

**PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Order Instituting Investigation into )  
implementation of Assembly Bill 970 regarding )  
the identification of electric transmission and )  
distribution constraints, actions to resolve those ) I.00-11-001  
constraints, and related matters affecting the )  
reliability of electric supply. )

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Conditional Application of Pacific Gas and )  
Electric Company (U 39 E) for a Certificate )  
of Public Convenience and Necessity ) A. 01-04-012  
Authorizing the Construction of the Los )  
Banos-Gates 500 kV Transmission Project )  
\_\_\_\_\_)

**REPLY BRIEF OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR  
ON PATH 15 BENEFITS**

Charles F. Robinson, General Counsel  
Jeanne M. Solé, Regulatory Counsel  
California Independent System Operator  
151 Blue Ravine Road  
Folsom, CA 95630  
Telephone: 916-351-4400  
Facsimile: 916-608-7222

Dated: April 22, 2002

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## **I. INTRODUCTION AND SUMMARY**

The California Independent System Operator Corporation (CA ISO) respectfully submits its reply brief in the above captioned case. In this phase of the proceeding, the California Public Utilities Commission (CPUC or Commission) is assessing the benefits that would result from upgrading Path 15 by adding approximately 1500 MW of transfer capability.

In this reply brief, the CA ISO responds to various arguments in the Opening Brief of the Office of Ratepayer Advocates (ORA) and addresses a further point with regards to Existing Transmission Contracts (ETC) given the declaration in the Opening Brief of Pacific Gas and Electric Company (PG&E) that there are no limitations in the California Department of Water Resources (CDWR) Comprehensive Agreement.

The Opening Brief of ORA does little to engage the fundamental issue in this phase of the proceeding, to establish a range of potential benefits from the Path 15 upgrade against which the costs of the upgrade can be evaluated in subsequent phases. Rather than addressing this issue in any rigorous manner (the Opening Brief of ORA contains no recommendation as to an appropriate range of benefits), the Brief focuses on minimizing the potential ratepayer harm from an on-going ability on the part of suppliers to exercise market power, ascribing suspect motives to the unusual process that has resulted from President Lynch's order to PG&E to file a Certificate of Public Convenience and Necessity (CPCN) for the project, and leveling largely unsubstantiated criticisms against the CA ISO assumptions and methodology for ascertaining upgrade benefits. Each of these "concerns" will be addressed in turn.

In short, ORA's Opening Brief offers little analysis regarding the central question in this phase of the proceeding, an appropriate range of benefits to be used to assess the cost-effectiveness of a Path 15 upgrade. As set forth in great detail in the CA ISO's Opening Brief,

the CA ISO considers that based on the record in this proceeding, a \$300 million dollar upgrade cost could easily be recovered within four years using reasonable assumptions including a plus or minus 25% factor to account for uncertainties. Further, whereas the risk of going forward with the upgrade is capped at the upgrade cost, the costs from not proceeding with the upgrade are double the project costs in one year, in unlikely but possible scenarios. Accordingly, there is a strong basis for proceeding with the upgrade. ORA's Opening Brief offers no analysis to refute these conclusions.

## **II. UPGRADING PATH 15 IS A KEY AND COST EFFECTIVE COMPONENT OF A COMPREHENSIVE STRATEGY TO REDUCE THE ABILITY OF SUPPLIERS TO EXERCISE MARKET POWER.**

The CA ISO's Opening Brief discusses in detail, the reasons why the CA ISO considers that it is important to undertake a comprehensive approach to address the key structural deficiencies that allow for the exercise of market power, including going forward with key cost-effective transmission infrastructure additions such as the Path 15 upgrade. The CA ISO will not repeat all its arguments here. Nonetheless, it is important to respond to a number of assertions related to this argument in the ORA Opening Brief.

In summary, as set forth in the CA ISO's Opening Brief, the CA ISO considers that it is important to put into place the key structural elements that support a workably competitive wholesale electricity market for the following reasons:

- It is risky to rely indefinitely on effective Federal Energy Regulatory Commission (FERC) mandated market mitigation measures since FERC has repeatedly stated explicitly that the current package of measures are temporary in nature, and that California should not delay putting into place structural corrections to support a

workably competitive wholesale electricity market relying on continued FERC mandated market mitigation measures. In particular, the CA ISO is extremely concerned that after September 30, 2002, any market mitigation measures are likely to be limited to California and hence markedly less effective.

