

March 31, 2000

The Hon. David P. Boergers,
Secretary
Federal Energy Regulatory Commission
888 First Street, N.W.
Washington, D.C. 20426

Re: **California Independent System Operator Corporation
Transmission Access Charge Methodology, Docket No.
ER00-____-000**

Dear Secretary Boergers:

Enclosed for filing on behalf of the California Independent System Operator Corporation ("ISO") in accordance with Section 205 of the Federal Power Act, 16 U.S.C. § 824d, and Section 35.13 of the Commission's regulations, 18 C.F.R. § 35.13, are six copies of an amendment ("Amendment No. 27") to the ISO's Operating Agreement and Tariff (the "ISO Tariff"). Amendment No. 27 presents a revised methodology for determining transmission Access Charges, through which the embedded costs of the transmission facilities comprising the ISO Controlled Grid are recovered, together with associated changes adopted by the ISO's Governing Board.¹

The ISO believes that the revised transmission Access Charge methodology is fully consistent with and satisfies the goals of the Commission's Order 2000. In Order 2000 the Commission identified certain goals and preferences, including, but not limited to, the elimination of rate pancaking and the use of single system access charges. The ISO's proposed Access Charge methodology establishes a mechanism that satisfies both of those objectives. As discussed in more detail below, once a new Participating Transmission Owner ("Participating TO") joins the ISO, the ISO will implement a two-tiered Access Charge, whereby the Transmission Revenue Requirement of local "low voltage" transmission facilities will continue to be recovered by the individual

¹ Capitalized terms that are not defined in this transmittal letter are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

Participating TOs from the customers served in their service area and the costs of the regional "high voltage" transmission facilities will be recovered from all transmission customers, first within limited areas then on an ISO Controlled Grid basis. The ISO believes that such a proposal will ensure that no transmission customer pays pancaked transmission rates and will provide access to and incentives to expand the regional transmission system. As explained further below, the ISO has striven over the past year to develop an Access Charge methodology that provides for an equitable balance of costs and benefits among those entities and their customers that choose to turn control of their transmission facilities over to the ISO, and the establishment of a uniform high-voltage Access Charge across the entire ISO Controlled Grid. The ISO believes that a proposal which satisfies those goals will provide the necessary incentives for greater participation in the ISO and lead to the development of a more efficient western Energy market. The adoption by the ISO Governing Board of the proposed methodology by a 16-5 vote testifies to the successful accomplishment of these objectives.

I. BACKGROUND

The rolled-in embedded costs of the transmission facilities making up the ISO Controlled Grid are recovered primarily through Access Charges levied, in accordance with Section 7.1 of the ISO Tariff, on Market Participants withdrawing Energy from the ISO Controlled Grid.² Currently, each Participating TO determines the Access Charge applicable to Market Participants withdrawing Energy from the ISO Controlled Grid in its Service Area, based on the costs of its transmission facilities and Entitlements, in accordance with its Transmission Owner's Tariff.³ A Participating TO that does not own or have Entitlements to enough firm transmission capacity to meet its monthly Peak Demand is deemed to be a Dependent Participating TO and must pay a portion of the Access Charge of the Participating TO to which it is interconnected based on the extent to which it is not Self-Sufficient. Customers withdrawing Energy in the Service Area of a Dependent Participating TOs thus could be required to pay all or portion of the Access Charge of another Participating TO, in addition to the Access Charge of their local Participating TO. (See ISO Tariff, Section 7.1.3.)

The Commission has determined that this current structure represents a reasonable approach to the recovery of the Transmission Revenue

² Market Participants using the ISO Controlled Grid for the transmission of Energy to serve a Load located outside the ISO Controlled Grid pay the Wheeling Access Charge under Section 7.4 of the ISO Tariff.

³ For the transmission of Energy out of or through the ISO Controlled Grid, a Wheeling Access Charge is imposed under Section 7.1.4.1 of the ISO Tariff, based on Transmission Revenue Requirement of the Participating TO or TOs that own the facilities at the Scheduling Point where the Energy is scheduled to exit the ISO Controlled Grid.

