UNITED STATES OF AMERICA 113 FERC ¶ 63,017
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation — Docket No. ER04-835-000

and

Pacific Gas and Electric Company

v. — Docket No. EL04-103-000 (Consolidated)

California Independent System Operator Corporation

INITIAL DECISION

(Issued October 31, 2005)

APPEARANCES

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H. PETER YOUNG, Presiding Administrative Law Judge

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[1] Recitation of the issues in this Initial Decision has been modified slightly from that reflected in the Joint Stipulation of Contested Issues (JSCI) submitted by the participants to ameliorate awkward phrasing. Unfortunately, I am unable similarly to ameliorate the distressing lack of attention to logical progression reflected in the JSCI, which imposes an incongruent sequence of issue analyses on the Initial Decision.

A. JOINT PROCEDURAL HISTORY[2]

1. On May 11, 2004, the California Independent System Operator Corporation ("ISO") filed Amendment No. 60 to its tariff in Docket No. ER04-835-000. In Amendment No. 60, the ISO proposed modifications to provisions of its tariff related to the implementation of the Must-Offer Obligation ("MOO"), including modifications to the ISO's process for denying MOO waivers and allocating MOO costs and the establishment of conditions in which Condition 2 Reliability Must Run ("RMR") units would be subject to the Must-Offer Obligation. The Commission issued a Notice of Filing on May 13, 2004.

2. Numerous interventions were filed in Docket No. ER04-835-000.[3] Protests and/or comments were filed by Calpine, the CEOB, Cities/M-S-R, the CPUC, Duke, IEPA, Mirant, Modesto, MWD, Powerex, SCE, SMUD, the Southern Cities, SWP, TANC, and Williams.

3. On May 18, 2004, PG&E filed a complaint in Docket No. EL04-103-000 against the ISO pursuant to Rule 206 of the Commission's Rules of Practice and Procedure, alleging that the ISO's methodology for allocating MOO costs to PG&E was unjust,

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[2] This Joint Procedural History was prepared and submitted by the participants. It was accepted for inclusion in the Initial Decision without modification on June 28, 2005. Tr. 74.

[3] Interventions were filed by the California Department of Water Resources State Water Project ("SWP"); the California Electricity Oversight Board ("CEOB"); the California Municipal Utilities Association ("CMUA"); the California Public Utilities Commission ("CPUC"); Calpine Corporation ("Calpine"); the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (collectively, the "Southern Cities"); the Cities of Redding and Santa Clara, California and the M-S-R Public Power Agency ("Cites/M-S-R"); the City of Vernon, California; Duke Energy North America, LLC and Duke Energy Trading and Marketing, L.L.C. (collectively, "Duke"); the Independent Energy Producers Association ("IEPA"); the Los Angeles Department of Water and Power ("LADWP"); the Metropolitan Water District of Southern California ("MWD"); Mirant Americas Energy Marketing, LP, Mirant California, LLC, Mirant Delta, LLC, Mirant Potrero, LLC (collectively, "Mirant"); the Modesto Irrigation District ("Modesto"); the Northern California Public Power Agency ("NCPA"); Pacific Gas & Electric Company ("PG&E"); Powerex Corp. ("Powerex"); the Sacramento Municipal Utility District ("SMUD"); San Diego Gas & Electric Company ("SDG&E"); Southern California Edison Company ("SCE"); the Transmission Agency of Northern California ("TANC"); the Turlock Irrigation District ("TID"); and Williams Power Company and West Coast Power, LLC (collectively, "Williams").

unreasonable, and unduly discriminatory. PG&E alleged that Amendment No. 60, as filed by the ISO, indefinitely prolonged the period in which the ISO's allocation method for MOO costs remained in place, even though the ISO had the ability to apportion MOO costs more equitably in a more timely manner. PG&E sought to have its complaint consolidated with Docket No. ER04-835-000. PG&E's complaint was noticed by the Commission on May 19, 2004.

4. Interventions in Docket No. EL04-103-000 were filed by Calpine, the CEOB, Cities/M-S-R, Duke, Modesto, MWD, NCPA, Powerex, SCE, SMUD, SWP, and TID. The ISO filed an answer to PG&E's complaint on June 7, 2004.

5. On July 8, 2004, the Commission issued an order setting PG&E's complaint for an evidentiary hearing and consolidating Docket Nos. ER04-835-000 and EL04-103-000. *See* "Order Setting Complaint for Hearing, Establishing Hearing Procedures and Refund Effective Date, and Consolidating Proceedings, and Regulatory Fairness Act Notice," 108 FERC ¶ 61,017 ("July 8th Order I"). In the July 8th Order I, the Commission granted all motions to intervene and established a refund effective date of July 17, 2004.

6. Also on July 8, 2004, the Commission issued an order in Docket No. ER04-835-000 accepting, subject to modification, Amendment No. 60, granting all motions to intervene, and establishing hearing procedures regarding the allocation of MOO costs. *See* "Order On Tariff Amendment No. 60," 108 FERC ¶ 61,022 ("July 8th Order II"). The Commission concluded that: (1) the ISO's Amendment No. 60 cost allocation proposal had not been shown to be just and reasonable; (2) the ISO's methodology properly allocates costs associated with non-RMR use of a Condition 2 RMR Unit on a system-wide basis; (3) the ISO's proposal to use the Security-Constrained Unit Commitment ("SCUC") application in evaluating Must-Offer Waiver Denials ("MOWD") is just and reasonable; (4) the ISO's proposal to include auxiliary power, intrastate transportation costs, and municipal use fees as legitimate cost recovery components of actual start-up and minimum load costs in Minimum Load Compensation Costs ("MLCC") is acceptable; (5) the ISO's proposal to discontinue rescinding MLCC payments to MOO generating units awarded ancillary services is reasonable; and (6) the ISO's proposal to pay the greater of the market clearing price or a unit's cost when dispatching the unit at minimum load is appropriate. *See id.* at PP 63, 50, 75, 81, 89, 101. The Commission also directed the ISO to modify several of the procedures relating to the dispatch of Condition 2 RMR Units and MLCC compensation, to make a compliance filing reflecting those modifications, and to submit Operating Procedure M-432 in a compliance filing. *See id.* at PP 43, 45, 95, 107. The Commission also determined that matters concerning the definition of Reliability Services Costs would be subject to the outcome of that hearing. *See id.* at P 69.

7. Pursuant to a July 20, 2004 "Order Establishing Procedural Schedule," discovery in the consolidated proceedings commenced on July 19, 2004, the ISO submitted direct

testimony and exhibits on August 16, 2004, and PG&E submitted direct testimony and exhibits on September 8, 2004. Under a revised procedural schedule issued on October 8, 2004, the ISO re-filed its direct testimony and exhibits on October 26, 2004 to include MLCC data for June, July, and August 2004.

8. Pursuant to the revised procedural schedule issued on October 26, 2004, intervenors submitted direct/answering testimony and exhibits on December 7, 2004, and the ISO submitted supplemental MLCC data for September and October 2004 on December 30, 2004.

9. Pursuant to a further revised procedural schedule issued on February 14, 2005, the ISO submitted errata exhibits on February 18, 2005, and Commission Staff submitted direct/answering testimony and exhibits on February 28, 2005. On March 10, 2005, the Chief Judge issued an "Order Extending Procedural Dates," which set revised dates for the filing of testimony, the last day for the submission of discovery requests (May 16, 2005), the filing of the joint stipulation of issues (May 31, 2005) and pre-hearing briefs (June 14, 2005), and the commencement of the hearing (June 28, 2005). Commission Staff submitted supplemental testimony on March 28, 2005, intervenors submitted cross-answering testimony and exhibits on April 12, 2005, PG&E submitted rebuttal testimony and exhibits on April 29, 2005, and the ISO submitted rebuttal testimony and exhibits on May 2, 2005.

B. SUPPLEMENTAL PROCEDURAL HISTORY/BACKGROUND

Supplemental Procedural History

10. The hearing was conducted from June 28, 2005 through July 19, 2005. The evidentiary record closed on August 1, 2005. Initial briefs were filed on August 16, 2005; reply briefs were filed on September 2, 2005.

Background

11. The Commission established a prospective price mitigation and monitoring plan for California wholesale electric markets on April 26, 2001 in response to the state energy crisis. A fundamental element of the plan was the implementation of a "must-offer" obligation designed to prevent generator withholding, and thereby to ensure that the ISO would be able to access available generation when needed. The obligation requires most generators serving California markets to offer all available capacity (not otherwise scheduled to run through bilateral agreements) in real time during all hours. As the Commission explained:

> This must-offer obligation is designed to ensure that the ISO will be able to call upon available resources in the real-time market to the extent that

> energy is needed. The basis for the requirement is that, under competitive conditions, a generator that has available energy in real time should be willing to sell that energy at a price that covers its marginal costs, since it has no alternative purchaser at that time.

San Diego Gas & Electric Co., et al., 95 FERC ¶ 61,115 at 61,355-56 (2001).

12. Must-offer generators receive Minimum Load Costs Compensation (MLCC) if they are required to operate at minimum load to ensure that they are/will be available for the ISO to dispatch in real time. Prior to Amendment No. 60, the ISO essentially allocated MLCC to market participants on a system-wide basis. Amendment No. 60, in contrast, proposes to allocate MLCC under a three (3) category (or "bucket") rate design based on an ISO determination that must-offer generation has been committed primarily to satisfy system, local or zonal reliability requirements.

13. A generating unit may request a waiver of its must-offer obligation. If the ISO denies such a waiver request (must-offer waiver denial or MOWD), the generator is required to remain in operation and is compensated for the costs of running at its minimum operating level, including instances where the ISO actually dispatches energy from the unit or the generator provides ancillary services. The costs associated with an MOWD include start-up and emissions costs in addition to MLCC.

14. Amendment No. 60 proposes to modify provisions of the ISO tariff related to implementation of the must-offer obligation, including changes to the ISO's processes for allocating must-offer obligation costs and denying must-offer obligation waivers, as well as establishing conditions under which Condition 2 Reliability Must-Run (RMR) units may be committed (outside of their RMR contracts) to satisfy system reliability requirements.

C. ISSUE ANALYSES

Cost Allocation Issues

1. What Factors Should Be Considered in Determining Whether the ISO's Amendment No. 60 Cost Allocation Proposal is Just, Reasonable and Not Unduly Discriminatory?

a. Party Positions

ISO

15. ISO emphasizes as a threshold matter that it need only establish that Amendment No. 60 is just and reasonable, not that it is the *most* reasonable alternative. ISO maintains

that any inquiry into the proposals reflected in Amendment No. 60 initially must be confined to the proposals reflected in the ISO filing itself. Alternatives proposed by other participants may be considered only if Amendment No. 60 is first determined to be unjust, unreasonable or unduly discriminatory. ISO also stresses that its burden of coming forward with evidence supporting Amendment No. 60's justness/reasonableness is limited to the amendment's proposed changes to the prior, Commission-approved, allocation methodology. Participants objecting to unchanged features of the methodology bear the burden of establishing that the feature in question is unjust, unreasonable or unduly discriminatory. The preceding positions notwithstanding, ISO notes that it does not object to deeming Attachment E—which was not part of the original Amendment No. 60 filing—to be included in the amendment.

16. ISO argues that cost causation principles should determine whether Amendment No. 60 is just and reasonable. ISO characterizes the relevant inquiry in terms of two issues: (1) whether cost allocation in accordance with cost causation appropriately may turn on a benefits analysis; and (2) how strong the benefits correlation must be. ISO contends that the Commission's cost causation concept is not strictly limited to causality, but rather incorporates an alternative benefits analysis. According to ISO, minimum load cost compensation historically reflects an allocation based on a benefits-received approach; all that has changed with Amendment No. 60 is the need to assign MLCC at a more differentiated level to reflect the fact that benefits are now being provided at a more differentiated level. And while ISO concedes that cost allocation based on a benefits-received approach requires some "substantial" degree of demonstrated benefits, it maintains that there is no bright line threshold which satisfies this requirement. ISO therefore takes the position that the task is simply to determine whether Amendment No. 60 allocates MLCC in a reasonable and non-discriminatory manner in light of the costs incurred and benefits received.

Commission Trial Staff (Trial Staff)

17. Trial Staff takes the position that "cost causation" and "benefits received" are two primary factors that should be considered in determining whether ISO's cost allocation is just, reasonable and non-discriminatory. Trial Staff states that the Commission historically has applied both factors consistently in determining that transmission expansion or upgrade facility costs should be rolled-in. Trial Staff also states that both factors have been applied to allocate other transmission services, including ISO's Control Area Services Charge[4] and certain ISO New England Inc. uplift charges. On Trial Staff's

[4] The participants frequently employ defined terms (capitalized) reflected in the ISO tariff Master Definitions Supplement, Appendix A (Item By Reference #1, v. 2). Technical terms used throughout the balance of this Initial Decision may or may not strictly accord with tariff definitions, and therefore are not capitalized—other than in acronyms which are consistent with tariff definitions.

account, the primary reason the Commission considers benefits when allocating various transmission and generation costs is the customer advantage resulting from enhanced reliability and market stability. Trial Staff maintains the evidence in this proceeding demonstrates that one benefit received by affected customers is a reliable and market-stable inter-zonal connection, noting in addition that this circumstance is consistent with the very purpose of the Commission-instituted must-offer program: to ensure reliable energy supplies and continued short-term market stability in the Western wholesale energy markets.

18. Trial Staff characterizes cost causation and benefits as two sides of the same equation or alternate means of expressing the same concept, underscoring the fact that it is possible to reap benefits without creating the cost of producing those benefits. Trial Staff cites various Commission opinions to support this characterization, concluding that Commission precedent and the fact that all demand within an affected zone benefits from a reliable and market-stable inter-zonal connection support MLCC cost allocation based on benefits received as well as cost causation.

SCE

19. SCE also adopts the position that both cost causation and benefits received should be considered in determining whether Amendment No. 60's MLCC cost allocation is appropriate. SCE maintains that cost causation and benefits received are merely alternate means of expressing the fundamental Commission objective of matching costs to customers. SCE submits that the relevant inquiry under cost causation principles is whether a particular load or load paired with a generator using a transmission system causes the incurrence of specific costs, while the relevant inquiry under the benefits received approach is who benefits from reliable grid operation. SCE asserts that Commission policy, precedent and fundamental fairness all support allocating reliability-related costs such as MLCC to all transmission grid users because all users collectively create the need for the ISO to procure reliability and all loads benefit from that reliability.

20. SCE emphasizes that while the Amendment No. 60 cost allocation is benefits-driven, it nevertheless reflects geographically-focused allocations based on comparative cost causation/benefits received at specific localized constraints. Thus, SCE explains, costs are allocated under Amendment No. 60 to the zone where the predominant cost causation/benefits received are attributable to that zone's load. Local MLCC costs are likewise allocated to loads in Participating Transmission Owners' (PTOs') service territories because those loads are the predominant contributors to/beneficiaries of the need to incur MLCC in those particular areas. SCE therefore dismisses any criticism of Amendment No. 60's cost allocation methodology based on undue cost socialization or subsidization.

PG&E

21. Just and reasonable cost allocation, in PG&E's view, encompasses both cost causation and benefits derived. PG&E therefore contends that determining whether Amendment No. 60's cost allocation methodology is appropriate requires a dual examination of which entities cause MLCC costs to be incurred and which entities benefit from the underlying MOWDs. Although PG&E acknowledges a universal benefit in maintaining a safe and reliable transmission system, it assigns far greater importance to the fact that Amendment No. 60 is specifically designed to allocate costs with greater focus on causal nexus—*i.e*. to the entities benefiting *most directly* from the underlying MOWDs. PG&E endorses this enhanced benefits approach as just and reasonable in that it more directly/specifically links costs to causation through a comparative benefits analysis.

22. PG&E also believes it is appropriate to consider whether Amendment No. 60 allocates MLCC costs in a comparable and non-discriminatory manner vis-à-vis other ISO costs. In particular, PG&E believes that RMR cost allocation should be considered in determining whether SCE's suggested "net incremental cost of local" approach should be adopted. PG&E argues that since ISO allocates the fixed costs of RMR calls to the indicated PTO and its customers, the same approach should be used to allocate "local" bucket MLCC charges in this case. On PG&E's account, the "net incremental cost of local" approach inures solely to SCE's benefit and consequently would be unduly discriminatory.

SMUD

23. SMUD generally supports MLCC cost allocation in accordance with Amendment No. 60. SMUD maintains that the amendment's causation-based allocation replaces a methodology that was patently unjust and unreasonable in that it socialized costs among all market participants based on load despite the fact that nearly all of the costs were attributable to an identifiable sub-region within the market: the SP 15 zone in southern California subsuming the historical SCE and SDG&E service areas. Amendment No. 60, in contrast, is not generally unjust/unreasonable in SMUD's view because it assigns MOWD-related costs to the specific regions or locations where the underlying constraints are located. SMUD nevertheless characterizes Amendment No. 60 as unjust and unreasonable in two discrete respects: (1) it allocates a portion of system remainder MLCC to wheel-through transactions; and (2) it inadequately defines "Reliability Services Costs."

24. As a threshold matter, SMUD asserts that the unjust and unreasonable pre-Amendment No. 60 allocation methodology renders it unjust and unreasonable to allocate MLCC costs under that methodology past the earliest refund effective date of July 17,

2004 in this proceeding. SMUD next asserts that allocating a portion of "System" MLCC to wheel-through transactions is unjust and unreasonable because wheel-throughs neither cause those costs nor benefit from their incurrence. SMUD states that unlike pure exports—which take energy from ISO Control Area resources—wheel-throughs do not contribute to the Control Area generation shortfalls allocated to the "System" bucket because wheel-throughs simultaneously inject and withdraw non-ISO generation. SMUD similarly dismisses any contention that transmission losses or congestion management provide adequate alternate bases for allocating "System" MLCC to wheel-through transactions. Last, SMUD maintains that the "Reliability Services Costs" definition is vague and overbroad, and should be rejected without prejudice as a consequence.

