling Points that exit the ISO Controlled Grid.

Q. DOES THE USE OF THE PRESENT UTILITY-SPECIFIC ACCESS CHARGE RESULT IN "PANCAKED" RATES?

A. No. Eligible customers pay an Access Charge based on the rolled-in embedded cost of the Participating TO's transmission system where the scheduled power leaves the ISO Controlled Grid. Therefore, for example, Load in SCE's Service Area that is served from resources in the Pacific Northwest will only pay SCE's Access Charge for transmission over the ISO Controlled Grid. With respect to Wheeling, the ISO Tariff provides that where two or more Participating TOs own the facilities at the exit point, the charge will be the weighted average Access Charge of all

Participating TOs at that exit point. Such wheeling revenues are treated as revenue credits to the Participating TOs Transmission Revenue Requirement, thereby reducing their Access Charge. Accordingly, customers of the original Participating TOs have access to the entire ISO Controlled Grid at non-pancaked rates.

Q. ARE THERE ANY OTHER FEATURES OF THE CURRENT ACCESS CHARGE?

A. Yes. The ISO Tariff applies a "Self-Sufficiency test" to all Participating TOs. The ISO Tariff defines a "Self-Sufficient" Participating TO as one for which the sum of the Dependable Generation within its Service Area (regardless of ownership) and the Firm Import Interconnection Transmission Capacity (including transmission rights) to the Participating TO's Service Area is greater than or equal to the monthly peak Demand for the Participating TO's Service Area plus resources necessary to meet WSCC Minimum Operating Reliability Criteria. In other words, a Self-Sufficient Participating TO is one whose internal generation and import capability, combined, are enough to serve the load on its system reliably. Conversely, Dependent Participating TOs are those entities whose sum of generation and transmission import capability is less than its monthly peak Demand plus their resources necessary to meet WSCC Minimum Operating Reliability Criteria. Currently there are no Dependent Participating TOs (i.e., there are dependent transmission owners, but none have executed the Transmission Control Agreement to become Participating TOs). However, if there were, Dependent

Participating TOs would be charged a transmission access fee that would include a portion of the Access Charge derived from the Participating TO's Transmission Revenue Requirement (i.e., the Participating TO for which the Dependent Participating TO is interconnected). Specifically, a Dependent Participating TO would pay to the Participating TO to which it is physically interconnected, an Access Charge equal to: (i) the product of the Non Self-Sufficient Contract Demand Rate of that Participating TO and the Non Self-Sufficient Contract Demand of that Dependent Participating TO; plus (ii) the Transmission Revenue Balancing Account adjustment charges as provided in Section 5.5 of the Participating TO's TO Tariff. The Non Self-Sufficient Contract Demand Rate is equal to that other Participating TO's Base Transmission Revenue Requirement divided by the sum of the highest hourly system demand for each month of the year used by that other Participating TO for rate development.

Q. HAVE ANY ENTITIES INDICATED CONCERNS WITH THIS SELF-SUFFICIENCY REQUIREMENT?

A. Yes. As noted in the Commission's October 1997 Order conditionally authorizing operation of the ISO, a number of parties claimed that the definition of Firm Import Interconnection Transmission Capacity is too narrow because it includes only that transmission import capacity which is directly connected with a Transmission Owner's system and therefore excludes certain transmission assets that are not directly connected. Parties also claimed that the definition of Dependable Generation does not give full credit for generating capacity that is available to such Party. The

self-sufficiency test has been cited by California utilities that have not joined the ISO as one of the issues they believe creates a barrier to entry for them.

Q. ARE THERE OTHER ISSUES THAT THE CURRENT ACCESS CHARGE DOES NOT ADDRESS BUT THAT ARE PERCEIVED AS A POTENTIAL BARRIER TO ISO PARTICIPATION?

A. Yes. The fact that a Participating TO's own Transmission Revenue Requirement currently is recovered from its own End-Use Customers represents a concern for potential Participating TOs that provide transmission service to the End-Use Customers of other Participating TOs, without having significant amounts of their own end-use Load. The Western Area Power Administration - Sierra Nevada Region ("Western"), for example, does not serve many End-Use Customers directly. Its transmission service customers are primarily wholesale customers. Western pointed out to the ISO that under the current utility-specific Access Charge methodology, the recovery of Western's Transmission Revenue Requirement would either place an undue burden on Western's own End-Use Customers, or require Western to impose charges onto its wholesale customers in addition to the charges such wholesale customer would be paying as an End-Use Customer of a different Participating TO. Western argued that, if it were to become a Participating TO, the latter option would cause "pancaked" transmission rates by imposing charges on customers for Western's power who already would have to pay the Access Charge of the Participating TO that is their retail service provider.

This concern pointed out by Western would also represent a problem for any future Participating TOs (such as merchant transmission lines or independent transmission companies) that might not have any, or few, of their own End-Use Customers.

Q. WHY DID THE ISO DEVELOP A REVISED ACCESS CHARGE METHODOLOGY?

A. California's restructuring legislation included a requirement for the ISO to recommend to the Federal Energy Regulatory Commission, no later than two years after the ISO Operations Date, a revised rate methodology for the Access Charge. In its Orders of November 1996 and October 1997 conditionally authorizing establishment and operation of the ISO, the Commission confirmed the requirement to file a successor Access Charge methodology no later than sixty days in advance of the second anniversary of the ISO Operations Date. The Commission subsequently granted the ISO motions to extend the date for the ISO's filing until March 31, 2000.

This requirement is reflected in sections 7.1.3.1 and 7.1.6 of the ISO Tariff.

Q. HOW WERE THE PRIOR ACCESS CHARGE NEGOTIATIONS REFLECTED IN THE RESTRUCTURING LEGISLATION?

A. The restructuring legislation reflects the fact that negotiations regarding an appropriate Access Charge methodology had been going on among the

interested stakeholders for some time, but had not reached an acceptable resolution. The stakeholders were willing to agree to the current "utility-specific" Access Charge structure, in which each Participating TO determines an Access Charge based on the costs of its own transmission facilities, but only as a temporary solution, with the assurance that the issue would be revisited by the ISO Governing Board two years after the ISO Operations Date.

Q. DID CALIFORNIA STATE LAW, THE COMMISSION ORDERS, OR THE ISO TARIFF REQUIRE THE ADOPTION OF A SPECIFIC ACCESS CHARGE METHODOLOGY?

A. No. Under the California restructuring legislation there were three possible procedural outcomes for determining the ISO's Access Charge methodology. First, if the ISO Governing Board adopted a new Access Charge methodology, the ISO was to use this new methodology in its submission to the Commission. The Governing Board was to base its decision on principles approved by the Board including, but not limited to, an equitable balance of costs and benefits. The Board was also required to define the transmission facility costs, if any, that were to be rolled in to the transmission service rate and spread equally among all ISO transmission system users and those transmission facility costs, if any, which should be specifically assigned to a specific utility's Service Area. Accordingly, the ISO Governing Board had latitude with respect to the selection of a particular Access Charge methodology. As I will explain, the

ISO Governing Board has adopted an Access Charge methodology, which I will describe later in my testimony.

If the ISO Governing Board had failed to reach a consensus decision on the rate methodology, it was to be determined through the ISO's Alternative Dispute Resolution ("ADR") Procedures. Finally, if the ADR procedures were needed but were unsuccessful, the restructuring legislation provided that the ISO was to file with the Commission a two-part default rate methodology consisting of: (1) a uniform "regional" transmission Access Charge; and (2) a utility-specific "local" transmission Access Charge. In the legislation, regional was defined as 230 kV and above, and local was defined as below 230 kV. Because the ISO Governing Board agreed on an Access Charge methodology, the second and third paths did not become operative.

Starting with its Orders conditionally approving the California ISO's rates and continuing through other ISO ratemaking Orders and Order 2000, the Commission has set forth policies on transmission and ISO rates. However, neither the Commission orders authorizing the establishment and operation of the ISO, nor the ISO Tariff mandated the adoption of a specific ratemaking approach for the Access Charge. The rate the ISO is filing today is fully consistent with the Commission's general guidance and precedent.

