

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

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

**BRIEF ON EXCEPTIONS
OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Charles F. Robinson
General Counsel
Stephen A. M. Morrison
Corporate Counsel
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-2207
Fax: (916) 351-4436

J. Phillip Jordan
Michael E. Ward
Theodore J. Paradise
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW – Suite 300
Washington, DC 20007-5116
Tel: (202) 424-7500
Fax: (202) 424-7643

Counsel for the California Independent
System Operator Corporation

Dated June 10, 2002

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY
COMMISSION**

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

**BRIEF ON EXCEPTIONS
OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to Rule 711 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.711 (2001), the California Independent System Operator Corporation (“ISO”) submits this Brief on Exceptions to the Initial Decision issued in this matter on May 10, 2002. *California Independent System Operator Corp., et al.*, 99 FERC ¶ 63,028 (2002) (“Initial Decision” or “I.D.”).

I. STATEMENT OF THE CASE

A. Background

The ISO is a non-profit public benefit corporation which operates the ISO Controlled Grid and is the Control Area Operator for one of the largest transmission systems in the nation. ISO Initial Brief (“I.B.”) at 4. The ISO has no stockholders and no rate-base on which to earn a return. As a result, the ISO has

only one source of revenues – its Grid Management Charge (“GMC”). I.D. at 248; Tr. 218:13-14.

The ISO originally filed a GMC on October 17, 1997, as a bundled formula rate. The GMC was, and is, designed to collect the costs of operating the ISO, which includes meeting the ISO’s start-up and development costs, its capital costs and its operation and maintenance costs. Exh. ISO-1 at 3:11-14. The GMC was designed to be a monthly charge assessed to all Scheduling Coordinators (“SC”s). *Id.* at 3:14-15. The original bundled GMC was protested by various parties and resulted in an uncontested settlement.¹

The process of unbundling the GMC in concert with stakeholders began in early 1998, a few months after the filing of the original GMC. *Id.* at 22-23. That process assumed the form of a Stakeholder Steering Committee which selected a consultant to conduct the unbundling study required by the GMC Settlement. *Id.* at 5:5-16, 9:1-21, and then worked with the ISO to develop three service categories and billing determinants for each, which were finally approved by the ISO’s stakeholder-composed Governing Board on June 22, 2000. *Id.* at 8:22 – 11:18.

The instant case commenced with the filing of the unbundled GMC on November 1, 2000. The procedural history of the case is included as part of the Initial Decision at pages 10-13.

¹ *California Independent System Operator Corp.*, 83 FERC ¶ 61,247 (1998) (“GMC Settlement”).

B. Initial Decision

The central issues for resolution by the Initial Decision were the justness and reasonableness of (i) the ISO's costs² and (ii) the structure of its GMC rate, and the justness and reasonableness of billing one of the three service categories, Control Area Services ("CAS"), on the basis of Control Area Gross Load and exports. The Initial Decision found that "the ISO has fully supported its revenue requirement...", I.D. at 248, that the structure of the GMC was just and reasonable, I.D. at 38, and that billing the CAS charge on the basis of Control Area Gross Load and exports was just and reasonable, *see e.g.*, I.D. at 86, 100 - 103.

The Initial Decision did find that \$1,834,267.00 in incentive compensation, that had been budgeted by mistake, was not just and reasonable. As discussed below, the Initial Decision deferred to the Commission the question of whether the return of these funds to rate payers through a reduction of the 2002 GMC was an acceptable resolution. I.D. at 20 - 21. In addition, the Initial Decision directed that instead of billing the SC for the Utility Distribution Company ("UDC") for CAS on the behind-the-meter Load of Qualifying Facilities ("QFs"), and the SC for the behind-the-meter Load of Governmental Entities ("GEs"), the ISO should make a compliance filing to bill the QFs and GEs directly. I.D. at 145. The Initial

² Unlike a traditional rate case, rate of return is not an issue in the instant proceeding as the ISO has no rate-base through which to earn a return on equity. The GMC rate recovers only the ISO's costs.

