

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION
101 FERC ¶ 61,353

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell

City of Vernon, California

Docket No. EL00-105-006

California Independent System Operator
Corporation

Docket No. ER00-2019-005

ORDER ON REMAND
INITIATING SETTLEMENT PROCEEDINGS

(Issued December 23, 2002)

1. On October 15, 2002, the United States Court of Appeals for the District of Columbia Circuit remanded to the Commission the question of whether the review conducted by the Commission of the revenue requirements of a non-jurisdictional entity – the City of Vernon, California (Vernon) – that is part of a jurisdictional Independent System Operator (ISO) – the California Independent System Operator Corporation (CAISO) – was sufficient to ensure that the CAISO's rates will be just and reasonable under section 205 of the Federal Power Act. In this order on remand, the Commission initiates settlement proceedings.

Background

2. The CAISO sought to encourage non-jurisdictional, municipal utilities to join the CAISO and sought to amend its tariff accordingly. In response to a Commission order,¹ the CAISO modified its tariff to allow the Commission to review the Transmission Revenue Requirements (TRRs) of governmental entities. The modified tariff provided:

If the Participating TO is not FERC jurisdictional, the Participating TO shall at its sole option: (1) file its High Voltage TRR and Low Voltage TRR for those facilities and Entitlements under the Operational Control of the ISO directly with the Commission in

¹See California Independent System Operator Corp., 93 FERC ¶ 61,104 (2000).

accordance with the rules and requirements established by the Commission; or (2) submit to the ISO its TRR. . . . The decision of the [Revenue Review] panel shall be subject to review and acceptance by the FERC.^[2]

Vernon, a municipally-owned utility located in the same Transmission Access Charge (TAC) rate area as Southern California Edison (SCE), voluntarily submitted its TRR for Commission review.

Underlying Commission Orders

3. In its request for declaratory order, Vernon explained that its TRR is presented to the Commission as a finally approved rate by the body of state government responsible for setting the rate, and requested that the Commission give deference to the TRR determination. Vernon explained that its TRR uses proxy numbers for its rate of return on common equity and depreciation rates that are identical to those used by the IOU that is in the same TAC area, *i.e.*, SCE. It further explained that it uses the same methodology for developing A&G expenses, cash working capital allowance and regulatory commission expense as used by SCE in its TRR proceeding before the Commission. Vernon's proposed annual TRR is approximately \$13.1 million.

4. In addressing Vernon's submittal, the Commission explained that it does not have jurisdiction under section 205 and 206 of the Federal Power Act over municipal entities such as Vernon. The Commission explained, however, that it had the authority to evaluate non-jurisdictional activities to the extent they affect the Commission's jurisdictional activities. The Commission further explained that the purpose of its review is to determine whether Vernon's rate methodology will result in a just and reasonable component of the CAISO's rates.³

5. The Commission accepted Vernon's use of the rate methodology used by SCE, but indicated that it could not conclude that Vernon's rate methodology and resulting TRR were just and reasonable unless Vernon made certain modifications. In particular, while the Commission accepted Vernon's use of SCE's return on common equity (11.6 percent), the Commission required Vernon to use SCE's capital structure. The Commission also required Vernon to remove from its TRR the inclusion of unused

²Id. at 61,287 (2000).

³See City of Vernon, California, 93 FERC ¶ 61,103 at 61,285 (2000).

transmission capacity expense as inconsistent with the costs that SCE includes in its TRR.

6. The Commission denied rehearing of its order.⁴ In challenges to its jurisdiction, the Commission explained that it was not expanding its jurisdiction, but was evaluating Vernon's proposed TRR as a means of ensuring that the costs ultimately charged by the ISO are just and reasonable.⁵ In response to other jurisdictional challenges, it explained that it did not have to meet the mandates of section 205 of the Federal Power Act in reviewing Vernon's TRR because it lacked section 205 jurisdiction over non-public utilities. The Commission also denied rehearing as to its finding that Vernon's proposed TRR was just and reasonable, that Vernon should exclude unused transmission capacity expense and that Vernon properly relied on SCE's rate methodology. PG&E appealed the Commission's orders to the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit).

D.C. Circuit Decision

Standard of Review to be Used by the Commission

7. The court rejected PG&E's argument that Vernon's TRR must be independently subjected to the just and reasonable standard of section 205 of the Federal Power Act. It explained that the Commission may use a different approach so long as the Commission can ensure by examining Vernon's TRR that the CAISO's rates will be just and reasonable.