Requirements of Participating TOs.⁴ That conclusion was informed in part by the fact that the ISO was obligated by California's electricity restructuring legislation to submit a revised Access Charge methodology to the Commission within two years of the ISO's initiation of operations.⁵ Specifically, Section 9600(a)(2)(A) of California's A.B. 1890 calls upon the ISO to recommend for adoption by the Commission "a rate methodology determined by a decision of the [ISO's] governing board, provided that the decision shall be based on principles approved by the governing board including, but not limited to, an equitable balance of costs and benefits." The Commission confirmed this requirement, directing the ISO to submit a revised Access Charge methodology no later than sixty days in advance of the second anniversary of the ISO Operations Date on March 31, 1998.⁶ The Commission subsequently granted motions submitted by the ISO to enlarge the time for filing a new Access Charge methodology to March 31, 2000.⁷

Following an extensive stakeholder process (described below), the ISO Governing Board approved the new Access Charge methodology that is proposed in Amendment No. 27 at its March 22, 2000 meeting.⁸ The ISO views this Access Charge methodology as an extremely important step in the further development of open and competitive electricity markets in California and the Western United States in accordance with the policies and objectives of California, as set forth in A.B. 1890, and of the Commission, as set forth in Order No. 2000.⁹ The ISO has developed and approved an Access Charge methodology that reflects an interrelated series of compromises that treats all classes of stakeholders fairly and results in a carefully crafted "equitable balance of costs and benefits."

By addressing (though not completely satisfying) the concerns of entities that own transmission facilities or Entitlements in California that have not yet chosen to place those facilities or Entitlements under the ISO's Operational Control, the proposed methodology represents an important step toward expanding the scope of the facilities that are operated by the ISO for the benefit

⁴ *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,504 (1997); *Pacific Gas & Electric Co., et al.*, 77 FERC ¶ 61,204 at 61,826 (1996).

⁵ *Id.*, 81 FERC at 61,500; 77 FERC at 61,827.

⁶ *Pacific Gas & Electric Co., et al.*, 77 FERC at 61,827.

⁷ See Orders dated January 10, 2000 and January 24, 2000 in *Pacific Gas & Electric Co. et al.* Docket Nos EC96-19-000 and ER96-1663-000.

⁸ A copy of the ISO Governing Board's resolution is attached to the accompanying testimony of Zora Lazic, the ISO's Vice President of Client Services. A.B. 1890 also includes certain provisions describing alternatives, including a default rate methodology, that the ISO would be required to employ if the Governing Board failed to reach a decision. In light of the Governing Board's March 22, 2000 resolution, those provisions are moot.

⁹ *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809, FERC Stats. & Regs., Preambles ¶ 31,089 (1999), *on rehearing*, Order No. 2000-A, 90 FERC ¶ 61,201 (2000).

of the region as a whole. Decisions by such entities (predominantly Local Publicly Owned Electric Utilities) to become Participating TOs under the revised Access Charge methodology will alleviate conditions that currently lead to inefficiencies in the operation of the high voltage transmission system, to the benefit of all consumers and Market Participants who rely on it. The need to develop and implement mechanisms to encourage and facilitate participation by publicly owned transmission owners in Regional Transmission Organizations ("RTOs") was one of the principal challenges identified in Order No. 2000 to the creation of RTOs with broad and inclusive regional scope.¹⁰ The ISO's Access Charge methodology represents the first proposal to address an important issue that will have to be faced across the Nation.

Further, while the Commission has already recognized that the ISO is structured and governed in a manner that assures its independence of Market Participants, the proposed Access Charge methodology will enhance the independence of the ISO by broadening the areas in which the ISO will have exclusive and independent authority to make filings under Section 205 of the Federal Power Act with respect to the rates and other terms of access to the ISO Controlled Grid.¹¹

II. STAKEHOLDER PROCESS

The Commission found the consultative process outlined in the California restructuring legislation to be consistent with its policy, as outlined in Order No. 888, of encouraging consensus-building processes to support ratemaking and cost allocation proposals.¹² To ensure that the ISO Governing Board's deliberations regarding a new Access Charge methodology were informed by broad stakeholder input, the ISO commenced a stakeholder process to consider Access Charge methodologies in December 1998. That process, which is described in detail in the accompanying testimony of Deborah Le Vine, the ISO's Director of Contracts & Compliance, involved four basic stages.

First, in December 1998, the ISO solicited transmission Access Charge methodology proposals from any interested stakeholders. Approximately twenty-two proposals were received. Parties interested in submitting proposals were requested to do so by February 1999. Ultimately, four basic Access Charge methodology proposals were selected for further exploration by the stakeholders.

Second, the ISO established a TAC Working Group ("TACWG") and conducted a series of meetings, open to all interested stakeholders who executed a confidentiality agreement, to consider and evaluate the various

¹⁰ Order No. 2000, FERC Stats. & Regs. at 31,197.

