CALIFORNIA ISO

California Independent
System Operator

Memorandum

To: ISO Board of Governors

From: Zora Lazic, Vice President of Client Services
Deborah Le Vine, Director of Contracts & Compliance

CC: ISO Officers

Date: March 9, 2000

Re: Access Charge Proposal - Tariff Amendment

This memorandum requires Board action.

EXECUTIVE SUMMARY

Both AB 1890 and the November 1996 Federal Energy Regulatory Commission ("FERC") Order required the ISO to file an Access Charge within two years of start-up. An overarching issue in devising an Access Charge is its relationship to the issues surrounding full participation by Governmental Entities[1] in the ISO. Because the Governmental Entities that will become the New Participating Transmission Owners ("New PTOs") generally have newer, higher-cost transmission facilities, most traditional transmission rate designs would result in substantial transmission rate reductions per kW or kWh for these New PTOs. Although customers of the three investor-owned utility ("Original PTOs") would see a corresponding dollar-for-dollar increase in their transmission rates, the per kW or kWh effect would be much smaller given the relative sizes of the Original PTOs and the New PTOs.

During 1999, Management worked with Market Participants through the Market Issues Forum and the Transmission Access Charge Work Group (TACWG) to discuss and try to resolve various Access Charge issues. The ISO Governing Board at its October Board meeting resolved certain fundamental issues affecting the Access Charge methodology and directed Management to develop a comprehensive proposal based on the Board's determinations, including a plan for mitigating the impact of cost increases and decreases among New and Original PTOs and their respective customers. With the decision in October, the stakeholder groups were put on hold and Management worked with the Board negotiating group, established by the Board and made up of Board members. Subsequent to the full Board meeting on January 13, 2000, the Board met approximately weekly, many of these meeting with stakeholders to further develop the Access Charge compromise. Based on a compromise proposal put forward by the End-Use representatives of the Board that is a delicate balance of benefits and burdens, draft tariff language is attached to this memorandum (*Attachment A*) implementing the proposal. The detailed Tariff amendments include resolution of a number of details that are driven by the general policies. The most significant are as follows:

- The Access Charge will be a High Voltage TAC Area[2] rate and a Low Voltage Utility-specific rate transitioning over 10-years to a High Voltage ISO Grid-wide rate and a Low Voltage Utility-specific rate.

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1 Governmental Entities means municipal utilities, state agencies and federal agencies that own or have contractual rights to transmission.

2 The existing ISO Control Area would consist of three TAC Areas, the Northern Area, the East Central Area, and the Southern Area. If LADWP joins, an additional TAC Area in California would be formed, the West Central Area.

- The TAC Area rate will be initiated when one New PTO executes the Transmission Control Agreement (TCA) and turns over all transmission assets to ISO Operational Control.
- New high voltage transmission systems and capital additions will be included initially in the ISO Grid-wide component of the High Voltage Access Charge.
- Maximum impact annually to Original PTOs during 10-year transition will be $32 Million for Pacific Gas & Electric Company and Southern California Edison Company, and $8 Million for San Diego Gas & Electric Company.
- The New PTOs will be "held harmless" for rate increases due to billing based on Gross Load for the High Voltage Access Charge and the Grid Management Charge and benefits are to be used to reduce transmission asset debt.
- Gross Load will be billed the Access Charge through UDCs and, where applicable, Metered Subsystems (MSSs), except for exports or Load not associated with a MSS or UDC, which will be billed to Scheduling Coordinators. Gross Load also exempts qualifying facilities that meet Section 218 of the California Public Utilities Code, Section 201 of the Public Utility Regulatory Policies Act, was serving customer load as of December 20, 1995, and is a Standby Service Customer with a PTO.
- The ISO will treat all PTOs uniformly including operation, participation and market rules after transition.

In addition, certain details are *not* included in the Tariff amendment because we believe that they are best handled at the time that a New PTO gives notice of intent to join. They include details on conversion of Existing Contracts and FTRs assignment, and MSSs Agreement. Additionally, the procedures for a newly created Revenue Review Panel will need to be developed and approved by the Board along with the requirements for rate information and accounting procedures to be provided to the ISO for Non-Jurisdictional PTOs.

