UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid	Docket No.PL03-1-000

COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to the January 15, 2003, Notice of Proposed Policy Statement ("NOPPS" or "Proposed Policy Statement"), the California Independent System Operator Corporation ("CA ISO"), respectfully submits its comments in this matter.

Generally, the CA ISO supports the efforts of the Commission to provide incentives for the construction of needed transmission facilities, and to explore technologies to enhance the efficient use and expansion of the existing grid. The CA ISO agrees that it is important to further develop a robust transmission system in order to ensure reliability and support liquid and competitive wholesale electricity markets.

However, the CA ISO is concerned that, as currently conceived, the Proposed Policy Statement is unsupported and could be disruptive to California and could delay the progress that is being made towards stabilizing the California electricity markets. This is because the Proposed Policy Statement limits incentives to only those entities that participate in recognized RTOs, whereas the Commission has delayed recognizing that the CA ISO meets the Commission's RTO criteria. The CA ISO has been providing the benefits that flow from the formation of RTOs to California and the West over the past five years. Nonetheless, if the Proposed Policy Statement were adopted

without change, the CA ISO's Participating Transmission Owners ("PTOs" or "Participating TOs") would not be able to respond to certain of the incentives offered by the Commission and may be encouraged to leave the CA ISO – a consequence that may delay the gradual stabilization of the Western electricity markets. .

Further, the CA ISO urges the Commission to consider a more refined approach to incentives for new transmission facilities. First, the Commission should reiterate that public utilities have an obligation to participate in the relevant ISO/RTO planning process and to build reliability-driven projects that are identified as needed by the relevant ISO/RTO. The Commission may also want to consider targeting incentive rate treatment to projects that have a particularly high priority.

Further, while the CA ISO agrees that rate incentives may help in getting needed facilities built, as a practical matter many needed facilities will *not* get built until there is improved coordination between public utilities, Independent Transmission Providers[1], the Commission and state authorities regarding the planning and siting of new transmission facilities.

Finally, the CA ISO recommends a methodical approach to the introduction of new technologies to better utilize the existing system. The CA ISO's existing transmission Maintenance Standards and process already encourage more reliable and efficient operation of the transmission system. This approach could serve as a model for other parts of the country.

The CA ISO also supports the development of new technologies and new approaches to maximizing the efficient use of the existing transmission system. However, the CA ISO cautions the Commission to carefully consider the manner by

[1] RTOs, ISOs, and Independent Transmission Companies.

which such new technologies are deployed. The CA ISO recommends that all new technologies be deployed in a careful and deliberate manner; an approach that will ensure that the use of new technologies is consistent with and supports established reliability criteria. To achieve that outcome, the CA ISO urges the Commission to coordinate with the Department of Energy, the North American Electric Reliability Council ("NERC") and other entities in the industry to develop and further the reliable use of new technologies that can enhance the efficient use of the grid.

I. The California Independent System Operator.

The CA ISO is a non-profit public benefit corporation organized under the laws of the State of California and responsible for the reliable operation of a grid comprising the transmission systems of a number of public utilities and cities in California, as well as for the coordination of the competitive Ancillary Services and real-time electricity markets in California.

The CA ISO was formed when the California Investor Owned Utilities ("IOUs") turned over their transmission facilities for operation by the CA ISO in accordance with the California restructuring law, AB 1890. In its omnibus Order regarding the CA ISO issued October 30, 1997, the Commission found that "the ISO meets the Commission's eleven ISO principles set forth in Order 888."[2] On June 1, 2001, the CA ISO filed a submission (under protest) demonstrating how the CA ISO plans to meet the Commission's requirements for Regional Transmission Organizations ("RTOs") in Docket No. RT01-85-000. To date, the Commission has not acted on this filing.

II. As Currently Conceived the Proposed Policy Statement Does Not Recognize the Benefits that the CA ISO Already Provides to California and the West.

[2] Pacific Gas and Electric Co. et al, 81 FERC ¶ 61,122 at 61,435 (1997).