¹¹ *Id.*, FERC Stats. & Regs. at 31,075.

¹² *Pacific Gas & Electric*, 77 FERC at 61,827.

proposals that were submitted. The ISO requested the owners of transmission facilities and Entitlements in California, including Participating TOs as well as entities that might become Participating TOs, to submit data concerning their Transmission Revenue Requirements and Loads, so that the impact of the different proposed rate methodologies on the Access Charges paid by customers in different utilities' Service Areas could be evaluated. This process required the negotiation of a confidentiality agreement so that the participants could be assured that the cost data they submitted could not be used against them in any subsequent proceedings (including proceedings established to review this filing); the assembly of Transmission Revenue Requirements data; the development by consultants retained by the ISO of models to evaluate different Access Charge methodology proposals on a consistent basis; and the review of the results with stakeholders. This process took place during meetings and conference calls extending from March through October 1999. Simultaneously, for those Market Participants who did not want to sign the confidentiality agreement, the ISO presented status reports at the monthly Market Issues Forum meetings on the current status of the TACWG.

During that stakeholder process, the ISO became concerned that, while a number of proposals were advanced by different stakeholders and groups of stakeholders, there appeared to be little movement toward a compromise or consensus position. Accordingly, at the stakeholder meetings in the Fall of 1999, the ISO presented a potential compromise proposal for the consideration of the stakeholders. This proposal attempted to blend features of the individual stakeholder proposals.

The ISO Governing Board received periodic reports of the progress of the stakeholder process. At its October 1999 meeting, the ISO Governing Board adopted a resolution setting forth principles for a new Access Charge methodology to guide further negotiations. The principles approved by the ISO Governing Board included the following:

- The Access Charge methodology would be a commodity-based (\$/MWh) charge. It would apply utility-specific rates for the recovery of costs of transmission facilities below 200 kV and, ultimately, one uniform ISO Grid-wide rate for transmission facilities at 200 kV and above.
- The high voltage Access Charges would initially be based on "TAC Areas" (discussed further below) and would transition to a uniform "postage stamp" charge over a period of years to be negotiated.
- The Access Charge methodology would include a plan, also to be negotiated, for mitigating cost shifts among current and new Participating TOs.

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

In addition, the ISO Governing Board approved the formation of a negotiating group, made up of six members of the Governing Board (two each from the Governors elected by the Participating Transmission Owner, Public Entity, and End-User sectors), to flesh out an Access Charge methodology consistent with these principles and to work with ISO Management to develop implementing tariff language.

In the third phase of the stakeholder process, the negotiating group appointed at the October 1999 Governing Board meeting met approximately weekly throughout November and December 1999, in an attempt to craft a fair and reasonable transmission Access Charge methodology consistent with the principles adopted by the ISO Governing Board. By early December, that negotiating group had focused its discussions on a revised proposal developed by the ISO's management, using elements of its earlier compromise proposal, other proposals that had been submitted by stakeholders, comments and concerns received from stakeholders, and the principles adopted by the ISO Governing Board.

In the fourth and final stage of the stakeholder process, a series of meetings were held in January, February, and March 2000. Those meetings included public meetings of the ISO Governing Board, executive sessions of the Board, stakeholder meetings open to all interested parties, and stakeholder meetings open only to the TACWG, in which analyses of the proposals being considered by the Governing Board on the basis of the transmission cost data provided confidentially to the ISO could be presented. During this stage of the stakeholder process, the discussions culminated in a compromise proposal presented by members of the ISO Governing Board representing the End-User sector, building upon ISO Management's prior proposal. Versions of this proposal, including implementing tariff language, were posted on the ISO Home Page on February 22, 2000 and March 3, 2000. Throughout this process, members of the ISO Governing Board and stakeholders submitted comments on the proposal and on the proposed tariff language, as well as alternative proposals.

The final stage of the stakeholder process was the consideration by the ISO Governing Board of a transmission Access Charge rate methodology, based on the "End-User Compromise proposal," modified in consideration of some further the stakeholder comments. At its meeting on March 22, 2000, the ISO Governing Board approved a resolution authorizing the filing of the new transmission Access Charge methodology by a 16-5 vote (with one abstention).