- A comprehensive strategy to address the various structural deficiencies that provide opportunities for suppliers to exercise market power is more likely to be effective in creating a workably competitive wholesale electricity market than a strategy that addresses only one aspect of the problem.
- Because market power issues related to the limited transfer capability across Path 15 affect state and region wide markets, they are poor candidates for on-going control through regulatory or contractual measures, as such measures would necessarily have to be regional in scope, and there is opposition on the part of many Western entities to a continued West-wide approach.

While these points respond to a number of ORA's arguments regarding market power, a few additional points are worth making. First, the CA ISO's interest in limiting the ability of suppliers to exercise market power is neither new nor concocted to justify the Path 15 upgrade, as ORA claims. Preventing the undue exercise of market power has been a CA ISO concern since its inception and has become an even more central concern in the wake of the unprecedented exercise of market power by suppliers during the past year and a half, and the resulting drastic harm that this exercise has occasioned on the state of California and its electricity consumers.

Further, the CA ISO is not, as ORA suggests, morbidly pessimistic about the ability of suppliers to exercise market power. ORA Opening Brief at 19-20. (The CA ISO might argue instead that, in light of recent history, ORA as a representative of customer interests is

unexplainably complacent on the topic.) Neither did the CA ISO assume non-existent market power problems to justify the Path 15 upgrade. ORA Opening Brief at 19. As the ORA's own witness, Mr. Logan, admitted in his discovery responses to CA ISO data requests, the CA ISO's assessment of the market power benefits of upgrading Path 15 (DMA study) does not assume that generators will exert market power in all cases. Exh. 218, First Data Response from ORA to the CA ISO, Response to Question 6. Instead, as ORA's own Opening Brief delineates, the DMA study assessed the ability of suppliers to exercise market power in different scenarios, and *where such ability was demonstrated*, assumed that it would be used. See ORA Opening Brief at 27-29.

Where studies demonstrate that conditions provide opportunities for suppliers to exercise market power and significantly increase costs to consumers, as is the case with regards to limited transfer capability over Path 15, the CA ISO considers that action is warranted. This is particularly true, where, as in the case of a Path 15 upgrade, the market power mitigation benefits of a potential solution significantly outweigh the project costs. ORA's own witness conceded that "[d]ecision makers can and should consider the impact of a transmission line on the ability of generators to exercise market power." Exh. 218, First Data Response from ORA to the CA ISO, Response to Question 12.

ORA argues that the fact that the upgrade reduces but does not eliminate potential costs to consumers from the exercise of market power supports a conclusion that the upgrade should not be undertaken. ORA complains that in many scenarios, upgrading Path 15 only eliminates one half to one third of the costs to consumers from the exercise of market power. ORA Opening Brief at 20-21. As set forth in the CA ISO's Opening Brief, the fact that the upgrade alone does not eliminate the ability of suppliers to exercise market power supports a concerted, multi-pronged effort to address all of the key structural limitations that allow suppliers to exercise

market power. It does not make sense to decline to make progress in curbing supplier market power because each element of a comprehensive strategy assessed individually is insufficient to eliminate the problem. Such a stance would result in paralysis and would guarantee that there will never be a solution to the problem. Put another way, it makes little sense to disdain over one hundred million dollars in annual market power benefits, because a further two hundred million dollars are available that can and should be pursued through complementary actions.

ORA reiterates that the CA ISO is unduly pessimistic in discounting FERC's role in controlling supplier market power on an on-going basis. The CA ISO is indeed concerned about the likelihood that an effective West-wide market power mitigation program will remain in effect beyond the fall of 2002, for the reasons documented on the record and in the CA ISO's Opening Brief. But further, the CA ISO believes that in a context where a competitive wholesale electricity market is a given, it is prudent and appropriate to put into place the structural elements required to support workable competition, rather than relying indefinitely on broad and intensive regulatory intervention. Tr. (Casey) at 770: 23-28; 939-940. In this regard, it is apparent that ORA and the CA ISO have a fundamental difference of opinion.