We therefore recommend the following motion:

Moved, that the Board:

- *directs the President and Chief Executive Officer to finalize and file at FERC by March 31, 2000 the Access Charge Tariff amendments, in the form presented at this meeting, with such changes as he determines.*

BACKGROUND

The ISO is required by AB1890 and a FERC order to develop an Access Charge and file it with FERC. At the October 1999 Board meeting the Board approved:

- An Access Charge methodology that uses Utility-Specific rates for the ISO Controlled Grid facilities below 200 kV and a regional rate for ISO Controlled Grid facilities at 200kV and above, all based on $/MWh, to be filed and effective June 1, 2000, provided that the methodology not preclude different retail rate designs;
- Network facilities at 200 kV and above be charged initially on the basis of three or four interim "TAC Areas" and transitioned over a period of years into a ISO Grid-Wide rate, commencing when a critical mass of New Firm Use import transmission capacity is obtained; and
- Development of a plan for mitigating the cost increases and decreases among the New and existing PTOs and their customers.

Through the subsequent process that took place in November 1999 through March 2000, and the additional stakeholder meetings during that time, the approved principles from October were changed slightly by the compromise proposal. However, the compromise proposal is a well-crafted balance of benefits and burdens among the transmission owners, the Market Participants and the End-Use Load. The slight changes in the compromise proposal from the October Board direction consist of:

- The Access Charge will not be effective June 1, 2000, rather it will be effective once a New PTO executes the TCA and FERC makes it effective;[3]
- Transition to ISO Grid-Wide rate will be a 10-year process and commences on either January 1 or July 1 after FERC has made the TCA effective versus commencing when a critical mass of New Firm Use import transmission capacity is obtained; and
- Mitigation plan for cost increases and decreases have been developed.

Since the October Board meeting, Management has developed proposed tariff language, summarized the language at the Market Issues Forum on November 3 and circulated it to Market Participants and the TACWG. The Board negotiating group met approximately weekly from November 16, 1999 through March 3, 2000. The stakeholders were brought back into the process in a public Stakeholder meeting on January 24, 2000 and supplied with a new management proposal and new draft Tariff language dated January 18, 2000. Because of concerns raised by some stakeholders with Management's mitigation proposal, the End-Users produced and championed an End-User Compromise Proposal, which is what is being forwarded to the Board for approval.

Because the new Access Charge will not materially change the current TO-specific rates until there is a New PTO, there is not a major change in the initial Access Charge methodology. For that reason, we believe a schedule leaving existing rates in place until a New PTO executes the TCA, to accommodate the extensive work that must be done to incorporate any New PTOs, meets the intent of FERC's Order and better achieves the policy behind it because the timing reflects stakeholder requests. Once a New PTO executes the TCA, all Access Charges will transition to TAC Area.

ISSUE STATEMENT

The Governing Board previously provided policy direction for the development of the Access Charge. The policy direction results in our replacing in its entirety the existing text on Access Charge and making a number of conforming changes throughout the Tariff wherever "Access Charge" is treated. The major policy directive of October and subsequent Board discussions drive resolution of a number of more detailed decisions that must be reflected in Tariff language. In order to focus on those details in approving the draft amendment, we summarize them in this memorandum. They are as follows:

- The TAC Area rate will be initiated once a New PTO executes the TCA.
- Transitioning from TAC Areas to ISO Grid-wide will be 10 years for each TAC Area.
- The amendment subjects UDCs and MSSs to financial security requirements similar to the requirements of Scheduling Coordinators, consistent with the ISO's bond requirements.
- The amendments requires the New PTO to turn over all transmission assets to ISO Operational Control and comply with all ISO Tariff requirements and applicable Agreements.

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[3] It is unknown at this time when a New PTO will execute the TCA, so the proposal allows for the new Access Charge to be implemented the following July 1 of January 1 in whatever year is appropriate.