III. OBJECTIVES AND BENEFITS OF THE PROPOSED TAC METHODOLOGY

The ISO Governing Board has striven in the process described above to develop an Access Charge methodology that satisfies the following objectives:

- First, the Access Charge methodology must satisfy the requirement of A.B. 1890 that it effect an “equitable balance of costs and benefits.” The ISO believes that the Access Charge methodology proposed in Amendment No. 27 fulfills this objective. As explained below, the proposed Access Charge methodology incorporates an integrated set of provisions to balance the costs borne and benefits received by all affected stakeholder classes. Customers of current Participating TOs may pay higher transmission rates, depending on which entities decide to become new Participating TOs, but the amount of the increase is mitigated by a phase-in plan, a ceiling on cost shifts at levels deemed acceptable by representatives of the End-Users who ultimately pay the transmission rates, maintenance of utility-specific rates for lower voltage transmission facilities and other provisions described below. In addition, the potential for cost increases is balanced by potential benefits to these customers, including lower charges for the recovery of the ISO’s expenses, reduced Congestion costs and possibly lower costs for Energy and Ancillary Services. Entities that choose to become new Participating TOs are protected against certain cost increases during a transition period associated with the Access Charge and the Grid Management Charge (“GMC”) and may realize reductions in their transmission cost responsibility through the blending of Participating TOs’ high voltage Transmission Revenue Requirements. Such benefits will be used during the transition period, however, to mitigate disparities in the transmission costs of Participating TOs and thereby to reduce cost shifting further. Transmission customers will benefit from the ultimate adoption of a single ISO Grid-wide “postage stamp” rate for the use of high voltage transmission facilities.
- Second, in light of the statutory directive that the ISO Governing Board, which is made up of representatives of various sectors interested in the ISO’s operations, endeavor to develop an Access Charge methodology, the ISO Board was acutely aware of the need to develop a proposal that, while not perfect from the standpoint of any industry sector, could receive the support of a majority of the sectors’ representatives on the Board. The adoption of the proposed methodology by a 16-5 vote testifies to the successful accomplishment of this goal.

- Third, the ISO Governing Board concluded that moving ultimately to a single ISO Grid-wide rate for the region's high voltage transmission facilities would further advance the movement toward a regional transmission grid that was not tied to the facilities or service areas of the individual transmission owners. As an ultimate objective, a single postage stamp rate would appropriately reflect the fact that the high voltage regional transmission system benefits consumers and Market Participants throughout the region.
- Fourth, the ISO Governing Board concluded that the establishment of a high voltage Access Charge rate in the ISO Tariff, rather than in each Participating Transmission Owners' TO Tariffs, enhanced the independence of the ISO by strengthening its control over the tariff provisions through which transmission rates are designed. In this way, the proposed Access Charge methodology moves toward achievement of one of the bedrock principles of the Commission's Order No. 2000.
- Fifth, the ISO Governing Board concluded that the ISO should afford comparable treatment not only to the transmission customers that rely on the ISO Controlled Grid, but also to Participating TOs that place their facilities under the ISO's Operational Control. Thus, while the proposed Access Charge methodology does include provisions that affords benefits for new Participating TOs for which the current Participating TOs are not eligible, the ISO has attempted to limit the extent and duration of such benefits. After the ten-year transition period, all Participating TOs and their customers receive uniform treatment with respect to determination of the Access Charge and other tariff provisions.
- Sixth, the ISO Governing Board believed that the new Access Charge methodology would inevitably be a critical factor in the willingness of additional transmission owners, including in particular publicly owned electric utilities, to place their transmission facilities under the Operational Control of the ISO.¹³ The ISO's obtaining Operational Control of these facilities is important for a number of reasons. The elimination of gaps in the facilities subject to unified regional control is

¹³ The ISO and the Governing Board recognize that some publicly owned entities have concerns about participation that are beyond the power of the ISO, or indeed of the Commission, to address, since they relate to the possible loss of tax-exempt status for certain financing. The ISO believes, however, that concerns about the consequences of participation on some entities' tax-exempt financing should not delay the adoption of an Access Charge methodology that eliminates other impediments to broader participation in the ISO by owners of transmission facilities and Entitlements in the region, especially since some potential new Participating TOs are not limited by the tax-exempt financing concern.

in the first instance an important part of establishing an efficient and level platform for competitive electricity markets in the region, consistent with Order No. 2000's objectives. The issues addressed in Amendment No. 27 thus present important policy questions for the Commission that will inevitably be presented in other regions, as well.