II. DEVELOPMENT OF THE REVISED ACCESS CHARGE

Q. PLEASE SUMMARIZE THE PROCESS USED BY THE ISO TO DEVELOP THE REVISED ACCESS CHARGE METHODOLOGY.

A. The development of the revised Access Charge was a substantial undertaking involving extensive consultation with all affected stakeholders. To summarize briefly, the ISO began by soliciting proposals from Market Participants in December 1998. ISO Management then formed both an internal project team and a large stakeholder-working group, the Transmission Access Charge Work Group ("TACWG") to evaluate these proposals. With the assistance of this working group and pursuant to a confidentiality agreement, we collected extensive amounts of data from all California utilities that owned or had contractual rights to transmission to evaluate the costs and benefits of the different Access Charge proposals. This information was shared with the TACWG.

When the working group failed to reach a consensus, ISO Management developed a compromise proposal for consideration by the TACWG and subsequently by the ISO Board of Governors. The compromise proposal was designed to come as close as possible to a fair compromise on a host of interrelated issues with divergent stakeholder preferences, while remaining fully consistent with Commission and AB1890 guidance.

At the October 1999 Board of Governors meeting, the Board approved several of the key features of the ISO compromise proposal in the form of certain principles regarding the new Access Charge methodology. At that

meeting it also formed a negotiating group, made up of Board members, to finalize the submission. This group met in a series of executive sessions during November and December 1999, trying to reach a compromise of the various issues. The full Board then took up this issue in January 2000 to further the negotiated resolution. As I explain later, in addition to the negotiating group comprised of Board members, the ISO continued to have public meetings with stakeholders to discuss the revised proposals through January, February, and March 2000.

As a result of these meetings, the ISO Management presented a revised Access Charge proposal in late January. This revised proposal was based on the original compromise proposal, but refined and added some new features. Following additional discussions of the Board and stakeholders, the End-Use customer representatives on the Board presented a further refinement of the revised January ISO Management proposal. This End-User proposal served as the basis for the tariff amendments approved by the full Board of Governors at their meeting in March 2000.

Q. WHEN DID THE ISO BEGIN TO SOLICIT PROPOSALS FOR THE REVISED ACCESS CHARGE METHODOLOGY FROM STAKEHOLDERS?

A. The ISO first requested in December 1998 that stakeholders concerned with the methodology for the revised Access Charge provide the ISO with a proposal in January 1999. The due date was subsequently extended to

February 26, 1999 at the request of various stakeholders who were trying to put together joint proposals with other stakeholders.

Q. WHO SUBMITTED PROPOSALS IN RESPONSE TO THE ISO's REQUEST?

A. Twenty-two entities submitted proposals regarding the ISO's Access Charge methodology: the California Department of Water Resources; the California Municipal Utility Association; the City and County of San Francisco, California; the Cities of Anaheim, Modesto, Palo Alto, Redding, and Vernon, California; ETGRID; Joint Parties (PG&E and SCE); the Los Angeles Department of Water and Power; The Metropolitan Water District of Southern California; the Northern California Power Agency; PG&E; Reliant Energy; Roseville Electric; Sempra Energy; Silicon Valley Power; SCE; the Transmission Agency of Northern California; the Turlock Irrigation District; and Western.

Q. WHAT DID THE ISO DO AFTER RECEIVING THE PROPOSALS?

A. The ISO took several actions. First, the ISO formed an internal project team to work with stakeholders in the development of the revised Access Charge. The team included individuals with a cross-section of expertise within the ISO as well as outside consultant and legal support.

Second, we prepared a draft project charter and circulated it to all Market Participants. A copy of this charter is provided as Exhibit No. ___ (ISO-4). The ISO worked with the various stakeholders to develop potential goals

for the process. The charter identified several potential goals for the revised Access Charge methodology including:

- Prevent pancaking by treating the ISO Controlled Grid as a single system;
- Be economically efficient;
- Provide predictable and stable transmission prices that facilitate needed new investment;
- Be consistent with other transmission-related costs such as congestion management and loss recovery;
- Minimize cost-shifting among transmission users;
- Be reflective of the underlying physics of the system;
- Encourage entities to join the ISO; and
- Be acceptable to all transmission owners who are or will be participating in the ISO.

Third we had a stakeholder meeting and formed the TACWG of stakeholders to provide a forum to consider the different Access Charge proposals under a confidentiality agreement.

Q. WHEN DID THE ACTUAL STAKEHOLDER PROCESS BEGIN?

A. We held the initial "kick-off" meeting for the stakeholders on March 29, 1999 and determined that for the group to work effectively it was decided that the TACWG should be formed under a confidentiality agreement. A subsequent public stakeholder meeting was held on April 21, 1999 and

parties who had still not executed the confidentiality agreement were allowed to participate.

Q. PLEASE DESCRIBE IN MORE DETAIL THE ACTIVITIES OF THE TACWG.

A. Additional meetings were held approximately monthly: May 11, 1999; June 10, 1999; June 16, 1999; July 13, 1999; August 10, 1999; September 21, 1999; and October 6, 1999. There were numerous other conference calls to discuss the confidentiality agreement, data collection efforts, the modeling of costs and benefits, and various other aspects of the Access Charge methodology.

Q. YOU MENTIONED A CONFIDENTIALITY AGREEMENT. WERE THE ACTIVITIES OF THE TACWG COVERED UNDER SUCH AN AGREEMENT?

A. Yes. In order to promote a full and frank exchange of ideas, to encourage participants to share data about the costs of their transmission facilities and about their loads, and to foster settlement negotiations about what had historically been a contentious issue, the ISO and the other participants of the TACWG executed a confidentiality agreement.

Q. PLEASE IDENTIFY THE ENTITIES THAT EXECUTED THE CONFIDENTIALITY AGREEMENT FOR THE TACWG.

A. A wide range of stakeholders executed the agreement and participated in the discussions. Entities that executed the confidentiality agreement

included: Alameda Power and Telecom; Baker G. Clay & Associates; Bay Area Rapid Transit; the Brattle Group; the California Department of Water Resources; the California Energy Commission; the California Large Energy Consumers Association; the California Municipal Utilities Association; the California Power Exchange; Call Company; the City and County of San Francisco; the Cities of Anaheim, Azusa, Banning, Burbank, Colton, Glendale, Palo Alto, Pasadena, Redding, Riverside, and Vernon, California; Contra Costa Water District; Duke Energy; Dynegy; the Electricity Oversight Board; the Energy Producers and Users Coalition; the Energy Users Forum; Enron; ETGRID; Exeter Associates; FPL Energy, Inc.; GWF Power Systems; Henwood Energy; the Imperial Irrigation District; the Independent Energy Producers Association; the Los Angeles Department of Water and Power; The Metropolitan Water District of Southern California; the Modesto Irrigation District; MZA Grid Services; NASA Research Center; the Northern California Power Agency; Ogden Pacific Power; the Office of Ratepayer Advocates; Oxbow Geothermal Corporation; PG&E; Patterson Consulting; PG&E Energy Services Corporation; PECO Energy Company; Phoenix Consulting; Powerex; Regulatory & Cogeneration Services; Reliant Energy; Robertson Engineering; Robinson-May; Roseville Electric; Rumla, Inc.; R.W. Beck; the Sacramento Municipal Utility District; the Salt River Project; SCD Energy Solutions; Scheuerman Consulting; Sempra Energy Companies; Sierra Pacific Industries; Silicon Valley Power; SCE; Southern California Gas Company; Southern Company; Strategic Energy. L.L.C.; Tabors, Caramanis & Associates; the Transmission Agency of Northern California;

Turlock Irrigation District; TURN; the U.S. Department of Energy, Oakland Operations Office; U.S. Generating Company; Vari Consulting; the Western Area Power Administration; and Williams Energy Services.