- The amendment requires Existing Contracts held by the New PTO to be converted to New Firm Uses effective upon execution of the TCA by the New PTO and its entitlement to rolled-in TAC Area High Voltage Access Charge Rates. Determination of FTRs for Existing Contracts will be done during the TCA negotiations. *This requirement forms the basis for making the new Access Charge methodology a "win-win." The immediate conversion creates savings in congestion management and market efficiency to offset the shift among customers of transmission revenue requirements.*
- Requires the New PTO to becomes its own Scheduling Coordinator or acquires the services of a Scheduling Coordinator (the Responsible PTO is no longer required to be the Scheduling Coordinator unless mutually agreed).
- The amendment provides that the Access Charge will be billed based on Gross Load and exports, with a specific exemption for qualifying facilities, through UDCs and, if applicable, MSSs and Scheduling Coordinators if the load and export is not associated with a UDC or MSS.
- The amendment provides for a Revenue Review Panel that will determine the non-FERC-regulated transmission revenue requirements that will be included in the High Voltage Access Charge.
- The amendment provides for mitigation of cost increases to New PTOs while setting an annual ceiling on the impact to the Original PTOs. The mitigation also requires the New PTOs to apply the benefits received to reduce its High Voltage Transmission Revenue Requirement in the following years.
- The amendment also develops MSSs and establishes the specifics of operation, control and System Units. The participants see this issue as one of the crucial components that must be decided prior to deciding to join the ISO.
- The amendment *does not* include specifics on how Converted Rights are treated under FTRs. A compromise could not be reached and a placeholder was included to allow determination of FTRs for Existing Contracts during the Transmission Control Agreement (TCA) negotiations. We believe details on implementation are best left to the negotiations with specific New PTOs.

OPTIONS CONSIDERED AND PROS AND CONS

<u>Access Charge Timing</u>

In comments to date, a concern was raised regarding the time and commitment of resources needed to amend existing Access Charges and file them with FERC and whether the effort is warranted if no New PTOs have given notice of intent to execute the TCA. To address this concern, Management is proposing that the Access Charge remains Utility-specific as each Original PTO has currently promulgated it before FERC until there has been a notice of intent from a New PTO. Once that occurs (by January 1 or July 1 notice cut-off), Original PTOs will be obligated to make the necessary filing and the Access Charge will transition to the new Access Charge methodology (TAC Area and ISO Grid-wide) for network facilities above 200 kV, and Utility-specific for network facilities below 200 kV on the scheduled effective date.

<u>New PTO Requirements</u>

The New PTO would be required to execute the TCA, turn over all transmission assets to ISO Operational Control and comply with all ISO Tariff/Protocols and applicable Agreements. During the application process of the TCA in accordance with Section 2.2, the exact facilities to be placed under ISO Operational Control and the cost of such facilities that would be included in the High Voltage Access Charge would be determined. Additionally, at this time, a determination of FTRs for Existing Contract rights and owned transmission rights would be decided.

The New PTO would also need to execute the applicable *pro forma* Agreements (Participating Generator Agreement, Meter Service Agreement, Scheduling Coordinator Agreement, etc.). If the New PTO is a MSS, a new *pro forma* MSS Agreement (that still needs to be developed) would be executed. The ISO will provide Market Participants with notice that the TCA has been executed when the amended TCA is filed with FERC. This will give the Market Participants at least 60 days notice of a change to the High Voltage Access Charge.

Additionally, a requirement for a New PTO is that the Scheduling Coordinator function must be performed by New PTO or its designee (but not the Responsible PTO unless mutually agreed by the New PTO and the Responsible PTO).

Existing Contracts

Currently, the ISO Tariff allows a New PTO the option, upon joining the ISO in that capacity, either to convert its Existing Contract rights to Converted Rights or to continue to exercise Existing Contract rights, as Non-Converted Rights, until March 31, 2003. *This conversion option would not be retained under the Access Charge proposal; principally because the market efficiency savings projected to make the proposed Access Charge a "win-win" are available only upon elimination of the "two pipe" congestion management model.*[4]

In addition, this option was part of an Access Charge structure in which each PTO's Access Charge reflects only the costs of its own facilities and contract entitlements. Retention of this option is problematic if the Access Charge is to be based initially on TAC Areas, transitioning to an ISO Grid-wide charge for high voltage facilities. It would give a new PTO the ability to shift costs associated with some of its transmission facilities and entitlements to other PTOs and their customers, while retaining other contract rights (presumably those that are more valuable, from a market perspective). Because the ISO will continue to have to administer and schedule the retained contract rights, savings that would otherwise offset a portion of the cost shifts associated with the proposed Access Charge methodology could not be obtained.