Decision explicitly stated that that the SC for the UDC should be billed for the behind-the-meter load of QFs if there was any problem with billing the QFs directly, I.D. at 146. In the case of GEs, the I.D. stated only that the ISO should bill the GEs “in the first instance.” *Id.*

II. LIST OF EXCEPTIONS

1. The ISO excepts to the failure of the Initial Decision to make appropriate findings to assist the Commission in its determination of the manner in which \$1,834,267.00 in collected funds should be returned to Market Participants. The ISO does not except to the Initial Decision’s determination that the issue is one of policy, to be determined by the Commission. The Initial Decision should have, however, made a finding regarding the interaction between the ISO’s non-profit structure, the existing ISO Commission approved tariff (“Tariff”) mechanisms relating to over-collections, and the conclusion that a reduction in the ISO’s incentive compensation is required.
2. The ISO excepts to failure of the I.D. to state explicitly which party should be charged in the event that direct charging of GEs for the CAS charge is not affirmed by the Commission. As it did with the direct billing of SCs, the I.D. should have stated explicitly that in the event that GEs cannot be billed directly for the CAS charge, that the SC should be billed.

III. ARGUMENT

1. Greater Detail is Needed Regarding the Alternatives to the ISO's Financial Operating Reserve for Commission Resolution of Policy Question

The Initial Decision found that \$1,834,267.00 in the ISO's 2001 cost estimates was included due to a programming error and therefore was not just and reasonable I.D. at 20. The Initial Decision ordered that the incentive compensation budget be reduced by that amount. *Id.* In addressing how to implement the conclusion that the compensation budget must be reduced, the Initial Decision identified, but did not address the import of evidence concerning 1) the ISO's non-profit structure, I.D. at 13, 2) the ISO's lack of any shareholder capital or rate-base returns from which to make a refund, I.D. at 13, 248, and 3) the ISO Tariff's direction that all funds collected in excess of a budgeted- for operating cushion of 15% of the ISO's operating and maintenance costs be credited back to market participants through a reduction of the next year's revenue requirement. I.D. at 23; Tr. at 505:1317; ISO I.B. at 4-5. Indeed, by November 2, 2001 – several months prior to the issuance of the Initial Decision – the ISO had already credited any over-collected funds back to market participants by reducing the 2002 GMC revenue requirement. *See* ISO Reply Brief (“R.B.”) at 9-10. Ordering of refunds in addition to this credit would result in returning such over-collection *twice* and would result in the ISO's failure to recover its costs. *Id.*

Commission Staff witness Stephen Pointer addressed the replacement of traditional refunds with the crediting mechanism of the financial operating reserve

to return over-collections. Mr. Pointer testified that use of the financial operating reserve to credit over-collections against the next year's revenue requirement would not result in problematic "generational shifting" (i.e., those who paid too much might not match exactly those who received the subsequent credit), because overpaid funds from one year are immediately returned in the next. Tr. at 2686:2-11.

The ISO also presented testimony that the GMC is the ISO's only source of revenue. Tr. 218:13-14. The real-world effect of this fact is that if a refund were to be ordered, the refund would ultimately be funded by the very ratepayers receiving the refund. This is true even if a refund were to come from the ISO's financial operating reserve, as that account is also funded by the same GMC collections.

The Initial Decision deferred to the Commission on the question of whether the ISO's credit of over-budgeted funds was an appropriate mechanism to return the over-collected \$1.8 million in lieu of a more traditional refund. I.D. at 21. The ISO does not except to the Initial Decision's deferral to the Commission's judgment. The ISO does, however, except to the lack of fact findings that will assist the Commission in determining how an alternative would be structured. For example, in its reply brief, the ISO suggested that if the Commission were to order a traditional refund of any disallowed amount in the 2001 revenue requirement, the Commission should allow the ISO to restate its 2002 revenue requirement upwards by an amount equal to that ordered refund, in order to effectively reverse

the benefit to ratepayers that the ISO already had provided (due to any over-collection in 2001) through the reduction of the revenue requirement for 2002. ISO R.B. at 10. If a refund mechanism other than the credit system employed by the ISO Tariff is ultimately ordered, the Commission must specify from what source the refunds are to be made, taking account of the non-profit structure of the ISO, as well as the fact that any over-collected funds have *already been returned* to market participants by means of a reduction in the ISO's 2002 revenue requirement. The Initial Decision fails to address how these consideration might affect the Commission's determination of need for such a refund.

2. Clarity is needed that Scheduling Coordinators may be billed for Governmental Entities, if it is found that Governmental Entities may not be billed directly.