Q. **AS THE TACWG PROCESS WAS CONFIDENTIAL, DID THE ISO TAKE ADDITIONAL MEASURES TO INFORM OTHER STAKEHOLDERS OR THE PUBLIC OF THE ISSUES SURROUNDING THE REVISED ACCESS CHARGE?**

A. Yes. However, it is important to note that the ISO considered the TACWG to be a stakeholder group, encompassing a broad sample of Market Participants. We did, nevertheless, take additional actions to inform stakeholders and the public about the progress that was being made in developing the revised Access Charge. This was done through the existing monthly meeting with the Market Participants, the ISO's Market Issues Forum, which is open to all stakeholders.

For example, presentations were made before the ISO's Market Issues Forum on April 7, 1999; June 9, 1999; August 11, 1999; October 13, 1999; and November 3, 1999.

In August 1999, we also briefed the ISO's Board of Governors on the progress of the Access Charge negotiations during the public portion of the Board's meeting. The memorandum to the Board, which was also part of the public record, is provided as Exhibit No. ___ (ISO-5).

Subsequent meetings and briefings of the public took place in 2000, which will be discussed later.

Q. PLEASE GENERALLY DESCRIBE THE PROCESS IN WHICH THE TACWG CONSIDERED THE PROPOSALS.

A. In our initial meetings, the TACWG reviewed the proposed goals for the revised Access Charge and the various proposals. Proponents of the various proposals were invited to make presentations and we discussed how to collect the necessary data to analyze the respective proposals.

Q. DID THE TACWG NARROW THE 22 INITIAL PROPOSALS?

A. Yes. The ISO and the members of the TACWG narrowed the submissions down to four main options that incorporated the key features of most of the 22 detailed proposals:

- Utility Specific - the continuation of the current Access Charge methodology in which Loads and exports pay the Access Charge designed to meet the Transmission Revenue Requirements of each specific Transmission Owner.

- Regional/Local Split - similar to the default methodology in AB1890, an Access Charge methodology where there would be an ISO Grid-wide charge for “Regional” transmission at and above 200 kV, and utility-specific rates for “Local” transmission below 200 kV.

- ISO Grid-Wide - an Access Charge methodology where all the Transmission Revenue Requirements for all of the Participating TOs would be combined into a single uniform charge applied to all End-User Load and exports, regardless of voltage level, for use of the entire ISO Controlled Grid.

- Power Flow Model - an Access Charge methodology based on a proprietary model that attempted to identify each customers' utilization of each individual transmission facility based on estimated power flows.

Q. PLEASE DESCRIBE THE ANALYSIS UNDERTAKEN BY THE ISO AND THE DATA COLLECTION EFFORTS.

A. The ISO and its consultant, with support from the members of the TACWG, undertook an extensive effort to develop a database of Transmission Revenue Requirement and Load data and to analyze the four main proposals. An extensive, confidential data set was used in the Access Charge analysis, provided by the transmission owners, including investor-owned utilities, public-owned utilities, state agencies and federal entities.

A Data Work Group was established which developed a set of guidelines and templates for each transmission owner to fill out. The guidelines and templates addressed the following issues in an effort to obtain a consistent set of data:

- timing of data, calendar year for base case (1998/99);
- wholesale transmission revenue requirements;
- gross plant data at various voltage levels;
- costs and revenues associated with Existing Contracts;
- capital additions and related transmission revenue requirements through 2003; and
- End-Use Load supplied by the transmission owners (MW and MWh for 1998/99; including estimated distribution losses).

Q. HOW WERE THESE DATA USED?

A. This information was used to model projected Access Charge rates associated with the four main approaches (utility-specific, grid-wide, regional/local, and power flow). We evaluated different scenarios including different voltage levels for the regional/local split, different assumptions regarding which entities would join the ISO, with and without Time-of-Use ("TOU") rates, and different assumptions on future system additions.

We also attempted to project potential benefits from increased participation in the ISO including: (1) reduction in the ISO's Grid Management Charge ("GMC"), (2) increased efficiency in usage of the ISO Controlled Grid, including reduced congestion, and (3) reduction in Ancillary Service costs.

We looked at means of reducing cost shifts through different phase-in periods and other mechanisms. We also evaluated a number of other Access Charge related issues as discussed further below.

Q. PLEASE EXPLAIN HOW GREATER PARTICIPATION IN THE ISO WOULD LEAD TO A REDUCTION IN THE RATE FOR THE ISO's GMC.

A. The GMC is assessed monthly to Scheduling Coordinators to recover both the ISO's startup and development costs and the costs associated with ongoing operation and maintenance, including financing costs. The GMC is assessed on a "volumetric" basis (MWh), currently subject to a FERC settlement. If costs remain approximately the same and more Load or wheeling transactions are subjected to the charge, the lower the rate will be for all Scheduling Coordinators. Increased participation will increase the amount of Load and thus decrease the GMC rate thereby, ultimately benefiting the End-Users of the original Participating TOs that pay the majority of the GMC today.

Q. PLEASE EXPLAIN HOW GREATER PARTICIPATION IN THE ISO WOULD LEAD TO MORE EFFICIENCY IN THE OPERATION OF THE ISO CONTROLLED GRID.

A. One significant benefit that can be achieved if additional entities join the ISO and convert their Existing Contract rights would be to mitigate the problem of "phantom Congestion." The problem is that a significant portion of the ISO Controlled Grid capacity is encumbered under Existing Contracts with non-Participating TOs. The scheduling timelines under

certain of the Existing Contracts are at odds with the ISO scheduling process defined in the ISO Tariff and the Scheduling Protocol. Because certain Existing Contracts permit the transmission customer to make changes in their scheduling reservation capacity after the close of the ISO's Hour-Ahead market, the ISO must reserve capacity for these transactions in both the Day-Ahead Market and the Hour-Ahead Market. This can result in phantom Congestion where transmission capacity is unavailable for use in the ISO Markets but which may not actually be utilized by the Existing Contract holder in real-time.

Q. HAS THE ISO PERFORMED ANY ESTIMATES OF THE COSTS OF THIS PHANTOM CONGESTION?

A. Yes. Exhibit No. ___ (ISO-6) contains an assessment performed by the ISO's Department of Market Analysis. Page 12 of the Exhibit estimates potential cost savings if unscheduled Existing Contract transmission capacity in real-time had been available in the Day-Ahead Market. This analysis evaluated actual data from December 1998 to November 1999. On six significant Inter-Zonal transmission paths, congestion costs would have been decreased by approximately $23.9 million. The charts of the exhibit also show that phantom Congestion accounts for a large portion of Congestion on most interfaces, and essentially all of the Congestion experienced on the California-Oregon Intertie, one of the most important interfaces into California.

Q. PLEASE EXPLAIN HOW GREATER PARTICIPATION IN THE ISO COULD LEAD TO A REDUCTION IN ANCILLARY SERVICE COSTS.

A. Each Control Area must have 5% of the load responsibility served by hydroelectric generation and 7% percent of the load served by thermal generation or protect against the loss of its single largest contingency (the potential loss of its largest source of supply, such as a forced outage at its largest Generating Unit), whichever is greater, to meet the established WSCC Minimum Operating Reliability Criteria for operating reserves. Because of the size of the ISO, the 5%/7% criteria applies. Some California utilities operate, for their Control Area or for their Existing Contract obligations, based on the single largest contingency. If they become Participating TOs, they could change criteria and reduce the amount of operating reserves that they are required to provide.

If entities that currently maintain reserves based on their single largest contingency, join the ISO, they would be able to receive the benefit of being able to reduce their reserve obligation to the 5% and 7% criteria. Additionally, increased participation of new Participating TOs in the ISO's Ancillary Services market, and the significant quantity of hydroelectric resources that some of these parties have, could potentially reduce the cost of Ancillary Services due to the increase in supply.

Q. WHAT ARE "COST SHIFTS", AS YOU USE THE TERM IN THIS FILING?

A. Cost shifts arise from a transmission customer perspective when transmission costs are "averaged" under certain Access Charge methodologies with the average rate being higher in some cases and lower in other cases than the utility-specific rate the customer is currently paying. If all Participating TOs' Transmission Revenue Requirements are added together and recovered in an Access Charge on an average basis from all of their customers, the customers of Participating TOs with the lower transmission costs will pay more than they would have paid under a utility-specific methodology and the customers of Participating TOs with the higher transmission costs will pay less.