In sum, the CA ISO is not unduly pessimistic. Instead, the CA ISO believes as a matter of policy that in the context of a competitive wholesale electricity market, regulatory intervention to prevent suppliers from exercising market power must be accompanied by actions, particularly those that are demonstrated to be cost-effective, to correct key structural deficiencies that afford suppliers the opportunity to exercise market power.

### **III. IN RESPONSE TO PRESIDENT LYNCH'S ORDER THE CA ISO DEVOTED SUBSTANTIAL RESOURCES TO EXPEDITIOUSLY ASSESS THE BENEFITS OF THE PATH 15 UPGRADE**

ORA's Opening Brief devotes several pages to implying that the CA ISO's testimony can be discounted in light of the unusual procedure for review of the Path 15 upgrade by the CA ISO. The unusual procedural posture associated with the Path 15 upgrade is both irrelevant to the consideration of benefits from the upgrade, and largely due to the fact that President Lynch required PG&E to file a CPCN for the project, and the CA ISO attempted to respond in as timely and thorough a manner as our limited resources allowed.<sup>1</sup>

ORA's Opening Brief correctly states that the proceedings regarding Path 15 before the CPUC commenced in late March 2001, when President Lynch expressed concern that the CPUC should act expeditiously to evaluate the need for, and the environmental impacts of relieving the transmission constraint over the Path 15 and ordered PG&E to file an application for a CPCN for a Path 15 upgrade by April 13, 2001. Immediately, the CA ISO began to work cooperatively with PG&E to undertake a thorough analysis of the need for the upgrade. The CA ISO and PG&E agreed early on that PG&E would take the lead on assessing reliability benefits, and the CA ISO would focus on economic benefits. Exh. 200, Testimony of Perez, Greenleaf and Casey at 4:16-22

The CA ISO had hoped to complete its assessment and present the project to the CA ISO Governing Board in Summer 2001. However, the economic assessment of Path 15 proved to be

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<sup>1</sup> Similarly, ORA's implication that the benefits of the project are somehow suspect because there is a lack of detail in the record at this time regarding project costs, business arrangements, and the allocation of costs and benefits is misdirected. These details are not in the record because they do not yet exist, and because this phase of the proceedings is not intended to address these details.

a significant undertaking, requiring a baseline study that did not consider the likely effects of market power, the development of an innovative model to predict the effect of market power, and application of that model to 24 different scenarios. Exh. 201, Attachment 4, at 19-20, Tables 3 and 4. In fact, the DMA study is among the first of its kind nationally. Exh. 200, Testimony of Perez, Greenleaf and Casey, at 17: 15-19. Under the circumstances, it is hardly surprising that the assessment took six months rather than the three months the CA ISO had initially projected and that the CA ISO was engaged in finalizing the studies and its testimony almost through the date on which its testimony was filed. Tr. (Casey/Treinen) at 709-710. Moreover, contrary to ORA's implication that the CA ISO's position regarding Path 15 is limited to a few staff members, the CA ISO position and testimony was approved by the highest levels of management, Tr. (Greenleaf) at 533, and shared with the CA ISO Governing Board on September 20, 2001, Exh. 200, Testimony of Perez, Greenleaf and Casey at 4:23-24.

On November 6, 2001, shortly after the testimony was filed and before the CA ISO could consider further official action on the project, PG&E notified the Commission that "[v]arious public and private parties, including PG&E, ha[d] entered a Memorandum of Understanding ("MOU") for the project (the "WAPA Project") to finance and co-own a transmission upgrade for Path 15" and withdrew its application for a CPCN for the Path 15 upgrade. See PG&E's Notice of Withdrawal of Conditional Application No. A.01-04-012. On November 30, 2001, the Assigned Commissioner, President Lynch, denied PG&E's notice (which the CPUC recharacterized as a motion to withdraw at the time it was filed), consolidated the application proceeding with I.00-01-001, and ordered a prehearing conference to address further steps.