The Proposed Policy Statement proposes to "provide generic ROE-based incentives to transmission owners that participate in RTOs, and [Independent Transmission Companies ("ITCs")] under RTOs. Under this proposed policy, any entity that transfers operation control of transmission facilities to a Commission-approved RTO would qualify for an incentive adder of 50 basis points on its ROE for all such facilities transferred." NOPPS at 15.

The CA ISO is concerned about this proposal so long as the Commission fails to formally recognize the CA ISO as an entity that meets the Commission's requirements for an RTO, as documented in the CA ISO's June 1, 2001 filing in Docket No. RT01-85-000.[3] First, the CA ISO affords to California and the West the benefits that the Commission has cited for encouraging a movement towards RTOs and accordingly, there is no basis under the Commission's authority and responsibility to assure just and reasonable rates for distinguishing between the rate treatment accorded to utilities that have become Participating TOs of the CA ISO and utilities that join organizations that the Commission has ruled meet its RTO standards. The proposal would unfairly penalize the CA ISO's Participating TOs for joining the CA ISO five years ago – well ahead of most jurisdictional transmission owners.

Over the past five years the CA ISO has strived to put into place a coordinated and efficient wholesale electricity market in California and to attract California transmission owning organizations, including municipal utilities, into the CA ISO to maximize market efficiency and minimize seams issues and market distortions. During

[3] The Commission has challenged the CA ISO's governance structure, and is engaged in litigation with the CA ISO before the D.C. Federal Court of Appeals to address the extent of the Commission's authority to mandate the details of the CA ISO governance. Thus, at this juncture, it is for the courts to determine the extent of the Commission authority to dictate the CA ISO's governance structure.

these five years, the CA ISO Controlled Grid has been operated as a single system, and the CA ISO has administered single and coordinated transmission/Congestion, Ancillary Services, and Supplemental Energy markets as to the facilities under its operational control, in accordance with the Commission's criteria for Independent System Operators. During these five years, the CA ISO has led a successful planning process that has resulted in the identification and implementation of a large number of projects. In recent years, the CA ISO has enhanced this process by integrating utility specific long-term plans into a grid-wide plan that includes additional assessments considering the needs of the entire CA ISO Controlled Grid. Further, as is described in detail in the CA ISO's June 1, 2002 RTO filing, given its characteristics and extensive size, the CA ISO has been providing, over the past five years, the benefits that the Commission has listed in support of its efforts to encourage the formation of RTOs.

In this context, there is no basis under the Commission's authority and responsibility to ensure just and reasonable rates, for the Commission to afford different rate treatment to utilities that join (or joined) the CA ISO and those that join RTOs that have been formally recognized by the Commission. In fact, from an equity standpoint, it is unfair that the CA ISO's existing Participating TOs should be effectively penalized for joining the CA ISO years ahead of the Commission's more formal efforts to form RTOs.

Further, if certain CA ISO members are encouraged to leave the CA ISO, the result could be a further fragmentation, rather than consolidation, of transmission service in California precisely at a time when the CA ISO has begun to successfully

attract additional Participating TOs[4]. This can only disrupt the electricity markets in California that have over the past year begun to stabilize, and could delay the on-going efforts of the Commission, the State of California and the CA ISO to correct structural deficiencies and reform the electricity markets in California.

There are two potential solutions possible to address the CA ISO's concerns. First, the Commission could act promptly to recognize the CA ISO as an entity that complies with the Commission's RTO criteria. In the alternative, the Commission could expand the incentives to cover entities that have joined an organization that has been found by the Commission to meet the ISO criteria laid out in Order 888. In fact, this second approach may make sense in any case, since becoming or joining an ISO is a significant first step in the development of competitive wholesale energy markets, and entities should be rewarded for taking this substantial initial step without fear that this progress would be undermined if they delay in moving rapidly to meet the Commission's RTO requirements.