For example, even among the original Participating TOs, there are differences in their Transmission Revenue Requirements. For a utility-specific high voltage Access Charge, the rates could vary because of the different proportions of Transmission Revenue Requirement to gross Load. Because many of the municipal systems have newer, higher cost transmission facilities, their corresponding utility-specific rates are, in most cases, substantially in excess of the original Participating TO utility-specific rates. When the high-average-cost systems and low-average-cost systems are combined in a single TAC Area, as will occur under our proposed rate design, the new average Access Charge for the combined areas results in higher rates for customers connected to the low-cost systems and vice versa. These changes in rates, which are paid by transmission customers, not the transmitting utilities themselves, are referred to as "cost shifts."

Q. PLEASE IDENTIFY OTHER ISSUES CONSIDERED BY THE TACWG.

A. The TACWG considered a number of additional issues including:

- Who should pay the Access Charge - whether it should be applied to Loads, exports, generation, imports, or some combination?

- Who should be billed the Access Charge and whether it should be a bill from the Participating TO or from the ISO?

- Whether holders of transmission rights under Existing Contracts should be required to convert those rights upon joining the ISO and, if they did so, should they receive Firm Transmission Rights in return.

- Should Governmental Agencies be permitted to operate as Metered Subsystems and, if so, what would be the conditions?

- Should Governmental Agencies be permitted to pay the Access Charge based on net Load that uses the ISO Controlled Grid or based on Gross Load?

- Should the Self-Sufficiency Test be modified or eliminated?

Q. WAS THE TACWG ABLE TO AGREE ON A REVISED METHODOLOGY FOR THE ACCESS CHARGE?

A. No. The proponents of the different Access Charge methodologies prepared white papers supporting their respective approaches. However, no single approach garnered unanimous support from the more than 75 disparate stakeholders in the TACWG.

Q. SINCE THERE WAS NO CONSENSUS PROPOSAL, WHAT ACTIONS DID ISO MANAGEMENT TAKE?

A. ISO Management considered proposing an ISO Grid-wide rate (or single "postage-stamp") to promote a uniform rate, but concluded that the initial cost shifts would be unacceptably large. Instead, ISO Management developed a compromise proposal based on a “TAC Area” concept for high voltage transmission facilities that transitioned ultimately to an ISO Grid-wide rate.

Q. PLEASE DESCRIBE THIS TAC AREA PROPOSAL.

A. ISO Management proposed to have a two-part Access Charge consisting of a high voltage (or “regional”) component to recover costs of ISO Controlled Grid facilities rated at 200 kV and above and a low voltage (or “local”) component to recover costs of ISO Controlled Grid facilities rated at less than 200 kV. The Access Charge for the local facilities would continue to be recovered on a utility-specific basis based on a tariff developed by each individual Participating TO. This aspect of the Access Charge, the "regional/local split" in rates was widely supported by most of the diverse stakeholder group.

The high voltage Access Charge would initially be based on "TAC Areas." At the outset, there will be three TAC Areas, one corresponding to the former WSCC Control Areas of the three original Participating TOs: a Northern Area (PG&E), a Southern Area (SDG&E), and an East Central Area (SCE). If the Los Angeles Department of Water and Power joined the ISO, a fourth TAC Area -- the West Central Area -- would be established. If the Imperial Irrigation District or entities from other states decided to join, the ISO Board would consider whether to establish additional TAC Areas, or add the new Participating TO to an existing TAC Area to minimize cost shifts.

Each TAC Area would include all Participating TOs, including investor-owned and governmental entities, within that area. For example, assuming all California Transmission Owners joined the ISO, the Northern Area would consist of PG&E, Sacramento Municipal Utility District, Western Area Power Administration -Sierra Nevada Region, Northern California Power Agency, City of Redding, Silicon Valley Power, City of Palo Alto, City and County of San Francisco, Alameda Bureau of Electricity, City of Biggs, City of Gridley, City of Healdsburg, City of Lodi, City of Lompoc Utility Department, Modesto Irrigation District, Turlock Irrigation District, Plumas County Water Agency, City of Roseville Electric Department, City of Shasta Lake, and City of Ukiah.

The high voltage Access Charge would initially be based on the sum of all the Transmission Revenue Requirements of all the then current

Participating TOs in the TAC Area divided by all of the gross Load served in the TAC Area. In other words, each TAC Area would have a single postage-stamp rate for all high voltage transmission access equal to the average of the combined costs of all Participating TOs in that TAC Area.

Under the first proposal, once a "critical mass" of new Participating TOs joined the ISO, there would be a five-year transition to a single, ISO Grid-wide Access Charge for the high voltage facilities. Critical mass was defined as 3,500 MW of additional new firm use transmission capacity from three or more new Participating TOs over certain specified Inter-zonal interfaces.

Q. WERE THERE ANY OTHER ELEMENTS OF THE INITIAL PROPOSAL?

A. Yes. There were a number of other elements to the overall initial proposal. First, ISO Management advised that under the TAC Area proposal the self-sufficiency test could be eliminated. Second, ISO Management recommended that all new Participating TOs would be required to convert their Existing Contracts upon joining the ISO. This aspect of the proposal was designed to mitigate the phantom congestion problem discussed earlier. Third, the charge would be a commodity-based charge. However, use of a $/MWh charge for the ISO's Access Charge was not meant to preclude the use of a different retail cost allocation and rate design. Fourth, the Access Charge was to be billed by the ISO to Utility Distribution Companies ("UDCs"), Metered Subsystems ("MSSs") or Scheduling Coordinators serving Load that is not included in a

UDC Service Area or a MSS. Fifth, the Wheeling Access Charge at joint facilities would be disbursed in proportion to the Transmission Revenue Requirements. Finally, at the time the TAC Area concept was developed, discussions with various Transmission Owners already had led to the proposal that holders of Existing Rights would, immediately after becoming a Participating TO, convert these Existing Rights to ISO scheduling timelines, dispatch and congestion protocols. Upon conversion of these Existing Rights, the Existing Rightsholders could receive Firm Transmission Rights ("FTRs") that tracked the transmission capacity that these Transmission Owners would have had available under Existing Rights. It was also discussed whether new Participating TOs would be able to receive such FTRs for transmission facilities owned by these entities in addition to their Existing Contract rights.

Q. DID ISO MANAGEMENT'S COMPROMISE PROPOSAL INCLUDE ADDITIONAL MECHANISMS FOR REDUCING COST SHIFTS?

A. Yes. ISO Management proposed that any new Participating TO that received a cost decrease due to implementation of the revised Access Charge methodology use 75% of that decrease, net of any increase in the ISO's GMC paid by that entity, to mitigate cost shifts either by using the funds to prepay the ISO's infrastructure cost or by accelerating repayment of the new Participating TO's transmission debt.

Q. DID THE ISO SEEK COMMENTS FROM STAKEHOLDERS REGARDING THE COMPROMISE PROPOSAL?

A. Yes. The initial proposal was discussed with stakeholders at the TACWG meeting on August 10, 1999.

Based on the comments at the meeting, ISO Management concluded that while the initial proposal was not a first choice of many of the entities it could form the basis of a viable compromise and should be refined further. The proposal was refined over a period of months and discussed again with the TACWG on September 21, and October 6, and at the Market Issues Forum on October 13, 1999.

Q. PLEASE DISCUSS ISO MANAGEMENT'S PROPOSAL TO THE GOVERNING BOARD AT THE OCTOBER 1999 MEETING.

A. Given the upcoming deadline for filing the revised Access Charge methodology, of December 31, 1999, ISO Management requested direction from the ISO's Governing Board on four key policy issues at the October 28, 1999 meeting:

- What is the appropriate design methodology for the Access Charge?
- Should the rate be implemented immediately of phased-in, and if the latter, how?
- Should the rate be demand and volume based, demand-based-only, or solely volumetric?
- If there are rate increases from the new rate methodology, notwithstanding the phase-in, should they be mitigated, and if so, how?

A copy of the memorandum to the Board is provided as Exhibit No. ___ (ISO-7).