SWP

25. SWP vigorously opposes MLCC cost allocation based on benefits received. According to SWP, it is uniquely situated in this proceeding in that its large curtailable loads do not cause or contribute to the vast majority of MLCC costs. SWP contends that Commission policy and precedent clearly establish that these costs should be allocated in strict accordance with causation, adding that such allocation also produces appropriate market price signals and demand responses. SWP finds further support for its position in the fact that the hearing order in this proceeding expressly states, as a general matter, that the Commission believes entities that cause costs should pay for such costs.

26. With respect to reliability costs such as those at issue, SWP argues, the Commission consistently has emphasized the need to employ a cost causation approach instead of a widely-socialized allocation based on presumed benefits—a commitment which is reconfirmed by a "new overarching analytic approach" articulated by the Commission in two recent orders. SWP criticizes a benefits-based allocation on other grounds as well, including: (1) cost causation principles dictate that costs incurred for load in a particular sub-zone should be paid by load in that sub-zone; (2) cost causation principles support allocating must offer generation costs to loads occurring in the peak hours for which the costs are incurred; (3) cost allocation in accordance with specific causation promotes transparency, accountability and cost reduction; and (4) a benefits-based allocation will not withstand review because it is unsupported by the evidence/applicable precedent and entails unjust and unreasonable subsidization.

Southern Cities

27. Southern Cities frame the central issue in this proceeding as whether the ISO's proposed Amendment No. 60 MLCC cost allocation methodology is consistent with cost causation principles. Southern Cities distill the debate as follows: Should the ISO allocate MLCC costs based on a broadly-articulated "benefits received" principle, or should it allocate those costs based either on Southern Cities' incentives-based approach or on SWP's entity-specific/constraint-specific approach? Southern Cities assert that the

record in this proceeding clearly establishes that the benefits-based approach advocated by ISO and SCE is overbroad in principle and unworkable in practice. In addition, Southern Cities claim that a benefits approach contradicts Commission policy and precedent by spreading costs in a manner that ignores or glosses over the root cause of MLCC costs, thereby muting price signals that would incentivize a long-term solution to the underlying transmission constraints. Southern Cities also denigrate SWP's approach as unprincipled and unworkable in that it permits entities to avoid cost allocation through individualized demonstrations that particular loads do not cause specific costs to be incurred. Southern Cities instead advocate an incentives-based approach, which they characterize as preferable because it: (1) allocates MLCC costs fairly in the short-term; (2) encourages a long-term solution to the underlying transmission constraints; and (3) allows entities to avoid costs by self-providing local generation.

28. Southern Cities concede the existence of Commission precedent supporting the appropriateness of benefits-based cost allocation in particular circumstances. They distinguish such circumstances from those presented here, however, arguing that the hearing order in this proceeding clearly indicates that any broad-based cost spreading proposal must be rejected in favor of a more focused allocation based on cost-causation. Southern Cities therefore propose a "standardized methodology" that encourages PTOs to make transmission upgrades and secure generation by allocating costs to the local PTO in accordance with ISO's Commission-approved methodology for allocating RMR costs. This methodology, they argue, is equitable and consistent with the strict cost-causation principles endorsed in the hearing order because it allocates costs to the entity best situated to ameliorate the underlying constraints in the long term—the responsible utility or transmission owner. And whereas the benefits-based methodology endorsed by ISO and SCE is inequitable and unworkable in Southern Cities' view because it is overbroad and vague, SWP's entity-specific/constraint-specific approach is diametrically inappropriate in that it requires an excessively-detailed approach to cost causation and allocation.

Powerex

29. Powerex objects to Amendment No. 60 insofar as it allocates MLCC costs in the "System" bucket to Net Negative Uninstructed Deviation (NNUD) and includes Wheel-Through Schedules and Existing Transmission Contracts in the allocation. Powerex maintains that this procedure is unjust and unreasonable for three reasons: (1) it violates cost-causation principles; (2) it imposes duplicative charges on energy imports; and (3) it creates significant uncertainty for importers.[5] Powerex therefore proposes an alternative methodology that allocates System MLCC costs to the specific Scheduling Coordinator(s) responsible for the Day-Ahead scheduled load/actual metered load differentials that cause the costs to be incurred.

[5] These objections are addressed under Issue #2, *infra.*

30. Powerex acknowledges that the Commission's cost causation principles involve both a cost causation component and a benefits received component. And while Powerex also acknowledges that the Commission often uses the two expressions as alternate means of stating the same concept, it highlights the fact that the Commission sometimes deems benefits inadequate to support cost causation/ allocation—particularly where the asserted benefits are minor or purely speculative. Powerex first argues that Amendment No. 60 violates cost-causation principles because it allocates a portion of System MLCC costs to Scheduling Coordinators scheduling imports into the ISO control area despite the fact that ISO incurs such costs solely to meet in-state demand. Further, ISO incurs those costs in the Day-Ahead timeframe—when it has no idea what Scheduled Interchange deviations actually will occur. Powerex also notes that deviations attributable to transmission or generation outages are beyond the importer's control, and therefore cannot legitimately be imputed to the importer based on causation. Powerex similarly disputes any contention that Scheduling Coordinators scheduling interchange into the ISO control area receive any benefits from MLCC cost-incurrence, stressing that ISO addresses Scheduled Interchange deviations through real-time energy purchases for which it is fully compensated. In Powerex's view, ISO's need to find replacement energy has little if anything to do with the cause of MLCC cost-incurrence: ISO's Day-Ahead decisions concerning the units it may need in real time.

31. Powerex next alleges that Amendment No. 60 is unjust and unreasonable in that it imposes duplicative charges on energy imports/interchanges. Powerex claims that Amendment No. 60 not only allocates MLCC costs to NNUD, but also imposes an Uninstructed Deviation Penalty on such deviations. The fact that one charge is a cost allocation and the other a penalty is irrelevant from Powerex's perspective. In addition, Powerex claims that Amendment No. 60 imposes duplicative charges in that it allocates System MLCC costs for real time replacement energy that ISO must procure to satisfy Scheduled Interchange deviations—the real time market cost of which Powerex and other Scheduling Coordinators already pay in full.

32. Finally, Powerex contends that Amendment No. 60 is unjust and unreasonable because allocating System MLCC costs to NNUD creates market uncertainty for importers. Powerex underscores the fact that ISO incurs MLCC costs based on MOWD decisions made in the Day-Ahead market, assessing the costs to Scheduling Coordinators based on subsequent real time delivered energy deficiencies. As a consequence, importers cannot determine in advance the potential financial impacts of failing to fulfill real time dispatch obligations due to circumstances beyond their control. Powerex submits that this inability could discourage importer participation in ISO markets.

b. Discussion/Analysis

Threshold Issue

33. Federal Power Act (FPA) § 205 (e) provides: "At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility. . . ." 16 U.S.C. § 824d (e) (2005). Accordingly, it is axiomatic in the posture of this proceeding that ISO bears a threshold burden of proving that the MLCC cost allocation methodology proposed in Amendment No. 60 is just and reasonable. It is equally axiomatic, however, that any determination with respect to just and reasonable MLCC cost allocation must begin with Amendment No. 60 as filed. If the amendment satisfies the just, reasonable and not unduly discriminatory standard, analysis must come to an end—it is immaterial whether better alternatives might be available. Only if Amendment No. 60 is determined to be unjust, unreasonable or unduly discriminatory in the first instance may analysis extend to the appropriateness of other alternatives. *See* 16 U.S.C. § 824e (a) (2005); *California Independent System Operator Corp.*, 111 FERC ¶ 61,337 at P 27 (2005). In determining whether Amendment No. 60 is just, reasonable and not unduly discriminatory as filed, however, ISO's threshold burden is not strictly confined to the *changes* the amendment proposes to the previously-approved tariff; it extends as well to the amendment's operational impact on previously-approved tariff provisions that the amendment does not propose to alter. *See, e.g.*, *ISO New England, Inc.,* 95 FERC ¶ 61,384 at 62,440-41 (2001). I therefore find and conclude that: (1) ISO bears a threshold burden to prove that each of the tariff changes proposed in Amendment No. 60 as filed is just, reasonable and not unduly discriminatory and that those changes do not render previously-approved tariff provisions unjust, unreasonable or unduly discriminatory; and (2) alternatives to any tariff change(s) proposed in the amendment may be considered only if one or more of the proposed changes is/are first found unjust, unreasonable or unduly discriminatory, and then only on a change-specific basis.[6]

Cost Causation/Derived Benefits

34. The fundamental dispute in this case distills to this: Does Commission policy mandate cost allocation in strict accordance with cost causation, or are derived benefits also a valid basis for MLCC cost allocation? SWP and—to a lesser degree—Southern

[6] I note that no participant appears to challenge in principle the type of three bucket allocation proposed in Amendment No. 60—instead, various participants object to being included in a particular allocation bucket or being included in any of the three at all.

Cities argue the former; all other participants addressing the issue argue the latter.[7] Each side cites Commission precedent to support its position.

35. SWP and Southern Cities focus first on the July 8th Order I, which states "[a]s a general matter, the Commission believes that the entities that cause costs should pay for such costs." *California Independent System Operator Corp.,* 108 FERC ¶ 61,022 at P 62 (2004) (footnote omitted). SWP and Southern Cities view this as unequivocal Commission endorsement of dedicated cost allocation in strict accordance with causation, as well as an express rejection of broad-based reliability cost-spreading or uplift. They claim further support for their position in that the quoted July 8th Order I language specifically cites *PJM Interconnection, LLC*, 107 FERC ¶ 61,112 at P 22 (2004) (*PJM*) in a footnote. On SWP's account, *PJM* articulates a "new 'overarching analytical approach'" to cost allocation by the Commission that rejects broadly spread reliability uplift charges and therefore prohibits the type of cost allocation proposed in Amendment No. 60.[8] SWP maintains that this new overarching analytic approach completely supplants prior Commission authority insofar as reliability costs are concerned.

36. ISO, Trial Staff, SCE and PG&E each posit slightly different characterizations of Commission policy with respect to the cost causation/derived benefits relationship in the reliability cost allocation context. All are similar, however, in maintaining that the Commission merely treats cost causation and benefits derived as alternate ways of expressing the concept that costs should be matched—to the greatest practicable extent—to the customers responsible for imposing the cost burden at issue or benefiting from it. In support of this position they variously cite an array of Commission precedent, including: *Midwest Independent Transmission System Operator, Inc.,* 108 FERC ¶ 61,163 at P 587 (2004); *California Independent System Operator Corp*., 103 FERC ¶ 61,114 at P 20-26 (2003); *Pacific Gas & Electric Co.*, 100 FERC ¶ 61,160 at P 15 (2002); *California Independent System Operator Corp.*, 99 FERC ¶ 63,020 at 65,109-11 (2002); *Midwest Independent Transmission System Operator Inc.*, 98 FERC ¶ 61,141 (2002).[9] Some of these orders draw an express equivalence between cost causation and

[7] SMUD generally supports Amendment No. 60 MLCC cost allocation as causation-based, but does so on the basis that the amended methodology assigns MOWD-related costs to the specific regions or locations were the constraints producing the costs are situated.

[8] SWP makes a similar claim about the Commission order in *Devon Power LLC*, 107 FERC ¶ 61,240 at P 43 (2004) (*Devon Power*). Southern Cities makes a slightly more restrained case for *PJM*, and does not rely on *Devon Power*.

[9] This list is illustrative, not exhaustive.

benefits derived. Others do so by implication. Most predate *PJM, Devon Power* and the July 8th Order I.

37. Powerex principally contends that Amendment No. 60 violates cost-causation principles because it allocates MLCC costs in the system bucket to NNUD and includes wheel-through schedules/existing transmission contracts in the allocation.[10] Although Powerex acknowledges that the Commission's cost-causation principles involve both a cost-causation component and a benefits-received component, and that the Commission often uses the two expressions as alternate means of stating the same concept, Powerex underscores the fact that the Commission sometimes deems benefits inadequate to support broad cost-causation/allocation—particularly where the alleged benefits are minor (citing *California Independent System Operator Corp.*, 106 FERC ¶ 61,032 at PP 5, 20-21 (2004)) or purely speculative (citing *New York Independent System Operator*, 102 FERC ¶ 61,284 at P 14-15 (2003)).

38. The body of precedent cited by the various participants confirms that the Commission generally endorses a cost causation approach that allocates costs in proportion to identifiable contributions to cost incurrence. The July 8th Order I underscores this tenet: "As a general matter, the Commission believes that the entities that cause costs should pay for such costs." *California Independent System Operator Corp*., 108 FERC ¶ 61,022 at P 62 (2004) (footnote omitted). This approach seems straightforward enough, but subtly begs the very questions it purports to address: What do we mean when we say that an entity *caused* costs to be incurred—that is, in what *sense* can an entity be said to have caused the costs, and does this provide adequate basis to allocate the costs to it?

39. Commission precedent seems conclusive—albeit obtuse in reason—on these questions. The overwhelming weight of Commission authority indicates that an entity may be deemed to have caused costs *either* if it is directly responsible for imposing the cost burden at issue *or* if the entity benefits from the cost incurrence. For example, in *California Power Exchange Corp.*, 106 FERC ¶ 61,196 at P 17 (2004), the Commission unequivocally stated: "The well-established principle of cost causation requires that costs should be allocated, where possible, to customers based on customer benefits and cost incurrence. Similarly, in *California Independent System Operator Corp.*, 106 FERC ¶ 61,032 at P 10 (2004), the Commission confirmed a prior ruling that "while the fundamental idea of matching costs with customers is often referred to in terms of cost causation, it has also been described in terms of the costs which 'should be borne by

[10] These detailed objections are addressed under more specific topics in subsequent sections of this Initial Decision, but Powerex's more immediate argument regarding the supplemental requirements of any benefits-based analysis warrants consideration here. See P 42 and footnote 13, *infra*.

those who benefit from them.'" *See also Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004) (citing *KN Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992), and holding that court evaluates compliance with cost causation principle "by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party."). This and a substantial body of similar authority[11] seem to establish beyond dispute that benefits derived properly may be considered in determining the justness/ reasonableness of the Amendment No. 60 cost allocation methodology.

40. As previously stated, however, SWP contends that the Commission's *PJM* and *Devon Power* orders supplant this entire line of authority with a new "overarching analytical approach" to cost allocation that unqualifiedly rejects broadly spread reliability uplift charges and therefore prohibits the type of cost allocation proposed in Amendment No. 60. My reading of *PJM* and *Devon Power*, however, compels me to conclude that SWP far overstates those orders' impact on the issue at hand. It is true that *PJM* outlines what the Commission characterizes as "an overarching analytical approach" intended to "institute a consistent and disciplined way of looking at [reliability compensation] issues" in PJM and other markets. *PJM*, 107 FERC ¶ 61,112 at P 15 (2004). It is also true that *PJM* reconfirms Commission "views regarding the negative implications of broadly spread uplift charges. . . ." *Id*. at P 22. What SWP ignores, however, is that *PJM*: (1) clearly distinguishes between short-term and long-term reliability compensation issues, expressly contemplating/permitting different types of solutions for each so long as the short-term solution does not impede long-term solution development (*Id.* at PP 14-18); (2) appears to endorse the very kind of long-term market design improvement currently being implemented by ISO in its Market Redesign & Technology Upgrade (MRTU), to which the current must-offer mechanism is now a relatively short-term bridge (*Id*.; Ex. SWP-49; Tr. 499, 725, 751, 776-77, 784);[12] and (3) negatively references broadly spread uplift charges as precursor to prescribing that reliability charges "should be allocated to the local area *benefiting* from the reliability improvement." *PJM*, 107 FERC ¶ 61,112 at P 22 (2004) (emphasis added). This quote not only expressly supports benefits-based cost allocation, but also seems to support Amendment No. 60's allocation of MOWD-related costs to the specific regions or locations where the underlying constraints are situated.

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[11] *See, e.g.*, cases cited at P 36, *supra*.

[12] *Also see generally California Independent System Operator Corp*., 112 FERC ¶ 61,013 (2005). I do not imply that unjust, unreasonable or unduly discriminatory rates of limited duration are acceptable—even for a day—only that the duration of otherwise just, reasonable and not unduly discriminatory interim structures is a valid consideration where long-term market design improvements are in the process of being implemented.

41. *Devon Power* is similarly unavailing to SWP. In contrast to the circumstances presented in that case, Amendment No. 60 does not propose to allocate MLCC costs on a state-wide or system-wide basis.[13] It proposes to allocate the costs into system, zonal and local categories based on data indicating that must-offer generation was committed to address operating problems at those specific operational levels and locations. Ex. ISO-20, pp.20-22; Ex. ISO-22, pp.23, 26-27, 30-33, 36-37. It follows that the market-wide subsidization concern expressed in *Devon Power* is inapposite here. Moreover, *Devon Power* appears to eschew piecemeal interim market design improvement in favor of more comprehensive long-term market re-design like MRTU, particularly where substantial benefits will not be realized or will not be appreciably accelerated by discrete interim measures. *Devon Power*, 109 FERC ¶ 61,156 at P 15, 38 (2004). The record before me indicates that the instant case presents such circumstances. *See, e.g.*, Ex. ISO-19, pp. 20-21; Ex. S-6, pp. 16-18; Tr. 499, 725, 782-84.