In order to avoid cherry picking and to obtain the administrative and cost savings, the Tariff language requires a New PTO to convert its Existing Contracts to the ISO's scheduling and operational procedures, rules and protocol. Thus Section 2.4.4 has been modified to require PTOs to convert their Existing Contracts immediately. We have therefore deleted the concept of Non-Converted Rights. We have also deleted the Self-Sufficiency Test which is not required when the TAC Area High Voltage Access Charge is implemented.

The proposed amendment does not address how Converted Rights for Existing Contracts are treated under FTRs. The ISO has made various proposals to the Governmental Entities regarding conversion of Existing Rights. No agreement has been reached regarding the various proposals. This is detail we believe can be addressed once a New PTO has given notice of intent to join and prior to execution of the TCA.

Billing and Settlement

As previously discussed, the new Access Charge will be billed to Utility Distribution Companies (UDCs) and, if applicable, MSSs or Scheduling Coordinators by the ISO. Because the Access Charge was previously utility-specific, each of the Original PTOs did its own billing and the ISO was only responsible for billing and settlement of Wheeling charges with Scheduling Coordinators. With the ISO's structure of PTOs and UDCs, it's the UDC that is the ISO's transmission customer. The PTOs are transmission providers and not transmission customers; therefore the ISO should be billing UDCs or MSSs and not PTOs. We also believe that a UDC that

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4 Currently the ISO reserves the transmission capacity amount defined in Existing Contracts through the Hour-Ahead Markets because most Existing Contracts allow the Existing Rightholder the ability to schedule up to 20 minutes before the hour. By requiring New PTOs to follow the ISO timelines, they would need to schedule this capacity in the Day-Ahead Market or lose it, and the ISO would no longer be required to reserve this capacity. This should substantially decrease the amount of "phantom congestion" that appears to exist due to this reservation for Existing Contracts that does not materialize in the real-time market.

resells transmission service it purchases from the ISO to its customers should be better able to recovery the cost it incurs.

The new Access Charge methodology will be filed as a formula rate with FERC initially based on aggregation of the PTOs' Transmission Revenue Requirements within their respective TAC Areas. Each Jurisdictional PTO will be responsible for obtaining regulatory approval of its Transmission Revenue Requirement. Each Non-Jurisdictional PTO will submit its Transmission Revenue Requirement to the Revenue Review Panel for approval. Various sections in the Tariff have been modified to incorporate the ISO and Revenue Review Panel performing this function and the actual formula rate. Further work will be done after the filing to develop the procedures for the Revenue Review Panel and taken to the Board for approval.

The Access Charge uses in its denominator the Gross Load, with a specific exemption for qualifying facilities, connected to the systems of the PTOs in the TAC Area. The forecast of the Gross Load and the exports will be done by the ISO based on data from the PTOs, Scheduling Coordinators, UDCs and MSSs. This will avoid any gaming by participants in determining the Access Charge for each year. With the addition of a balancing account, any errors in forecasting Gross Load and exports, and/or Transmission Revenue Requirement will be resolved in a true up at the end of the year.

The settlement section also requires UDCs and MSSs to maintain Approved Credit Ratings, similar to Scheduling Coordinators. If Approved Credit Ratings are not maintained, then like a Scheduling Coordinator, the UDC or MSS must provide a form of security as defined in sections 2.2.3.2 and 2.2.3.3 of the ISO Tariff. If an outstanding liability is not covered by the security, then a limitation will be placed on the trading ability of the UDC's or MSS's Scheduling Coordinator.