Q. WHAT ACTIONS DID THE ISO GOVERNING BOARD TAKE WITH RESPECT TO THE ACCESS CHARGE METHODOLOGY AT THE OCTOBER 1999 MEETING?

A. At the October 28, 1999 Board meeting the Board approved the following principles:

- The Access Charge methodology would apply utility-specific rates for the recovery of costs of facilities below 200 kV and ultimately a uniform ISO Grid-wide rate for facilities at 200 kV and above.

- The high voltage Access Charge would initially be based on TAC Areas and would transition to a uniform ISO Grid-wide charge over a period of years to be negotiated.

- The Access Charge methodology would include a plan, also to be negotiated, for mitigating cost shifting among current and new Participating TOs, and

- The ISO Access Charge methodology would not preclude the adoption by a utility that pays the ISO Access Charges the ability to adopt a different rate design for the recovery of those charges in its retail rates.

The Board directed ISO Management to provide Tariff language for Board approval by working with a negotiating group of board members representing a variety of stakeholder interests.

Q. DID THE ISO DEVELOP TARIFF LANGUAGE?

A. Yes. ISO Management developed tariff language and distributed the proposal to stakeholders on November 3, 1999. We received comments on this language from PG&E, SCE, the Office of Ratepayer Advocates, the City of Vernon, the California Municipal Utilities Association, the Western Area Power Administration, the City and County of San Francisco, the City of Redding, the California Department of Water Resources, the Sacramento Municipal Utility District, the Transmission Agency of Northern California, and the Los Angeles Department of Water and Power.

ISO Management's proposal is summarized in the memorandum prepared for the November 18, 1999 Governing Board Meeting. A copy of this document is provided as Exhibit No. ___ (ISO-8).

Q. WHAT ACTION DID THE ISO GOVERNING BOARD TAKE WITH RESPECT TO THE ACCESS CHARGE AT THE NOVEMBER 1999 MEETING?

A. The Board deferred taking action on the Access Charge methodology at that time, pending further negotiations of the Board negotiating group.

Q. PLEASE DESCRIBE THE NEGOTIATING GROUP.

A. The negotiating group was made up of six members of the ISO's Governing Board – two each from the Participating TO, Public Entity and End-User sectors of the Board. This group was to work on the further development of a methodology for the Access Charge consistent with the principles approved in the October Governing Board meeting and to work with ISO Management to develop implementing tariff provisions.

The Board negotiating group met in executive session on November 12, 1999; November 16, 1999; November 22, 1999; November 29, 1999; December 9, 1999; December 13, 1999; December 22, 1999; and December 29, 1999.

Q. WHAT TYPES OF ISSUES DID THE NEGOTIATING GROUP CONSIDER AT THIS POINT?

A. The negotiating group addressed a number of issues related to implementation of the Access Charge including gross vs. net billing, billing and settlement options, treatment of Existing Contracts, wheeling charges, establishment of Transmission Revenue Requirements, the definition of "critical mass", and the length of the transition period. The group also examined conversion of Existing Contracts to FTRs, the scope of facilities to be turned over to ISO Operational Control, and the Metered Subsystem concept.

Q. WITH THE DUE DATE FOR FILING THE ACCESS CHARGE PROPOSAL IMMINENT, DID THE ISO MANAGEMENT OR THE GOVERNING BOARD TAKE ANY ACTION?

A. Yes. It was decided that the Board wanted more time to consider the Access Charge methodology and requested that Management file with the Commission a request to extend the filing due date to February 7, 2000. Management made that filing on December 28, 1999, and the Commission granted the extension.

Q. DID THE NEGOTIATING GROUP AND ISO MANAGEMENT TAKE MEASURES TO INFORM THE FULL BOARD OF THE NEGOTIATING GROUP'S EFFORTS TO FINALIZE A PROPOSAL?

A. Yes. For example, ISO Management conducted a workshop for the full ISO Governing Board in Executive Session on the Access Charge on January 13, 2000 to discuss the background of the issue, why the Board needed to address the issue, and the current Management proposal which had been refined during the negotiating group process.

Q. WHAT DETERMINATIONS WERE REACHED BY THE BOARD NEGOTIATING GROUP?

A. The negotiating group developed certain principles regarding the Access Charge methodology. As posted on the ISO's Home Page on January 19, 2000, these principles included:

- Transition first to a TAC Area concept based on the previous WSCC Control Areas and then over a period of ten years transition to a single, ISO Grid-wide rate for facilities rated 200 kV and above.

- All transmission assets would be turned over to the ISO's Operational Control and scheduling, congestion management, and curtailment provisions of Existing Contracts would be adjusted to comply with the ISO's protocols.

- The Access Charge and the ISO's GMC would be assessed on a gross Load basis. Exports would also be billed for the Access Charge and the GMC.

- There would be a maximum annual impact to the End-Use Customers of the original Participating TOs of $20 million dollars a year for the ten-year transition period for PG&E and SCE and a gradual increase from $1 million to $5 million dollars for SDG&E during the first five years and staying at $5 million for the remaining five years of the transition period.

- Capital additions to high voltage transmission facilities would be immediately included in the ISO Grid-wide component of the high voltage Access Charge.

- There would be no increase to new Participating TOs for their Access Charge and GMC payments.

- If new Participating TOs received a benefit net of any GMC cost increases and Access Charge increases, that benefit would be used to reduce the new Participating TO's Transmission Revenue Requirement through pre-payment of its transmission assets.

- New Participating TOs would be given FTRs in exchange for conversion of their Existing Contracts and owned facilities.

Q. WAS THERE ANY ADDITIONAL ACTION TAKEN BY THE GOVERNING BOARD AT THIS TIME?

A. Yes, the Board requested that Management file an additional extension with the Commission moving the filing date for the Access Charge to March 31, 2000 which was the final date allowed by AB1890. Management made this filing on January 19, 2000 and the Commission again granted the extension.

Q. WHAT ACTIONS DID THE ISO GOVERNING BOARD TAKE NEXT WITH RESPECT TO THE ACCESS CHARGE AT THE JANUARY 21, AND 28, 2000 BOARD MEETINGS?

A. The Board met in Executive Session on January 21 and 28, 2000 to further consider the Access Charge proposal.

Q. YOU INDICATED THAT THE BOARD MET IN EXECUTIVE SESSION ON JANUARY 21, 2000. DID THE ISO TAKE ANY ADDITIONAL ACTION TO INFORM STAKEHOLDERS OF THE STATUS OF THE REVISED ACCESS CHARGE?

A. Yes. I conducted a public workshop on the revised Access Charge proposal on January 24, 2000. In that workshop, I discussed the principles that had been posted on the ISO's web site on January 19, 2000. I also informed the participants that the proposed Metered Subsystem concept tariff language had been developed.

Q. DID THE ISO CIRCULATE REVISED ACCESS CHARGE TARIFF LANGUAGE?

A. Yes. On February 1, 2000, we posted revised tariff language for stakeholder review and comment.

Q. DID THE ISO GOVERNING BOARD DISCUSS MANAGEMENT'S UPDATED ACCESS CHARGE PROPOSAL WITH STAKEHOLDERS?

A. Yes. The Governing Board convened a series of meetings with both the TACWG and stakeholders. These meetings were held on February 2, 2000, February 7, 2000, and February 14, 2000.

Q. WHAT HAPPENED NEXT?

A. The End-Use Customer representatives of the ISO Governing Board met to reconsider the revised Management proposal in light of the comments presented by stakeholders at the various meetings that had taken place.

They then put forth a further refined compromise proposal (the "End-User Proposal").

Q. PLEASE DESCRIBE THE MAJOR ADDITIONAL CHANGES IN THE END-USER PROPOSAL.

A. The End-User Proposal evolved from ISO Management's initial and revised proposals and added detail to the negotiating group principles that were circulated on January 19, 2000.