42. Accordingly, I find and conclude that the Commission's *PJM* and *Devon Power* orders neither supplant the long line of Commission authority endorsing benefits-based cost allocation under appropriate circumstances nor unqualifiedly prohibit the type of cost allocation proposed in Amendment No. 60. These rulings notwithstanding, I also find and conclude that Powerex is correct that Commission precedent does not support benefits-based cost allocation where the benefits at issue are insubstantial, limited or purely speculative. *American Electric Power Service Corp.*, 111 FERC ¶ 61,180 at P 5, 25-30 (2005); *California Independent System Operator Corp.,* 106 FERC ¶ 61,032 at P 5, 20 (2004); *New York Independent System Operator*, 102 FERC ¶ 61,284 at P 14-15 (2003). In determining whether cost allocation under Amendment No. 60 is just, reasonable and not unduly discriminatory, therefore, the *degree* of benefits received must be considered as well.[14]

Epilogue

43. The Commission often expresses identity or equivalence between cost causation and derived benefits. *See, e.g.*, *California Independent System Operator Corp.*, 103 FERC ¶ 61,114 at P 26 (2003) (confirming "cost causation and received benefits as alternate means of expressing the same concept"). Commission precedent notwithstanding, causal relationships necessarily implicate an underlying cause/effect paradigm. Within the paradigm, causes imply effects and effects imply causes, but the *causal relationship* between the two is unidirectional—while causes may create effects, effects cannot create their own causes. Where do benefits fall within this rubric?

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[13] Indeed, ISO has stipulated that such (pre-Amendment No. 60) allocation was unjust and unreasonable as of July 17, 2004. *See* Stipulation No. 3.

[14] ISO does not dispute this point. See ISO IB, pp. 11-13.

Clearly, benefits are not causes; they are effects. It follows that in a purely analytic sense there can be no identity or valid equivalence between benefits and causation. It is in this sense that SWP and Southern Cities state a legitimate position. I believe it is fair to characterize SWP and Southern Cities as construing the term "cause" to mean "actively be responsible for imposing." And whether SWP and Southern Cities receive any benefits or not from MLCC cost incurrence, they did not cause those costs to be incurred in the sense that they affirmatively requested ISO to incur the costs on their behalf or otherwise affirmatively acted in a manner which compelled ISO to do so.

44. What becomes obvious is that cost causation and benefits derived are *not* merely alternate ways of expressing the same concept. They are fundamentally different concepts, and any attempt to extrapolate from benefit to causation necessarily violates the cause/effect paradigm, producing the type of conceptual tension at the heart of the instant dispute. My assessment of what takes place once a benefit (and attendant cost) is identified is an uncritical process commencing with beneficiary identification, proceeding backwards to causal attribution and culminating in cost allocation. This process, however, cannot legitimately be characterized as causation-based in many instances because it lacks a valid causal nexus.[15] In such instances, causation is not established—it is merely imputed—seemingly based on equitable considerations: causal responsibility appears to be imputed, and costs allocated, to any identifiable beneficiary that has not paid for the benefit received, most likely to obviate/remediate any potential subsidization, windfall, or free rider problem.

45. The preceding discussion is not an academic exercise.[16] Rather, it is an effort to deconstruct benefits-based cost allocation in circumstances that provide the Commission an opportunity to abandon the problematic fiction that cost causation and benefits received are identical or equivalent concepts.[17] If consistent with current Commission policy, I believe it would be preferable for the Commission expressly to acknowledge and legitimize equitable cost allocation based exclusively on derived benefits where cost causation cannot be attributed in accordance with valid causal principles. Clarification of the Commission's position on this topic is therefore respectfully recommended.

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[15] Whether the Amendment No. 60 methodology constitutes such an instance is resolved at PP 61-62, *infra*.

[16] To wit, this entire controversy is rooted in the confusion.

[17] The Commission itself has previously acknowledged a disconnect between the two. *See, e.g., Williams Gas Pipelines Central, Inc.*, 88 FERC ¶ 61,198 at 61,681 (1999); *Southern Natural Gas Co.*, 75 FERC ¶ 61,046 at 61,166 (1996).

2. Whether it is Just and Reasonable to Classify MLCC Costs into Three Buckets: System, Local and Zonal

a. Party Positions

ISO

46. As previously stated, ISO contends that minimum load cost compensation historically has been allocated based on benefits—the only change that Amendment No. 60 implements is the need to assign MLCC at a more differentiated level to reflect the fact that benefits are now being provided at a more differentiated level. ISO therefore concludes that whether it is just, reasonable and not unduly discriminatory to allocate MLCC costs among the proposed system, zonal and local buckets depends on the allocation criteria employed for each bucket.[18] ISO notes that no participant objects to a three bucket allocation *per se*, but several suggest that Amendment No. 60 allocates certain costs to the wrong bucket, or that some bucket-specific billing determinants are unjust and unreasonable. ISO also implicitly reprises its threshold argument that it need only establish that the proposed three bucket allocation is just and reasonable, not that it is the only or *most* reasonable alternative.[19]

47. ISO stresses that it developed the three bucket allocation proposal through a lengthy stakeholder process intended to ensure that ISO had considered the views of impacted entities prior to filing Amendment No. 60. ISO submits that that the three bucket approach exhibits a reasonable level of differentiation among the allocation categories which: (1) is consistent with the current organization of ISO markets; and (2) rationally reflects the reasons MLCC costs may be incurred and assigns those costs in a manner consistent with cost causation.

Trial Staff

48. Trial Staff emphasizes that for a rate design proposal to be acceptable, it need be neither perfect nor the most desirable—only reasonable. From this premise, and the corollary principle that Commission authority to prescribe rates under FPA § 206 is contingent on a prior determination that proposed rates are unjust, unreasonable or unduly discriminatory, Trial Staff argues that alternatives to Amendment No. 60's three bucket allocation proposal may not be considered absent such a determination with

[18] Which are discussed under subsequent issues.

[19] By extension, alternatives proposed by other participants could be considered only if the three bucket proposal reflected in Amendment No. 60 first was determined to be unjust, unreasonable or unduly discriminatory.

respect to that proposal. Trial Staff asserts that no participant has demonstrated that the proposal is unjust, unreasonable or unduly discriminatory.

49. Trial Staff maintains that the proposal to allocate MLCC costs among system, zonal and local categories is designed to apportion the costs among market participants causing or benefiting from MLCC cost incurrence. Trial Staff contends that the proposed allocations are based on empirical data compiled by ISO which demonstrates that must-offer units were committed to mitigate constraints in specific regions or locations within the ISO control area, as well as on pre-Amendment No. 60 stakeholder input concerning that data. In addition, Trial Staff underscores the fact that Attachment E specifically defines each of the three allocation buckets based on how generating units are committed and operated, and sets forth a comprehensive statement detailing how costs will be allocated within each bucket.

SCE

50. SCE states that SCE, Trial Staff and all other active parties except SWP endorse the basic three bucket cost allocation methodology. SCE first summarizes the methodology, once again highlighting that its geographic focus allocates costs to the specific zone or PTO service territory whose loads are the predominant contributors to/beneficiaries of MLCC cost incurrence in those areas. SCE asserts that allocating MLCC costs at any finer level is impractical, overly complicated and unworkable, as well as inconsistent with Commission policy because it would allow certain beneficiaries of MLCC cost incurrence to evade responsibility for paying any share of the costs. SCE pointedly criticizes SWP's proposed alternative on these grounds, concluding that the three bucket cost allocation methodology proposed in Amendment No. 60 does the best job—consistent with Commission policy and the underlying ISO tariff—of allocating MLCC cost responsibility to the major cost causers and beneficiaries.

PG&E

51. PG&E asserts that no participant except SWP suggests that the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 is unjust, unreasonable or does not constitute a significant improvement over the prior methodology. Moreover, PG&E asserts, SWP takes issue with the three bucket approach only because SWP advocates more particularized cost allocation through geographic sub-zones and time-of-use rates. These points aside, PG&E emphasizes that what is at issue is the three bucket MLCC cost allocation methodology reflected in Amendment No. 60, and no alternative may be considered unless and until that methodology is shown to be unjust and unreasonable—a showing which no participant has made, according to PG&E.

SMUD

52. SMUD submits that the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 is, in general, not unjust and unreasonable because it assigns MOWD-related costs to the specific regions or locations where the underlying constraints are located. SMUD otherwise takes no position on this issue.[20]

SWP

53. SWP contends that the three bucket MLCC cost allocation approach is a sound starting point, but it is neither just nor reasonable because it violates cost causation principles. On SWP's account, it is unjust and unreasonable to allocate MLCC costs into three buckets without complying with the July 8, 2004 Order I policy statement that "the entities that cause costs should pay for such costs." With appropriate modifications, however, SWP maintains that the three bucket approach would become just, reasonable and not unduly discriminatory.[21]

Southern Cities

54. Southern Cities characterize the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 as conceptually unobjectionable. They qualify this endorsement, however, stating that it is appropriate to retain a three bucket approach only if: (1) certain transmission constraints are re-classified; (2) ISO is required to establish transparent guidelines for classifying constraints and allocating costs; (3) LSEs may avoid MLCC costs by self-providing local generation.[22] Southern Cities differentiate their proposed modifications from those proposed by SWP, which Southern Cities criticize as inappropriate insofar as SWP advocates additional/more specific allocation categories and entity-specific credits.

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[20] SMUD only objects to Amendment No. 60 insofar as it allocates a portion of system remainder MLCC to wheel-through transactions and defines "Reliability Services Costs."

[21] SWP discusses these modifications, which include establishing geographic sub-zones and time-of-use rates, under Issue #3.

[22] Southern Cities discuss these modifications under Issue #3, Issue #16 and Issue #11 respectively.

Powerex

55. Powerex does not oppose classifying MLCC costs into three buckets. Powerex nevertheless characterizes such classification as unjust and unreasonable insofar as it allocates MLCC costs in the system bucket to NNUD and includes wheel-through schedules/existing transmission contracts in the allocation.

b. Discussion/Analysis[23]

56. The three bucket MLCC cost allocation methodology proposed in Amendment No. 60 may be summarized as follows: MLCC costs are separated into three categories (buckets) based on the reason(s) generating units are committed and operated under the must-offer obligation.[24] The buckets are designated "local"—for costs incurred for local reliability reasons; "zonal"—for costs incurred to meet broader, regional, reliability requirements; and "system"—for costs incurred to meet control area-wide reliability requirements. MLCC costs incurred for local reliability reasons are allocated monthly to the PTO in whose service area the generating unit is located. MLCC costs incurred for zonal reliability reasons are allocated to total monthly demand within the affected zone. MLCC costs incurred for system reliability reasons are allocated first to NNUD, up to a capped $/MWh rate, with any excess allocated to monthly demand and in-state exports. Ex. ISO-20, pp. 20-21.

[23] The poorly crafted JSCI hampers my ability to address this issue in the comprehensive manner I would prefer. See Footnotes 1, 18 and 22, *supra*. Accordingly, I am forced to examine the three bucket allocation proposal here only in a generic/conceptual context, and to defer consideration of specific endorsements and objections to subsequent topics—particularly those dealing with Attachment E, which outlines the specific unit commitment/cost allocation criteria ISO would employ to implement Amendment No. 60.

[24] Although ISO incurs three types of costs under the must-offer obligation (generating unit start-up costs; emissions costs incurred while operating a generating unit in compliance with the must-offer obligation; costs of operating generating units at minimum operating levels in compliance with the must-offer obligation), only the costs associated with operating the units at minimum levels (*i.e.* MLCC costs) are addressed in Amendment No. 60. These costs consist of minimum operating level fuel costs plus a $6.00/MWh adder for variable operations and maintenance. Prior to Amendment No. 60, MLCC costs were allocated on a system-wide basis. Ex. ISO-20, pp. 10-12; Ex. S-18, p. 6.

57. I find and conclude that no participant except SWP takes the position that the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 is generally unjust, unreasonable or unduly discriminatory. I also find and conclude that every participant considers the proposed methodology an improvement over its predecessor.[25] These rulings notwithstanding, it remains incumbent on ISO *affirmatively to demonstrate* that its proposed three bucket MLCC cost allocation methodology is just and reasonable in every respect. 16 U.S.C. § 824d (e) (2005). Neither the failure of other participants to assert that the methodology is unjust, unreasonable or unduly discriminatory, nor their supporting imprimaturs, satisfies ISO's burden in this regard. And while other participants might preclude ISO from satisfying its burden by demonstrating that the proposed methodology is somehow unjust, unreasonable or unduly discriminatory,[26] their failure/inability to do so does not satisfy ISO's burden. It is, moreover, immaterial to this discrete issue whether the proposed allocation methodology is an improvement—even a significant one—over its predecessor; what matters is whether it is just, reasonable and not unduly discriminatory in itself.[27]

58. The record establishes that ISO committed to re-examine the pre-Amendment No. 60 must-offer process at a September 3, 2003 technical conference on the use of Condition 2 RMR units for system reliability purposes.[28] Ex. ISO-20, p. 14. ISO solicited questions and issues concerning the must-offer process from market participants at that conference, as well as at a follow-up conference conducted on September 24, 2003. *Id*. ISO hosted stakeholder meetings to discuss must-offer issues in Folsom, California on October 8, 2003, October 27, 2003, November 19, 2003, January 16, 2004 and March 10, 2004. *Id*. at pp. 14-15. ISO presented an initial proposal for refashioned must-offer cost allocation through a December 19, 2003 internet home page posting. *Id*. at p. 15.[29] It solicited comments on the proposal from all market participants via e-mail notice on the same date, posting all responses on its home page on January 14, 2004. *Id*. On March 4, 2004, ISO posted on its home page a notice of a March 10, 2004 stakeholder

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[25] Even SWP characterizes it as a "sound starting point. . . ." SWP IB, p. 21.

[26] This also would permit alternatives to be considered—as would ISO's independent failure to satisfy its burden.

[27] In contrast, any operational improvement which the amendment makes to the previously-approved tariff *would* be material to the corollary burden ISO bears with respect to the continuing justness/reasonableness of unchanged tariff provisions.

[28] The conference was convened by Commission staff in response to market participant concerns over how ISO was determining which generating units to commit through the must-offer process.

[29] URLs for all referenced internet postings are included in Ex. ISO-20, pp. 15-16.

meeting to further address must-offer cost allocation. *Id*. at p. 16. ISO posted a draft Amendment No. 60, including attachments, on its home page on April 26, 2004. *Id*. It also e-mailed the draft amendment directly to all must-offer stakeholder process participants on the same date, requesting further comments by May 3, 2004. *Id*. ISO filed Amendment No. 60 on May 11, 2004.

59. The record further establishes that in response to iterative input received during the must-offer stakeholder process ISO: (1) first proposed to change its must-offer cost allocation methodology from a control area-wide allocation to a two category allocation under which costs incurred for local reliability reasons would be allocated to the local PTO and control area-wide costs would continue to be allocated to demand and in-state exports; and (2) subsequently proposed to add a third allocation category covering costs that were more regional in nature, and therefore not purely attributable to local or control area-wide reliability problems/requirements. Ex. ISO-20, at pp. 16-17. The record confirms that ISO seriously considered other stakeholder-suggested modifications to the proposed MLCC cost allocation methodology as well, incorporating some into the May 11, 2004 (filed) version but declining to incorporate others. *Id*. at pp. 17-19; Tr. 708-10. The record also reflects substantial evidence that the ISO had legitimate bases for declining to incorporate various stakeholder-proposed modifications, including more geographically/temporally-particularized cost allocation and earlier tariff amendment effective date. *Id*. at pp. 38-39; Tr. 676, 693-94, 697, 705-07, 711-12, 1114-17; Ex. SCE-1, p.8; Ex. SCE-6, pp. 27-29.

60. I find and conclude that the process by which ISO formulated the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 supports a conclusion that that the methodology is generally just, reasonable and not unduly discriminatory. It is the product of comprehensive ISO efforts to identify and remediate must-offer cost allocation deficiencies in cooperation with all potentially affected stakeholders. Moreover, the process was based on empirical data and analyses which confirmed that it was possible for ISO—within certain operational, administrative and market limitations—to allocate MLCC costs with much greater geographic specificity than previously had been done. Ex. ISO-20, pp. 13. *Also see generally* Ex. ISO-18 (protected MOWD data in CD-ROM format)[30] *and* Ex. ISO-19, pp. 10-11. The resulting three category approach is specifically tailored to allocate MLCC costs among ISO market participants based on both direct cost causation and comparative benefits.

[30] A significant amount of material originally designated "protected" by various participants had that designation removed in the course of the hearing and afterwards. Materials designated "protected" throughout this Initial Decision have been so designated in accordance with a list of materials retaining protected status provided by the participants in joint Stipulation No. 2, filed on July 22, 2005.

61. Although geographically focused, the three bucket methodology proposed in Amendment No. 60 allocates both local and zonal MLCC costs on conceptually valid causal grounds—matching costs to customers by identifying the specific localized constraints responsible for the MOWDs underlying MLCC cost incurrence and targeting the costs to customers in those local areas or zones.[31] This approach also allocates local and zonal MLCC costs in accordance with comparative causation/benefit principles in that it targets the costs to the local service territory or regional zone which is the predominant contributor to/beneficiary of the underlying MOWD(s). System MLCC costs are apportioned among all market participants based on: (1) the stated premise that all market participants benefit from grid reliability; and (2) the implied premise that all market participants directly cause those costs to be incurred in the first instance through their *collective demand* for reliable grid operation.[32] While no individual market participant reasonably may be singled out as the *sine qua non* for system MLCC cost incurrence, it is indisputable that market participants' collective need/demand for, and expectation of, grid reliability is both the cause-in-fact and the proximate cause of such cost incurrence.