The current situation, moreover, creates particular problems for the ISO and Market Participants. In its October 30, 1997 Order conditionally approving the ISO Tariff, the Commission required the ISO to structure its operations so that customers receiving transmission service under Existing Contracts could exercise any rights they may have to submit schedule changes after the ISO's scheduling deadlines applicable to other users of the ISO Controlled Grid in the ISO's Day-Ahead and Hour-Ahead Markets.¹⁴ To fulfill this requirement, the ISO reserves some transmission capacity from availability for scheduling by Market Participants to enable it to accommodate within-the-hour schedules submitted by holders of Existing Rights.¹⁵ This sometimes results in insufficient capacity being available to accommodate all desired Schedules, requiring the ISO to resort to its Congestion Management procedures in the Day-Ahead and Hour-Ahead markets. The holders of Existing Rights have no obligation to notify the ISO in advance of the size of the transactions they intend to schedule using their within-the-hour scheduling rights or whether they intend to schedule any transactions at all. As a result of the present practices to preserve the within-the-hour scheduling rights associated with some Existing Rights, capacity that was reserved in forward markets for the later use of Existing Rights holders is often unused, even though other Scheduling Coordinators are required to pay Congestion costs in those forward markets. The ISO's analyses, appended to the testimony of Ms. Le Vine, suggest that this phenomenon, referred to as "phantom Congestion," imposes substantial costs on all Market Participants and, ultimately, on consumers.

In an attempt to alleviate phantom Congestion, the proposed Access Charge methodology requires new Participating TOs to convert their Existing Rights and comply with the ISO Tariff, thus eliminating with respect to those rights the scheduling disparity that gives rise to the problem. The proposed Access Charge methodology also includes a number of provisions, described in the next section, through which the ISO Governing Board has endeavored to address concerns

¹⁴ *Pacific Gas & Electric*, 81 FERC at 61,471.

¹⁵ See ISO Tariff, Section 2.4.4.1.5; Scheduling Protocol, Sections SP 7.4.3, SP 7.4.4, SP 7.5.

identified by entities with Existing Rights as impeding their participation in the ISO as Participating TOs.

While the resulting methodology does not satisfy all of the concerns of all entities with Existing Rights, the ISO Governing Board determined that it was not possible to do so within the confines of an Access Charge methodology that takes account of the interests of all classes of stakeholders and equitably balances costs and benefits to all affected sectors. The ISO recognizes that some entities with Existing Rights may conclude that the Access Charge methodology provides insufficient benefits to induce them to become Participating TOs, but believes that the proposal represents substantial and reasonable progress in removing road blocks toward expanding participation in the ISO.

IV. DESCRIPTION OF THE PROPOSED TAC METHODOLOGY

A. Overview

The proposed Access Charge methodology would continue to afford customers access to the ISO Controlled Grid at non-pancaked rates. The current Access Charge methodology, based on rates reflecting the rolled-in transmission Revenue Requirement of the Participating TO in whose Service Area the Energy is withdrawn, would apply until the Transmission Control Agreement ("TCA") has been executed by a new Participating TO. At that point, the Access Charge for the recovery of costs associated with and allocable to high voltage transmission facilities included in the ISO Controlled Grid would initially be based on the Transmission Revenue Requirements of all Participating TOs in each of three or four "TAC Areas," corresponding to each of the former control areas that were combined to form the ISO Control Area. Over ten years, the high voltage Access Charges for these TAC Areas would be combined to form a single ISO Grid-wide high voltage Access Charge. The Access Charge for the recovery of costs of low voltage transmission facilities would continue to be Participating TO-specific.

Over the same ten-year period, several transition mechanisms would be in effect to limit the amount of costs that would be shifted to the customers of any Participating TO during and after that period and to protect new Participating TOs against certain cost increases that they might otherwise experience. Other aspects of Amendment No. 27 would facilitate participation in the ISO by new Participating TOs. At the conclusion of the ten-year transition period, all Participating TOs would be treated comparably under the ISO Tariff's Access Charge methodology and the costs of their high voltage transmission facilities would be recovered through a single Access Charge, applicable to the withdrawal of Energy anywhere on the ISO Controlled Grid.

B. Initial TAC Area Methodology

Under Amendment No. 27, the current Access Charge methodology, whereby 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 TCA 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. (See ISO Tariff, Section 7.1 and Appendix F, proposed Schedule 3.) 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 operating at 200 kV and above, together with supporting facilities, will be collected under the ISO Tariff on the basis of TAC Areas.¹⁶ Each TAC Area will consist of the high voltage transmission facilities of the Participating TOs in one of the three control areas that were combined into the ISO Control Area, corresponding 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. (See ISO Tariff, Appendix F, Schedule 3, Section 3.)