In an effort to offer greater incentives to governmental entities to join the ISO, the End-Use representatives increased the amount of the potential maximum rate impact on the customers of the original Participating TOs for the ten-year transition period. Instead of $20 million dollars a year for PG&E and SCE and $5 million dollars for SDG&E, the End-Use representatives stated that they would not contest a rate increase for the original Participating TOs of $32 million each for PG&E and SCE transmission customers and $8 million to those of SDG&E. This raised the previous maximum impact to $72 million annually. This increase, averaged over all original Participating TO Load, is approximately 0.4 mills per kilowatt-hour. (This approximation does not address any questions associated with retail cost allocation and rate design.)

In reaction to the concerns expressed by PG&E, the End-User Proposal stated that upon joining the ISO, a new Participating TO that currently schedules Existing Contract rights through PG&E or SCE would either act

as its own Scheduling Coordinator or utilize another Scheduling Coordinator but that neither PG&E nor SCE would be required to act as Scheduling Coordinator. The End-Use representatives also proposed that the mitigation proposal be re-evaluated after three years.

Q. DID THE ISO CIRCULATE THE END-USER PROPOSAL TO STAKEHOLDERS?

A. Yes. The ISO circulated a summary of the End-Users Proposal and draft tariff provisions implementing the proposal to the TACWG and Market Participants on February 23, 2000 and requested comments by March 8, 2000. A copy of the summary is provided as Exhibit No. ___ (ISO-9).

To provide a further opportunity for direct stakeholder presentations to the Governing Board, now that the proposal and tariff language were available in writing, an additional ISO Governing Board meeting was conducted on March 3, 2000.

Q. YOU INDICATED THAT THERE WAS A MEETING BETWEEN THE BOARD AND STAKEHOLDERS ON MARCH 3, 2000. WHAT ACTIONS DID THE ISO MANAGEMENT TAKE FOLLOWING THAT MEETING?

A. On March 6, 2000, we circulated to the TACWG and Market Participants a summary of the changes the ISO proposed to make to the tariff language based on the changes requested by stakeholders at the March 3rd meeting which the End-Users' representatives believed could be implemented. A copy of this summary is provided as Exhibit No. ___ (ISO-10).

On March 8, 2000, I made a presentation to the Market Issues Forum regarding these latest developments on the Access Charge. A copy of that presentation is provided as Exhibit No. ___ (ISO-11).

Q. YOU HAD PREVIOUSLY SAID THAT STAKEHOLDER COMMENTS WERE DUE ON MARCH 8, 2000, WERE ANY COMMENTS RECEIVED AND WHAT DID THE ISO MANAGEMENT DO WITH THEM?

A. Yes. On March 8, 2000, the ISO received additional comments from a number of entities regarding the Access Charge proposal and the implementing tariff language. Each comment was considered and either changes were made to the proposed tariff language or a reason was provided as to why the ISO believed the revision should not be made. The resulting Access Charge methodology was presented at the March 22, 2000 Board meeting.

Q. WHAT DID ISO MANAGEMENT PROPOSE AT THE MARCH 22, 2000 GOVERNING BOARD MEETING?

A. ISO Management recommended that the Governing Board approve the revised tariff language that, as noted, was based on the compromise proposal put forward by the End-Use representatives of the Board as modified following the March 3, 2000 meeting. A copy of the memorandum to the Governing Board is provided as Exhibit No. ___ (ISO-12). Exhibit No. ___ (ISO-13) is a summary of Board requested changes to the Tariff and ISO Management's response . Exhibit No. ___ (ISO-14)

is a summary of requested stakeholder changes to the Tariff and ISO Management's response, and Exhibit No. ___ (ISO-15) summarizes additional general comments from stakeholders.

Q. WHAT ACTION DID THE ISO GOVERNING BOARD TAKE WITH RESPECT TO THE ACCESS CHARGE AT THE MARCH 22, 2000 MEETING?

A. By a 16-5-1 vote, the Governing Board authorized ISO Management to finalize and file the Access Charge proposal. The resolution of the Baord is provided as Exhibit No. ___ (ISO-2) to Ms. Lazic's tesimony. The main change made at the Board meeting was a modification to the definition of gross Load to exclude the Loads of customers served by certain existing Qualifying Facility generation.

III. THE FINAL ACCESS CHARGE PROPOSAL

Q. PLEASE DESCRIBE THE ISO's ACCESS CHARGE PROPOSAL AS REFLECTED IN AMENDMENT NO. 27.

A. An overview of the tariff language changes implementing the ISO's proposed Access Charge methodology is provided as Exhibit No. ___ (ISO-16). Under Amendment No. 27, the current utility-specific Access Charge methodology, in which each Participating TO's Access Charge is determined under its TO Tariff, would remain in effect until a new entity qualifies as a Participating TO by executing the Transmission Control Agreement and placing its transmission facilities and Entitlements under the ISO's Operational Control.

Upon the addition of a new Participating TO, the new Access Charge methodology would take effect. The Access Charge for the recovery of Participating TOs' costs associated with and allocable to high voltage transmission facilities (the "High Voltage Access Charge" or "HVAC"), defined as facilities at 200 kV and above, together with supporting facilities, will be collected with the Transition Charge to mitigate cost shifts during the transition period under the ISO Tariff on the basis of TAC Areas. Each TAC Area will consist of the high voltage transmission facilities of the Participating TOs in each of the three TAC Areas that were combined into the ISO Control Area. These TAC Areas correspond to the Service Areas of the three investor-owned utilities in California and the publicly owned facilities interconnected with each of them. In addition, if the Los Angeles Department of Water and Power chooses to become a Participating TO, its Control Area would become a fourth TAC Area. A map showing the initial TAC Areas is provided as Exhibit ___ (ISO-17).

The HVAC for a TAC Area will be based on the combined high voltage Transmission Revenue Requirements and gross Load of the Participating TOs in the TAC Area. The present Self-Sufficiency Test will no longer be needed; that is, the same HVAC will be used for the withdrawal of Energy at any location within the TAC Area, regardless of which Participating TO owns the transmission facilities at the point at which the Energy is withdrawn.

For the withdrawal of the Energy from a low voltage transmission facility within each TAC Area, an additional low voltage access charge (the "Low Voltage Access Charge" or "LVAC") would apply. The LVAC would be designed to recover costs associated with and allocable to the low voltage transmission facilities of the Participating TO that owns the facilities at the point of withdrawal. This charge would continue to be collected by each Participating TO under its Transmission Owner Tariff, based on the transmission revenue requirement associated only with its own low voltage transmission facilities and Entitlements (*i.e.,* this charge remains utility-specific).

Q. HOW LONG WOULD THE ISO UTILIZE TAC AREAS?

A. The separate TAC Area High Voltage Access Charges would transition via a phase-in to a single ISO Grid-wide High Voltage Access Charge over a ten-year period, following the addition of the first new Participating TO. This would be accomplished by blending the individual TAC Area high voltage Transmission Revenue Requirements with the sum of the high voltage Transmission Revenue Requirements of all Participating TOs. The blended average High Voltage Access Charge in each year is an increasing fraction of the ISO Grid-wide rate, starting at ten percent in the first year and increasing by ten percent each year. In year ten, the ISO Grid-wide portion is 100% and TAC Areas have been dissolved. This should create a smooth transition from disparate TAC Area rates to a single ISO Grid-wide rate over ten years.

In addition, capital investments by any Participating TO in new high voltage transmission facilities and in capital additions to existing high voltage transmission facilities would immediately be included in the ISO Grid-wide component of the High Voltage Access Charges. This will increase the pace at which the High Voltage Access Charges converge into a single charge. At the end of the ten-year transition period, a single High Voltage Access Charge would apply to the withdrawal of Energy at any point on the ISO Controlled Grid.

Q. DOES THE ISO PROPOSAL INCLUDE ADDITIONAL TRANSITIONAL ELEMENTS?

A. Yes. In addition to the transition to a single ISO Grid-wide High Voltage Access Charge described above, the Access Charge proposal includes a number of other transition mechanisms to mitigate cost shifting among Participating TOs and to facilitate the entry of new Participating TOs. These transition mechanisms are integral parts of the balanced compromise proposal adopted by the ISO Governing Board. They include: (1) a mechanism to hold new Participating TOs harmless with respect to certain cost increases they might otherwise incur; (2) a limitation on the increase in transmission costs borne by customers of current Participating TOs as a result of the adoption of the new Access Charge methodology; and (3) a mechanism designed to narrow the gaps between lower-cost Participating TOs and higher-cost Participating TOs through the application of certain benefits. Items (1) and (2) are implemented through a "Transition Charge" that, recovered with the

HVAC, forms an integral part of the Access Charge during the transition period. Item (3) requires Participating TOs with net benefits to use these net benefits to reduce their high voltage Transmission Revenue Requirement.