62. Revisiting the question left unresolved at P 44 and fn. 15, *supra*, I find and conclude that—conceptually speaking—the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 legitimately be characterized as causation-based in that each of the three proposed cost allocation categories exhibits a valid causal nexus to impacted customers. The methodology relies on empirical data and analyses to match both local and regional MLCC costs to responsible customers by (i) identifying the specific underlying local and regional constraints imposing the costs and (ii) allocating the costs to the local service territory or regional zone which is the predominant contributor to/beneficiary of the MLCC cost incurrence. Similarly, system MLCC costs are allocated among all market participants because their collective need/demand for reliable grid operation causes that category of MLCC costs to be incurred and because they collectively benefit from its incurrence. Although the allocation may not be perfect—and undeniably accommodates certain ISO operational, administrative and market limitations/priorities—it exhibits a level of differentiation among MLCC cost allocation categories that conceptually satisfies the Commission policy that costs be

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[31] The local MLCC cost allocation matches ISO's RMR cost allocation methodology. Ex. ISO-22, p. 27. The zonal MLCC cost allocation replicates the manner in which costs of generation re-dispatch to manage intra-zonal congestion currently are allocated under Section 7.3.2 of the ISO Tariff. *Id.* at p. 26.

[32] This analysis compels me to reject any claim that the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 generally produces cross-subsidization. Whether it does so in specific circumstances remains an open question at this point of the inquiry.

matched, to the greatest practicable extent, to the customers responsible for imposing the cost burden at issue or benefiting from it. *See, e.g., Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,163 at P 587 (2004*); California Independent System Operator Corp.*, 103 FERC ¶ 61,114 at P 20-26 (2003); *Pacific Gas & Electric Co.*, 100 FERC ¶ 61,160 at P 15 (2002); *California Independent System Operator Corp.*, 99 FERC ¶ 63,020 at 65,109-11 (2002); *Midwest Independent Transmission System Operator Inc.*, 98 FERC ¶ 61,141 (2002). It also conceptually satisfies the July 8th Order I specification that "*[a]s a general matter*, the Commission believes that the entities that cause costs should pay for such costs." *California Independent System Operator Corp.*, 108 FERC ¶ 61,022 at P 62 (2004) (emphasis added). I therefore find and conclude that the three bucket MLCC cost allocation methodology proposed in Amendment No. 60 is generally just, reasonable and not unduly discriminatory.[33] I now turn to whether it satisfies this standard in detail.

3. Should MLCC Costs Be Allocated, Pursuant to the Criteria Used by the ISO to Classify Units Committed Under the Must Offer Waiver Denial Process, as Set Forth in Attachment E of the ISO's May 11, 2004 Filing, to Each of the Local, System, Zonal Categories, or Should They Be Allocated in Another Manner or to Other Categories?

Introduction

63. As previously outlined, under the three bucket MLCC cost allocation methodology proposed in Amendment No. 60, MLCC costs are separated into three categories based on the reason(s) generating units are committed and operated under the must-offer obligation. The categories are designated "local" for costs incurred for local reliability reasons, "zonal" for costs incurred to meet broader, regional, reliability requirements, and "system" for costs incurred to meet control area-wide reliability requirements. MLCC costs incurred for local reliability reasons are allocated monthly to the PTO in whose service area the generating unit is located. MLCC costs incurred for zonal reliability reasons are allocated to total monthly demand within the affected zone. MLCC costs incurred for system reliability reasons are allocated first to NNUD, up to a capped $/MWh rate, with any excess allocated to monthly demand and in-state exports. Ex. ISO-20, pp. 20-21.

[33] An exclusively benefits-based analysis clearly would produce the same ruling. *See* Ex. S-6, at p. 20; Ex. SCE-6, at pp. 29-30; Tr. 232-33, 237, 286, 1130-31, 1154, 1551-53, 1628-29. Moreover, since each category of MLCC cost incurrence confers an identifiable and geographically distinct reliability benefit (Ex. ISO-20, p. 13; Ex. ISO-22, p. 33; Ex. ISO-18 (protected); Ex. S-6, at p. 20; Tr. 495), the three bucket MLCC cost allocation methodology also generally satisfies the Commission policy that benefits-focused cost allocation may not be based on insubstantial, limited or purely speculative benefits.

64. ISO's May 11, 2004 Amendment No. 60 filing included an Attachment E, which specifies the criteria ISO proposes to use to determine whether a generating unit is committed and operated under the must-offer obligation to satisfy local, zonal or system reliability requirements. The criteria reflected in Attachment E therefore would drive MLCC cost allocation in accordance with Amendment No. 60. Although Attachment E was included in the May 11, 2004 Amendment No. 60 filing, ISO did not propose to add it, or any criteria reflected in it, to the tariff itself.

65. Attachment E provides that MLCC costs will be considered local, and allocated monthly to the PTO in whose service area the implicated generating unit is located, if the unit is used to manage flows on a transmission line which is not considered to be an inter-zonal interface.[34] Ex. S-21, p. 1; Ex. ISO-22, p. 22. MLCC costs will be considered zonal, and allocated to total monthly demand within the affected zone, if incurred (i) to maintain the reliability of inter-zonal interfaces or transmission paths carrying power to customers in more than one PTO or (ii) to provide sufficient generating capacity to serve demand within an import-constrained area containing more than one PTO in the event that transmission serving such area is lost. Ex. S-21, pp. 2-3; Ex. ISO-22, pp. 26-27. MLCC costs will be considered system, and allocated first to NNUD (up to a capped rate),[35] with any excess allocated to monthly demand and in-state exports, if incurred to satisfy an anticipated disparity between control area-wide supply (*i.e.* control area generation plus imports) and the demand that scheduling coordinators have scheduled in advance of real time operations.[36] Ex. ISO-22, p. 27.

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[34] Inter-zonal interfaces consist of (i) transmission paths between the three existing ISO congestion zones (NP-15, ZP-26, SP-15) and (ii) transmission paths between the ISO control area and other control areas. Ex. ISO-22, p. 22. The Sylmar, Victorville-Lugo, South of Lugo, Miguel Substation (Miguel) and Southern California Import Transmission Nomogram (SCIT) transmission constraints all lie within the three existing ISO congestion zones. *Id.* at pp. 7, 23-25. South of Lugo, Miguel and SCIT technically do not satisfy the inter-zonal interface definition. *Id.* at p. 23; Ex. SCE-1, pp. 8-9.

[35] The capped rate is intended to serve as a proxy for what a reasonable per-MWh minimum load cost would be, and is calculated by dividing total monthly minimum load costs by total monthly MWh produced by units operating at minimum levels in accordance with the must-offer obligation. Ex. ISO-22, p. 29.

[36] NNUD represents the amount of energy ISO requires to balance demand and supply, and subsumes (i) real time demand not scheduled in forward markets, (ii) interchange scheduled in forward markets that does not appear in real time and (iii) generation scheduled in forward markets that does not appear in real time. Ex. ISO-22, pp. 27-28.

a. Party Positions

ISO

66. ISO's position on this issue presupposes that Attachment E will be treated as part of Amendment No. 60. As already noted, Attachment E was included in the May 11, 2004 Amendment No. 60 filing, but ISO did not propose to add it, or any criteria reflected in it, to the tariff along with the changes reflected in the amendment itself. ISO nevertheless states that it would not object to "deeming" Attachment E part of the underlying tariff amendment proposal in order to facilitate including Attachment E criteria as part of the proposal, subject to a refund effective date of July 17, 2004. From this, ISO proceeds to argue that Attachment E criteria are generally just and reasonable because they reflect the categorical cost causation on which Amendment No. 60 is predicated.

67. ISO first enumerates the three specific instances in which unit commitment/ operation will be classified as local under Attachment E, asserting that each arises from problems under control of the local PTO to whom the resulting MLCC will be charged.[37] ISO next enumerates the five specific instances in which Attachment E classifies unit commitment/operation as zonal, claiming that the cost of resolving these concerns appropriately is imposed on all demand within the zone because all zonal demand benefits from maintaining zonal import capacity and inter-zonal interface reliability.[38] Last, ISO enumerates the two specific instances in which unit commitment/operation will be classified as system, arguing that system MLCC costs are the consequence of the need to balance control area supply and demand when forward schedules deviate from real time requirements, and therefore appropriately should be allocated to NNUD—up to a $/MWh cap.[39]

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[37] ISO notes that it has in the interim proposed to exclude two constraints affecting more than one PTO service territory (Miguel and South of Lugo) from the local category. See footnote 36, *infra*.

[38] ISO proposes to include Miguel and South of Lugo in the zonal category despite the fact that they do not satisfy the specified zonal criteria. ISO maintains that these constraints involve transmission paths providing a regional benefit rather than a local one and, as a consequence, it would be unfair to assign their MLCC costs to a single PTO.

[39] ISO maintains that the cap feature is important because system costs are sometimes disproportionate to NNUD. Assessing above-cap system MLCC to control area demand and in-state exports is appropriate in ISO's view because it proportionately passes any excess/disproportionate system costs to all parties placing demands on control area supply.

68. ISO concedes that local and zonal MOWDs can provide wider benefits by preventing cascading outages, and further concedes that off-peak usage may be less responsible for cost incurrence than on-peak usage. These concessions notwithstanding, ISO submits that the Attachment E allocation criteria fall "within the zone of reasonableness" because they rationally match cost allocations to benefits received. ISO contrastingly criticizes as deficient SWP's proposals to modify Attachment E's local and zonal allocation criteria, Southern Cities' proposal to exclude various constraints from the zonal category, and Powerex's proposed modifications to system category cost allocation criteria.

Trial Staff

69. Trial Staff supports classifying units committed under the MOWD process for local, zonal and system reliability purposes in accordance with the criteria specified in Attachment E. Trial Staff enumerates each classification category's criteria, generally endorsing ISO's local, zonal and system MLCC cost allocations as according with them. The single exception is ISO's proposal to classify South of Lugo as a zonal constraint despite Trial Staff's view that Attachment E, ISO operating procedures and actual grid operating characteristics all indicate that it constitutes a local constraint.[40] Trial Staff opposes Southern Cities' proposals to classify Sylmar, Victorville-Lugo and Miguel as local instead of zonal constraints on similar grounds.

SCE

70. SCE endorses the Attachment E criteria for classifying constraints in the local and zonal categories, as modified by ISO in its testimony. Specifically, SCE supports classifying Sylmar and Victorville-Lugo as zonal because they constitute inter-zonal interfaces in ISO's congestion management system and support power imports into the SP-15 zone. SCE also supports ISO's proposal to classify South of Lugo, Miguel and SCIT as zonal—despite these constraints' technical failures to satisfy the Attachment E criterion of being associated with an inter-zonal boundary—because they benefit the entire SP-15 congestion zone. SCE emphasizes that South of Lugo and Miguel represent major 500kV transmission paths that also import power to large load centers serving all ISO grid customers in southern California, contending that they should be classified as zonal in light of that circumstance, as well as the circumstance that multiple PTOs (not just SCE in the case of South of Lugo, or SDG&E in the case of Miguel) are served directly from these paths and therefore derive substantial benefits from them.

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[40] Trial Staff states that SCE, PG&E and SWP also advocate a zonal or modified zonal allocation for South of Lugo costs.

71. SCE faults Southern Cities' proposal to allocate all non-SCIT costs[41] to the PTO in whose service territory a must-offer unit tapped by ISO is located. On SCE's account, this proposal "conveniently" imposes all southern California MLCC costs on SCE, and exempts Southern Cities from paying any such costs except for SCIT (whose MLCC costs would be spread among all SP-15 customers) and Miguel (whose MLCC costs would be assessed exclusively to SDG&E) since no MLCC cost-producing generating units are located in Southern Cities' service territories. SCE characterizes Southern Cities' proposal as unfair, unjust and unreasonable because it fails to reflect the facts that Southern Cities' substantial SP-15 imports both contribute to MLCC cost incurrence and significantly benefit from it. SCE adds that Southern Cities' proposal will do nothing to incentivize transmission/local generation expansion—its ostensible rationale—submitting that the proposal amounts to nothing more than a shallow attempt to evade appropriate cost allocation. Turning to Trial Staff's criticism that ISO improperly proposes to classify South of Lugo as a zonal constraint, SCE maintains it is unsupported. According to SCE, neither ISO operating procedures nor actual grid operating characteristics support a conclusion that South of Lugo constitutes a local constraint. SCE also claims that Trial Staff's criticism is inconsistent with its position regarding Miguel, as well as with cost causation/benefits considerations.

PG&E

72. PG&E states that it would have little stake in the outcome of this issue were it not for Amendment No. 60's "net incremental cost of local" aspect. On PG&E's account, the fact that Amendment No. 60 proposes to allocate local MLCC costs on a net incremental basis means that more of southern California's MLCC costs will be allocated to the system category—and consequently will be imposed on PG&E ratepayers—if more southern California conditions are categorized as local. PG&E states that it would take no position with respect to South of Lugo costs were the Commission to reject the "net incremental cost of local" approach as PG&E urges. If the Commission accepts that approach, however, PG&E supports ISO's proposal to categorize South of Lugo as a zonal constraint despite the fact that it does not literally satisfy the "zonal" definition reflected in Attachment E. It is more appropriate in PG&E's view for MLCC costs incurred to address southern California system conditions to be allocated to southern California grid users.

[41] SCE states that Southern Cities also seek to avoid SCIT-related costs by somehow self-providing SCIT resources.

SMUD

73. SMUD states that it takes no position on this issue except insofar as Amendment No. 60's proposed allocation of system remainder MLCC costs to wheel-through transactions is implicated.[42] On this point, SMUD asserts that allocating a portion of system MLCC to wheel-through transactions is unjust and unreasonable because wheel-throughs neither cause those costs nor benefit from their incurrence. SMUD maintains that in contrast to pure exports, which take energy from ISO control area resources, wheel-throughs do not contribute to the control area generation shortfalls allocated to the system category because wheel-throughs simultaneously inject and withdraw non-ISO generation. SMUD also disputes any contention that transmission losses or congestion management provide adequate alternate bases for allocating system costs to wheel-through transactions.

SWP

74. SWP contends that MLCC costs should not be allocated in accordance with Attachment E unless: (1) zonal and system must-offer generation costs are allocated to the peak period loads for which they are incurred—*i.e.* time-of-use rates are implemented;[43] (2) inter-zonal congestion costs are not allocated to service under existing transmission contracts; (3) Amendment No. 60 costs are allocated only to loads located in areas for which costs are incurred, based on scheduling coordinator-identified load groups or other designations consistent with ISO settlements, and excluding loads located in areas that do not cause MLCC costs to be incurred—*i.e.* geographic sub-zones are established; (4) to the extent that must-offer generation costs are allocated based on the reliability benefits of avoiding load curtailments, pump loads that may be interrupted/ curtailed as reliability resources are not allocated the same costs as other firm loads; and (5) must-offer generation costs incurred to secure ancillary services are not allocated to market participants who fully self-provide ancillary services.[44]

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[42] Although it generally endorses the methodology proposed in Amendment No. 60 in that it allocates MOWD-related costs to the specific regions or locations where the underlying constraints are located (Ex. SMD-1, p. 15; SMUD IB, p. 5), SMUD does not address the Attachment E criteria on which the allocations are based.

[43] SWP defines "peak period loads" as occurring Monday through Saturday (excluding holidays) between 1:00 p.m. and 6:00 p.m. in summer and between 3:00 p.m. and 8:00 p.m. in winter.

[44] SWP maintains that must-offer generation costs never should be incurred to secure ancillary services.

Southern Cities

75. Southern Cities support classifying/allocating MLCC costs in accordance with Attachment E criteria.[45] Southern Cities maintain, however, that Attachment E compels ISO to classify South of Lugo and Miguel as local rather than zonal constraints because neither is an inter-zonal transmission path. They criticize any attempt to substitute a vaguely-articulated "regional benefits" standard for the criteria specified in Attachment E insofar as these constraints are concerned as disingenuous and self contradictory. In addition, Southern Cities challenge any ISO attempt to modify Attachment E criteria through any mechanism other than a new FPA § 205 filing. They take the position that while Attachment E criteria should be included in the tariff, the only procedurally permissible way to change a previously-filed tariff is to file an amendment to it. For these and other reasons—including grid operational realities and a continuing general rejection of benefits-based cost allocation—Southern Cities contend that SCIT alone legitimately may be characterized as a zonal constraint, and all MLCC costs associated with Sylmar, Victorville-Lugo, South of Lugo and Miguel therefore must be categorized as costs incurred for local reliability reasons and allocated to the PTO(s) in whose service area the cost-producing generating unit(s) is/are located. Southern Cities also maintain that ISO must amend its tariff to establish transparent guidelines for classifying constraints/allocating costs and to permit LSEs to avoid MLCC costs by self-providing local generation.

Powerex

76. Powerex objects to the system category criteria specified Attachment E insofar as they allocate system MLCC costs to NNUD, and include wheel-through schedules and existing transmission contracts in the allocation. It maintains that these procedures are unjust and unreasonable because they violate cost causation principles, impose redundant charges on energy imports and create importer uncertainty. Specifically, Powerex argues that Attachment E violates cost causation principles because it (i) allocates a portion of system MLCC costs to scheduling coordinators scheduling imports into the ISO control area despite the fact that ISO incurs such costs solely to meet in-state demand and (ii) ISO incurs those costs in the day-ahead timeframe—when it does not know what scheduled interchange deviations actually will occur in real time. Powerex adds that deviations attributable to transmission or generation outages are beyond the importer's control, and consequently cannot legitimately be imputed to the importer based on

[45] Southern Cities explicitly endorse the Attachment E criteria and methodology under Issues #15 and #16 rather than here.

causation.[46] Moreover, because ISO incurs MLCC costs based on MOWD decisions made in the day-ahead market, but assesses the costs to scheduling coordinators based on subsequent real time delivered energy deficiencies, Powerex complains that importers cannot determine in advance the potential financial impacts of failing to fulfill real time dispatch obligations due to circumstances beyond their control. Powerex suggests that this inability could discourage importer participation in ISO markets. To remediate these deficiencies, Powerex proposes an alternative methodology that allocates system MLCC costs to the specific scheduling coordinator(s) responsible for the day-ahead scheduled load/actual metered load differentials that cause the costs to be incurred.