President Lynch noted that "[t]he MOU provides a very general discussion of the planned expansion project but leaves to future agreements the definition of parties' shares of the project cost and benefits, as well as specific roles and responsibilities." Assigned Commissioner Ruling

Consolidating Application 01-04-012 With Investigation 00-11-001 And Denying [Pacific] Gas and Electric Company's Motion to Withdraw at 3. Subsequent to the prehearing conference ordered by President Lynch, Administrative Law Judge Gottstein issued an order providing that hearings on benefits from a Path 15 upgrade would take place in February, and that within three days of receipt of signed implementation documents associated with the WAPA Project, PG&E is to file these documents with the CPUC. December 28, 2001, Administrative Law Judge's Ruling Regarding Hearings on the Path 15 Expansion Project . Testimony and hearings regarding the implementation documents would follow. *Id.* Clearly, President Lynch and Administrative Law Judge Gottstein considered that the level of detail in the MOU was insufficient to allow for adequate review of the merits of the project from the standpoint of cost-estimates, business arrangements including the allocation of costs and benefits, and specific roles and responsibilities among the parties. Similarly, without further details on project costs, business arrangements, and the allocation of costs and benefits, the CA ISO has considered that submitting the Path 15 upgrade for consideration by the CA ISO Governing Board would be premature. *Tr. (Greenleaf) at 535-536.*

In sum, ORA's suggestion that there is something improper about how the CA ISO has proceeded with regards to the Path 15 upgrade is disingenuous. The CA ISO did not initiate an expedited process for consideration of a Path 15 upgrade, the CPUC did. In response, the CA ISO has devoted a substantial proportion of its limited resources to assist the Commission to expeditiously assess the benefits of a Path 15 upgrade and has maintained its Governing Board informed of its activities. At the same time, like the CPUC, the CA ISO must defer official action on the project by its Governing Board until there are adequate project details.

#### **IV. THE CA ISO'S ASSUMPTIONS AND METHODOLOGY ARE SOUND AND SUPPORTED BY THE RECORD.**

Without reference to the record, the ORA Opening Brief contends that the CA ISO's assumptions are unduly pessimistic and that the CA ISO's methodology for assessing the market power benefits of the Path 15 upgrade are flawed. The CA ISO will not repeat herein the detailed discussion set forth in its opening brief of the reasonable assumptions that are supported by the record, and how these support a conclusion that the project will pay for itself within four years. However, a number of points are worth highlighting in response to ORA's Opening Brief.

- ORA's Opening Brief complains that as a result of the upgrade, the load that would have to be shed in the event of a double line contingency north of Path 15 would increase. ORA Opening Brief at 14. ORA's Opening Brief fails to mention that: 1) even without the Path 15 upgrade a substantial level of Remedial Actions Scheme (RAS) is in place that could result in load shedding in the event of double line contingencies, in order to support the current Path rating, Exh. 214, Opening Testimony of PG&E, Tab 6, at 7, Table 4; 2) the RAS amount reported by PG&E is a maximum number, it is not the level of load that necessarily will be dropped in any given circumstance, Tr. (Morris) at 813: 9-12; and 3) although, as a result of the upgrade, the level of load subject to the RAS increases for a double line contingency north of Path 15 (from 0 to 997MW), also as a result of the upgrade, the level of load subject to a RAS decreases for a double line outage South of Path 15 (from 900 to 0 MW), Exh. 214, Opening Testimony of PG&E, Tab 6, at 7, Table 4. Any concerns associated with the RAS are thus fairly concerns that exist today.

- ORA's Opening Brief emphasizes that in the absence of market power, the Path 15 upgrade is unlikely to be cost-effective. ORA Opening Brief at 18. The CA ISO agrees that, if it is arbitrarily assumed, without an assessment of whether this is indeed the case, that there will be no exercise of market power, then the Path 15 upgrade is only cost-effective in unlikely scenarios. Tr. (Casey) at 630:23-26. However, the CA ISO considers that it is far more accurate to determine whether suppliers have market power and if they do, to assume that they will exercise it, than to blindly assume no market power effects. ORA's Opening Brief argues that the CA ISO assumes a problem and then assigns benefits to reducing it. ORA Opening Brief at 19. To the contrary, whereas the CA ISO undertook an analysis to determine whether suppliers would have market power in different scenarios, and assumed that they would exercise market power in cases where market power was demonstrated to exist, ORA would have the CPUC assume that suppliers will not exercise market power in scenarios where the CA ISO's analysis clearly demonstrates that market power exists.
- ORA suggests that the CA ISO overestimates the benefits of the Path 15 upgrade because the CA ISO assumed that there would be no FERC mandated market power mitigation measures in 2005. ORA Opening Brief at 21. Further ORA argues that it is unrealistic to assume that no FERC mandated market power mitigation measures will be in place in 2005 since suppliers will have market power whether Path 15 is upgraded or not. Id. Aside from philosophical differences on this matter, discussed in section II above, it is worth pointing out that in 2000, the year which the CA ISO used to develop the relationship between Residual Supply Indices, system load and Lerner Indices, FERC had in effect price caps that were intended to control market