Mitigation Plan

The compromise proposal establishes a mitigation plan which provides for limits for the Original PTOs and specific requirements for New PTOs. The maximum annual impact to Original PTOs during the 10 year transition period is $32 Million for Pacific Gas & Electric and Edison and $8 Million for San Diego Gas & Electric (increased averaged over all Load is approximately 0.4 mill)[5]. This is based on Gross Loads and exports, except specific qualifying facilities, paying the Access Charge. Additionally, all PTOs will pay the GMC based on Gross Load.

For the New PTOs, during the transition period, there is a "hold harmless" clause whereby the New PTO will not incur a cost increase (net burden (high voltage Access Charge and/or GMC), and if one does occur, it will be paid by the Original PTOs up to the ceiling addressed above. The New PTOs will be required to apply benefits received by the new Access Charge rate structure to reduce high voltage Transmission Revenue Requirement ("TRR") in the following years, i.e., assume for TRR purposes that the New PTO applied the benefits to buy down its investment in high voltage transmission assets. This results in lower costs for all transmission users as the decrease in cost will be reflected in a percentage of the TAC Area and ISO Grid-wide component of the High Voltage Access Charge.

Metered Subsystems

The Metered Subsystem ("MSS") portion of the proposal was been sufficiently fleshed out to be included in the compromise proposal at this time. It is the culmination of numerous months' efforts with municipal utilities to facilitate their retention of a vertically integrated utility in the restructure California utility paradigm. A MSS could be established for a geographically contiguous system of a New PTO within the ISO Control Area within a single

[5] This does not address any questions associated with retail cost allocation and rate design.

congestion zone.[6] The MSS would retain its ability to control its own generation through a System Unit (subject to requirements applicable to all generating units under the PGA to avoid a System Emergency) and be required to schedule gross Generation, imports, exports and gross Load, through the ISO scheduling systems. The MSS would be metered at interface points and Generators using ISO certified revenue-quality meters.

To participate in ISO markets for Ancillary Services and Supplemental Energy, the MSS may participate based on a System Unit, subject to all requirements of the ISO Tariff for such participation.

The MSS would pay the costs for relieving intra-zonal congestion only internal to the MSS, between the ISO Controlled Grid and the MSS, and for its use of the ISO Controlled Grid. Additionally, the MSS would be deemed an UDC, and UFE would be calculated for each MSS. The MSS would also be responsible for and bear the cost of reliability measures within the MSS such as RMR generation, voltage support, black start, transmission line outages and voltage support.

POSITIONS OF THE PARTIES

Comments of the Board members are included in *Attachment B*. Specific tariff language changes of the various parties who have commented as of 5 p.m. on March 8, 2000 are included in *Attachment C*. Various parties who made general comments or statements in what the ISO received as of 5 p.m. on March 8, 2000 are included in *Attachment D*.

MARKET ANALYSIS OPINION

The Department of Market Analysis (DMA) previously expressed its support for the design principles of the Access Charge in the October 19, 1999 Board memo. We believe the Access Charge is designed to enhance the efficiency of the ISO markets by: (1) ultimately having one ISO Grid-wide rate for all high voltage ISO-controlled facilities should improve efficiency of transaction across the ISO Controlled Grid; (2) conversion of all Existing Contract capacity to New Firm Uses at the same time as the rolled-in TAC high voltage rate becomes effective; and (3) assessing the Access Charge based on gross Load. These will help to maximize and to distribute equitably the system benefits achieved when New PTOs join the ISO system. DMA also notes that if a different level of firmness for Existing Contracts converted into FTRs is requested in individual negotiations, then this would require a different treatment of ETC FTRs with regard to their scheduling priority and financial entitlements. The FTR software must then be modified to recognize and treat differently the ETC FTRs. This may have an impact on the operational software for FTRs.

MANAGEMENT RECOMMENDATION

Management recommends that the Board approve the draft Tariff language and authorize Management to make a filing at FERC to seek approval of the proposed Access Charge and that Management be authorized to finalize and file language concerning the Access Charge consistent with the principles provided to the Board.

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[6] Concern was raised about the potential, and impact, of implementing new zones. Instead of trying to speculate a solution at this time, Management believes it would be better to resolve this concern when it materializes.