77. Insofar as Attachment E's alleged imposition of redundant charges on energy imports/interchanges is concerned, Powerex complains that the system criteria allocate MLCC costs to NNUD in complete disregard of the fact that an Uninstructed Deviation Penalty (UDP) already is imposed on such deviation(s). That one charge is a cost allocation and the other a penalty is irrelevant from Powerex's perspective—they are duplicative levies on the same deviation(s). This redundancy is further compounded on Powerex's account by the fact that scheduling coordinators already pay the full real-time market cost of any replacement energy that ISO must procure to balance the deviations.

b. Discussion/Analysis

78. The logical hash the JSCI makes of any attempt to address the universe of issues in a sensible/coherent progression is at this point too unwieldy to accommodate further. Accordingly, I will address a number of interdependent topics in the context of the immediate discussion/analysis.

Attachment E

79. ISO blithely presupposes that Attachment E simply will be considered part of Amendment No. 60 for purposes of determining the amendment's justness/ reasonableness. In contrast, I consider the attachment quite problematic. Attachment E was included in the May 11, 2004 Amendment No. 60 *filing*, but the filing did not propose to incorporate the attachment—or any criteria reflected in it—into the *tariff* along with the actual changes comprising the amendment itself. Nevertheless, it is by these very criteria that ISO seeks to establish that Amendment No. 60 is just, reasonable and not unduly discriminatory—despite the fact that any analysis in this regard

[46] Powerex also disputes any contention that scheduling coordinators scheduling interchange into the ISO control area receive any benefits from MLCC cost-incurrence, asserting that ISO addresses scheduled interchange deviations through real-time energy purchases for which it is fully compensated.

necessarily must be confined to the amendment itself, not as it might be modified[47] or explained in attachments. Moreover, ISO made no attempt to cure this deficiency by further amending its tariff to incorporate the Attachment E criteria and, in fact, continues to take the position that changes to Attachment E would not constitute revisions to Amendment No. 60 itself. *See* Ex. ISO-19, p. 7. It follows that Attachment E criteria do not constitute part of Amendment No. 60 or, by extension, the tariff terms and conditions under which ISO would be required to allocate MLCC costs were the amendment to be approved.

80. Other record evidence supports this conclusion. Attachment E itself is designated a "*Proposal* for classifying units for local/Zonal/system requirements". Ex. S-21, p. 2 (emphasis added). It reflects various ISO beliefs, recommendations and conditional commitments in addition to the specific local, zonal and system categorization criteria summarized at PP 63-65 and footnotes 33-34 of this Initial Decision. *Id*., pp. 1-2. Further, ISO considers even the specific categorization criteria reflected in Attachment E to be largely a matter of ISO discretion. Ex. ISO-19, p. 7. More troubling still, ISO's position with respect to Miguel, South of Lugo and SCIT confirms that ISO does not believe it is required to adhere to the unit/MLCC cost classification criteria enumerated in the attachment. *See, e.g.*, Ex. ISO-22, pp. 23-26. This evidence compels a conclusion that Attachment E constitutes nothing more than a summary of discretionary internal ISO must-offer unit/ MLCC cost classification procedures—albeit one incorporating detailed classification criteria.

81. The preceding circumstances suggest that Attachment E should be accorded little or no weight in evaluating the justness/reasonableness of Amendment No. 60. And were this the limit of analysis, I would be compelled to find and conclude that it is unjust and unreasonable to allocate MLCC costs under Amendment No. 60 because it is devoid of specific, fixed or transparent must-offer unit classification criteria. In apparent recognition of this predicament, ISO now states that it would not object to "deeming" Attachment E a part of Amendment No. 60 in order to facilitate incorporating the attachment's classification criteria into the tariff amendment proposal, subject to the July 17, 2004 refund effective date established in the July 8th Order I. ISO IB, pp. 8, 43. *See also* Tr. 870-71; Ex. ISO-19, pp. 7-8; Ex. ISO-20, p. 40; Ex. S-18, p. 31. ISO contemplates that any such incorporation would be accomplished through a compliance order/filing. Ex. ISO-19, p. 8. Trial Staff and Southern Cities support deeming Attachment E a part of Amendment No. 60[48] (Trial Staff IB, pp. 67-68; Southern Cities

[47] ISO repeatedly makes this precise argument with respect to other participants' proposals.

[48] Although Southern Cities reason that it would be procedurally impermissible to *modify* Attachment E criteria through any mechanism except a formal FPA § 205 tariff amendment filing, they do not extend this reasoning to the May 11, 2004 version of the

IB, p. 49); SCE and SWP oppose it (SCE IB, pp. 43-44; SWP IB, pp. 61-62); all other participants take no position on the issue.

82. I previously ruled that neither the failure/inability of other participants to demonstrate that Amendment No. 60 is somehow unjust, unreasonable or unduly discriminatory nor their supporting imprimaturs satisfies ISO's burden affirmatively to establish that the amendment is just, reasonable and not unduly discriminatory. This ruling is equally applicable to Attachment E. As a consequence, ISO bears two burdens with respect to the attachment: (1) affirmatively to prove as a threshold matter that Attachment E appropriately may be "deemed" part of the tariff amendment to which it was appended; and (2) if so, affirmatively to prove that Amendment No. 60 is just, reasonable and not unduly discriminatory considered in conjunction with Attachment E. Since ISO has failed to address the threshold procedural issue in any way, I am compelled to find and conclude that Attachment E may not simply be "deemed" incorporated into its proposed tariff amendment.[49] I am likewise compelled at this point to find and conclude that ISO has failed affirmatively to satisfy its burden to prove that Amendment No. 60 is just, reasonable and not unduly discriminatory because—considered by itself, as proposed—the amendment lacks any specific must-offer unit classification criteria.

83. Having found ISO's Amendment No. 60 proposal unjust and unreasonable, I may now consider the appropriateness of other alternatives. *See* 16 U.S.C. § 824e (a) (2005); *California Independent System Operator Corp.*, 111 FERC ¶ 61,337 at P 27 (2005). In doing so, however, I am not confined to the alternatives proposed by other participants. Among the proposed alternatives in this proceeding is one which supplements Amendment No. 60 with Attachment E by incorporating the attachment into the proposed amendment. I find and conclude that it is appropriate under all the circumstances[50] first

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attachment, arguing instead that Attachment E should be deemed part of Amendment No. 60 because "[t]the criteria and methodology for classifying units operated for reliability reasons described in Attachment E *are critical* to cost allocation under Amendment [No.] 60. *See* Southern Cities IB, p. 19 at footnote 12, pp. 49-50 (emphasis added).

[49] This is particularly true in light of ISO's purposeful decision(s) not to include Attachment E in the tariff amendment proposal itself. Moreover, deeming Attachment E part of Amendment No. 60 would circumvent FPA § 205 procedural notice requirements (16 U.S.C. § 824d (d) (2005)), and might violate other statutory and regulatory mandates/ protections as well.

[50] Most notable among these are the circumstances that (i) Attachment E was filed along with Amendment No. 60 on May 11, 2004 and (ii) Attachment E criteria as filed, as well as any required modifications to those criteria, would be considered binding on ISO were the Amendment No. 60/Attachment E combination to be determined to be just,

to consider an alternative in which Attachment E constitutes an integral component of Amendment No. 60 as originally proposed by ISO (*i.e.* without the attachment). The Southern Cities, SWP and Powerex alternatives will be considered thereafter *seriatim*.

Attachment E Redux

84. I reject at the outset any suggestion that the relevant inquiry here concerns whether Attachment E criteria fall "within a zone of reasonableness" which merely requires ISO rationally to match cost allocations to benefits received. The applicable standard is whether the attachment's classification criteria are just, reasonable and not unduly discriminatory. The criteria either satisfy this standard or they do not. There is no hierarchy or spectrum of reasonableness. Moreover, Commission policy mandates that costs be matched to the customers responsible for imposing the cost burden at issue or benefiting from it to the greatest practicable extent—not merely on a rational basis. *See, e.g., Midwest Independent Transmission System Operator, Inc*., 108 FERC ¶ 61,163 at P 587 (2004); *California Independent System Operator Corp*., 103 FERC ¶ 61,114 at P 20-26 (2003); *Pacific Gas & Electric Co.*, 100 FERC ¶ 61,160 at P 15 (2002); *California Independent System Operator Corp*., 99 FERC ¶ 63,020 at 65,109-11 (2002); *Midwest Independent Transmission System Operator Inc*., 98 FERC ¶ 61,141 (2002). And if costs are matched based exclusively on benefits, the benefits may not be insubstantial, limited or purely speculative. *American Electric Power Service Corp.*, 111 FERC ¶ 61,180 at P 5, 25-30 (2005); *California Independent System Operator Corp*., 106 FERC ¶ 61,032 at PP 5, 20 (2004); *New York Independent System Operator*, 102 FERC ¶ 61,284 at P 14-15 (2003).

85. I already have ruled that Amendment No. 60 is generally just, reasonable and not unduly discriminatory because it allocates MLCC costs to the local, zonal and system categories in accordance with valid causal principles. See PP 60-62, *supra*. I also have ruled that an exclusively benefits-based analysis would produce the same result because each category of MLCC cost incurrence confers an identifiable and geographically distinct reliability benefit. See P 62 and footnote 32, *supra*. Accordingly, the instant analysis will be directed to: (1) whether Attachment E classifies must-offer units/ MLCC costs as local, zonal or system in a just, reasonable and not unduly discriminatory manner through clear, adequately-detailed and appropriate classification criteria; (2) whether those criteria allocate MLCC costs in a just, reasonable and not unduly discriminatory manner in accordance with Commission policy; and (3) whether ISO proposes to apply the criteria in a manner consistent with the criteria themselves and Commission policy.

86. Attachment E classifies a unit as committed or operated for local reliability requirements if, in accordance with any of three enumerated operational purposes, the

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reasonable and not unduly discriminatory and be re-filed as ISO's tariff amendment.

unit is used to manage flows on a transmission line which is not considered to be an inter-zonal interface. Ex. S-21, p. 1; Ex. ISO-22, p. 22. The attachment classifies a unit as committed or operated for zonal reliability requirements when, in accordance with any of five enumerated operational purposes, the unit is used either (i) to maintain the reliability of inter-zonal interfaces or transmission paths carrying power to customers in more than one PTO or (ii) to provide sufficient generating capacity to serve demand within an import-constrained area containing more than one PTO in the event that transmission serving such area is lost. Ex. S-21, pp. 2-3; Ex. ISO-22, pp. 26-27. Attachment E classifies a unit as committed or operated for system reliability requirements if the unit is used either (i) to meet forecast control area demand or (ii) to provide ancillary services, if ISO is procuring them on a control area-wide basis. Ex. S-21, p. 3. The attachment specifies (i) that all local MLCC costs will be allocated monthly to the PTO in whose service area the implicated generating unit is located; (ii) that all zonal MLCC costs will be allocated to total monthly demand within the affected zone; and (iii) that all system MLCC costs will be allocated first to NNUD (up to a capped rate), with any excess allocated to monthly demand and in-state exports. Ex. S-21. I find and conclude that these criteria are just and reasonable in that they are clear, unambiguous, adequately-detailed and incorporate objective unit classification/MLCC cost allocation benchmarks.[51]

87. I also find and conclude that, on their face, the enumerated unit classification criteria reflect adequate geographic, operational and functional specificity to satisfy the just, reasonable and not unduly discriminatory standard insofar as Commission policy with respect to cost causation/benefits derived is implicated. Each of the enumerated criteria in all three categories exhibits a direct and predominant causal/benefit connection to the geographic/operational category to which it is assigned and MLCC costs allocated. Each enumerated local criterion addresses problems predominantly under control of the local PTO to whom the resulting MLCC will be charged. The costs of resolving each enumerated zonal criterion is imposed on all demand within the zone because zonal demand causes the cost incurrence and all zonal demand benefits from maintaining zonal import capacity and inter-zonal interface reliability. Both enumerated system criteria reflect ISO's need to satisfy control area-wide requirements. And, as previously established, the classification criteria rely on empirical data and analyses to match both local and regional MLCC costs to responsible customers by (i) identifying the specific underlying local and regional constraints imposing the costs and (ii) allocating the costs to the local service territory or regional zone which is the predominant contributor to/beneficiary of the MLCC cost incurrence. Similarly, system MLCC costs are allocated among all market participants because their collective need/demand for reliable grid

[51] Whether the benchmarks result in just, reasonable and not unduly discriminatory cost allocation, particularly insofar as system costs and the "incremental cost of local" reliability component are concerned, remains to be determined.

operation causes that category of MLCC costs to be incurred and because they collectively benefit from its incurrence. Although must-offer unit/MLCC cost classification ideally might be based on more precise criteria, those specified in Attachment E exhibit sufficient levels of geographic, functional and operational differentiation to satisfy the Commission policy that costs be matched, to the greatest practicable extent, to the customers responsible for imposing the cost burden at issue or benefiting from it.

88. The same does not hold true for ISO's proposed application/implementation of the Attachment E criteria. The record establishes that SCIT, Miguel and South of Lugo do not satisfy the inter-zonal interface definition.[52] Ex. ISO-22, p. 22; Ex. SCE-1, pp. 8-9. As a consequence, these constraints would fall into the local cost allocation category under the Amendment No. 60/Attachment E methodology.[53] ISO nevertheless proposes to include SCIT, Miguel and South of Lugo in the zonal cost allocation category on the basis that, in operation, each provides a "more regional benefit" to the entire SP-15 zone. Putting aside for the moment whether SCIT, Miguel and South of Lugo properly belong in the zonal cost allocation category because they predominantly provide regional/zonal benefits, it is not just and reasonable in my view to establish objective must-offer unit/ MLCC cost allocation criteria, only to deviate from them at the outset. Neither would it be just and reasonable: (1) to sidestep this contradiction by merely enumerating constraint-specific exceptions to the categorical classification criteria; or (2) to eviscerate

[52] Again, inter-zonal interfaces consist of (i) transmission paths between the three existing ISO congestion zones (NP-15, ZP-26, SP-15) and (ii) transmission paths between the ISO control area and other control areas. Ex. ISO-22, p. 22. South of Lugo and Miguel are classified as *intra*-zonal constraints. Ex. ISO-22, p. 23. SCIT is not a physical constraint; it is a nomogram—a set of operating or scheduling rules which are used to ensure that simultaneous operating limits are respected. Item By Reference #1, v. 1, Seventh Revised Sheet No. 334A.

[53] Southern Cities argue that distinguishing zonal from local categorization based on the inter-zonal interface standard is inappropriate, and therefore maintain that Sylmar and Victorville-Lugo also should be categorized as local constraints. Ex. SOC-1, pp. 10-12. I reject this position for purposes of the instant discussion on the bases that: (1) it is completely at odds with ISO's congestion management system; (2) it relies on cost-causation/benefits assumptions and vagueness allegations concerning Amendment 60/Attachment E categorization criteria that are inconsistent with my prior rulings; (3) ISO Operating Procedures support a conclusion that Sylmar/Victorville-Lugo should be categorized as zonal constraints (*see* Ex. S-14 (protected)); and (4) enumerated Attachment E criteria indicate that Sylmar/Victorville-Lugo should be categorized as zonal because they support energy transfers among multiple LSEs within SP-15 and are subject to a nomogram governing the operations of inter-zonal transmission paths. *See* Ex. SOC-10, p. 2, (d); Ex. S-21, p. 2 *and* P 89, *infra*.

the criteria's objectiveness by designating them in any respect discretionary. If Attachment E's local/zonal classification criteria are adequate and appropriate as enumerated, they should be strictly observed. If SCIT, Miguel or South of Lugo properly should be categorized as zonal constraints based on their operational characteristics, Attachment E's local/zonal classification criteria are in obvious need of revision. ISO cannot have it both ways; it must elect one course or the other.

89. Turning to whether SCIT, Miguel and South of Lugo properly belong in the zonal cost allocation category, I observe that although Attachment E does not specifically reference SCIT, the attachment's first enumerated zonal criterion is "maintain operations within the requirements of any nomogram that governs the operations of [an] inter-zonal transmission path(s)." Ex. S-21, p. 2. The record indicates that SCIT applies to five transmission paths importing power into southern California from Arizona, Nevada, Utah and the Pacific Northwest. Ex. ISO-22, pp. 24-25. I therefore find and conclude that SCIT: (1) is appropriately categorized as zonal under Attachment E criteria; and (2) would not require Attachment E's zonal criteria to be modified.

90. Although ISO currently classifies Miguel as an intra-zonal constraint, my review of a various protected materials, including ISO Operating Procedures, confirms that Miguel properly should be categorized as zonal under Attachment E criteria. *See generally* Ex. S-13 (protected) *and* Ex. S-6, pp. 22-24 (protected). Miguel's actual operational characteristics also support a conclusion that it provides regional reliability benefits that would be more consistent with a zonal categorization than with a local one. Ex. SCE-1, pp. 8-9; Ex. SCE-6, p. 10. I therefore find and conclude that Miguel: (1) is appropriately categorized as zonal under Attachment E criteria; and (2) would not necessarily require Attachment E's zonal criteria to be modified. These rulings aside, ISO should be required to modify either the tariff definition of Inter-Zonal Interface or the attachment's enumerated zonal criteria in a manner that accommodates Miguel.