8. The court then explained that "there is no objection to the general approach taken by FERC." However, it asserted that it is unclear under what standard the Commission reviewed Vernon's TRR to ensure that a pass through of its costs by the CAISO would be just and reasonable. It further pointed out that, in contrast, the Commission elsewhere asserted that the purpose of its review was to determine whether Vernon's rate methodology will result in a just and reasonable component of CAISO's rates. The court concluded that the Commission never clarified and developed either the approach or the standard that it applied in this case.

9. The court added that the Commission does not claim that its standards ensure that Vernon's TRR itself will be just and reasonable, but noted that the Commission's

⁴See City of Vernon, California, 94 FERC ¶ 61,148 (2000).

⁵Id. at 61,564.

approach might be acceptable if the Commission tested the final CAISO composite rate to determine whether it was just and reasonable (which it noted the Commission had not done). Thus, the court remanded the case so that the Commission could articulate with clarity the approach and standard it would use that would ensure that CAISO's rates are just and reasonable under section 205 of the Federal Power Act.

Other Procedural and Substantive Matters

10. The court deferred to the Commission's determination that a hearing was not necessary, but added that "it does not follow that legal and policy disputes about the sufficiency of the evidence might not require further elaboration on remand." The court emphasized that on remand the Commission must be able to show that there was substantial evidence to support a conclusion that the CAISO's rates after the inclusion of Vernon's TRR are just and reasonable.

11. In reviewing Vernon's costs, the court explained that the Commission does not need to apply to non-jurisdictional utilities its regulations that are applicable to jurisdictional utilities. It concluded that the Commission's review of Vernon's costs was not arbitrary and capricious, but again explained that the problem is the amorphous standard by which the Commission reviewed the impact of Vernon's TRR on CAISO's rates.

12. With respect to Vernon's use of SCE as a proxy for the rate of return on common equity and the depreciation rate, the court found that the Commission provided only an inadequate conclusory statement that the Commission thought use of the proxy was appropriate because SCE and Vernon were in the same TAC area. The court noted that Vernon itself sought to distinguish itself from SCE and that the Commission had left unanswered protests to the use of SCE's rates. The court further explained that

[o]n appeal, FERC maintains that it was necessary for Vernon to rely on [SCE]'s capital structure and overall return as a proxy because Vernon's return could only be measured indirectly, and Vernon and [SCE] had the same risks because they provide services in the same TAC area. The Orders on review do not provide that explanation and the court cannot rely on FERC's post hoc justifications for its action.

The court concluded that while the Commission has discretion in formulating its approach with respect to a non-jurisdictional utility, it must ensure that CAISO's rates meet the just and reasonable standard of section 205 of the Federal Power Act.

Discussion

13. The Commission believes that it would be beneficial for the parties to resolve the matters at issue through settlement. To aid the parties in their settlement efforts, a settlement judge will be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.⁶ If the parties desire, they may, by mutual agreement, request a specific judge as the Settlement Judge in this proceeding; otherwise, the Chief Judge will select a judge for this purpose.⁷ The Commission will order further procedures to resolve outstanding issues if necessary.

14. In October of this year, four other cities in California filed petitions for declaratory order that their TRRs are proper for the purpose of their becoming participating transmission owners (PTO) in the CAISO.⁸ These filings raise issues similar to those in this proceeding. In a separate order in Docket Nos. EL03-14-000, et al., being issued concurrently with this order, the Commission initiates settlement proceedings for these proceedings and consolidates them with this proceeding for purposes of settlement.

The Commission orders:

(A) Pursuant to Rule 603 of the Commission's Rule of Practice and Procedure, 18 C.F.R. § 385.603 (2002), the Chief Administrative Law Judge is hereby authorized to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge in writing or by telephone within five (5) days of the date of this order.

⁶18 C.F.R. § 385.603 (2002).

⁷If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. FERC's website contains a listing of the Commission's judges and a summary of their background and experience. (www.ferc.gov - click on Office of Administrative Law Judges)

⁸Petitions for declaratory order were filed by the City of Riverside, City of Banning, City of Azusa and City of Anaheim (Docket Nos. EL03-20-000, EL03-21-000, EL03-14-000 and EL03-15-000).

Docket Nos. EL00-105-006 and ER00-2019-005

- 6 -

(B) Within sixty (60) days of the date of this order, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

By the Commission.

(S E A L)

Linwood A. Watson, Jr.,
Deputy Secretary.