Q. PLEASE EXPLAIN ITEM (1), THE HOLD HARMLESS PROVISIONS FOR NEW PARTICIPATING TOs.

A. The proposed methodology recognizes that a new Participating TO may bear increased costs in several ways. First, if a New Participating TO's high voltage Transmission Revenue Requirement is lower than the average for Participating TO's, the blending of the Transmission Revenue Requirements through the proposed Access Charge methodology could increase the transmission costs borne by its customers. Second, Scheduling Coordinators serving a new Participating TOs' customers could become responsible for a greater share of the ISO's expenses through an increased allocation of GMC. The GMC cost increase arises from the fact that the current GMC methodology, established by a settlement accepted by the Commission in Docket Nos. ER98-211-000 and ER99-473-000, provides certain exemptions for Loads served by Energy delivered under Existing Contracts. When an entity becomes a Participating TO and converts its Existing Contract rights to ISO transmission service, it no longer qualifies for those exemptions. As a result, a new Participating TO may be responsible for greater GMC payments than it had previously paid. At the same time, spreading the

ISO's expenses over a larger volume of Energy deliveries reduces the per-unit GMC rate payable by all Market Participants.

So that increased high voltage transmission costs and increased exposure to GMC charges will not present an obstacle to the entry of new Participating TOs, the proposed methodology includes a provision under which the original Participating TOs would collect increased revenues from their customers, which would then be used to compensate customers of new Participating TO's customers (via rates lower than would otherwise be possible) for any net increased costs the latter would be required to bear under High Voltage Access Charges and GMC charges during the first ten years that the new Access Charge methodology is in effect. The compensating revenues required to be collected from and distributed to the customers of the Participating TOs under this provision become part of the Transition Charge.

Q. DOES THIS PROTECT NEW PARTICIPATING TOs FROM ALL COST INCREASES ASSOCIATED WITH JOINING THE ISO?

A. No. This is a compromise and does not cover costs such as Scheduling Coordinator fees and other market costs that every Market Participant pays on a comparable basis such as Unaccounted for Energy, Neutrality, Energy imbalance deviations and Wheeling costs. I would note however, that Amendment 27 does include a cap on Neutrality Adjustment that can only be exceeded by ISO Governing Board action.

Q. HOW DOES THE ISO's FILING REFLECT ITEM (2), THE "COST SHIFT CAP" UNDER THE END-USERS' PROPOSAL?

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

Amendment No. 27 provides for cost shift caps that represent a maximum increase in transmission Access Charges to Loads in the Service Areas of current Participating TOs of approximately 0.4 mills/kWh. (This increase is averaged over all original Participating TO Load and does not address any questions associated with retail cost allocation and rate design.) The individual caps provide for up to a total of $72 million of cost shifts during each year, though the amounts of costs that will actually be shifted will depend upon how many entities, and which entities, decide to become Participating TOs.

If the total cost shift would exceed this cap, the customers of the new Participating TOs with net benefits would contribute part of their net

benefit in order to limit cost shifts to this level. Again, this mitigation measure would be implemented through the Transition Charge.

Q. PLEASE DESCRIBE ITEM (3), THE TRANSITION MECHANISM TO REDUCE THE GAP BETWEEN LOWER COST PARTICIPATING TOs AND HIGHER COST PARTICIPATING TOs.

A. The proposed Access Charge methodology attempts to reduce the disparity in transmission costs among the original and new Participating TOs (and thereby to limit the cost shifting that would occur during and following the ten-year transition period) by including a credit, in the calculation of each Participating TOs' high voltage Transmission Revenue Requirement, to recognize the cost-shift benefit (net of any GMC increase and Transition Charge) that a Participating TO with higher than average transmission costs will receive during the transition period. The credit reduces the Participating TOs' high voltage Transmission Revenue Requirement by applying the cost-shift benefit received during preceding years to amortize the Participating TOs' investment in high voltage transmission facilities. The Participating TO may use the amount of the cost-shift benefit to retire the debt supporting its transmission facilities or to establish a fund to service that debt, thereby tracking the credit that will be applied in calculating its high voltage Transmission Revenue Requirement annually, or for some other purpose. This mechanism further reduces the extent to which the blending of Participating TOs' high voltage Transmission Revenue Requirements shifts costs from higher cost Participating TOs to lower cost Participating TOs, both during and after the

ten-year transition period. Additionally, this mechanism should result in converging the varying Transmission Revenue Requirements over the ten-year transition period.

Q. DID YOU PREPARE A NUMERICAL EXAMPLE OF HOW THE ISO's PROPOSED HIGH-VOLTAGE ACCESS CHARGE AND THE ASSOCIATED MITIGATION MEASURES WORKS?

A. Yes, a hypothetical example is presented in Exhibit No. ___ (ISO-18). This exhibit shows how the HVAC would be calculated and how the mitigation measures would limit cost shifting among nine hypothetical Participating TOs during the transition period. The exhibit picks the second year of the transition and assumes that all nine hypothetical Participating TOs are transitioning from four separate TAC Areas as discussed below. Exhibit No. ___ (ISO-18) first shows the High Voltage Transmission Revenue Requirement for each of the nine hypothetical Participating TOs and the utility-specific rates under which they would recover these costs under the ISO's current utility-specific rate methodology. Note that the utility-specific charges of this example vary by a factor of more than three.

Step 1 of the example derives the HVAC for each TAC Area in year two of the transition period, where the charges are a blend of 80% of the Transmission Revenue Requirements of existing transmission facilities within each TAC Area and 20% of the ISO Grid -wide Transmission

Revenue Requirement for existing facilities plus 100% of the Transmission Revenue Requirements for new facilities (*i.e.*, capital additions).

Step 2 of the Exhibit shows the net increase or decrease in costs borne by the customers of the nine Participating TOs as a result of the move from a utility-specific Access Charge to the TAC Area approach.

Step 3 of the example shows the net burdens and benefits that result when all Participating TOs are required to pay the GMC on 100% of their Load. Prior to joining the ISO, the six municipal utilities did not pay the ISO's GMC or only paid it on a portion of their Load. Thus, subjecting all Load of all Participating TOs to the GMC reduces the GMC rate because GMC costs are spread over more Load. This, in turn, lowers the GMC payments for the original Participating TOs, that have been paying the GMC on their gross Load since the ISO Operations Date.

Step 4 of Exhibit No. ___ (ISO-18) first calculates the net benefit or burden for each Participating TO, accounting for both the HVAC and the GMC. Column 31 shows that the hypothetical limit on the net burden for municipal members is set to zero (reflecting the "hold harmless" provision) and $3 and $1 million for the investor-owned utilities ("IOUs") (reflecting the ceiling on the burden that customers of original Participating TO will bear). Columns 32 through 35 illustrate how these limits can be implemented to calculate the total payments or receipts collected or

disbursed through the Transition Charge in Column 36. Column 37 calculates net benefits after these adjustments.

The calculations in Step 4 also show that five Participating TOs – IOU 1, IOU 2, Muni 3, Muni 5, and Muni 6—incur a cost increase that, prior to mitigation, exceeds the limit on annual cost increase set under the ISO's proposed Access Charge methodology for this hypothetical example. IOU 3, conversely, realizes a benefit that, in this example, exceeds the collective burden of the five Participating TOs with cost increases in excess of their cap. Since IOU 3 is assumed to be an original Participating TO, it can compensate the new Participating TOs that have cost increases in excess of their cap. (If IOU 3's benefit did not equal or exceed the collective burden of those Participating TOs with burdens in excess of their cap, the municipal utilities with net benefits would have to make transfer payments as well.) Column 36 reallocates the total IOU burden so that all IOUs "share" the burden of cost increases in proportion to their cost shift ceiling.