91. ISO's proposal to designate South of Lugo a zonal constraint is by far the most controversial. SCE supports this proposal;[54] Trial Staff and Southern Cities vigorously oppose it. I find and conclude that the record supports categorizing South of Lugo as a local constraint under an Amendment No. 60/Attachment E analysis. South of Lugo indisputably is an intra-zonal constraint. Ex. ISO-22, pp. 22-23; Ex. S-18, p.11; Ex. S-21, pp. 2-3. It both satisfies enumerated Attachment E local criteria and patently fails to satisfy enumerated Attachment E zonal criteria in that it: (1) does not implicate transmission paths between congestion zones; (2) constitutes a network location where must-offer generation is used to maintain acceptable voltage levels; and (3) does not

[54] Again, PG&E supports the proposal only insofar as it impacts MLCC cost allocation in accordance with the "net incremental cost of local" feature designated Issue #4. SWP advocates establishing sub-zones.

operate within the requirements of any nomogram governing the operations of an inter-zonal transmission path. Ex. S-6, p. 28: 12-18 (protected); Tr. 1536; Ex. S-21, pp. 1-3. South of Lugo's operational characteristics, as well as ISO Operating Procedures,[55] also support a conclusion that it properly should be categorized as a local constraint. Ex. S-6, pp. 28-30 (including p. 28: 12-18 (protected)); Ex. SOC-1, p. 17; Ex. SOC-28, pp. 11-12; Tr. 1574 (protected). In contrast, the record support for categorizing South of Lugo as zonal consists of little more than broad assertions that South of Lugo facilities constitute major transmission lines serving more than one SP-15 zone PTO, and should be categorized as zonal because they benefit customers throughout the zone. *See, e.g.*, Ex. ISO-22, pp. 25-26; Ex. SCE-1, pp. 8-9; Ex. PGE-5, p. 13; Ex. SWP-18, p. 19. On the record before me, I am compelled to find and conclude that South of Lugo: (1) is appropriately categorized as local rather than zonal under Attachment E criteria; and (2) would require Attachment E's enumerated local and zonal criteria to be modified in the event that the Commission determines that the constraint should be categorized as zonal for MLCC cost allocation purposes, as well as in the event that ISO itself in the future seeks to categorize South of Lugo as a zonal constraint on functional/operational bases.

The Southern Cities Alternative

92. Southern Cities propose what they designate a "standardized methodology" intended to encourage PTOs to make transmission upgrades/secure adequate generation by allocating all MLCC costs to local PTOs in accordance with ISO's Commission-approved methodology for allocating RMR costs. They maintain that this incentives-based approach is both equitable and consistent with the cost-causation principles endorsed in the July 8th Order I because it: (1) allocates MLCC costs in the short term based on established indicia of cost causation; (2) allocates long-term MLCC costs to the entity best situated to ameliorate the underlying constraint—the local PTO in whose service territory any must-offer unit required by ISO to provide reliability services is located; (3) provides consistent and transparent cost allocation guidelines; and (4) allows entities to avoid MLCC cost incurrence by providing their own generation.

93. The record establishes that Southern Cities' RMR analogy is inapposite to the entire spectrum of MLCC costs.[56] RMR costs are essentially local in nature. Tr. 460-62,

[55] *See* Ex. S-16 (protected). Although this operating procedure was revised effective February 23, 2005 (Operating Procedure T-144, Version No. 4.4 (Ex. SCE-12 (protected)) in a manner consistent with zonal categorization for South of Lugo, its four previous iterations (in effect for approximately five years) were consistent with local categorization. Moreover, the record confirms that the Version No. 4.4 revision was not based on any engineering studies, analysis, calculations or other documentation. Ex. S-42; Tr. 612-13 (protected).

[56] This stands in contrast to the Amendment No. 60 proposal to allocate only *local*

710-11, 846-47. They are incurred/paid in accordance with bilateral contracts specifying that RMR units will be dispatched exclusively to satisfy local reliability needs or to manage intra-zonal congestion. *See, e.g., AES Southland, Inc.*, 94 FERC ¶ 61,249 at 61,873 (2001); Tr. 846-48. Must-offer obligations are neither contractual nor limited to local reliability needs/intra-zonal congestion management. In addition, the record confirms that both Miguel and South of Lugo are associated with a number of 500kV transmission paths (Ex. ISO-22, pp. 23, 25), but RMR criteria do not apply to 500 kV constraints. Tr. 500-01; Ex. SOC-3, p. 137. It follows that it would be inappropriate to allocate zonal and system MLCC costs in the same manner as RMR costs are allocated.

94. It is similarly inappropriate to draw an equivalence between local and zonal MOWDs on the rationale that local and zonal constraints are both attributable to the same underlying causes: insufficient local generation and inadequate transmission. The constraints that produce local MLCC costs (*i.e*. inadequate intra-zonal transmission facilities) are local *by definition*—they lie within a single PTO service area. The constraints that produce zonal MLCC costs, in contrast, are *inter*-zonal interfaces which by definition cannot be confined to a single PTO service area and which provide benefits throughout the zone. Ex. SCE-1, p. 8. Further, *all* MLCC costs are attributable to the generation and transmission deficits Southern Cities cite. In light of this circumstance, it makes no more sense to allocate all MLCC costs to the local category than it would to socialize the costs among all customers on a control area-wide basis—which was the very procedure that ISO employed prior to Amendment No. 60 and to which Southern Cities objected as being unjust and unreasonable. This no doubt is where Southern Cities' "incentives" argument comes to bear: although control area-wide MLCC cost socialization provides no incentive to construct new generation/transmission where it is needed to alleviate a specific constraint, allocating MLCC costs to the PTO in whose local service area the generating unit(s) utilized to alleviate that constraint is located presumably would do so. This reasoning, however, exhibits some fundamental flaws. First, there is no guarantee that the generator(s) required by ISO to alleviate a particular constraint will be near the constraint—or even in the same PTO service area. The record establishes that unit size or effectiveness factor may be as important as proximity in alleviating a particular constraint. Tr. 332-33, 1127; Ex. SCE-12, p. 4 (protected); Tr. 329-30 (protected). Second, the presumption that allocating MLCC costs to the PTO in whose service area a generating unit utilized to alleviate a specific constraint is located will incentivize the PTO to invest in additional generation or transmission as a long-term solution to the problem is itself based on the faulty premise that the PTO decides whether a transmission project is needed within its service territory. The record indicates otherwise: ISO makes those determinations. Tr. 326-28. *See also* Item By Reference #1 § 3.2 (First Revised Sheet No. 141), § 3.2.1 (First Revised Sheet No. 141A), § 3.2.1.1.3.1 (First Revised Sheet No. 142).

MLCC costs in the same manner as RMR costs. *See* Ex. ISO-22, p. 27.

95. Southern Cities' proposal undeniably exhibits the virtues of clarity and simplicity. These virtues aside, the record indicates that Southern Cities import the vast majority of the power they use to serve their loads from outside the SP-15 zone—indeed, from Arizona, New Mexico and Utah. Ex. SCE-19, p. 2; Ex. SCE-10, pp.2-3; Tr. 1404-06 (protected); Ex. SOC-42, pp. 6-7. The record also indicates that Southern Cities loads impact power flows throughout the SP-15 zone, and are indistinguishable from SCE loads in this regard. Ex. S-37; Ex. SCE-6, pp. 9-11; Tr. 1387-88. Southern Cities loads therefore undeniably cause and benefit from SP-15 zonal MLCC cost incurrence, and in the same manner as SCE loads. Due to the circumstances that (i) Southern Cities loads are wholly embedded in the SCE PTO service territory and (ii) and Southern Cities' service territories do not subsume any MLCC cost-producing generators, however, Southern Cities' MLCC cost allocation proposal would impose nearly 100% of the entire southern California region's MLCC costs on SCE.[57] Ex. SCE-9, pp. 6, 9.

96. It strains credibility to conclude it is mere happenstance that Southern Cities' MLCC cost allocation proposal effectively exempts it from paying any MLCC costs whatsoever. This circumstance aside, allocating MLCC costs in accordance with Southern Cities' proposal clearly would violate the Commission policy that costs be matched, to the greatest practicable extent, to the customers responsible for imposing the cost burden at issue or benefiting from it. I also find and conclude that it is otherwise unjust, unreasonable and unduly discriminatory to adopt Southern Cities' proposal because it treats similar entities in an egregiously dissimilar and inequitable fashion.[58]

97. Southern Cities' comprehensive MLCC cost allocation alternative includes a

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[57] SCIT-related costs would be spread among all SP-15 customers, and Southern Cities' proposal to allow LSEs to self-provide generation (inertia) is intended to exempt any LSE electing to do so from SCIT-related MLCC costs. See PP 97-99, *infra*. Miguel-related costs would be allocated exclusively to SDG&E because no MLCC cost-producing generating units are located in Southern Cities' service territories. Ex. SEC-6, p. 12; Ex. SCE-9, pp. 6, 9.

[58] I am mindful that inasmuch as South of Lugo costs comprise a significant proportion of the costs allocated to the local category under Attachment E criteria, a similar criticism can be levied against the Amendment No. 60/Attachment E alternative. That alternative is distinguishable in one important respect, however: South of Lugo's local categorization is dictated by the criteria enumerated in Attachment E, not by design. And whether the disproportionate impact of categorizing South of Lugo as local in accordance with Attachment E's currently-enumerated criteria rises to the level of unjust, unreasonable or unduly discriminatory is a matter more appropriately decided by the Commission.

proposal to establish a mechanism that would allow LSEs to self-provide their load-ratio share of generation, thereby avoiding SCIT-related MLCC cost allocation. I find and conclude that this proposal is severable from the balance of Southern Cities' MLCC cost allocation alternative. I therefore address it on its own merits.

98. Southern Cities suggest that ISO should implement a mechanism through which an LSE may self-provide its load-ratio share of generation—*i.e.* inertia—to resolve the SCIT constraint in lieu of paying its demand-based share of SCIT-related (zonal) MLCC costs. They contend that since SCIT is resolved by increasing SP-15 generation levels, an LSE should have the option to satisfy its SCIT-related obligation by independently providing its *pro rata* share of the necessary generation. To achieve this objective, Southern Cities propose to amend the operating rules reflected in ISO Operating Procedure T-103 (SCIT nomogram, ISO Website Version 6.6 (Ex. SOC-29)) by adding two provisions—the first establishing a new operating procedure, the second establishing a revised settlement process. Ex. SOC-64, pp. 6-8; Tr. 1467. Although ISO and Trial Staff each oppose the proposal on practical and operational grounds, they do not oppose self-providing inertia in concept.[59] *See, e.g.*, Ex. S-6, p. 17; Tr. 419-22.

99. There appears to be no compelling Commission policy-based reason to reject Southern Cities' self-provision proposal.[60] This circumstance notwithstanding, ISO should not be *required* to revise Operating Procedure 103 to accommodate self-provision of inertia—at least not at this time. The record indicates that implementing Southern Cities self-provision proposal currently is infeasible because: (1) LSEs do not provide ISO with the real-time power flow information required to determine LSE-specific load-ratio shares of inertia for SCIT; and (2) ISO cannot determine SCIT-related inertia requirements—which are zonal—until after it has addressed its local reliability requirements, which would be too late to accommodate self-provision of inertia for SCIT. Ex. ISO-21, pp. 11-12; Tr. 419, 422. The record also indicates that implementing Southern Cities' self-provision proposal would require resource/time-intensive modifications to ISO operating and settlement procedures and software. Ex. S-6, pp.18-19; Ex. 19, p. 22; Tr. 499. Such commitments would be disproportionate to any resulting advantages—particularly in light of the facts that: (1) they would apply to a single constraint; (2) record evidence confirms that the SCIT nomogram is anticipated to be

[59] SCE opposes the self-provision proposal in principle, summarily concluding that it is unworkable, fails to recognize other southern California LSEs' contributions to support the SCIT nomogram, would be expensive to implement and does nothing to address SCIT-related costs already incurred. SCE RB, p. 25.

[60] I note that the proposal is limited to SCIT, and therefore could have discriminatory implications insofar as self-provision of inertia might be a viable MLCC cost avoidance mechanism for other constraints.

superseded by June 2006 due to system upgrades/expansions (Ex. S-6, pp. 16-17); and (3) self-provision of inertia appears to fall into the class of long-term market design improvement currently being implemented by ISO in its MRTU.[61] For the preceding reasons, I find and conclude that ISO should not be required to revise Operating Procedure 103 to accommodate self-provision of inertia at this time. Instead, Southern Cities should pursue this proposal with ISO in the context of the ongoing MRTU proceeding.

The SWP Alternative

100. SWP proposes to allocate MLCC costs in accordance with Attachment E with the following modifications: (1) zonal and system must-offer generation costs should be allocated daily instead of monthly, and to the peak period loads for which they are incurred—*i.e.* time-of-use rates should be implemented; (2) inter-zonal congestion costs should not be allocated to service under existing transmission contracts; (3) Amendment No. 60 costs should be allocated only to loads located in areas for which costs are incurred, based on scheduling coordinator-identified load groups or other designations consistent with ISO settlements, and excluding loads located in areas that do not cause MLCC costs to be incurred—*i.e*. geographic sub-zones should be established; (4) to the extent that must-offer generation costs are allocated based on the reliability benefits of avoiding load curtailments, pump loads that may be interrupted/curtailed as reliability resources should not be allocated the same costs as other firm loads; and (5) must-offer generation costs incurred to secure ancillary services should not be allocated to market participants who fully self-provide ancillary services.[62]

101. SWP submits first that zonal and system MLCC costs should be allocated on a daily basis instead of monthly as Amendment No. 60 proposed. It maintains that the causes underlying must-offer generation commitments vary by day and hour, and that employing a daily allocation reflects different cost-causation factors between weekdays

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[61] The record establishes that ISO would have to divert MRTU personnel to implement self-provision of inertia. Tr. 499. With respect to points (2) and (3), I again do not imply that unjust, unreasonable or unduly discriminatory rates of limited duration are acceptable—only that the duration of otherwise just, reasonable and not unduly discriminatory structures is a valid consideration where long-term market design improvements are in the process of being implemented. Southern Cities propose to supplement the otherwise just, reasonable and not unduly discriminatory SCIT-related MLCC cost allocation with a self-provision alternative, not to replace it. *See* Ex. SOC-28, pp. 8-9.

[62] SWP maintains that must-offer generation costs never should be incurred to secure ancillary services.

and weekends. Ex. SWP-1, p. 7. SWP nevertheless argues that Sunday costs should be allocated to Monday because the primary reason Sunday costs are incurred is to have must-offer generators with lengthy start-up periods ready to meet Monday peak load conditions. *Id.*, p. 9. Trial Staff, PG&E and Powerex object to SWP's daily allocation proposal on feasibility grounds; Trial Staff also objects on procedural and precedent-based grounds.

102. The record indicates that ISO does not oppose calculating zonal/system MLCC on a daily basis. Ex. ISO-20, p. 36; Tr. 852. It also confirms that ISO is capable of calculating these costs on a daily basis, and has in fact done so in various exhibits prepared for this proceeding. Ex. ISO-9; Ex. ISO-11; Ex. ISO-15; Ex. ISO-17; Ex. ISO-20, pp. 46-47. I therefore reject any claim that it is infeasible for ISO to calculate/ allocate zonal and system MLCC on a daily basis. Daily allocation also better satisfies the Commission policy that costs be matched, to the greatest practicable extent, to the customers responsible for imposing the cost burden at issue or benefiting from it—particularly insofar as PG&E, SCE and SDG&E are concerned. *Compare* Ex. ISO-8 *with* Ex. ISO-9. *See also* Tr. 936, 945. Moreover, such allocation is not inconsistent with procedural requirements or other Commission precedent. I previously ruled that Amendment No. 60 by itself is unjust, unreasonable and unduly discriminatory. Although that ruling did not specifically address the amendment's proposed monthly zonal/system cost allocation component, such level of specificity was not required in order for me to consider alternative MLCC cost allocation methodologies. And while *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 97 FERC ¶ 61,293 at 62,363 (2001) states that ISO should recover MLCC costs "consistent with the methodology utilized for the recovery of emissions and start-up fuel costs," that methodology has yet to be determined due to my prior ruling that Amendment No. 60 is unjust, unreasonable and unduly discriminatory as filed.[63] Further, it is not necessarily inconsistent—within whatever *comprehensive* MLCC cost allocation methodology that may be approved by the Commission—for zonal/system MLCC costs to be allocated on a daily basis while start-up and emissions costs are allocated monthly, particularly if such allocations respectively reflect the greatest practicable degrees of cost matching. I therefore find and conclude that it would be just, reasonable and not unduly discriminatory for ISO to allocate zonal and system MLCC on a daily basis. I expressly decline to extend this ruling to SWP's proposal to allocate Sunday zonal/system MLCC costs to Monday. The record before me demonstrates that any attempt to shift weekend MLCC costs to weekdays is inappropriate and impracticable, and has arbitrary and

[63] I note that SWP advocates allocating start-up and emissions costs on a percentage basis rather than monthly as Trial Staff alleges. SWP-1, pp. 39-41.

discriminatory consequences.[64] *See, e.g.*, Ex. PGE-4, pp. 8:1-9:6; Tr. 393, 571-75, 1097-1102.