III. The Proposed Incentives for New Transmission Facilities Should be Refined.

In the Proposed Policy Statement the Commission proposes "a generic ROE-based incentive equal to 100 basis points for investment in new transmission facilities which are found appropriate pursuant to an RTO planning process." The CA ISO agrees that it is important to encourage the construction of "needed" transmission facilities (i.e., facilities found by the applicable RTO/ISO to be necessary pursuant to established reliability and economic criteria). However, the CA ISO has a number of concerns about the Commission's new transmission incentive proposal.

[4] The 2001 Commission audit of CA ISO noted a lack of participation by governmental entities. The CA ISO has taken steps to rectify this shortcoming; 5 municipal utilities have to become Participating TOs and an additional 11 have become Metered Subsystems.

First, the incentive proposal implies that cooperation in the ISO/RTO planning process is optional; i.e. the Commission will not question proposed transmission facilities that have not been found to be needed by an ISO/RTO, it will merely provide added ROE basis points for projects that are found to be needed by an ISO/RTO. This approach is problematic and could result in inappropriate and inefficient development of the system.[5]

Participating TOs should be required to participate in the relevant ISO/RTO's planning process such that the ISO/RTO will make a determination of need. To encourage such participation the Commission should either automatically reject, or at a minimum review in great detail, any proposal to flow through to the customers of a Participating TO the cost of transmission facilities that have not been found to be needed by the ISO/RTO. While the CA ISO agrees that the transmission system in general is in need of substantial upgrading, the CA ISO does not believe that ratepayers should be required to shoulder the cost of any and all transmission projects. Rather, transmission projects that are to be paid for by ratepayers must be justified either on reliability or economic grounds.

Participating TOs should be required to implement all transmission upgrades that the relevant ISO/RTO finds to be required to maintain reliability since the provision of reliable transmission service is a core responsibility of both Participating TOs and ISOs/RTOs. In fact, this responsibility is so fundamental that the Commission should reiterate the responsibility of public utilities offering transmission service to undertake reliability projects found to be needed by the relevant ISO/RTO.

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[5] The CAISO assumes, of course, that the Commission's entire incentive proposal would not apply to "participant funded" transmission where the project sponsor does not anticipate rate base recovery of its investment but instead only receives the "financial rights" associated with the project.

Projects that cannot be justified on reliability grounds should be justified on economic grounds; in other words, as to non-reliability projects that are paid for by ratepayers, ratepayers should realize economic benefits that exceed the costs of the project. Again, the CA ISO believes that the Commission should reject outright, or at a minimum be very skeptical of, non-reliability transmission projects that have not been demonstrated to be economically beneficial and deemed "needed" by the relevant ISO/RTO.

The CA ISO supports the provision of some level of incentive to Participating TOs that undertake projects that have been found by the relevant ISO/RTO to be justified on a reliability or economic basis, to the extent incentives are needed to encourage the implementation and financing of needed projects. The CA ISO notes, however, that the category of projects determined to be needed by ISOs/RTOs could include many different kinds of projects including routine upgrades. The Proposed Policy Statement does not distinguish among projects, or seek to target limited incentive dollars to projects that face particular implementation/financing barriers. Nor does the Proposed Policy Statement consider the use of incentives to encourage utilities to act more promptly to address critical transmission upgrade needs. The CA ISO recommends that the Commission solicit further comment on, or hold workshops to discuss, options for a more targeted approach.

The CA ISO notes that it is supportive of encouraging utilities to undertake economically justified projects, in addition to reliability based projects, in large part because the CA ISO is skeptical that market forces alone will drive adequate investment

in transmission facilities that could provide economic benefits to ratepayers.[6] The CA ISO believes that such projects will most likely be undertaken by entities that will choose to recover their revenue requirement directly from ratepayers through transmission access charges.

Finally, the CA ISO notes that while it would likely be helpful to provide additional incentives for utilities to undertake projects that the relevant ISO/RTO finds to be justified, in order to facilitate additional investment in all types of transmission projects better coordination is required among utilities, ISO/RTOs, the Commission and state agencies responsible for transmission siting. In particular, it would be helpful to clarify the respective roles and responsibilities of these entities and to develop a consistent and coordinated approach for the identification and permitting of transmission facilities to the extent practical.