power. Tr. (Casey) at 924-925 and 928-930. Thus, the DMA study incorporates the benefits of FERC mandated price caps.

- ORA suggests that the DMA study assumes worst-case scenarios. ORA Opening Brief at 22-23. This is incorrect. The CA ISO Opening Brief carefully lays out the reasonable assumptions that the record supports, and suggests a plus or minus 25% screen to account for uncertainties. The CA ISO supports moderate assumptions: a one in ten year drought pattern (even though a number of dry years in a row are certainly possible, Tr. (Casey) at 561); a low to moderate generation build out scenario (even though ORA's own projection of new generation North of Path 15 is lower than the CA ISO's low build out scenario, cf, Exh.218, First Response of ORA to CA ISO, Response to Question 3 (ORA new generation assumption North of Path 15 is 2970 MW) and Exh. 222, Response of the CA ISO to Certain Questions of ALJ Gottstein, Response to Question 4 (Low new generation scenario is 4,590 MW)); continued existence of the current contracts between CDWR and suppliers (even though there are factors that could lead the state to renegotiate or terminate these contracts, Exh. 200, Testimony of Perez, Greenleaf and Casey at 12: 16-21); and the same proportion of unused ETC capacity in 2005 as occurred in 2000 taking account of the contracts that will no longer be in effect. These assumptions are reasonable, not worst-case. Nonetheless, the CA ISO considers that it is worth considering that in worst-case scenarios very high costs could be borne by consumers if the upgrade is not pursued, whereas the costs associated with going forward are capped at the project cost.
- ORA's Opening Brief complains that the CA ISO's analysis overemphasizes the impact of drought years. First, the CA ISO has clarified over and over again that it

considers it reasonable to assume a one in ten year drought. Accordingly, the CA ISO considers that it is reasonable to assume that one out of four years following the Path 15 upgrade would be a drought year. The CA ISO did not assess the recovery of the Path 15 upgrade costs over ten to fifteen years because reasonable scenarios indicate that such recovery is likely within no more than four years. In any event, given the revised reasonable scenario that results from a detailed analysis of the record, as described in the CA ISO Opening Brief, it is now clear that the upgrade costs could be recovered within four normal years. Further, although the CA ISO does not condone the approach, which would require extrapolating the assessment of benefits for many years beyond the 2005 study year, the CA ISO illustrated in footnote 5 of its Opening Brief, how the 2005 benefit numbers could be used to create an annual benefits range that incorporates a one in ten year drought assumption.

- The ORA Opening Brief waxes eloquent on the subject of the ongoing existence of the CDWR contracts with suppliers. In fact, the CA ISO's reasonable assumptions scenario as described in the CA ISO's Opening Brief assumes, notwithstanding the existence of factors that could support a contrary conclusion, that all the current CDWR contracts will remain in effect.
- The ORA Opening Brief criticizes the CA ISO's new generation assumptions arguing that the Power Authority will give priority to development of generation North of Path 15 and that the CPUC could allocate CDWR contracts in a manner that minimizes congestion on Path 15. ORA Opening Brief at 25. Again, the new generation scenario that the CA ISO considers to be reasonable based on the record is 3,020 MWs higher than the MWs ORA's witness stated could be expected to develop North of Path 15 in 2005. Cf, Exh.218, First Response of ORA to CA ISO, Response

to Question 3, and Exh. 222, Response of the CA ISO to Certain Questions of ALJ Gottstein, Response to Question 4. Further, as Mr. Casey explained, it is inaccurate to assume that because agencies (or utilities) can or do manage their resources to reduce congestion over Path 15, limited transfer capability will not create costs. Tr. (Casey) 575-577. Instead, such costs will be internalized. Id. Further, ORA provides no reference to the record to show that the assignment of certain CDWR contracts to certain utilities would affect the ability of suppliers of the capacity that is not covered by the CDWR contracts to exercise market power, and in fact such assignment would have no effect.