103. SWP next proposes that zonal and system must-offer generation costs should be allocated exclusively to the peak period loads for which they are incurred. It defines peak period loads as occurring Monday through Saturday (excluding holidays) between 1:00 p.m. and 6:00 p.m. in summer and between 3:00 p.m. and 8:00 p.m. in winter. Ex. SWP-18, pp. 15-16. According to SWP, ISO concedes that the "overwhelming majority of [MLCC] costs are incurred to meet on-peak needs,"[65] that off-peak MLCC costs are incurred to meet on-peak needs as well, and that all MLCC costs should be allocated to peak period loads—as SWP defines them—as a consequence. I disagree. First, my review of the evidence which SWP cites in support of its position (*see, e.g.*, Ex. SWP-5D, pp.1-2; Ex. ISO-22, p. 35; Tr. 1637) confirms that SWP grossly overstates or purposefully misinterprets ISO's position.[66] ISO in fact takes the position that the must-offer obligation is designed "to ensure that the ISO has sufficient capacity reserves to deal with a Contingency,[67] particularly the failure of a major transmission line or Generating Unit. A contingency may occur any hour of the day, off or on peak." Ex. ISO-21, p. 6. Second, the record confirms that most MLCC costs actually are incurred in off-peak hours, that a variety of off-peak events and circumstances require ISO to commit must-offer generation, and that off-peak loads themselves benefit from both off-peak and on-peak MOWDs.[68] Ex. ISO-22, p. 35; Tr. 142, 145, 156-58, 182-83, 388-92, 571-75. Third, the record establishes that ISO does not operate in accordance with anything remotely resembling SWP's proposed peak period definition. The record indicates—albeit somewhat confusingly—that ISO adheres to the standard NERC and WECC definitions of peak period for the Western Interconnection: 7:00 a.m. to 10:00 p.m.

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[64] This ruling reflects full awareness of the MLCC/Start-Up Cost distinction.

[65] With the exception of Sylmar-related costs.

[66] SWP tends to seize on general answers to general questions, some of which were posed/answered months prior to the hearing, in an attempt to legitimize its own very specific positions on very specific points. The hearing transcript reflects a number of instances where witnesses were obliged to clarify SWP mischaracterizations in this regard. *See, e.g.*, Tr. 388-93, 571-75, 1636-38.

[67] The ISO tariff defines Contingency as "Disconnection or separation, planned or forced, of one or more components from an electrical system." Item By Reference #1, v. 1, Substitute Fourth Revised Sheet No. 308.

[68] In addition, the record confirms that various *non-load* factors occurring off-peak can contribute to MOWDs. *See* Ex. S-45; Tr. 1170.

Monday through Saturday (excluding specified holidays).[69] Tr. 146, 149, 387; Ex. S-1, pp. 10-11; Ex. S-2; Ex. S-3. The record gives no indication that ISO deviated from this definition when it prepared the peak hour cost allocation exhibits it submitted in this proceeding (Ex. ISO-9; Ex. ISO-11; Ex. ISO-15), at least two of which (Ex. ISO-11; Ex. ISO-15) SWP itself used to prove the feasibility of its proposal to allocate zonal/system MLCC costs on a daily basis. *See* SWP IB, p. 25.

104. Most important, the record simply does not support the peak period load analysis which lays the foundation for SWP's proposal to allocate zonal/system MLCC costs exclusively to loads occurring Monday through Saturday (excluding holidays) between 1:00 p.m. and 6:00 p.m. in summer and between 3:00 p.m. and 8:00 p.m. in winter. Here again, SWP misconstrues the evidence to achieve its objective. SWP exploits various deposition characterizations of "maximum" on-peak hours, "super" peak, "highest" load hours and "highest" peak to extrapolate to a narrow definition of "peak period loads"—one that ostensibly reflects ISO's own operational demarcations. *See generally* Ex. SWP-5, pp. 20-21; Ex. S-1, pp. 8-10. This definition, however, is egregiously insufficient and unrepresentative. Ex. S-1, pp. 12-14; Ex. S-5. I therefore find and conclude that SWP has failed to satisfy its burden to prove that it would be just, reasonable and not unduly discriminatory for ISO to allocate zonal/system MLCC costs in accordance with it. I further find and conclude that SWP has failed to prove: (1) that it would be just, reasonable and not unduly discriminatory for ISO to deviate from the NERC/WECC definitions of peak period for the Western Interconnection for any purpose; or (2) that it would be just, reasonable and not unduly discriminatory for ISO to allocate zonal/system MLCC costs in any manner—other than daily—based on time-of-use.

105. Turning to the matter of existing transmission contract schedules, Amendment No. 60 allocates zonal MLCC costs to total demand within the affected zone, including existing transmission contract (ETC) loads. SWP and PG&E propose to exempt ETC schedules from the portion of zonal MLCC costs associated with inter-zonal congestion. They note that ETC schedules pre-date the ISO and, as a consequence, the transmission rights conferred under ETCs generally were not subject to any supplemental congestion charges incurred by the control area operator. SWP and PG&E take the position that it would be consistent with these historical circumstances to exempt ETCs from the portion of MLCC costs incurred to manage inter-zonal congestion.[70] ISO counters that it is

[69] Unfortunately, counsel and witnesses repeatedly used the term "peak" in a number of different senses before and during the course of the hearing, including as operational shorthand for specific points in time, one to two hour periods, "highest" peak periods of indeterminate hourly durations, particular days, etc. In addition, at least one data response creates some ambiguity with respect to whether ISO excludes Sunday from the peak period definition. *See* Ex. S-4.

[70] This "grandfather" component of the SWP/PG&E arguments fails to account for

incorrect to equate MLCC costs with congestion charges. ISO emphasizes that MOWDs are issued in *anticipation* that real-time inter-zonal congestion will materialize; hence the impacted generator receives MLCC whether it is dispatched or not. Ex. ISO-19, p. 16; Tr. 721-22. In contrast to MLCC costs, ISO argues, the *dispatch* costs of addressing real-time inter-zonal congestion are covered under section 11.2.4.2.2 of ISO's tariff rather than under Amendment No. 60. Although MLCC costs may be related to ISO's need to address real-time inter-zonal congestion in that they are incurred to ensure real-time inter-zonal interface reliability, they not properly considered inter-zonal congestion costs because they are not incurred for the purpose of actually scheduling transactions. *Id.*, pp. 16-17. SWP responds that the ISO tariff does not expressly distinguish congestion costs from MLCC costs, emphasizing that the Commission previously has prohibited ISO from charging ETCs "congestion charges *of any kind*" except in circumstances involving contract conversion or termination (citation omitted)(emphasis supplied).

106. I accept for argument's sake SWP's contention that the Commission previously has prohibited ISO from charging congestion charges of any kind to ETCs except in circumstances involving contract conversion/termination. I nevertheless reject SWP's contention that this prohibition exempts ETCs from MLCC cost allocation. Inter-zonal congestion charges are functionally distinct from MLCC. Congestion charges are based on grid usage; MLCC costs are incurred to ensure grid reliability. ETC schedules are exempted from usage charges because the contracts grant firm rights to schedule transactions without paying any additional congestion charges. Dissimilarly, MLCC costs are not based on usage. They are based on a functionally distinct need to ensure grid reliability in anticipation of potential real-time congestion. MOWDs provide an *extra-contractual* benefit to ETC holders because MOWDs substantially reduce the potential for curtailment—a benefit which the contracts themselves do not provide.

107. My review of the ISO tariff reveals no specific differentiation between congestion costs and MLCC costs. The tariff nevertheless supports such a distinction. It defines Inter-Zonal Congestion as "Congestion across an Inter-Zonal Interface." Item By Reference #1, v. 1, First Revised Sheet No. 323. It defines Congestion as "A condition that occurs when there is insufficient Available Transfer Capacity to implement all Preferred Schedules simultaneously or, in real time, to serve all Generation and Demand." *Id.*, Second Revised Sheet No. 307A. These definitions suggest that

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the fact that the must-offer obligation was an emergency measure implemented by the Commission in April 2001 in response to the California energy crisis. It also fails to reconcile the specific Commission edict that "*all users* of the transmission grid will be assigned [MLCC] costs consistent with the ISO's markets performing a reliability function." *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.,* 99 FERC ¶61,158 at 61,633 (2002) (footnote omitted) (emphasis added).

congestion charges are real-time congestion management costs, not anticipatory grid reliability costs. This conclusion is buttressed by ISO tariff section 2.4.4.4.4.1, which exempts ETC holders from *usage* charges imposed as a means of apportioning transmission capacity over congested inter-zonal interfaces. *Id.*, Original Sheet No. 56; Ex. S-18, p. 20.

108. I find and conclude that ETC schedules should not be exempted from the portion of zonal MLCC costs associated with inter-zonal congestion. It follows that Amendment No. 60 is just, reasonable and not unduly discriminatory insofar as it allocates zonal MLCC costs to total demand within the affected zone, including ETC loads.

109. SWP's highly-detailed geographical cost allocation proposal is perhaps the easiest component of its alternative to address. Essentially, SWP suggests allocating zonal MLCC costs at a much finer level than Attachment E criteria achieve by establishing various geographical sub-zones, as well as constraint/entity-specific cost assignment and exemption criteria. Ex. SWP-1, pp. 8-9, 24-25, 38-39. Despite its conceptual detail, however, SWP's proposal exhibits a fatal lack of attention to feasibility/implementation detail. For example, the record establishes that SWP's proposals cannot be implemented without wholesale revision of ISO scheduling and metering procedures/protocols. Ex. ISO-19, p. 21. Scheduling coordinators currently are required to submit schedules and report meter data to ISO based on demand zones, load groups and buses. These data points do not correlate to the geographic sub-zones SWP proposes, let alone to the constraint/entity-specific data points that SWP's methodology otherwise would require. Tr. 676; Ex. SWP-17; Ex. SCE-6, pp. 28-29. Moreover, even if ISO could somehow acquire appropriate data, the resulting allocations would have to be performed manually; ISO does not have the requisite software. *Id. See also* Tr. 686, 697. Exacerbating the infeasibility of SWP's proposal are the practical concerns that (i) it would require constant revision as system infrastructure changes/evolves and (ii) it conceptually would permit any entity with potential zonal MLCC cost allocation liability to attempt to establish that it should be exempted from that allocation on some basis. Tr. 1111-12, 1121-25. I find and conclude that SWP's geographical cost allocation proposal has not been shown to be just, reasonable and not unduly discriminatory because it is impracticable for all the preceding reasons.[71]

The Powerex Alternative

110. Powerex objects only to the system category criteria specified Attachment E, and only insofar as the criteria: (1) allocate system MLCC costs to NNUD; and (2) include

[71] Although implied, I expressly extend this ruling to SWP's proposal to exclude pump loads. I also note that I find scant Commission policy support for SWP's sub-zone proposal in *PJM*, discussed *supra*, at P 40.

wheel-through schedules and existing transmission contracts in the allocation.[72] Powerex primarily argues that the system criteria violate cost causation principles because they allocate a portion of system MLCC costs to scheduling coordinators scheduling imports into the ISO control area despite the fact that ISO incurs such costs solely to meet in-state demand. Additionally, Powerex maintains that deviations attributable to transmission/generation outages are beyond the importer's control—hence they cannot legitimately be imputed to the importer based on causation. Powerex further complains that allocating system MLCC to NNUD imposes duplicative charges on energy imports. It proposes to remedy these defects by allocating system MLCC costs to the specific scheduling coordinator(s) responsible for the day-ahead scheduled load/ actual metered load differentials that cause the costs to be incurred.

111. Focusing first on Powerex's complaint that allocating system MLCC to NNUD unfairly imposes duplicative charges on energy imports, I accept Powerex's contention that the allocation compels it to make two payments based on the same deviation. But it does not follow from this that the payments are duplicative. Consider a situation in which someone drives through a highway toll plaza without paying and is fined for the infraction. Like UDP, the fine is a penalty imposed to discourage undesirable behavior. The penalized behavior, however, is not driving down the highway/through the toll plaza; it is failing to pay. Using the highway on which the toll plaza sits is a different behavior with a different cost—the toll. The driver is not excused from paying the toll even if s/he pays the fine because the costs are imposed for different reasons. Like the toll, system MLCC allocated to NNUD is not a penalty; it is a use charge that recoups the proportionate cost the underlying deviation imposes on the transmission system. It follows that no duplicative charge is involved.[73]

112. The preceding analogy clearly does not consider fault, which brings me to Powerex's contention that deviations attributable to transmission/generation outages cannot legitimately be imputed to the importer based on causation because such deviations are beyond the importer's control. Powerex's reasoning presupposes that MLCC cannot fairly be allocated to NNUD unless the underlying deviation is intentional or negligent—*i.e.* that the allocation is a penalty on undesirable behavior due to fault. This premise has been discredited. It follows that it is entirely appropriate to allocate

[72] The ETC issue was resolved under the SWP Alternative discussion, *supra.*

[73] The same holds true insofar as Powerex claims redundancy due to the circumstance that scheduling coordinators pay the full real-time market cost of any replacement energy ISO must procure to balance schedule/real-time demand deviations. MOWDs are issued to ensure that ISO will have sufficient generating *capacity* available to it. The consequent MLCC costs are incurred whether the cost-producing units are dispatched or not. Ergo, they are not *energy* costs.

deviations beyond importer control to NNUD because fault is immaterial to cost incurrence—and therefore to causation. Put in causal terms, the underlying deviation was a cause-in-fact (*sine qua non*) of the cost incurrence irrespective of whether it ultimately was its proximate cause. To reiterate, attributing system MLCC to NNUD is not a penalty—it is simply the mechanism through which costs incurred to keep schedules and real-time system demand in balance are recouped/allocated. Fault is immaterial to this calculus. It is now clear why deviations beyond the importer's control are excused from UDP (a fault-based penalty), but not from system MLCC (the use-based cost of balancing system schedules and real-time demand).[74] *Accord* Tr. 812. *See also* Tr. 531, 534, 817.

113. My analysis thus far has assumed that it generally is appropriate to allocate system MLCC to NNUD as specified in Attachment E. Powerex strenuously contests this point. According to Powerex, any such allocation is wholly inappropriate because system MLCC costs are incurred in the day-ahead timeframe, but NNUD is a function of real-time imbalances between schedules and demand. Powerex therefore concentrates on day-ahead schedules, proposing that scheduling coordinators be encouraged to submit more accurate day-ahead load schedules by allocating system MLCC costs proportionately among scheduling coordinators when total system scheduled load is less than 95% of metered load. Ex. PWX-1, p. 10; Tr. 1485-86. Powerex also proposes to exempt wheel-through schedules from the allocation.[75]

114. The record before me does not support Powerex's proposed allocation. Although it indisputably is desirable from a system operations standpoint for day-ahead schedules to match scheduling coordinators' actual metered loads as closely as possible, Powerex has demonstrated no legitimate reason to bind scheduling coordinators to total day-ahead

[74] Powerex complains that allocating system MLCC to NNUD precludes importers from determining in advance the potential financial impacts of failing to fulfill real-time dispatch obligations due to circumstances beyond their control, suggesting that this inability could discourage importer participation in ISO markets. In my view, any such uncertainty is simply an unavoidable consequence of the nature of *force majeure* events in general—and not one that is limited to importers. It therefore makes no sense—and in fact would be discriminatory—to allocate these uncertainty costs only to scheduling coordinators who prove to be causes-in-fact of the day-ahead scheduled load/actual metered load differentials that required system MLCC costs to be incurred. This is particularly true in light of the circumstances that (i) *force majeure* events by definition do not implicate fault and (ii) system MLCC cost allocation is not fault-driven.

[75] SMUD also advocates exempting wheel-through schedules from system MLCC cost allocation, although it does not oppose otherwise allocating system MLCC costs to NNUD.

scheduled load for system MLCC cost allocation purposes.[76] First, ISO does not make its MOWD determinations based solely—or even primarily—on day-ahead schedules. The record demonstrates that ISO uses those schedules merely as a starting point, applying historical data to formulate estimates of the real-time deviations it will encounter from hour to hour. S-18, p. 18; Ex. PWX-2, p.6; Tr. 570-71. The record confirms that scheduling coordinators—including Powerex—rely heavily on their ability to utilize the hour-ahead market to adjust day-ahead schedules.[77] Ex. JNT-1, p. 12; Ex. PGE-5, pp. 5-6; Tr. 1510. *See also* SWP IB, p. 58. It also confirms that schedule changes made in the interim between day-ahead and hour-ahead data points figure into the MOWD calculus. Tr. 571. I therefore find and conclude that Powerex has failed to demonstrate that it would be just, reasonable and not unduly discriminatory to allocate system MLCC costs proportionately among scheduling coordinators when total system scheduled load is less than 95% of metered load. Instead, I find and conclude that it is generally just, reasonable and not unduly discriminatory to allocate system MLCC to NNUD because such deviations are the predominate cause-in-fact of system MLCC cost incurrence.

115. The preceding ruling assists in resolving the Powerex/SMUD proposal to exclude wheel-through schedules from system MLCC cost allocation. If system MLCC costs are allocated *exclusively* to NNUD, wheel-through schedules require no exclusion because they are by definition simultaneous imports/exports, deemed delivered, and consequently cannot possibly result in NNUD. Even under the Amendment No. 60/Attachment E alternative, system MLCC costs could be allocated to wheel-through schedules only insofar as the specified NNUD cap is exceeded and only inasmuch as they legitimately could be classified as exports. Ex. S-21, p.3. This means that—in the worst-case scenario—system MLCC costs could be allocated to wheel–through schedules *only if*: (1) ISO were to be incurring system MLCC costs; (2) the specified NNUD cap were to be exceeded; *and* (3) the wheel-through transaction(s) at issue qualified as exports—*i.e*. the schedule(s) covered energy transmitted from the ISO control area to a different California control area. Ex. ISO-20, p. 33. Of course, these circumstances must be balanced against countervailing ones. Wheel-through schedules originate outside the ISO control area and are delivered outside it. Ex. SMD-1, pp. 6-7. ISO has no involvement in such transactions apart from serving as the transmission provider and the control area services coordinator, both of which services are fully compensated through wheeling/grid access

[76] Although the 5% tolerance band incorporated into the proposal obviously was intended to temper it somewhat, Powerex has provided no basis for this figure other than a data response indicating it is generally accepted that forward market schedules should be within 5% of real-time load. Ex. S-24, p. 2. Moreover, how (and why) system MLCC costs would be allocated when the total system day-ahead schedule/metered load differential falls between 95% and 100% is unclear to me. *But see id.*, pp. 2-3 (indicating that these costs would be allocated to monthly demand and monthly in-state exports).