Step 5 of the Exhibit provides a summary of cost shifting associated with the Access Charge methodology, net of mitigation effects. Column 46 also shows the funds that new Participating TOs with net benefits would use to amortize or "buy down" the cost of their high voltage transmission facilities.

Q. HOW WILL THE REVENUE REQUIREMENTS FOR PARTICIPATING TOs BE DETERMINED?

A. The blending of Participating TOs' high voltage Transmission Revenue Requirements into High Voltage Access Charges paid by customers of all Participating TOs required the adoption of mechanisms for the review and for ensuring consistency of those Participating TOs' Transmission Revenue Requirements. For Participating TOs whose transmission rates are subject to the jurisdiction of the Commission (including federal entities, such as Western, whose rates are reviewed by the Commission under statutes other than the Federal Power Act), the ISO Tariff will continue to use Transmission Revenue Requirements approved by the Commission. The submission of the Participating TOs' high voltage Transmission Revenue Requirement for review by the Commission assures the reasonableness of the amounts to be reflected in the ISO's High Voltage Access Charge.

For Participating TOs that are not subject to the Commission's transmission rate jurisdiction, the issue was more controversial. Stakeholders representing publicly owned utilities objected to subjecting their Transmission Revenue Requirements to Commission review. Other stakeholders objected to paying a HVAC that included costs that had not been subjected to an independent regulatory review in accordance with the Commission's ratemaking standards. The ISO Governing Board adopted a compromise solution to this issue, requiring non-jurisdictional Participating TOs to submit their high voltage Transmission Revenue Requirements to the ISO and, in the case of disputes, to an independent Revenue Review Panel to be established by the ISO, which would test

those submissions against the standards developed by the Commission in determining just and reasonable transmission rates.

Q. DOES THE PROPOSED ACCESS CHARGE METHODOLOGY ADDRESS THE PROBLEM OF "PHANTOM CONGESTION"?

A. Yes. As I explained earlier, in order to ensure that the addition of new Participating TOs provides benefits to consumers and other Market Participants commensurate with the cost shifting that will occur under the new Access Charge methodology, the proposal would require a new Participating TO to convert its Existing Rights to transmission service on the ISO Controlled Grid to ISO Tariff transmission service. In this way, the transmission capacity that the ISO must reserve for the exercise of within-the-hour scheduling rights can be reduced, freeing up more capacity for scheduling by Market Participants as new firm uses in the Hour-Ahead market and reducing Congestion costs. The limited opportunity for a new Participating TO to continue to exercise Existing Rights as Non-Converted Rights, currently set out in Section 2.4.4.2 of the ISO Tariff, is accordingly eliminated by Amendment No. 27.

Q. HOW DO NEW PARTICIPATING TOs JOIN THE ISO?

A. In Amendment No. 27, we modified Section 3.1 of the ISO Tariff to describe the procedures to be followed by an entity seeking to become a new Participating TO. Each new Participating TO must first apply to become a Participating TO in accordance with the Transmission Control Agreement ("TCA") Section 2.2.1. Once the facilities have been mutually

agreed to, the new Participating TO must execute the TCA and turn over to the ISO's Operational Control all of its transmission facilities and contractual Entitlements that satisfy criteria established by the ISO Governing Board. To avoid frequent changes in the HVAC associated with the addition of new Participating TOs, the effectiveness of participation by a new Participating TO will be limited to January 1 and July 1 of each year, following the completion of the necessary arrangements, including the filing and acceptance of required agreements with the FERC.

Q. ARE THERE ASPECTS OF THE PROPOSAL WHICH ARE MEANT AS AN INDUCEMENT FOR NON-PARTICIPATING TOs TO JOIN AND CONVERT THEIR EXISTING TRANSMISSION RIGHTS?

A. Yes. Under Article 9 of the ISO Tariff, the ISO makes FTRs available through periodic auctions to enable Market Participants to hedge their exposure to Inter-Zonal Congestion costs imposed through Usage Charges. FTRs entitle the holder to receive a share of the Usage Charge revenues paid to the ISO. Revenues that the ISO receives through the auction of FTRs are distributed to Participating TOs whose transmission facilities and Entitlements comprise the Inter-Zonal Interfaces for which FTRs are issued.

During the negotiations, representatives of some publicly owned utilities expressed the concern that replacing their Existing Rights, one for one, with FTRs acquired through the ISO's auction or the secondary market

would impair their ability to continue to serve their customers economically. The Access Charge proposal adopted by the ISO Governing Board accordingly provides that, during the ten-year transition period (or a shorter period representing the term of an Existing Contract), a new Participating TO that converts Existing Rights to ISO transmission service will receive FTRs represented by those rights directly, without the necessity of participating in the ISO's auction. The number of FTRs that the new Participating TO receives will be commensurate with the transmission service represented by its Converted Rights, which will be determined when an entity with Existing Rights applies to become a Participating TO.

The new Access Charge methodology approved by the ISO Board also includes provisions that would enable the systems of new Participating TOs to qualify as Metered Subsystems.

Q. WHAT IS A METERED SUBSYSTEM?

A. The Loads and Generation of a Metered Subsystem would have to be scheduled with the ISO by a qualified Scheduling Coordinator (which could be the Metered Subsystem Operator or another entity it designates). The Metered Subsystem's Scheduling Coordinator would have the opportunity, however, to aggregate the Metered Subsystem's Generating Units and Participating Loads and submit Schedules and bids from the aggregated "System Unit," provided that the resources making up the System Unit can be operated internally in such a way that power flows on

the ISO Controlled Grid are not affected by changes in the operating levels of each individual resource.

Q. CAN ANY TRANSMISSION OWNER OR MARKET PARTICIPANT BECOME A METERED SUBSYSTEM?

A. The ISO believes that limiting the availability of Metered Subsystem status to entities that elect to become Participating TOs under this revised tariff is consistent with the original intent of the concept as a means of encouraging participation by publicly owned entities that chose to remain vertically integrated. It is also consistent with the Commission's recognition in Order No. 2000 that it is appropriate to encourage participation by such entities in RTOs, and for RTOs to distinguish between entities that choose to participate and those that do not. Vertically integrated publicly owned utilities that chose not to become Participating TOs will still be able to use the ISO Controlled Grid to participate in competitive markets, including the ISO's markets, as several such utilities currently do. However, these entities will use the ISO Controlled Grid as Wheeling customers, not as members.

Q. WHY ARE METERED SUBSYSTEMS IMPORTANT TO ATTRACT NEW PARTICIPATING TOs?

A. Both prior to and during the Access Charge Stakeholder process, existing governmental entities have sought implementation of a Metered Subsystem concept to provide greater certainty with respect to allocation of certain operational responsibilities and ISO-related costs. Again, in an

effort to encourage broader participation in the ISO, we have included the Metered Subsystem concept in the Access Charge proposal.

Q. HOW DOES THE ISO PROPOSE TO SETTLE THE BILLING ASPECTS OF THE FINAL ACCESS CHARGE?

A. Section 7.1 of the ISO Tariff and related provisions are modified to provide for the ISO's collection and settlement of two Access Charge components, the HVAC and the Transition Charges. These Access Charge components will be collected by the ISO from Utility Distribution Companies and Metered Subsystem Operators for the delivery of Energy to Loads on their systems. For Loads that are not located on the system of a Utility Distribution Company or Metered Subsystem, the HVAC and the associated Transition Charge will be collected from the Scheduling Coordinator serving such Load. These Access Charge components will be assessed on the basis of the Gross Loads of these entities, defined as all Energy (adjusted for distribution losses) delivered for the supply of End-Use Customers on their systems, with the exception of wheeling exports and customers served by certain existing Qualifying Facilities that had entered into Standby Service arrangements under which they pay charges that reflect (among other things) the transmission costs of the utility to which they are connected or Qualifying Facilities that are non-firm interruptible customers.

Q. THANK YOU. I HAVE NO FURTHER QUESTIONS.