The HVAC for a TAC Area will be based on the combined high voltage Transmission Revenue Requirements of all of the Participating TOs in the TAC Area. The present Self-Sufficiency Test will no longer be necessary; that is, the same HVAC will apply 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 TO Tariff, based on the transmission revenue requirement associated only with its

¹⁶ The reference to "supporting facilities" in the new definition of "High Voltage Transmission Facilities" is intended to capture facilities, such as transformers, that may bridge the dividing line between High Voltage Transmission Facilities and Low Voltage Transmission Facilities. The ISO is required by Amendment No. 27, if it is accepted, to develop a set of guidelines to ensure the uniform development of High Voltage Transmission Revenue Requirements by Participating TOs. The ISO is currently working on the development of those guidelines and expects to release a draft for stakeholder comment in the coming months, well before the introduction of a new Participating TO would cause the proposed Access Charge methodology to take effect.

own low voltage transmission facilities and Entitlements. (See ISO Tariff, Appendix F, Schedule 3, Section 5.)

C. Transition to ISO Grid-Wide Rate for High Voltage Transmission Facilities

Over a ten-year period following the qualification of a new Participating TO, the separate TAC Area HVACs would be combined into a single ISO Grid-wide HVAC. 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, with the proportion represented by the ISO Grid-wide portion increasing by ten percent each year. In addition, capital investments by any Participating TO in new high voltage transmission facilities and in additions to existing high voltage transmission facilities would immediately be included in the ISO Grid-wide component of the HVACs to increase the pace at which the HVACs converge into a single charge. At the end of the ten-year transition period, a single HVAC would apply to the withdrawal of Energy at any point on the ISO Controlled Grid. (See ISO Tariff, Appendix F, Schedule 3, Sections 4 and 5.)

This mechanism provides a smooth transition from the initial TAC Area HVAC to a single postage stamp rate for the use of high voltage transmission facilities included in the ISO Controlled Grid. The gradual transition over a ten-year period limits the potential for customers of any Participating TO to experience abrupt cost shifts as a result of the movement toward a single ISO Grid-wide HVAC. In addition, as discussed below, other transition mechanisms have been included in Amendment No. 27 to further mitigate these shifts.

D. Additional Transition Mechanisms

In addition to the phase-in of a single "postage stamp" HVAC 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 delicate, balanced compromise proposal adopted by the ISO Governing Board. They include: (1) a mechanism to hold new Participating TOs harmless with respect to increases from the Access Charge and the GMC that 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 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.

- The proposed methodology recognizes that a new Participating TO may bear increased costs in one of two ways. First, if a Participating TO's high voltage

Transmission Revenue Requirement is lower than the average for Participating TOs in their TAC Area, the blending of the Transmission Revenue Requirements through the proposed methodology could increase the transmission costs borne by its customers. Second, Scheduling Coordinators serving a new Participating TO's customers could become responsible for a greater share of the ISO's expenses through an increased allocation of the GMC. The GMC cost increase arises from the fact that the current GMC methodology, established by a settlement accepted by the Commission in Docket No. ER98-211-000 and subsequently extended, subject to refund, provides certain exemptions for Loads served by Energy delivered under Existing Contracts. When an entity with transmission service rights under Existing Contracts becomes a new Participating TO and converts its Existing Contracts and ownership rights to ISO transmission service, it no longer qualifies for those exemptions.¹⁷ As a result, a new Participating TO may be responsible for greater GMC payments. 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 Access Charge methodology includes a provision (proposed Section 8.6 of the ISO Tariff) under which current Participating TOs would compensate new Participating TOs for any net increased costs the latter would be required to bear under HVAC charges and GMC during the first ten years that the new Access Charge methodology is in effect. The payments Participating TOs are required to make or receive under this provision are recovered and disbursed through a Transition Charge that is collected or credited by the ISO as part of the Access Charge.

- The proposed methodology also recognizes that the adoption of the TAC Area approach and the phased introduction of a single ISO Grid-wide HVAC could cause considerable cost shifting among the original Participating TOs. Most publicly owned utilities in California that own transmission facilities have higher per-MWh transmission costs than the original Participating TOs, largely because the public utilities' transmission facilities were constructed more recently. Blending the Transmission Revenue Requirements of such higher-cost Participating TOs with the Transmission Revenue Requirements of other Participating TOs over the transition period will tend to increase the charge for the withdrawal of Energy for customers in the Service Areas of original Participating TOs. To mitigate these cost shifts, the proposed Access Charge methodology includes a ceiling on the amount by which the costs payable for the withdrawal of Energy within the Service Area of each original

¹⁷ Any uncertainty about this effect is clarified by the changes to Appendix F, Schedule 1 proposed in Amendment No. 27.