[77] The degree of Powerex reliance is indeterminate. *See* Tr. 1510.

charges. Ex. SMD-1, pp. 18-19; Ex. SMD-2. All requisite ancillary services are provided by the sending/receiving control areas. Ex. SMD-2. Wheel-through schedules therefore have no significant causal nexus to system MLCC cost-incurrence.[78] On balance, however, I find and conclude that wheel-through transactions derive sufficient benefit from reliable grid operation to justify the minimal level of potential system MLCC cost liability that might be imposed on them under the Amendment No. 60/ Attachment E alternative, were it adopted. *Compare* Ex. SMD-1, p. 10 *with* Ex. SMD-1, p. 26.

Conclusion[79]

116. I find and conclude on the record before me that the only MLCC cost allocation alternative that potentially satisfies the just, reasonable and not unduly discriminatory standard is the Amendment No. 60/Attachment E alternative. Consistent with my prior rulings, that alternative would—at a minimum—require amendment in a number of respects. Principal among these, it would have to be re-filed with the Commission—either in accordance with a compliance filing directive or *de novo* in accordance with FPA Section 205. Any such filing must enumerate MLCC cost categorization criteria that are clear, objective and not subject to ISO discretion in application. If ISO considers the current Attachment E criteria adequate to categorize all relevant constraints in an appropriate manner, it should be required strictly to abide by them. If the operational characteristics of certain constraints require categorization that is at odds with the enumerated criteria, the criteria (and/or ISO Operating Procedures) should be modified in a manner that facilitates appropriate categorization.[80] I reiterate that it would be

[78] The record contains some evidence that line losses—the amount of electric energy turned into thermal energy due to resistance as electricity is transmitted—are an integral component of ISO's congestion management calculus, and that wheel-through transactions necessarily factor into the calculus as a consequence. *See* Ex. ISO-21, pp. 12-13; Tr. 791. I consider this evidence credible, but I do not consider it adequate to establish a significant causal nexus. I nevertheless consider it germane to a benefits-based analysis.

[79] This summary is a general recap of my primary rulings under Issue # 3. It does not supersede any specific rulings made in the preceding analyses, nor does it modify any rulings made under subsequent issues.

[80] In this regard, I invite the Commission's attention specifically to whether the disproportionate impact of categorizing South of Lugo as local in accordance with Attachment E's currently-enumerated criteria (and ISO Operating Procedure T-144, Version 4.3) rises to the level of unjust, unreasonable or unduly discriminatory. If so, I believe one viable option would be to establish South of Lugo as an equitable exception in reliance on superseding ISO Operating Procedure T-144, Version 4.4—but only if

inappropriate/arbitrary merely to enumerate constraint-specific exceptions to the categorical classification criteria or to compromise the criteria's objectiveness by designating them discretionary in any material respect. Finally, although I ruled it would be just, reasonable and not unduly discriminatory for zonal/system MLCC costs to be allocated on a daily basis, and I believe it would be preferable to do so, I find and conclude that it also would be just, reasonable and not unduly discriminatory for ISO to allocate these costs on a monthly basis as Amendment No. 60 proposes—particularly in light of the circumstance that monthly allocation squares with ISO's start-up and emissions cost allocation methodology.

4. Whether the "Incremental Cost of Local" Approach for Determining the Allocation of MLCC Costs Between "System" and "Local" Categories is Just and Reasonable

117. In the context of the MLCC stakeholder process described *supra*, PP 58-59, SCE requested that when a must-offer unit is committed for local reliability requirements, and the unit commitment simultaneously satisfies a system requirement, ISO allocate only the incremental cost of committing the unit to the local category/PTO.[81] Ex. S-21, p. 2. This "incremental cost of local" is calculated by subtracting the cost of committing the cheapest available unit(s) from the cost of committing the required must-offer unit(s). *Id*. The calculation requires ISO to run its Security Constrained Unit Commitment (SCUC) software application twice. It first must determine and manually "flag" all must-offer units required to satisfy local reliability requirements, and run the SCUC application based on the ISO demand forecast/system requirements to derive a constrained total "extra market" unit commitment cost. It then must turn off the flagged units and re-run the SCUC application using the same demand forecast/system requirements to derive an unconstrained total "extra market" unit commitment cost. The second (unconstrained) run will commit different units if the units committed in the first (constrained) run were not the cheapest available resources. The differential reflects the incremental cost of local; the second run costs reflect system requirements. *Id*. Attachment E proposes to implement the incremental cost of local cost allocation methodology. *Id*.

ISO, as part of its compliance/FPA Section 205 re-filing, is able to demonstrate that Operating Procedure T-144, Version 4.4 is based on legitimate engineering studies, analyses or other appropriate support.

I also encourage the Commission to consider whether it would be desirable to require ISO to accommodate self-provision of inertia in the MRTU.

[81] PG&E suggests that SCE's request and ISO's accommodation took place outside of the stakeholder process. PG&E IB, p. 10. The record reflects no support for this suggestion.

a. Party Positions

118. Joint Parties[82] and Southern Cities object to the net incremental cost of local methodology. They contend the methodology is not just and reasonable because it mutes appropriate price signals by shifting costs from the local area/PTO—which is in the best position to effect changes that would reduce MLCC cost incurrence—to all ISO market participants. JNT-1, p. 6; Southern Cities IB, p. 35. Joint Parties also contend that the net incremental cost of local approach is inconsistent with recent CPUC decisions concerning local reliability/resource adequacy because it affirmatively induces greater LSE reliance on must-offer resources. Ex. JNT-1, pp. 6-9. PG&E and Southern Cities underscore the circumstance that SCE appears to be the lone beneficiary of the approach. Southern Cities advocate implementing an undefined "net incremental cost of zonal" methodology if the net incremental of local approach is adopted. Southern Cities IB, p. 36.

119. ISO, SCE and Trial Staff all support the net incremental cost of local approach. ISO emphasizes that the approach is both feasible and entirely consistent with the general local MLCC cost allocation proposed in Amendment No. 60 and Attachment E.[83] SCE underscores the fact that the approach is consistent with RMR cost allocation—which also is local in character—because the RMR methodology allocates only the incremental (above market) portion of RMR units' variable costs to the local PTO(s). SCE also maintains that the net incremental cost of local approach accounts for the reality that must-offer units simultaneously may satisfy both local and system requirements, and therefore is more consistent with cost-causation. Trial Staff echoes the ISO and SCE arguments, supplementing them with a rebuttal of the net incremental cost of local approach's alleged inconsistency with recent CPUC local reliability/resource adequacy decisions.

b. Discussion/Analysis

120. Both Commission policy and the record in this proceeding overwhelmingly support the net incremental cost of local approach. The record clearly establishes that ISO is capable of implementing the methodology as specified in Attachment E. Ex. S-21, p. 2; Ex. ISO-20, p. 18. It is equally clear that the methodology is capable of differentiating between local and system MLCC cost components when a must-offer unit

[82] Joint Parties consist of PG&E, CPUC and IEPA.

[83] ISO notes that the approach would require some modification insofar as the period between July 17, 2004 and September 3, 2004 (the date SCUC became operational) is concerned. ISO proposes to utilize a proxy methodology (detailed at Ex. ISO-22, pp. 40-42) for this period.

committed for local reliability requirements simultaneously satisfies system requirements. Such differentiation inarguably is consistent with the Commission policy that costs be matched, *to the greatest practicable extent*, to the customers responsible for imposing the cost burden at issue or benefiting from it. This was the fundamental purpose of the MLCC stakeholder process/Amendment No. 60 filing: to produce better-targeted MLCC cost allocations.

121. Contrary to Joint Parties/Southern Cities contentions, the net incremental cost of local methodology results in appropriate cost *sharing*, not cost *shifting*. Joint Parties/Southern Cities presuppose that non-differentiated local category costs do not subsume any system costs. If that is the case, however, the dual SCUC runs will produce identical results and no costs will be allocated to the system category. Any resulting price signals will be entirely appropriate. And I am at a loss to understand how sending more accurate price signals affirmatively would induce *greater* LSE reliance on must-offer resources. I therefore reject any claim that the net incremental cost of local approach undermines CPUC policies with respect to local reliability/resource adequacy. I similarly reject any contention that the approach is somehow discriminatory or preferential because it inures primarily—or even exclusively—to SCE's benefit. A non-differentiated local MLCC cost allocation obviously imposed unwarranted system costs on SCE.

122. I find and conclude that the net incremental cost of local methodology reflected in Attachment E is generally just, reasonable and not unduly discriminatory. This ruling notwithstanding, the record indicates that ISO should be directed to make certain modifications to the methodology, both as reflected in the attachment and in application. First, in consideration of the serious data inaccuracies that have plagued ISO throughout the course of this proceeding, it should be required to post on its website adequate information to provide market participants with the ability to confirm the appropriateness/accuracy of its net incremental cost of local allocations in accordance with the SCUC application. In addition, it should be required to provide all data, protocols and calculations on which it relies in allocating net incremental local/system costs for the period between July 17, 2004 and September 3, 2004 in accordance with the SCUC proxy methodology detailed at Ex. ISO-22, pp. 40-42.

5. Whether Non-Local MLCC Costs Should Be Allocated on a Daily or Monthly Basis

123. This issue is resolved in accordance with my rulings concerning Issue #3.

6. Whether Non-Local MLCC Costs Should Be Assessed Only to Loads Occurring in the Peak Time Periods for Which Must Offer Waivers are Denied

124. This issue is resolved in accordance with my rulings concerning Issue #3.

7. If Non-Local MLCC Costs Should Be Allocated Only to Loads Occurring in the Peak Time Periods for Which Must Offer Waivers are Denied, How Should the Peak Period Be Defined?

125. This issue is resolved in accordance with my rulings concerning Issue #3.

8. Whether ETC Schedules Should be Exempted from All or Some Zonal MLCC Costs

126. This issue is resolved in accordance with my rulings concerning Issue #3.

9. Whether Wheel-Through Schedules Should be Exempted from All or Some System MLCC Costs

127. This issue is resolved in accordance with my rulings concerning Issue #3.

10. Whether Pump Loads Should be Exempted from All or Some MLCC Costs

128. This issue is resolved in accordance with my rulings concerning Issue #3.

11. Whether Load Serving Entities Should be Permitted to Self-Provide Local Generation (or Inertia) and Thereby Avoid SCIT-Related MLCC Costs

129. This issue is resolved in accordance with my rulings concerning Issue #3.

12. How Should the ISO Treat MLCC Costs Related to Must Offer Waivers Denied for More Than One Reason?

130. In accordance with standard practice, ISO records the reason a must-offer generator is committed in a SLIC (Scheduling and Logging for ISO of California) logging system, including a reference to the specific constraint addressed. Ex. ISO-22, pp. 36-37. A proper entry would reference only one constraint. Between July 17, 2004 and August 27, 2004, however, ISO personnel sometimes improperly referenced two constraints in the same entry. Ex. SWP-18, p. 38:15-22 (protected). These dual references are problematic for cost allocation purposes to the degree that the constraints fall into different MLCC cost classification categories.

131. The record indicates it would be difficult and resource-intensive to attempt to determine the appropriate classification category for these improper entries. ISO, Trial Staff, SWP and SCE therefore propose a 50/50 cost allocation between categories. No participant opposes this solution. I find and conclude that it is reasonable under the circumstances to adopt the 50/50 dual allocation proposal.

13. Whether the ISO Should Allocate System Minimum Load Costs Based on Deviations Between Metered Load and Day-Ahead Scheduled Load (Where Day-Ahead Scheduled Load Deviates from Total Metered Load by More Than a 5 Percent Threshold)

132. This issue is resolved in accordance with my rulings concerning Issue #3.

14. Whether Start-Up and Emissions Costs of Units Denied Must Offer Waivers Should be Allocated in the Same Manner as Those Associated With MLCC and Whether a Revision to the Allocation of These Costs Should Be Addressed in This Proceeding

133. My review of the July 8th Orders I & II reveals no indication that the Commission intended to set issues related to anything other than MLCC cost allocation for hearing in this proceeding. The record before me, moreover, indicates that MLCC costs are clearly distinct from Start-Up and Emissions costs. *See, e.g.,* Tr. 1096-97. And while *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 97 FERC ¶61,293 at 62,363 (2001) states that ISO should recover MLCC costs "consistent with the methodology utilized for the recovery of emissions and start-up fuel costs," that language puts at issue ISO's *MLCC cost allocation methodology*—it cannot legitimately be used to bootstrap the justness/reasonableness of ISO's Start-Up and Emissions cost allocation methodology into the mix. I find and conclude that the justness/reasonableness of ISO's Start-Up and Emissions cost allocation methodology is beyond the scope of this proceeding.

15. Whether Attachment E, as Included in the ISO's May 11, 2004 Filing, Should Be Deemed Part of Amendment 60 to The ISO Tariff as Filed

134 This issue is resolved in accordance with my rulings concerning Issue #3.

16. Whether the Criteria Used by the ISO to Classify Units Committed Under the Must Offer Waiver Denial Process Should Be Included in the ISO Tariff

135. This issue is resolved in accordance with my rulings concerning Issue #3.

17. Whether the Proposed Definition of "Reliability Services Costs" is Just and Reasonable

136. In the context of the MLCC stakeholder process described *supra*, PP 58-59, SCE requested that local MLCC costs allocated to a PTO be characterized as Reliability

Services Costs. ISO complied, including the following definition in the Amendment No. 60 filing:

> The costs associated with services provided by the ISO: 1) that are deemed by the ISO as necessary to maintain reliable electric service in the ISO Control Area; and 2) whose costs are billed by the ISO to the Participating TO pursuant to the ISO Tariff. Reliability Services Costs include costs charged by the ISO to a Participating TO associated with service provided under an RMR contract (Section 5.2.8), local out-of-market dispatch calls (Section 11.2.4.2.1), and Minimum Load Costs associated with units committed under the must-offer obligation for local reliability requirements (Section 5.11.6.1.4).

Item By Reference #1, v.1, Superseding Second Revised Sheet No. 344. SMUD and TANC maintain that this definition is so vague, overly broad and discretionary that it is essentially meaningless, challenging its justness and reasonableness on these bases and arguing that it should be excised from the tariff as a consequence. ISO counters that the July 8th Order I expressly authorizes including a Reliability Services Costs definition in the tariff, and the only matter at issue is whether the definition Amendment No. 60 proposes is just and reasonable.

137. I find and conclude that Paragraphs 69 and 70 the July 8th Order I expressly contemplate that ISO will include a Reliability Services Costs definition in its tariff. I further find and conclude that the definition ISO proposes is—on its face—not so vague, overly broad or discretionary as to be unjust or unreasonable. The Commission left it to ISO to define the term as it, the entity best situated to set its parameters, deemed appropriate. ISO crafted a definition that enumerates three specific criteria by which it must abide in classifying charges as Reliability Services Costs. These criteria are augmented by the MLCC cost classification/categorization criteria enumerated in Attachment E—which themselves must be clarified/augmented in accordance with this Initial Decision. The possibility that the Reliability Services Costs definition may prove inadequate or problematic in application/operation is a matter that cannot be addressed here in any fashion that would not be purely speculative, arbitrary and capricious.

18. Does the ISO Have the Authority to Commit a Generating Unit Under the Must Offer Obligation to Provide Ancillary Services?

138. I find and conclude that ISO has utterly failed to establish that it has any authority whatsoever to commit must-offer generation to provide ancillary services. Despite ISO's assertions, I find no such authority in the tariff. ISO merely cites Amendment No. 60 itself, apparently taking the position that proposing to grant itself authority to commit must-offer generation to provide ancillary services actually confers that authority. Such claims merit no discussion. ISO should not be permitted to circumvent and expand the

ancillary services market by abusing the must-offer obligation to force generators into a position where they have no rational choice but to offer into that market.

19. Should Scheduling Coordinators Who Self-Provide Ancillary Services Be Allocated MLCC Costs for Ancillary Services?

139. This issue need not be addressed in light of my ruling concerning Issue #18.

20. Whether the Manner in Which the ISO Allocated Must Offer Obligation-Related Charges, Including MLCC Costs, Prior to October 1, 2004 Was Just, Reasonable and Not Unduly Discriminatory

140. This issue was resolved by Stipulation #3, filed in this proceeding on July 29, 2005. The stipulation specifies that as of July 17, 2004 it was no longer just and reasonable for ISO to allocate costs in that manner.

21. Whether the Refund Effective Date of July 17, 2004 Should Be Conditioned in Any Way

141. Although ISO does not object to a July 17, 2004 refund effective date, I note that net incremental local costs should not be used to calculate refunds for the period from July 17, 2004 through September 30, 2004.

D. MATTERS NOT DISCUSSED

142. This Initial Decision's failure to discuss any matter raised by the parties, or any portion of the record, does not indicate that it has not been considered. Rather, any such matter(s) or portion(s) of the record has/have been determined to be irrelevant, immaterial or meritless. Arguments made on brief which were otherwise unsupported by record evidence or legal precedent have been accorded no weight.

E. ORDER

143. Wherefore, it is ordered, subject to review by the Commission on exceptions or on its own motion, as provided by Commission Rules of Practice and Procedure, that within thirty (30) days of the issuance of the final Commission order in this proceeding, ISO shall comply with the findings and conclusions reflected in this Initial Decision, as adopted or modified by the Commission.

H. Peter Young
Presiding Administrative Law Judge