- The ORA Opening Brief claims that the CA ISO's assessment of the ETC capacity that will remain unused is "selective". ORA Opening Brief at 26-27. It is unclear what ORA means by "selective". In any event, as set forth in the CA ISO's Opening Brief, the CA ISO has revised its assessment of the capacity that should be assumed to remain unavailable and unused in 2005 based on a careful review of the record. See CA ISO Opening Brief at 16-21. The CA ISO's current assumption of 29% of the ETC capacity reserved in 2000 is consistent with historic usage and accounts for the fact that certain contracts will no longer be in effect in 2005. Further, the CA ISO heartily agrees with and joins in the ORA's exhortation to the Commission, and all other relevant parties to exert utmost efforts to reduce the level of "paper congestion" in California. However, these efforts can go forward hand-in-hand with other efforts to reduce the ability of suppliers to exercise market power, including upgrading Path 15.
- The ORA Opening Brief contends that the levels of price-cost mark ups in the DMA study are "extremely pessimistic". ORA Opening Brief at 27-30. The DMA study did not manufacture price-cost mark ups out of thin air, it measured price-cost mark

ups in 2000 for a large number of hours, and assumed that given similar conditions in 2005, price-cost mark ups would be similar. As Mr. Casey explained during the hearings, there is no way of knowing the future, and no methodology can eliminate the uncertainties associated with the future. Tr. (Casey) at 545. Nonetheless, as documented in the CA ISO Opening Brief, the DMA study has been adequately validated. CA ISO Opening Brief at 11-14. The discrepancies in predicted versus actual prices in 2001 were foreseen by Mr. Casey before the validation exercise was undertaken due to highly anomalous circumstances in 2001. Tr. (Casey) at 623-624.

In sum, ORA's provides little record support for its criticisms of the CA ISO's assumptions and methodology.

**V. EVEN IF THE CDWR COMPREHENSIVE AGREEMENT WERE AVAILABLE TO MEET UTILITY LOAD, THE PATH 15 UPGRADE WOULD PROVIDE SUBSTANTIAL ECONOMIC BENEFITS.**

Judge Gottstein asked PG&E to state in its opening brief whether there are limitations in the CDWR Comprehensive Agreement that limits the use of the rights under the contract to CDWR water related transactions. Mr. Casey had indicated during the hearings his belief that there were in fact such limitations. PG&E's Opening Brief indicates that "[t]he terms of that CDWR ETC do not limit the purposes for which CDWR may transmit electricity across Path 15." The CA ISO stands corrected in this regard, although the CA ISO still believes that CERS, the scheduling coordinator for the CDWR contracts, is a distinct division from the other functions of CDWR. Moreover, a review of Exhibit 223, does not indicate a marked reduction in the level of unused and unscheduled ETC capacity in 2001, when CDWR was engaged in purchasing power on behalf of utility customers, from 2000; particularly in the second half of the

year once the transition was fully in effect. Again, the CA ISO welcomes any progress that can be ordered by the Commission that would reduce the level of unused ETC capacity in the future. Nonetheless, given the CA ISO's revised assumptions about new generation development and the protection afforded by existing CDWR contracts, even if all ETC capacity were available in 2005, the market power mitigation benefits of the Path 15 upgrade to consumers would be \$158 million dollars in a drought year and \$64.5 million dollars in a normal year. See CA ISO Opening Brief Appendix A. Thus, even if all the capacity currently subject to ETCs becomes available in 2005, the Path 15 upgrade would still offer substantial market power mitigation benefits to consumers.

## **VI. CONCLUSION.**

Contrary to ORA's suggestions, the CA ISO has demonstrated using an innovative but rigorous methodology and reasonable assumptions that the Path 15 upgrade would provide substantial benefits to California consumers and should be undertaken.

Respectfully submitted this 22nd of April, 2002 by:

Jeanne M. Solé  
Regulatory Counsel  
California Independent System Operator  
151 Blue Ravine Road  
Folsom, CA 95630  
(916) 608-7144