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 discussed above.

The level of the cost shift ceiling was a subject of substantial debate and negotiation among stakeholders and the ISO Governing Board. The compromise proposal presented by Board members representing the End-User sector and ultimately reflected in the Governing Board’s decision provides for cost shift ceiling that represent a maximum average increase in transmission charges to Loads in the Service Areas of the original Participating TOs of approximately 0.4 mills/kWh.¹⁸ The ceiling provides for up to \$72 million to mitigate the blending of high voltage Transmission Revenue Requirements during each year, though the amount of costs that will be shifted will depend upon how many entities, and which entities, decide to become new Participating TOs. (See ISO Tariff, Appendix F, Schedule 3, Section 7.) Payments between Participating TOs necessary to implement this ceiling would be recovered or credited through the Transition Charge by the ISO with the HVAC.

The ISO Governing Board determined that cost shifts of up to this ceiling allowed substantial benefits for new entities that choose to become Participating TOs and combine their high voltage Transmission Revenue Requirements with those of current Participating TOs. At the same time, transmission rate increases for customers of original Participating TOs of up to this level were reasonable in light of benefits that are expected as a result of the addition of new Participating TOs and, in particular, the conversion of their Existing Rights to transmission capacity that would be scheduled in accordance with the ISO’s scheduling timelines and protocols.

It is important to note that the cost-shift issue was framed in terms of reasonable cost increases to *customers* of the original Participating TOs to facilitate increased transmission capacity, decrease congestion and potentially decrease Energy and Ancillary Service costs. The proposed Access Charge methodology was developed in the expectation that any increased amounts payable by a Participating TO under that methodology (in the Participating TO’s capacity as a Utility Distribution Company paying HVAC charges) would be recoverable from retail and wholesale customers in its transmission rates or in the transmission component of bundled rates.

- The proposed Access Charge methodology includes another provision to reduce the disparity in transmission costs among the original and new

¹⁸ This approximation does not address any question associated with retail cost allocation and rate design.

Participating TOs, thereby limiting the cost shifting that would occur during and following the ten-year transition period. This is accomplished by including a credit, in the calculation of each new Participating TO's high voltage Transmission Revenue Requirement, to recognize the cost-shift benefit that a new Participating TO with higher than average transmission costs will receive during the transition period. (See ISO Tariff, Appendix F, Schedule 3, Section 6.1(b).) The credit reduces the new Participating TO's high voltage Transmission Revenue Requirement by applying the transition benefit received during preceding years to amortize the high-cost Participating TO's investment in high voltage transmission facilities. The high-cost Participating TO may use the amount of the transition 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 Transmission Revenue Requirement. 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 and should assist in narrowing the gap between the various Participating TOs' transmission costs.

E. Other Mechanisms To Facilitate Participation by New Participating Transmission Owners

Under Article 9 of the ISO Tariff, the ISO makes Firm Transmission Rights ("FTRs") available through periodic auctions to enable Market Participants to hedge their exposure to Inter-Zonal Congestion costs imposed through Usage Charges.¹⁹ 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 with FTRs that would be acquired through the ISO's auction or the secondary market would impair their ability to continue to serve their customers economically. The Access Charge methodology adopted by the ISO Governing Board accordingly provides (in Section 9.4.3 of the ISO Tariff) 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 would be determined when an entity with Existing Rights applies to

¹⁹ See *California Independent System Operator Corp.*, 87 FERC ¶ 61,143 (1998).

become a Participating TO.

The 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 to facilitate their continued operation of vertically integrated utility systems while also providing an alternative way to participate in the ISO's markets and to use the ISO Controlled Grid for transactions with their surplus resources.²⁰ The Loads and Generation on 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 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 materially affected by changes in the operating levels of individual resources.

The ISO believes that limiting the availability of Metered Subsystem status to entities that elect to become Participating TOs 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 and 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.²¹ 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.

F. Implementation Provisions

The Access Charge methodology adopted by the ISO Governing Board includes a number of implementation provisions.