The ISO proposed to bill the portion of the CAS Charge that was based on the Control Area Gross Load of Qualifying Facilities and Governmental Entities to the SCs for QFs, and to the SCs of GEs. ISO I.B. at 40-44. The SCs would in turn pass the CAS charge through to the QFs via rate authority sought from the California Public Utilities Commission, or through to GEs as costs for new services under existing contracts, as found by the Initial Decision. *See e.g.*, I.D. at 191. The ISO also presented a proposal to bill "other appropriate parties" ("OAP") whereby QFs and GEs could voluntarily elect to be billed directly as an OAP for their CAS charges without becoming a SC. *See generally*, Exh. ISO-27.

The Initial Decision directs the ISO to make a compliance filing in order to bill OAPs such as QFs and GEs directly for the GMC. I.D. at 145. This direction underlies the Initial Decision conclusions on Issue I.J, which addresses to two aspects of billing the CAS component:

(1) whether a UDC should be billed the CAS charge for Load served by QFs within its service territory (Issue I.J.1) and (2) whether an entity that schedules transactions on the ISO Controlled Grid pursuant to an Existing Contract (“EC”) with a GE is responsible for CAS charges in connection with the portion of that GE’s behind-the-meter Load that is not scheduled on the ISO Controlled Grid. (Issue I.J.3).

I.D. at 146.

In addressing the first issue, the Initial Decision stated:

[A] UDC should be billed the CAS charge for Load served by QFs within its service territory only in the event the Commission determines that there are statutory, regulatory, or jurisdictional impediments to direct billing as recommended herein.

Id.

The Initial Decision is clear as to its holding: QFs are to be billed directly unless there are legal impediments that make that impossible. In the event that QFs cannot be billed directly, the Initial Decision directs that UDCs are to be billed. *Id.*

Continuing, the Initial Decision states:

The same reasoning supports a finding that an entity that schedules transactions on the ISO Controlled Grid pursuant to an EC with a GE is not responsible *in the first instance* for CAS charges in connection with the portion of that GE’s behind-the-meter Load that is not scheduled on the ISO Controlled Grid.

Id. (emphasis added). The Initial Decision notes that the same reasoning applies as was employed when addressing QF billing, and that SCs are not responsible for CAS charges *in the first instance*. This implies – as in the case of the QFs – that entities that schedule transactions pursuant to an EC with a GE should be billed directly for transactions not scheduled under the EC (*e.g.*, a GE’s behind-the-meter load) if there are “statutory, regulatory, or jurisdictional impediments to direct billing.” But the Initial Decision does not so state explicitly. This failure to make this ruling explicit is the basis of the ISO’s exception.

In the *Discussion and Findings* section under Issue I.J.3., the Initial Decision finds unpersuasive the ISO’s reasoning that an entity that has executed a responsible participating transmission owner Agreement (“RPTO”) is responsible for the CAS charge to the GE’s behind-the-meter Load. I.D. at 155. Without further clarification by the Commission, if the Commission affirms the Initial Decision’s conclusion regarding the allocation of the CAS charge to Control Area Gross Load – as the ISO believes it should - but does not uphold the direct billing ordered by the Initial Decision, the ISO could be left to argue that the Initial Decision *implicitly* intended the SC to be billed, or else be left with a right without a remedy – the right to bill CAS on the Control Area Gross Load of GEs, but no party to bill.

In the event that the Commission affirms that Initial Decision conclusion, regarding the allocation of the CAS charge to Control Area Gross Load, but does not affirm the direct billing ordered by the Initial Decision, the ISO requests that

the Commission reexamine the Initial Decision's ruling that the ISO does not currently have the authority to bill entities, which normally act as SC's for a given GE, for CAS on that GE's behind-the-meter Load. If the Commission affirms that the latter conclusion, the ISO asks that it direct the ISO to make a compliance filing to provide that authority. Without this closing of the payor loop – similar to the one the I.D. establishes for QF billing – the ISO will not be able to recover its Commission-approved costs, which would place in jeopardy not only the ISO's ability to provide for a reliably operated transmission system in California, but also the ISO's continued existence I.D. at 248.

IV. CONCLUSION

WHEREFORE, for the reasons stated above, the Commission should provide the clarifications sought or relief requested above.

Respectfully submitted,

Charles F. Robinson
General Counsel
Stephen A. M. Morrison
Corporate Counsel
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-2207
Fax: (916) 351-4436

J. Phillip Jordan
Michael E. Ward
Julia Moore
Theodore J. Paradise
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW – Suite 300
Washington, DC 20007-5116
Tel: (202) 424-7500
Fax: (202) 424-7643

Counsel for the California Independent
System Operator Corporation

Date: June 10, 2002