In sum, the Commission's proposal to encourage new transmission facilities should be targeted more effectively. First, entities such as the CA ISO that have been found to comply with the Commission's ISO requirements should not be disadvantaged vis a vis RTOs. Second, utilities should be required to participate in the relevant ISO/RTOs planning process; the Commission should either reject outright, or carefully scrutinize, any transmission related costs that utilities propose to flow through to ratepayers associated with transmission projects that have not been found to be needed by the relevant ISO/RTO. Third, the Commission should clarify that it is a core responsibility of transmission utilities to undertake the reliability-based projects that are

[6] The CA ISO recently amended its tariff to afford to merchant transmission providers that turn over their Entitlements to CA ISO operational control, the option of either receiving FTR auction revenues, Wheeling revenues and Usage Charge revenues or recovering their Transmission Revenue Recovery in accordance with the CA ISO Tariff.

determined to be needed by the relevant ISO/RTO. Fourth, the Commission should consider the possibility of targeting incentives towards projects that face particular barriers. Finally, the Commission should work with utilities, ISOs/RTOs and state siting agencies to develop a more coordinated approach to the identification and siting for new transmission facilities.

IV. The CA ISO's Transmission Maintenance Standards Could be a Model for Encouraging Improved Grid Performance.

The Proposed Policy Statement seeks "suggestions on how to measure improved performance of the grid." The CA ISO has developed detailed maintenance standards that monitor availability and encourage good performance by a Participating TO's transmission facilities, as well as providing proscriptive guidelines. The maintenance standards are set forth in Appendix C to the Transmission Control Agreement between the CA ISO and Participating TOs, and are attached herein as Attachment 1.

The CA ISO maintenance standards are intended to:

- Ensure that the safety and availability performance levels inherent to transmission facilities are achieved;
- Restore the safety and availability levels inherent to transmission facilities when degradation has occurred;
- Provide for gathering information that can be used as the basis for optimizing and forecasting maintenance for transmission facilities;
- Extend the useful life of transmission facilities while maintaining the inherent levels of availability; and

- Achieve the aforementioned objectives at a minimum total cost for maintenance and outages.

The CA ISO maintenance standards address the following topics:

- Transmission facilities covered by the standards;
- Availability measures;
- Availability measure targets;
- Maintenance guidelines for Participating TO maintenance practices;
- Qualifications of maintenance personnel;
- Maintenance record keeping and recording;
- Establishment of a maintenance coordination committee;
- Incentives and penalties for Participating TO availability performance;
- Compliance with laws and regulations; and
- Dispute resolution.

The CA ISO would be happy to discuss these standards further with the Commission and other stakeholders, addressing both the successes and challenges of implementing the standards. Rather than reinvent the wheel, the CA ISO proposes that the Commission use the availability portion of CA ISO's maintenance standards as the basis for standards to measure transmission system performance.

V. Incentives for More Aggressive Use of the Transmission System Must Recognize the Respective Roles of the Utilities, ISOs/RTOs, and the Commission and Be Tempered With the Need to Ensure Reliability.

The Proposed Policy Statement seeks comments on incentives for innovative operating practices, such as operation of facilities beyond traditionally accepted limits, distributed generation, demand response or demand-side management. NOPPS at 19.

The CA ISO agrees that companies should be encouraged to optimize use of their transmission facilities; the maintenance standards described above have encouraging optimization as one of their objectives. However, the CA ISO cautions that any approach that provides incentives for the use of new and untested technologies must be balanced with measured and prudent deployment of such resources. The reliability of the grid could be compromised by the rushed deployment of new technologies. In addition, if demand response or demand-side management are to be alternatives to transmission, the Commission should address cost recovery for these types of efforts.