First, Section 7.1 of the ISO Tariff and related provisions are modified to provide for the ISO's collection and settlement of Access Charges, including HVAC and Transition Charges. Those charges will be collected from Utility Distribution Companies and Metered Subsystem Operators for the delivery of Energy to Gross Loads on their systems. For Loads that are not located on the

²⁰ (See primarily proposed Section 3.3 of the ISO Tariff.) The Commission has recognized that the implementation of a Metered Subsystem concept was an important means of encouraging greater participation in the ISO. *Pacific Gas & Electric*, 81 FERC at 61,496. The proposed Metered Subsystem provisions were developed based on discussions that have been taking place among the ISO and various stakeholders over the period since the ISO commenced operations.

²¹ Order No. 2000, FERC Stats & Reg. at 31,180.

system of a Utility Distribution Company or Metered Subsystem, the HVAC will be collected from the Scheduling Coordinator serving the Load. Access Charges 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 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 interruptible customers.

Second, Section 3.1 of the ISO Tariff is modified to describe the procedures to be followed by an entity seeking to become a new Participating TO in conjunction with the application process in section 2.2 of the TCA. Each new Participating TO must execute the TCA and turn over to the ISO's Operational Control its transmission facilities and 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.

Third, as explained above, in order to ensure that the addition of new Participating TOs provides benefits to consumers and Market Participants commensurate with the cost shifting that would be created by the new Access Charge methodology, Amendment No. 27 would require a new Participating TO to convert its Existing Contracts and ownership rights to transmission service on the ISO Controlled Grid and comply with the ISO Tariff. 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 and reducing Congestion costs, all as discussed above. 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. 27.²²

Fourth, the blending of Participating TOs' high voltage Transmission Revenue Requirements into HVAC paid by customers on the systems of other Participating TOs required the adoption of mechanisms for the review 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 the Western Area Power Administration, whose rates are reviewed by the Commission under statutes other than the

²² The ability of a Participating TO to continue to exercise contractual transmission service rights as Non-Converted Rights would, in any event, expire five years after the commencement of ISO Operations, or March 31, 2003.

Federal Power Act), the ISO Tariff will continue to use Transmission Revenue Requirements approved by the Commission. The submission of the Participating TO's high voltage Transmission Revenue Requirement for review by the Commission assures the reasonableness of the amounts to be reflected in the ISO's HVAC.

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 HVAC rates that included costs that had not been subjected to 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 Governing Board 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. (See the revisions to Section 7.1.1 and Appendix F, Schedule 3, Section 9, of the ISO Tariff.) A new non-jurisdictional Participating TO will have the opportunity to go through this process prior to executing the TCA so that it can determine the initial level of its Transmission Revenue Requirement before making that commitment.

V. EFFECTIVE DATE

The ISO requests an effective date for Amendment No. 27 of June 1, 2000, which provides a notice period slightly in excess of the sixty days required by the Commission's regulations. As explained above, until a new entity decides to place its transmission assets and Entitlements under the Operational Control of the ISO and completes all of the steps necessary to become a Participating TO, the current Access Charge methodology will remain in effect. The prompt effectiveness of Amendment No. 27 is nevertheless important so that entities considering becoming Participating TOs will be aware of the Access Charge methodology that would apply so they can evaluate the costs and benefits of that decision.

VI. NOTICE AND SERVICE OF DOCUMENTS

Communications regarding this filing should be addressed to the following individuals, whose names should be placed on the official service list established by the Secretary with respect to this submittal:

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18 C.F.R. § 385.203(b)(3).

The ISO has served copies of this letter, and all attachments, on the Public Utilities Commission of the State of California, the California Energy Commission, the California Electricity Oversight Board, and on all parties with effective Scheduling Coordinator Service Agreements under the ISO Tariff. In addition, the ISO is posting this transmittal letter, proposed tariff sheets and testimony (but not all the Exhibits to the testimony) on the ISO's Home Page.

VII. SUPPORTING DOCUMENTS

The following documents, in addition to this letter, support this filing:

Attachment A	Revised Tariff Sheets
Attachment B	"Black-lined" Tariff provisions showing additions to and deletions from existing Tariff provisions.
Attachment C	Testimony and Exhibits of Zora Lazic
Attachment D	Testimony and Exhibits of Deborah Le Vine
Attachment E	A form of Notice suitable for publication in the Federal Register.

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An additional copy of this filing is enclosed to be date-stamped and returned to our messenger. If there are any questions concerning this filing, please contact the undersigned.

Respectfully submitted,

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