The question of how aggressively to use existing facilities is in part an economic question. More aggressive use may reduce the current need for transmission upgrades, but may result in a shorter life span for equipment that could accelerate the need for transmission additions in the future and impact reliability. Recognizing this fact, and the fact that it is the utilities that ultimately make transmission facility investments, the CA ISO has in the past afforded utilities a fair degree of flexibility in making determinations on transmission facility ratings and hence on how aggressively to use transmission facilities.

In addition, the CA ISO notes that any incentive to use existing facilities more aggressively must also consider the reliability implications of such use and impacts on operations. Ultimately, unduly aggressive use of facilities could endanger reliability. Moreover, any changes to how transmission equipment is used must be coordinated with the relevant system operator. For example, in the past, the CA ISO has discouraged certain proposals to establish more aggressive dynamic transmission line ratings that rely on real-time monitoring, where these would place undue burdens on

dispatchers and operators, and could present complications in maintaining adequate SCADA/relay setting limits.

In sum, unless they are coordinated with and approved by system operators, schemes to use transmission facilities more aggressively could endanger reliability. The objective of maximizing the usefulness of transmission equipment must be tempered by the need to maintain reliability, manage the reliability and life span of facilities and ensure that facilities can be operated reliably within allowable limits on a day-to-day basis.

Further, with regards to incentives for demand response and demand-side management, the CA ISO notes that if these are to be used as alternatives to investment in the transmission system, it is important to address cost recovery in transmission rates for these types of activities. This issue was touched upon but not resolved when the CA ISO undertook a pilot non-wires solicitation for alternatives to transmission upgrades.

V. A Coordinated Approach is Required to Encourage Adoption of New Technologies.

The Proposed Policy Statement provides that the Commission is interested in encouraging investment in new technologies that can be installed relatively quickly and that may include use of improved materials that allow significant increases in transfer capability, equipment that allows greater control of energy flows, sophisticated monitoring and communications equipment, and other measures. With the provisos described in the section above, the CA ISO concurs that utilities should be encouraged to try out and benefit from new technologies.

The process for adoption of new technology requires a more coordinated approach than mere incentives, however. Promising technologies must be identified, in some cases encouraged, beta tested, and the results made publicly available so that additional entities are encouraged to adopt successful improvements. The industry already undertakes collaborative work to promote these types of efforts under the auspices of a variety of organizations including the Electric Power Research Institute ("EPRI"). Nonetheless, the results of EPRI programs may be limited to EPRI members or in some cases to the entities that participate in and fund the program. Thus, there may be a role for the Federal Agencies including the Department of Energy ("DOE") and the Commission to cooperate with industry and the reliability councils (NERC and the regional councils) on programs to stimulate the development of, identify, test and disseminate broadly information regarding new technologies.

A coordinated approach is required. Merely providing incentives will not distinguish between meritorious efforts and efforts that are ill advised and will not ensure that all aspects of the cycle for encouraging adoption of promising technologies are addressed in an effective sequence. The Commission may want to hold workshops to discuss further a coordinated approach with the DOE, the reliability councils and industry.

VI. Conclusion

In sum, the CA ISO sympathizes with the Commission's desire to stimulate investment in needed transmission upgrades and improved and innovative use of existing transmission facilities. The CA ISO agrees that much can and should be done in this regard. However, the CA ISO has a number of concerns about the Proposed

Policy Statement as it is currently drafted, particularly to the extent that it could undermine the CA ISO's efforts to stabilize California's electricity markets.

Respectfully submitted,

By: _____

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Date: March 13, 2003

CALIFORNIA ISO

California Independent
System Operator

March 13, 2003

Magalie Roman Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid: Docket No.PL03-1-000

Dear Secretary Salas:

Enclosed please find an electronic filing in the above-captioned proceeding of the Comments of the California Independent System Operator Corporation. Thank you for your attention to this filing.

Respectfully submitted,

Jeanne M. Solé
Counsel for the California Independent
System Operator Corporation

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Folsom, CA, on this 13th day of March, 2003.

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Jeanne M. Solé